

EQ

IS VOLUME STILL KING?



Payment processors have in many cases developed from bank-owned shared service centres into full-grown and independent market parties. In the specific area of payment processing, many have outgrown their founders, which in some cases also redefines the former governance relationship with shareholders into a new customer centric relationship.

“Banks sometimes may feel like they regret this,” says Johan Kestens, financial services specialist and partner at A.T. Kearney Belgium, an international management consulting firm. He believes this is something the banks will have to learn to live with. “It doesn’t have to be a bad thing, provided there is enough competition. Besides, in the aftermath of the financial crisis, banks now have many matters to deal with, in terms of capital structure and business mix.”

A national infrastructure was natural

Historically, collaboration between banks to create efficient infrastructures was a natural thing to do. In the seventies, when ATMs were introduced and later on POS systems, the natural step for banks in several European countries was to jointly establish a national infrastructure. This was more cost-effective than each of them attempting it on their own. Consequently, Belgium, France, the Netherlands, Portugal, and others set about realising this goal, resulting in ever-more efficient national payment systems. Subsequently, the euro and SEPA arrived. So, at first sight, what would be more logical to cooperate on a common infrastructure again?

Fragmentation of interests

Apart from the many subtle but relevant differences in payment systems and conventions, the European banking market today is far less ready to collaborate on new infrastructures, unless encouraged by regulators,

such as the creation of CLS or Target II. A wave of domestic bank mergers in the first half of the nineties was followed by another wave of cross-border mergers, resulting in international banking giants. For example, ING acquired BBL and a few other banks, HSBC bought CCF, Deutsche Bank took over Crédit Lyonnais Belgium, and Santander purchased a large number of banks in Spanish-speaking regions and one in the UK. All of these banks started occupying specific positions in the international markets. This led to fragmentation of interests. “Which also means that the argument for joint investment in a European infrastructure has now lost some of its weight,” says Johan Kestens.

**A VOLUME OF 10 BILLION
TRANSACTIONS
FACILITATES THE
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WITH A WIDE RANGE OF
REQUIREMENTS**

A new market structure

“A new market structure is currently taking shape. The direction it will take is currently anyone’s guess, but a group of banks may be established which focuses on

global transaction banking – in other words, cash flow and transaction management for customers. Other banks may focus on taking deposits and lending them at the local level based on their knowledge of the creditworthiness of their customers. Consequently, they may outsource the non-core activity, for example international payments. Finally, a third, hybrid category may present itself, combining lending with regional payments. The choice a bank makes will also depend on the resulting changes in business portfolio as a consequence of the crisis. I expect ten to twelve worldwide players and 20 to 25 regional players will form the core in Europe. Examples of banks with global ambitions are HSBC and Deutsche Bank, on a regional level Nordea, UniCredit and KBC are examples.”

Profitability requirements

For the payment processors, developments in the banking market have had entirely different consequences. Johan Kestens: “Over the years processors matured, and in many cases became independent, or even were sold to third parties whose shareholders have profitability requirements. Banksys, which was sold to Atos, is one such example. There have been similar developments in securities trading. Mergers allow stock exchanges such as NYSE Euronext to turn themselves into information powerhouses. Banks of course benefited by capital gains at the sale or IPO, but I wonder whether they nowadays sometimes regret the loss of influence.”

Solutions for a wide variety of needs

“Processors will continue to strengthen their positions, as scale is essential in an increasingly competitive market. Prices for end consumers in Europe are already extremely low, compared to North America for example. By inference, processors are fairly efficient, but now have to carry the investments of adopting the new SEPA instruments. But the

A few major players, countless innovators?

“The ongoing consolidation will lead to the establishment of pan-European clearing houses. I expect there will be room for three to five truly pan-European processors in the broad electronic debit and credit market. Specialists and niche players will as always survive, and there could be a continuing

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processing business can not be consistently loss-making. It requires a proper earnings model. Companies need to be coerced to meet the required efficiency levels, but at the same time they need to be sufficiently profitable to realise growth and make improvements in their products and services. In the future, the ability to process at least 10 billion transactions annually will be essential to achieve a cost position to survive as a mainstream processor. However, this volume will not only be used to offer low unit prices, it should also be a platform that has the scope to offer differentiated services to end customers, as those will need these services to develop unique propositions for their customers. What will be important is that an annual volume of at least 10 billion facilitates the development of solutions for customers with a wide range of requirements. If volume is king, service is heir to the throne.”

burst of innovative start ups covering specific payment areas such as pre paid or electronic invoicing. Banks must pay attention regarding electronic transactions, as new players will try to penetrate the market in a wide variety of ways. This includes payments for cinema tickets, parking, mobile phone calls, public transport passes, but also for online purchases while watching TV. I believe it is dangerous for banks to leave these activities to other market players and create opportunities for aggregators to bundle these types of payments and allow customers to pay in one go. This is a case of re-intermediation by new entrants, creating some distance between banks and their customers.”

More critical regulators

“The position of the major processors is something regulators will start looking at more closely – not only from a competition perspective, but also from the perspective

Equens’ vision on infrastructure

In today’s market payment processors are in the position to take the lead in creating a common infrastructure. In doing this, they will have to meet the banks’ two main requirements of today:

- Flexibility to facilitate solutions for a wide range of requirements;
- Reach throughout the euro zone and beyond.

Equens is working on several fronts to realise this by:

- A comprehensive SEPA compliant product portfolio;
- Full reach throughout Europe via the three-tier strategy: Equens community (intra-CSM), the EACHA inter-CSM network and PE-ACH;
- Participation in the International Payments Framework Association (IPFA) to create a global payments network.

of systemic risk. For instance, what could happen when a processor’s operations are disrupted, or when it goes into liquidation? This in principle requires some form of redundancy, which could be a limiting factor for the growth of, for instance, Equens. For this type of vital function, all aspects that may have consequences for the society as a whole will have to be considered carefully. Europe, for many years has been the leader in efficient interbank and point-of sale electronic payment systems, and they have become an essential artery for the economic fabric. Therefore their continued well being, but also fitness level is really key to the broader economy. This will become an important consideration for banks, their customers and policy makers alike.”