The Boston Consulting Group Launches "Navigating to Win: Global Payments 2006"

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BOSTON CONSULTING GROUP REPORT TELLS BANKS WORLDWIDE: CONFRONT SERIOUS THREATS TO PAYMENTS BUSINESS OR RISK SHARP DECLINE IN PROFITS

Banks must rethink strategies to cope with worsening margin pressure, shifting regulatory constraints, a tough innovation climate, and intensifying customer demands, BCG says

LONDON – May 18 — Banks are facing a host of forces that threaten to seriously undermine their payments businesses—a traditional bulwark of overall banking profitability—if they do not confront them head-on and navigate through them successfully, according to a new report by The Boston Consulting Group (BCG).

The report, *Navigating to Win: Global Payments 2006,* BCG's eighth major study of the payments industry, says the key global trend is increasing volumes amid thinning margins. BCG forecasts that by 2013, payments will be a $703 billion industry, up from $467 billion in 2003. The firm also estimates that average revenues per transaction will decline to $1.58 for domestic payments and to $7.27 for cross-border payments by 2013—down from $2.08 and $9.33, respectively, in 2003. The report, which analyzes the worldwide payments market by region—Europe, the Americas, and Asia-Pacific—adds that banks must cope with both global and region-specific dynamics that threaten to dampen revenues and raise costs.

Europe. The report says that the Single Euro Payments Area (SEPA), the legislation intended to harmonize European payments platforms, will bring measurable benefits to consumers and is worth the investment that European banks must make — an estimated €500 million— to meet the requirement of bringing pan-European payments capability alongside domestic schemes by 2008. But the next step in SEPA, the expected elimination or conversion of all domestic schemes by the end of 2010, will require roughly €5 billion in additional investment with little additional benefit. Full migration to the SEPA standard by 2010, the report says, will in fact decrease efficiency and possibly reduce functionality by compelling banks, payments processors, and corporations to adopt pan-European products and to discard highly-efficient domestic ones.

"The bottom line is that pushing for the full SEPA concept to be achieved by the end of 2010 will actually destroy value," says Nick Viner, a senior vice president in BCG's London office and lead author of the report. "A far more workable solution would be to allow payments players to invest in the full SEPA requirements in line with their natural investment cycles for IT infrastructure, cards, terminals, account engines, merchant contracts, and related elements."

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BCG advises European banks to avoid massive spending for the first phase of SEPA in 2008, to lobby for the delay of full migration by 2010, and to aggregate SEPA investments as much as possible. Given that European banks have few prospects for revenue enhancement through innovation, these measures are critical, the report says.

The Americas. According to the report, banks in the United States are battling slowing growth in credit card usage owing to a saturating market, increased use of substitute credit lines (such as those based on home equity), and a shift by consumers toward debit instruments. Interchange revenues, which reached an average of 175 basis points per transaction in 2005, are also under siege because of a series of lawsuits brought by retailers claiming that interchange rates are unfairly high. BCG says that if interchange income—which represents about one-third of risk-adjusted revenues for U.S. card issuers— were to be slashed, banks would need to review their core business models. In addition, business-to-business payments in the United States remain inefficient, and banks and companies must find ways to engineer paper-based instruments out of the process.

“One way that U.S. banks can significantly help themselves is by better analyzing their flow of transactional data to track their customers’ evolving needs,” says Carl Rutstein, a vice president in BCG’s Chicago office and a co-author of the report. “Customer demands are intensifying every day, and true innovation is rare. Banks that really pay attention to spending behavior can deepen relationships and markedly increase their stocks of loans and deposits.”

The report points out that the legislation known as Check 21, which has provided a new legal framework for U.S. banks to accept electronic images of checks, will not be a differentiator for banking customers. “But banks can leverage to their advantage the dynamics that the legislation has created if they take a strategic approach,” says Rutstein.

Asia-Pacific. The Asia-Pacific payments market is burgeoning and highly diverse, the report says, and a grab for market share is underway. Payments opportunities for multinational banks are greatest in China— where payments revenues are estimated to grow at nearly 13 percent per year through 2013—and in India. But other countries, such as Indonesia, the Philippines, and Thailand, offer significant growth possibilities as well. Technological advancements are allowing some markets in the Asia-Pacific region to leapfrog traditional evolutionary stages in payments that more developed markets have already passed through.

BCG says that multinational banks wishing to gain a foothold in the Asia-Pacific region—or to expand positions already staked out—must invest the time to learn about specific domestic markets, develop capabilities to navigate varying regulatory climates and national interests, and try to build relationships at all levels of government in their chosen markets.

“Ultimately,” says Nick Viner, “the winning navigators in the payments industry in every region will be the players that most accurately anticipate their customers’ evolving needs. It may sound simple, but, as always, the devil is in the details.”

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