



Ten Years Of Forecasting – The Lessons Learned

It is ten years since I began attempting to forecast the strategic direction of Europe’s payments business for European Card Review and its predecessor Credit Card Management Europe. Looking back, some of my predictions have been accurate but several have been off the mark. So I thought it would be interesting to review five predictions made in the early and mid 1990s that are still relevant today, and to examine why they failed to materialise completely.

First, low value cross border money transfers and payments. In 1990 the EC Commission and DG15 criticised banks for the high cost and unreliability of low value cross border payments. Green papers were issued and advisory committees established. Bank cynics claimed that it was a non-issue raised by bureaucrats and MEPs who found it difficult to pay Brussels rents from accounts in Spain. Despite the stalling tactics of the banking associations DG15 continued to press its case, supported by several consumer bodies. Many new low cost cross border delivery solutions suddenly appeared. Some forecast the growth of banking clubs. Others predicted use of the low cost international plastic card scheme’s infrastructures. Many saw the linking of Europe’s ACHs as the only credible option for a low cost solution. Over 15 different delivery solutions were identified. Hopes were high that within three years transfer costs would fall from 30 euro to 5 euro, and that within five years cross border transfers, direct debits and credits would be down to 60 cents, close to domestic clearing tariffs.

Reflecting this optimism, in 1992 I made several predictions as follows: that EU banks would not co-operate in the development of a common system; that low value payments systems would develop on an ad hoc basis; that banks would self regulate and improve services working to a Code of Practice; that gradually Europe’s ACHs would be linked, and that the winners (in terms of delivery system providers) would be Visa; EPSnet (because of their very low transmission costs), and SWIFT.

Forecast Event in 1992	What Happened by 2001
• Transfer costs at <60c	• Expected within the next 3-5 years
• EU banks fail to co-operate	• No EU wide co-operation until 1998/1999
• No central system	• Only now being developed by the EBA
• Self-regulation/Codes of Practice	• Failed to be effective. Regulated in 1997
• Use of card schemes	• Has not happened. Seen as a threat to traditional correspondent banking structures
• Linking of ACHs	• Pilots between UK/Italy and others but no volume

Table 1 Low Value Cross Border Payments Predictions

Well, as Table 1 indicates, my predictions were partly correct! A common system did not develop. Banking Associations lost considerable face with the Commission and failed to enforce

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a Code of Practice. Surveys showed that prices and services levels remained unacceptable eventually forcing the Commission to regulate these payments in 1997. The concept of linking Europe's ACHs was tested but almost total lack of support from banks, because of the potential revenue losses, has meant that volumes transferred have been negligible. Of the delivery system providers only SWIFT have come through as a winner. The two international schemes that could have developed common systems have been sidelined.

So ten years on and still no very low cost method of moving money around Europe. The Commission has lost face by regulating but failing to encourage new service delivery system development. Banks have placed self-interest and the fear of the loss of revenue before co-operation. Citizen Europe, one year away from euro conversion, is still being ill served. However, the future is not totally bleak. The EBA has taken ownership of the concept and launched Step1. There are hopes that a common central very low cost solution for retail low value payments will be available within the next two to three years.

My second prediction (made in 1991) related to the development of pan-European Acquisition, now more commonly known as Cross Border Acquisition (CBA). It was expected that, following the introduction of the Open Market in 1992, British acquirers would lose large UK retailers with European-wide operations to mainland European acquirers who wanted to enter the UK market. Many expected that in a similar manner to the EC Commission's initiative on low value payments, DG15 would press for the loosening of the international card scheme's restrictive country rules for CBA.

I optimistically predicted that by 1993 scheme rules would change. If they did not then legal challenges from retailers must be expected. I also predicted that because of the high cost of developing multi-currency software, CBA acquirers would be limited to three to six, and that by mid-decade a common EU wide interchange would apply.

Forecast Event 1991	What Happened by 2001
• EC pressure for change by 1993	• Initiatives taken eventually in 2000
• Loosening of country boundaries by 1993	• Barriers began to change from 1998
• Legal challenges from merchants by 1994	• Eurocommerce challenge in 2000
• No low cost multi-currency software	• New products launched in 1997/1998
• Only 3 to 6 CBA acquirers	• 30+ but of these only 5 to 6 of substance
• Common EU wide interchange	• Still to happen, expected in 2-3 years

Table 2 Cross Border Acquiring Predictions

So ten years on where are we? Scheme rules for CBA developed in the mid 1990s and were eventually productised and on general offer by 1997/1998. The EU Commission maintained a very low profile and only in 2000 decided to examine CBA and interchange as a result of pressure from the Eurocommerce merchant association. The two British banks (Barclays and NatWest) that invested heavily in CBA products and technology in the early 1990s did not lose customers to mainland European acquirers, quite the reverse. Both banks now lead in European CBA, are the largest European credit card acquirers, have the most credible products and systems, have won the most relationships, and threaten many domestic mainland acquirers. In addition, they are now the major players in providing e-CBA to the worldwide e-commerce market.

But ten years on the market is still small, some barriers still remain, local interchange is still a deterrent in some countries, and those French and German bank competitors in the UK market still have to emerge.

Still on the topic of merchant acquisition, in 1992 I wrote of the need to **“Re-engineer Merchant Accounting and Settlement”** amongst Europe's acquiring bans. My thesis was that the development of modern back-end systems for merchant accounting was being ignored

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by banks and software developers. The focus was on front-end processors and new issuer systems, leaving the acquiring business to operate on 1980's imported systems based on out of date architectures designed for US SMEs. In 1992 batch processing, extended settlement periods, paper output, and paper communications had not changed in almost 20 years. To me, Europe's merchant accounting engine was underpowered, lacked product differentiation, and provided a low quality service to the continent's merchants. Not only were acquirers' systems outdated, they also failed to meet the needs of the top 100 merchants who typically generate 50%-60% of each nation's plastic card volume. Large merchants wanted low cost services, with the minimum of exceptions, with very low support costs, and which enabled very fast settlement. What was needed was a product and software specifically designed for the very large, offering a totally electronic service with online access and reporting, same day settlement, workflow management, and many efficiency improvements to automate chargebacks and exceptions!

Forecast Event 1992	What Happened by 2001
<ul style="list-style-type: none">• Service tailored for largest merchants	<ul style="list-style-type: none">• No such service yet exists
<ul style="list-style-type: none">• New Merchant Accounting Software	<ul style="list-style-type: none">• Several new medium volume packages from 1997 onwards
<ul style="list-style-type: none">• End-to-end electronic service	<ul style="list-style-type: none">• Many paper and batch systems remain still
<ul style="list-style-type: none">• Fully automated chargebacks	<ul style="list-style-type: none">• Rapidly being implemented to support EMV
<ul style="list-style-type: none">• Online enquiries	<ul style="list-style-type: none">• Web-based services now emerging
<ul style="list-style-type: none">• Online access into MA database	<ul style="list-style-type: none">• Very few examples in Europe

Table 3 Re-engineering Merchant Accounting and Settlement Predictions

As Table 3 shows, some of these predictions were ahead of their time. Only in the past three years have we seen major changes in the design of merchant accounting software. New products have been developed for the small and medium acquirer players (Bankworks 3, Flexicom). However, many major acquirers still use very old platforms, either homegrown, or variants of Cardpac with modern tack-ons such as the Peregrine chargeback processing software. Yes, web-based online settlement enquiry features are being offered, but online terminal access into the merchant accounting database is relatively rare. We know of only one organisation (PayServ in Switzerland) that has radically redesigned its merchant accounting from top to bottom. Their product and service appears to be one of the best designed in the EU marketplace.

Most disappointing is that no one has developed a product specifically targeted at the very large merchant. There are several reasons for the slowness of change. Merchant acquiring is a low margin operation, thus the business case for investment in new products is difficult. Europe's narrow acquiring market generates limited demand for modern merchant accounting software and has discouraged independent software development. However, large acquirers must change if they are to meet the needs of their large customers for modern systems. A gap in the market still exists and there is a substantial prize to be won.

Interchange has been a very emotional topic throughout the 1990s. Switch, the UK debit card attracted substantial criticism from merchants in 1991/1992 when its members implemented a charge for their payments guarantee. Multibanco, the Portuguese debit card, followed in 1993/1994 and created the only known strike (one day) against the introduction of an MSC. More recently British merchants have stalled co-operation with the implementation of EMV chip in an attempt to lever interchange rates downwards.

However, interchange (the transfer of cost between banks for the services they provide to each other's customers) is a vital lubricator of Europe's payment systems. In 1993 I argued that interchange delivered more benefits than its detractors appreciated. After all, without interchange, worldwide plastic card acceptance at the ATM and the POS would have been much

slower. With interchange comes a formal framework that ensures payments are guaranteed. This framework also ensures certainty of settlement and enables dispute resolution. Buoyed up with enthusiasm for the concept I argued that interchange should become a core component of the most common methods of payment. Money transmission is very much about managing payment risk, and for this reason banks should leverage their knowledge of their customers' risk profile and use this data to increase their revenues through the provision of more payment guarantees. Thus, I argued, why not positive interchange for cheque guarantee? Similarly, a case could be made for a guarantee component within direct debits given the paying bank has a bad debt risk each time a payment is made. Corporate originators could be charged for this component and generate income for banks. In addition, in many countries, most corporate relationships are owned by two to three large banks with a mass of smaller banks owning personal accounts that generate the volume of consumer to business payments. Interchange could be a method of sharing corporate revenues amongst the paying banks that carry the risk. The interchange concept could also be applied to cross border payments guaranteeing money transfers and cross border direct debits.

Forecast Events 1993	What Happened by 2001
<ul style="list-style-type: none"> • Payments guarantee for the cheque 	<ul style="list-style-type: none"> • Examined in UK in 1994/1995 but considered too complex to implement
<ul style="list-style-type: none"> • Payments guarantee for domestic debit cards 	<ul style="list-style-type: none"> • Considered by 1 to 2 interbank associations but none have yet implemented
<ul style="list-style-type: none"> • Payments guarantee for cross border transfers and cross border direct debits 	<ul style="list-style-type: none"> • Reviewed closely by several cross border associations

Table 4 Interchange for Common Payment Instruments

So an original concept, but has anyone taken up the idea of interchange for non-plastic payment instruments? Several interbank associations have looked at the concept for cheques, direct debits, and cross border payments, but we know of no one who has implemented yet. Unfortunately the current climate is probably unfavourable for an extension of the interchange concept. In the UK, ATM and POS interchange levels have been criticised heavily by Cruikshank, and POS interchange is under review by the UK Competition Commission. Similarly the EU Commission is looking into interchange and MSCs across Europe. So it may be another ten years before this concept takes off, if at all.

Finally, the chip card and the electronic purse. The development and use of the electronic purse was a key issue for armchair generals and consultants throughout the 1990s. In 1994 I suggested that the Mondex electronic money was a technology based concept in search of an interested customer. To me it appeared that commercial sense and focus had become subordinate to technological innovation. Few banks and card associations were thinking through the practical issues of promoting and selling the purse concept. I argued that Mondex was unlikely to be successful in Europe and that simple audit based systems were more likely to succeed.

Forecast Events in 1994	What Happened by 2001
<ul style="list-style-type: none"> • EP technology lead concept – no business case 	<ul style="list-style-type: none"> • Generally accepted no money to be made from low value payments
<ul style="list-style-type: none"> • Mondex likely to fail in mass market 	<ul style="list-style-type: none"> • Limited success in physical world but greatest potential in virtual
<ul style="list-style-type: none"> • Fully accounted mass market EPs succeed 	<ul style="list-style-type: none"> • Commercial failure in most countries
<ul style="list-style-type: none"> • Failure through poor marketing and selling 	<ul style="list-style-type: none"> • Business case cannot support costs of promoting concepts
<ul style="list-style-type: none"> • Common standards unlikely 	<ul style="list-style-type: none"> • CEPS targeted implementations in 2001

Table 5 The Electronic Purse

Seven years on the mass bank electronic purse is now generally accepted as a failed concept in the physical world. Neither Mondex, nor most fully accounted schemes, have been successful. Consumers have shown little interest in the concept and actively dislike loading. Merchants have lost interest in bank promoted schemes. Revenues are low and crippling promotional costs make nonsense of the business case. The purse has been successful in closed applications. I argued two years ago that banks should now exit fast, hand over the purse to the non-banking sector and use the chip to develop debit card based applications for low value payments. There is now some evidence to support this view with many EP initiatives on hold. Mondex is understood to be seeking non-bank investors and sees its future in the virtual rather than the physical world.

So what do we learn from this analysis? Several conclusions can be drawn. The most important is that change in payment systems always takes much longer than expected. As a general rule add three to five years to any forecast for a realistic implementation date. Also do not overestimate the effect of key drivers for change. Regulators (national and EU) have been slow to open up markets. However, a more pro-active policy appears likely over the next five years.

Similarly, the primary competition in the payments business is within the domestic markets. Despite almost ten years of an open market, cross border competition is limited to a small number of banks serving a small number of large corporates. Active cross border competition is probably three to five years away, if not more.

Also, change within the banking associations and card schemes will always be slow. Larger banks want open markets, and common tariffs and infrastructures. Smaller banks and smaller nations are naturally defensive and will always seek to protect their domestic relationships and traditional banking structures and systems. So far the smaller banks have won the day.

Finally, do not assume that innovative concepts and new payment methods will be attractive to cautious hard-nosed bankers, unless, of course, you invent another Mondex!