European Payments Strategy Report

Winning the Growth Challenge in Payments

Payments are a unique battleground pitting banks, mobile operators, e-commerce players, and retailers against one another. What is the path forward?
Europe in the time of Columbus: a continent poised for unprecedented growth, bolstered by a bevy of new innovations and new lands to explore. In the centuries that followed, Europe’s dynamics were inexorably changed. While some countries focused on territorial fights within the continent, those leading the expansion to new shores, such as Spain and Portugal, saw massive growth.

In many ways, today’s payments industry in Europe faces a similar landscape. The old powers—the incumbent banks and payment systems—are seeing past success threatened by new regulations and new competitors, while alternative payment providers have taken advantage of the relatively new landscape of the Internet.

**Within a rapidly evolving environment, what is the path to new wealth in the payments industry?** How can players in all segments of the market make sure they don’t get left behind?

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This report, based on A.T. Kearney’s benchmarking database for the payments industry, our forecast for the industry’s future, and a survey of industry experts, seeks to answer these questions. We examine the state of the industry in Europe, the relevant shifts in volumes, revenues, and products, and the steps companies across the payments spectrum can take to succeed over the next decade (see sidebar: About the Study).

### About the Study

**This independent A.T. Kearney study** examines more than 100 recent payments projects across Europe, the Middle East, and Africa, and builds on our extensive industry experience.

There are three additional sources of insight in this study:

**Expert interviews.** We conducted more than 50 interviews with payments experts and decision makers. The interviews were structured around 11 questions about growth prospects, top providers and solutions, major growth areas, and strategic priorities. The questions covered all major European countries and players (including banks, MNOs, online challengers, associations, schemes, and processors).

**Payment market model.** We developed a forecast model for the European payment market, including number of transactions and revenue pools. The model builds on as-is transactional data from the European Central Bank and various industry sources for market shares and revenues. We also tapped into our deep industry knowledge to develop a volume and revenue growth scenario through 2020.

**Benchmarking.** A.T. Kearney operates one of the most exhaustive benchmarking databases in cards and payments, covering the cost side of major transaction types (paper and electronic, SEPA, domestic, and cross-border) and debit and credit issuing. More than 35 banks and processors from 15 countries have participated to date. The benchmarking is updated every two years and during projects. It provides rich insight into unit and activity-based cost and structures, efficiency, best practices, and opportunities.
A Growth Industry in a Stagnating Environment

One-third of the world’s roughly 280 billion annual non-cash payments occur in Europe—and this number is growing. In the 27 countries of the European Union (EU-27), the number of non-cash transactions increased from 70 billion in 2005 to 91 billion in 2011, a CAGR of 4.5 percent. Going forward, non-cash payments could grow at 8 percent per year through the end of the decade, to exceed 175 billion transactions by 2020 (see figure 1).

European countries differ considerably in the maturity of their payments market; those with the best balance of ACH and card transactions tend to have more non-cash transactions. Still, growth is common in both mature and less developed countries (see figure 2 on page 4). This trend is remarkable considering the macroeconomic context; while sectors such as retail and telecommunications and parts of the banking industry have been flat in recent years, non-cash payments have increased considerably.

Why are payments such a sweet spot within a sour meal? There are a number of underlying factors:

1. **The overall number of transactions is increasing.** The number of retail payments in Europe is expected to grow from 405 billion to 440 billion by 2020 as the economy recovers and private spending grows. The Economist Intelligence Unit (EIU) forecasts the European economy to resume growth in 2014, while private consumption expenditure is expected to grow 1 percent per year in Western Europe and 3 percent per year in East and Central Europe through 2017. Additionally, we expect electronic transactions, which account for about 25 percent of the total, to grab a larger share, particularly in high-value purchases.

2. New payment policies and corporate counterparty risk management are also playing a role in increasing payment splitting, which may add as much as 1 percent to the growth of payment transactions.

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Figure 1

Non-cash transactions in Europe

<table>
<thead>
<tr>
<th>Year</th>
<th>Billion transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>70</td>
</tr>
<tr>
<td>2010</td>
<td>87</td>
</tr>
<tr>
<td>2015e</td>
<td>121</td>
</tr>
<tr>
<td>2020e</td>
<td>177</td>
</tr>
</tbody>
</table>

Note: ATM transactions not included.

Sources: A.T. Kearney European payment market model, which builds on as-is data from the European Central Bank, Retail Banking Research, and other sources.

ACH is Automated Clearing House. In this paper it includes credit transfers, direct debits, and cheques.
Electronic transactions are displacing cash and cheques. More people are using electronic means for transactions. New card terminals, more accessible solutions for smaller merchants (such as cloud-based solutions and dongles), cashless ticketing in transit, smartphones with near-field communication (NFC) technology, and contactless cards are all playing important roles. Decreasing transaction fees in many countries (for example, France and Spain) provide additional incentives to switch.

Government-led initiatives are also helping. For instance, many European countries have imposed limits on cash payments. In Italy, all purchases over €1,000 must be paid electronically, and public authorities have discussed lowering that limit to €300. In France and the United Kingdom, electronic payments are increasingly replacing once-dominant cheques.

E-commerce is spreading. In the rapidly growing world of online and mobile commerce, nearly all payments are cashless. Even in countries where retail sales are flat, the shift from cash-dominated face-to-face commerce to e- and m-commerce is accelerating the growth of electronic payments. The expansion of e-commerce to new categories will help overcome possibly shrinking volumes in digital goods, such as music.
A Sea Change for the Revenue Pool

The payments revenue pool is set to shift—and grow. The Single Euro Payments Area (SEPA), the Payment Services Directive, and other changes have limited many standard revenue sources in recent years, including intra-Europe cross-border payments, card transactional fees, and interchange fees on direct debits. Many payment experts we interviewed for this report anticipate payment revenues will stay flat in the next several years, primarily because of the regulatory and competitive pressures on current business.

The increased use of alternative payments, coupled with fewer cash and ACH transactions, will offer much more revenue potential to the payments industry.

However, the spread of alternative payment methods—payments not initiated through a bank account and conducted between mobile phones, through m- or e-wallets, or other non-standard arrangements—could change this dynamic. Increased use of alternative payments, coupled with a decrease in cash and ACH transactions, could bring more potential revenue to the payments industry and play a fundamental role in its future growth.

In our payments industry “growth scenario,” revenues could increase by 75 percent between 2010 and 2020 (see figure 3). By 2020, alternative payment methods may account for up to 20

Figure 3
Payment revenues are expected to increase sharply through 2020

European payments industry revenues
(€ billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>Alternative payment methods</th>
<th>Debit and credit cards</th>
<th>Credit transfers and direct debits</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>-33</td>
<td>13</td>
<td>14</td>
</tr>
<tr>
<td>2010</td>
<td>-37</td>
<td>15</td>
<td>16</td>
</tr>
<tr>
<td>2015e</td>
<td>10-16</td>
<td>16-22</td>
<td>18-22</td>
</tr>
<tr>
<td>2020e</td>
<td>18-26</td>
<td>18-26</td>
<td>20-24</td>
</tr>
</tbody>
</table>

Notes: Alternative payment methods include payments not initiated through a bank current account. They include transactions between mobile phones or through m- or e-wallets. Debit and credit cards include transactional issuing and acquiring revenues. Credit transfers and direct debits include paper and electronic transactions, high-value and international transactions, and exception handling.

Sources: A.T. Kearney European payment market model, which builds on as-is data from the European Central Bank, Retail Banking Research, and other sources.
percent of transactions (see figure 4). Even as these alternatives face pressure from new competition, standardization, regulation, and price reductions (of up to two-thirds, we estimate), payment revenues are expected to grow at an impressive pace, with alternative payments as the growth engine. At the same time, the share of credit transfers and direct debit is expected to fall by more than one-fifth. Revenues from these methods—typically used for salary payments, public administration, social welfare, and telco, utility, and insurance payments—are lower when compared to e- and m-payment methods, which have higher pricing to compensate for risk (such as non-payment, fraud, and chargebacks) and added value (such as buyer protection, payment guarantees, and returns handling).

In this new world of payments, are banks “dinosaurs” from the past awaiting extinction, or “sleeping giants” ready to awaken? Are alternative payment providers the lonely innovators ready to take charge of the payments industry—or are banks and mobile network operators (MNOs) primed to pounce? Most of the payment experts we interviewed believe banks will maintain a strong position, considering they still own most financial services relationships with customers. But change is on the way as alternative payment providers and MNOs seek a larger piece of the pie.

The bottom line: To be relevant in payments, innovation and the ability to act quickly are crucial. The winners will attract many users and do so quickly. To do this, they can follow several routes: displace cash; capture in online and mobile commerce; address “use cases”; and take advantage of “rich data.” In the following sections, we examine these routes.

**Displacing Cash in Face-to-Face Settings**

A starting point: discouraging the use of cash. Uppsala, Sweden’s fourth largest city, offers a glimpse at how this can be done effectively. Many local bank branches are cash-free, eliminating the risk of robberies and the costs of cash handling. A program supported by...
banks, insurance companies, the Swedish Trade Federation, and others educates merchants on how to reduce cash. Some restaurants only accept non-cash payments, and even churches are allowing parishioners to donate with payment cards. This promising joint effort has cut costs, increased security and convenience, and reduced the prevalence of the shadow economy.

Achieving a cashless future requires several actions:

**Ensure banking inclusion.** Eliminating cash requires giving “underbanked” segments, such as youths and the poor, access to non-cash payments. Prepaid and mobile solutions are crucial, and public entities (for example in education and social welfare) are important pilot users.

**Encourage low-value electronic payments.** The greatest source of new payments is in increasing the number of low-value payments in segments where cards are already common, such as supermarkets, drugstores, and transit. Contactless cards and mobile phones provide important convenience benefits here.

**Displace cheques.** Promoting modern non-cash payments will cut processing costs for banks. Examining sub-segments and cheque usage and providing alternative solutions are important here.

**Break the “wheel of cash.”** The traditional payment system is built around cash. To change this, society must make cash payments the exception rather than the rule. Figure 5 illustrates ways to achieve that, starting with discouraging cash circulation and broadening card acceptance across all regions and segments, encouraging POS use and electronic payments in general, and ensuring quick and easy cash deposits. This should be supported by general measures promoting the safety and convenience of non-cash payments, along with accompanying policy measures (such as those that foster financial inclusion, encourage electronic payments, or reduce red tape).

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**Figure 5**

**Breaking the cash cycle**

- Discourage cash circulation
- Increase electronic payments
- Encourage POS use
- Broaden card acceptance
- Encourage cash deposits
- Enact policy measures
- Focus on convenience and security

Cash displacement

Note: POS is point-of-sale.
Source: A.T. Kearney analysis
Capturing the E- and Mobile Opportunity

While the majority of today’s commerce remains offline and in stores, online and mobile payments represent perhaps the biggest battleground today in payments as more shoppers spend money in e-commerce. How can players make the most of this dynamic, still-evolving opportunity?

**Position for “e” to win in “m.”** With smartphone penetration nearing 50 percent in Europe (compared with 30 percent globally), the best mobile payments solution in most markets is simply a convenient e-commerce option that works on different screen sizes, rather than a “closed” mobile solution. (One exception is Turkey, where most users do not have a smartphone.) In other words, those that excel in e-commerce, e-invoicing, and other aspects of e-payments can do well in mobile as well.

Although many believe in the potential of near-field communication, the infrastructure constraints in terms of handsets and acceptance have kept developments slow.

**Stay flexible on mobile technologies and business models.** Mobile payments have not taken off in face-to-face environments in Europe yet, largely because MNOs and banks are struggling to build business cases that make all parties happy. Recent developments, such as the abandonment of an NFC joint venture in the Netherlands, show that cooperation is also fraught with regulatory difficulties.

Which technology will prevail in mobile remains unresolved. Although many believe in the potential of NFC, the infrastructure constraints in terms of handsets and acceptance have kept developments slow. As a result some players are experimenting with non-NFC solutions, such as QR codes and one-time passwords, which rely less on physical infrastructure.

The smartphone revolution offers many options for payments and value-added services. Beyond wallet solutions and using smartphones for card payments, industry participants are excited about combining payments and loyalty systems, geo-location, and augmented reality. One large bank in Poland has experimented with card-agnostic mobile payment solutions. In France, banks, retailers, MNOs, and alternative payment providers have joined together to launch mobile payment services. In Sweden, a consortium of large banks is competing against top MNOs on mobile person-to-person payments.

For now, closed ecosystems with limited synergies and no common infrastructure prevail. The long-term winner, however, will likely be a single solution that combines user convenience, appealing prices for consumers and merchants, security, and mass coverage.
Thrive in convenience. Our survey respondents cite convenience as the top battleground in payments going forward (see figure 6). Simply put, payment solutions need to work regardless of the setting. In the traditional bricks-and-mortar environment, convenience means accepting many payment solutions with a short processing time. Online, convenience has similar but broader interpretations. Naturally, ease of use and speed, both in terms of registering and at checkout, are important. However, the user experience is changing rapidly and the line is blurring between pure online and traditional payment solutions, thanks to new devices, new applications, and ubiquitous broadband access. A convenient e-commerce proposition will soon be a requirement for any payment provider hoping to win and retain end-customers.

**Figure 6**
Convenience is seen as the most important battleground, and wallets are seen as most likely to win in e-commerce

<table>
<thead>
<tr>
<th>What payments battleground is most important going forward? (% of respondents)</th>
<th>Which aspect of payment convenience will be most relevant in 2015? (% of respondents)</th>
<th>Which solution stands the best chance to win in e-commerce? (% of respondents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Convenience</td>
<td>Ease of use</td>
<td>Wallet</td>
</tr>
<tr>
<td>E- and m-commerce solutions</td>
<td>Speed of use</td>
<td>Credit card</td>
</tr>
<tr>
<td>Big data</td>
<td>Ease of registration</td>
<td>OBeP</td>
</tr>
</tbody>
</table>

Note: OBeP is online banking e-payment. It is also known as bank button or pay by link. Only the top three answers are shown.
Source: A.T. Kearney survey of payments industry experts

Pick the right solution. As figure 6 shows, survey respondents see online wallets—central locations for users to store payment information and conduct payments—as the winning solution in e-commerce. Success with wallets is related to offering anonymity, reducing the clicks required for checkout, allowing for different payment mechanisms or cards within the wallet, and adding value-added services.

Other alternatives could succeed, however. Online banking e-payment (OBeP) solutions—speedy ways to pay online using bank accounts, also referred to as bank button or “pay by link” in some countries—have seen recent growth, particularly in the Netherlands, Sweden, and Poland. Credit and debit cards and invoice solutions will apply in certain situations, such as for one-time shoppers. Real-time ACH payments, including those recently launched in Poland and the UK’s more established Faster Payments, could grow rapidly as well.

Differentiate by market. In general, three different e-commerce payment patterns have emerged across Europe (see figure 7 on page 10).

- **Card markets.** Denmark, the United Kingdom, France, Norway, Switzerland, Luxemburg, and Spain have high card penetration and online buyers prefer paying with cards, aware of their benefits (such as chargebacks) and ready to accept secure authentication procedures online.
Winning the Growth Challenge in Payments

• **OBeP markets.** The Netherlands (with its iDEAL solution), Sweden, Finland, and Poland, are markets with fewer credit card payments where banks have provided convenient ways to pay online from bank accounts.

• **ACH markets.** Germany stands alone as its online market is dominated by credit transfers (both prepayments and by invoice) and direct debit. Credit cards account for fewer than one-fifth of e-commerce payments, debit cards are not yet available online, and convenient OBeP solutions are growing but are still comparably small. Why is Germany the “odd man out”? We believe it is not because of consumer or merchant preference, but rather about the absence of targeted, convenient solutions.

Each situation requires a differentiated approach based on the preferences of both merchants and consumers. Convenience and security will always rank highly, but the details (one-click or regular checkout), the wish for control (pay at purchase, at shipping, at delivery, or after inspecting the merchandise), and the appetite for additional services (including financing, coupons, and loyalty programs) differ by market and segment. Failure to understand this may elicit bitter user reactions. Getting it right by market and evolving as needed requires investment and a multi-year roadmap.

**Build scale.** Reaching a large customer and merchant base quickly is crucial to succeed in e- and m-payments. While the payment market has always relied on scale and network effects (as increasing merchant acceptance brings higher value to customers and merchants alike), new factors are in play that demonstrate the importance of scale.

As transaction prices shrink, scale ensures profitability by lowering operational costs, strengthening security through data-dependent risk engines, and ushering in value-added services. Online payment solutions are reaching the market quickly, especially in e- and m-commerce.
Speed is crucial for both traditional players and new competitors—some of which boast large customer bases—in developing loyal customers before competitors step in (see figure 8).

**Work with merchants and billers.** Many believe that consumer preferences determine merchant or biller preferences. But this dynamic is changing. Merchants and billers (including telcos, utilities, insurers, and government institutions) are increasingly careful about which payment methods they offer to users, in order to minimize dropout rates and build safe, seamless consumer journeys. With more payment options available (more than 120 in Europe alone), the choices of merchants and billers will prove important.

What do they value in payment options? Most of our survey respondents say cost, “essentials” (acceptance, integration, and basic service), and reach are most important (see figure 9 on page 12). Therefore, the “mechanics” matter: The billing process must work, with low end-to-end costs mattering more than value-added services. Some interviewees say direct debit is in good position in some countries (such as Germany and Spain), yet it remains to be seen whether it has a chance to expand further in other places. Innovative forms of “push payments” (credit transfers from a consumer’s bank to the merchant that are released by the consumer) might be better suited to collect payments with finality, address user concerns about control, and provide a cost-efficient collection mechanism. The real value in billing and collection therefore needs further examination.

A.T. Kearney’s experience suggests a complex landscape. Merchants are increasingly articulating specific requirements. Full checkout solutions are replacing simple payment gateways;

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**Figure 8**

**Company customer bases by industry**

<table>
<thead>
<tr>
<th>Million customers</th>
<th>Visa</th>
<th>MasterCard</th>
<th>American Express</th>
<th>Facebook</th>
<th>Google</th>
<th>Apple</th>
<th>PayPal</th>
<th>Amazon</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cards</td>
<td>2,470</td>
<td>1,780</td>
<td>102</td>
<td>&gt;1,000</td>
<td>&gt;500</td>
<td>&gt;500</td>
<td>230</td>
<td>164</td>
</tr>
<tr>
<td>Alternatives</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mobile network operators</td>
<td>Vodafone</td>
<td>400</td>
<td></td>
<td>Deutsche Telekom</td>
<td>182</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Citigroup</td>
<td>100</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Santander</td>
<td>100</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>HSBC</td>
<td>58</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UniCredit</td>
<td>35</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes: Cards totals are number of cards for 2011. Visa includes the Visa Europe portfolio. MasterCard includes Maestro and excludes Cirrus. Alternatives’ totals are for customer accounts. Totals for mobile network operators and banks are customers in 2012.

Sources: Press releases, annual reports, A.T. Kearney analysis
multi-channel is replacing e-commerce-only; one-screen checkouts are replacing multi-screen and redirect flows. Merchants want additional services around payments, for example to facilitate shipping, offer installment options, or tack on additional benefits such as loyalty programs and coupons. Yet at the end, the fundamentals remain the same: The purchase process must be seamless.

Addressing “Use Cases”

Early transportation methods used stone roads or natural paths such as rivers to ship goods. Over time, civilizations added roads, canals, railways, and airports to connect the world. Today, infrastructure planners combine street-making techniques, rail transport, and any number of other technologies to transport people and their goods over any terrain.

The payments industry, in contrast, has so far only offered a limited set of options to traverse its increasingly complex landscape. With the core functionality in place for decades now—even after the SEPA project, which sought to simplify cross-border payments in Europe—the focus has been on standardization and consolidation rather than on creating more tailored solutions.

The industry needs a new paradigm, replacing the inward-looking approach—“What capabilities do we have?”—with a needs-driven, “use case” view—“What do our customers want?”

Our analysis finds more than 20 distinct use cases that payments companies can take on board to create immediate value and long-lasting growth in different industries. Following are just a few:

• **Utilities.** In industries with regular payments, such as utilities, insurance, or telecom, a cheap mechanism that provides payment finality is the core requirement—not necessarily speed or guarantee. Upcoming “request to pay” solutions may soon upend direct debit in this segment.

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**Figure 9**

Cost is the most important selection criterion for large billers

What factor matters most when choosing a payment method? (% of respondents)

<table>
<thead>
<tr>
<th>Factor</th>
<th>% of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>48%</td>
</tr>
<tr>
<td>Essentials</td>
<td>15%</td>
</tr>
<tr>
<td>Reach</td>
<td>13%</td>
</tr>
<tr>
<td>Checkout convenience</td>
<td>6%</td>
</tr>
<tr>
<td>Value-added services</td>
<td>4%</td>
</tr>
<tr>
<td>Returns and chargeback support</td>
<td>2%</td>
</tr>
<tr>
<td>Cross-channel coverage</td>
<td>0%</td>
</tr>
<tr>
<td>Other</td>
<td>12%</td>
</tr>
</tbody>
</table>

Note: Essentials include terminal capability, integration, and basic service.
Source: A.T. Kearney survey of payments industry experts
Online apparel. Online apparel shoppers want to know they can easily return products they don’t like—including parts of orders. In this segment, a payment solution must be able to handle returns and refunds.

Transit. In transit and vending machines, users want fast, easy payments, combined with reloading and ticketing options.

Non-durable goods. In non-durables (primarily digital goods), authentication is crucial to reduce fraud and ensure that customers get the content they’ve acquired. Convenience and speed are also important, so there is room for targeted offerings beyond traditional card and ACH solutions.

Consumer electronics. Both in face-to-face and online settings, consumer electronics sales require a financing option. Risk management is crucial.

Rich Data before Big Data

When a doctor today sends an invoice for a medical service, there are typically four transactions taking place in one, comprising a mix of what we call “rich data” (that which includes more than just the payment) and “poor data” (only the payment information). The first transaction is a rich data invoice sent by mail to the patient, including a due date and other information. Next is a poor data payment by the patient to the doctor. Third is a rich data collection from the patient to his or her insurer for a refund. Last is another poor data payment from the insurer to the patient. For all parties involved, this process is costly and cumbersome. It is a situation crying out for an intelligent solution that combines rich data and payment into one single transaction. Requiring close cooperation from different groups, it solves a real use problem and could be priced separately.

While today much of the talk is about “big data”—and particularly in collecting as much data as possible, even if it is not useful yet—we believe there is an immediate opportunity in “rich data” in the payment industry. Rather than finding “the hammer that hits all nails,” what will prove more useful today in payments is picking the right data for the right situations. We suggest that payment providers focus on processing select data that can add value to the start by helping to address specific, lucrative “use cases.” If payment providers can gain scale in the most important core data, they can tailor their offerings and gain an immediate advantage.

Salary payments, social welfare payments, and tax collections are just a few possible applications of “rich data.” An example of a possible solution comes from Australia’s pension contributions. There, a whole range of rich data is exchanged both in contributing to and managing what is called the “superannuity account.” Because of this data, customers can make more educated investment decisions. Rich data providers have started integrating what formerly had been two separate data flows—one rich, one poor. This shows how payment service providers could offer major cost improvements and convenience for their users.

Actions for All Players

Payments are at the heart of today’s financial services transformation. The coming decade will bring payments innovations, new offerings, and new providers more quickly than before, and many will be seeking a share of the reward.
How to sort the hype from reality? What is the real opportunity and threat for new and incumbent players? What avenues can be pursued and what priorities should be set out for proposition and infrastructure development?

Based on the actions presented in figure 10, different industry players can find the best positioning and strategy to capture the growth in payments.

**Banks.** Deciding where to play—face-to-face, e-, or mobile transactions?—and how much to commit to each segment is important as banks hope to avoid cannibalization while responding to changing market needs. Defining partnerships to increase uptake is required. Banks should have much more confidence in core assets that have not been sufficiently exploited yet. Tapping into the trust banks enjoy from customers and their online banking capabilities for authenticating payments and services seems promising.

**Online challengers.** Alternative payment providers face a battle for convenience, rather than features, when aiming at mass-market coverage. Further developments beyond e-commerce will depend on expanding into the physical world, and these players will likely need to find partners if they want to reach scale at the point of sale.

**MNOs.** MNOs benefit by aligning with other players such as banks or specialists rather than fighting against them. Building on important capabilities in acceptance and NFC, MNOs can bridge the infrastructure gap in mobile payments with clear differentiation from device manufacturers.

**Processors.** SEPA migration offers two thus-far largely untapped opportunities for card processors. One is re-platforming to bring technology to the next level and save costs in the long run (see sidebar: Rethinking Operational Excellence on page 15). The second is routing optimization, for example through bilateral agreements that avoid intermediaries and generate additional clearing volume. It is also time to think beyond SEPA. Transaction processing beyond payments and “rich data”-related services tailored to specific use cases are just two promising examples.

**Figure 10**

**The burning platform**

<table>
<thead>
<tr>
<th>Banks</th>
<th>Online challengers</th>
<th>MNOs</th>
<th>Processors</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Decide necessary range of solutions&lt;br&gt;• Define partnering to gain uptake&lt;br&gt;• Take advantage of core assets</td>
<td>• Strive for convenience&lt;br&gt;• Address multi-channel needs and transition&lt;br&gt;• Define partnering for scale and relevance</td>
<td>• Embed with m-commerce&lt;br&gt;• Get aligned with banks&lt;br&gt;• Define partnering in near-field communication and face-to-face to solve infrastructure</td>
<td>• Make the most out of SEPA migration: re-platforming and routing optimization&lt;br&gt;• Seek transaction processing beyond payments</td>
</tr>
</tbody>
</table>

**All**

• Focus on market positioning<br>• Pick the right use cases<br>• Put upgraded authentication and risk management approach in place<br>• Think like a user (including merchants, consumers, corporates)

Notes: SEPA is Single Euro Payments Area. MNO is mobile network operator.  
Source: A.T. Kearney analysis
Rethinking Operational Excellence

The payments industry has a long history of operational improvements and cost reductions, tied to its perception as a commodity in which cost is the main differentiating factor. National and European legislation have also put pressure on payment processors to re-assess their price levels. Our research suggests that the Single Euro Payments Area (SEPA) also lowered general cost levels for domestic and cross-border payments, with domestic payment costs per transaction falling more than 50 percent between 2006 and 2010 (see figure). At the same time, cross-border unit cost per transaction surged due to the dramatic volume shift to SEPA.

Operational excellence and cost reduction will remain high on the operations agenda, particularly for incumbent banks and processors. But platform renewal may reduce costs better than scale effects. Most mid- and large-sized banks are already on the flatter part of the cost curve, and additional volume will contribute little to lower transaction costs. The irony of SEPA is that the cost cutting the European Commission sought will not come from standardization and volume pooling, but rather from IT investment and platform renewal.

Many European banks and processors have implemented intermediary SEPA solutions, but volumes will soon grow beyond what these solutions can sustain, and these solutions can grow costly as legacy systems remain largely untouched. The most sustainable solution for banks and processors may be to decommission legacy payment systems—certainly a challenging task. Finding structural solutions for SEPA offers benefits in three major areas: credit and debit card platforms that are often operated separately; separate payment systems for different entities (such as corporate clients, international, and domestic retail); and separate systems (particularly at incumbents) for processing direct debit and credit transfers as opposed to card payments. This area offers potential for cost reduction, but bridging the platform divide comes at considerable effort, requiring simpler product and service portfolios, a break from traditional banking paradigms, and new governance models. Modularized propositions open the door to payment engine integration and reduce the time-to-market for various product innovations.

Innovation is critical to growth for both new entrants and incumbent players as they seek to retain existing clients and their associated volumes. However, innovation funds for incumbents are limited, and cost-cutting initiatives and regulatory changes are dominating the project calendar and IT roadmap. If senior payment managers had an opportunity to invest €25 million on top of their current budget, most would go to innovation.

Figure
Processing costs for the payments industry are shifting

Indexed processing costs (2006 = 100)

Note: SEPA is Single Euro Payments Area
Source: A.T. Kearney benchmark database
Each player in the payments industry should reconsider its product portfolio from a needs-driven perspective. Use cases offer new ways to grow and differentiate, while clear market positioning can address country and segment specifics. Risk management remains essential, with new authentication methods offering new levels of convenience. In order to reach the next stage, payment providers must understand what their users want and need, and address real, specific problems.

Cultivating Continuous Growth

Looking back at post-Columbus Europe, we can now say that not every colonial leader was able to translate its early advantages into sustainable, long-term economic growth. And when industrialization arrived in the 18th and 19th centuries, it produced new shifts in power and prosperity.

Looking at today’s fight for growth in payments, it’s not only the incumbents but also the newcomers and innovators that must react to a changing industry to secure continuous growth. The main challenge today is keeping the pace of innovation high, focusing on what customers really need, and remaining open to new partnerships.

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The authors wish to thank their colleagues Joakim Karlsson, Johan Kestens, Justin Krampe, and Paul Laechelin for their valuable contributions to this paper.
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