

# Europe Set to Lose Its War on Cash



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**Despite its high profile there are indications that the eurozone may lose its 'War on Cash'. The banking sector appears unable to deliver a strategy and vision.**

Europe's payments business has many contradictions and none more so than its strategy for the displacement of cash. Two opposing views have emerged over the past two years. To a degree this divergence in vision is now damaging growth and performance.

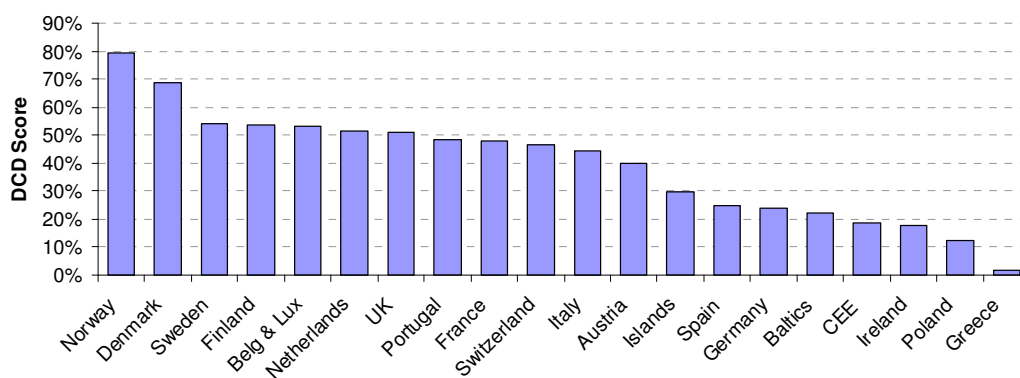
Seven years ago the Lisbon Accord set ambitious targets for EU efficiency improvement, which the payments sector appears to have missed, conceding leadership to the US. The eurozone remains highly cashcentric and there is evidence that the current cash growth outstrips substitution by cards and electronics. For some the 'war on cash' reflects a clash of cultures – cashcentric fearful traditionalists who wish to retain the status quo, versus cardcentric modernisers for whom technology will reduce costs and improve efficiency. However beneath this headline conflict there is also a philosophical debate over the strategy for cash and the future of the EU's card payments business.

The purpose of this article is to examine the background to the displacement debate, to present the cashcentric and cardcentric visions, to reach a conclusion and to suggest a potential outcome.

First, how cashcentric is Europe and what does cash cost society? Cash represents 85% of the EU's estimated 460 billion annual payment transactions; electronic payments 9%; cards 5%-6%, and cheques 1%-2%. Although the volume of transactions is enormous, a very significant proportion are below €15 (56% in France) with 30% below €5 (in UK and France).

The annual cost of cash has been variously estimated at between 0.4% and 0.6% of EU Gross Domestic Product (GDP), between €45 billion to €70 billion. For the largest nations the cost is between €4 billion to €6 billion and the smallest €0.75 billion to €1.0 billion. Euro note issue growth is 7%+ per annum. ATM cash withdrawal 6% to 7% in the eurozone (average value of €121) compared with 4% to 4.5% in four countries (UK, Sweden, Denmark, Norway) outside the eurozone (average value of €95).

An indicator of cash usage is a Debit Cash Displacement (DCD) score, which calculates the ratio of debit card usage to ATM cash withdrawal (see Table 1). Best performers are Scandinavia (Norway 72%), Benelux and the Netherlands, followed by UK, Portugal and France. Of the larger nations Italy, Spain and Germany have low scores.



Source: PSE Consulting Research  
 Note: UK data excludes credit card usage

**Table 1: Debit to ATM Cash Displacement (DCD) Score by European Country**

The views of cash users vary significantly. Consumers have a strong attachment - it's free, real and enables instant value transfer, but consumers are also unaware of its full end to end costs. The highest consumer cash usage is in the older groups; conversely many young perceive cash as an old fashioned payment method. Small merchants have a strong preference although they have great concerns over security and the risks of cash theft. Large merchants are ambivalent - most would displace more cash if they could win a better banking deal. All wish to reduce their back office costs and improve security.

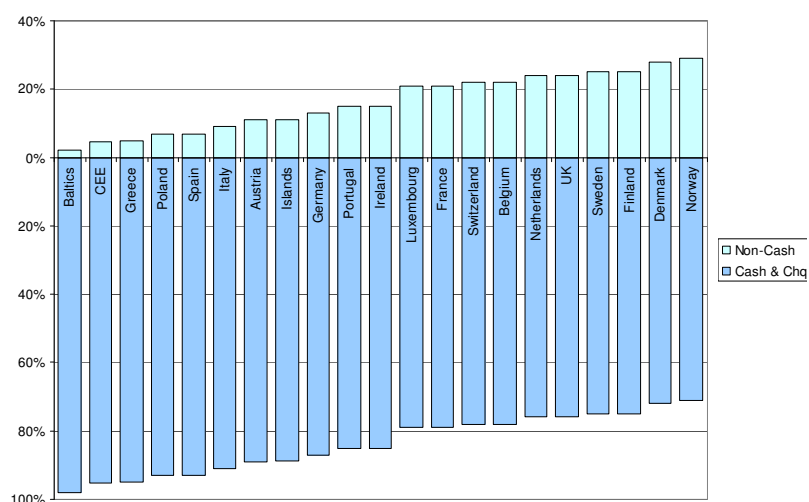
The public and private transport sectors face huge cash costs, are seeking alternatives and in some nations pricing out cash (UK – Transport for London). Some public authorities and large corporates, particularly in the CEE, are high cash acceptors for bills payment. Within the EU there are still examples of welfare payments in cash. Government and the EU are positive for displacement to support the police and security services in reducing money laundering, to counter the unofficial economy and improve the tax take-up.

Central banks face both ways in that seignorage income is a significant revenue generator. However the European Central Bank (ECB) recently gave strong support [UK Financial Times "Europeans still addicted to Cash", 29<sup>th</sup> January 2008], with Gertrude Tumpel-Gugerell saying that she would "prefer if banks spent the money they spend on handling of cash on investing in their systems and the development of new products".

Banks have traditionally invested heavily in alternatives to cash. Corporate cash wages and salaries were displaced by credit transfers in the 1960s/1970s. ATMs and cards began to displace counter cash in the 1980s. Direct debits/giro payments started to displace cash/cheque bills payment in the 1980s/1990s. Similarly, ATM cards evolved into debit cards and eftpos. With the exception of France and the UK, the cheque had almost disappeared at European POS by the early 2000's. Banking sector spend on core EU payment card and electronic infrastructures have exceeded €20 billion over the past 20 years.

Despite this long term strategy and commitment, the sector's vision for further cash displacement is currently unclear. This indecision partly reflects the lack of success of debit

cards and eftpos in the core eurozone nations of Germany, Italy and Spain, plus Austria and Ireland (see Table 2).



Source: PSE Consulting Research

**Table 2: Estimated Cash and Cheque Usage Compared with Non-Cash as a Percentage of all Payments by EU Country**

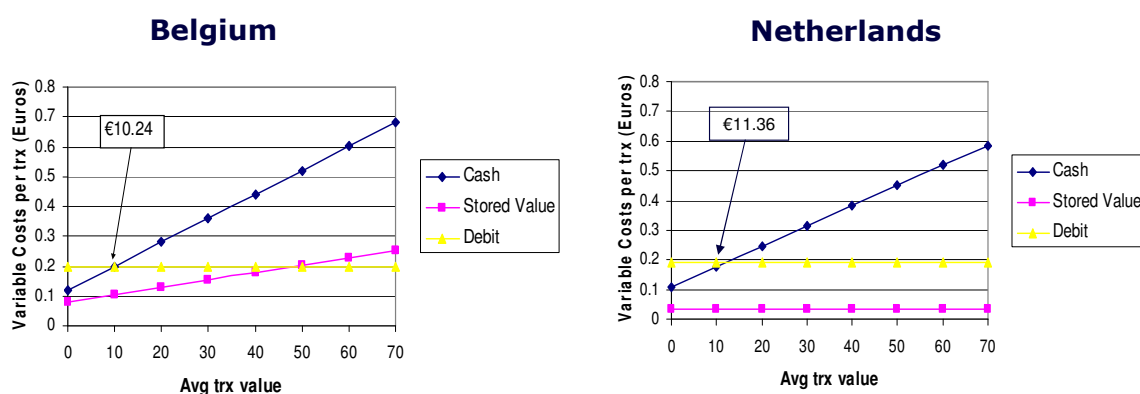
These nations are still high cash users despite having implemented sophisticated infrastructures and installed a large population of card acceptance points. The reasons for their slow uptake of card usage are many. A comparison with Scandinavia and Benelux indicates cardcentric nations first won the support of the largest merchants enabling base volumes to be quickly established. Equally important is a national consensus that cards/electronics are more efficient than cash. Strong leadership by government, central banks (Norway is a best practice example) and banking associations appears vital, as do the implementation of simple commercial frameworks and consumer fee structures enabling the method of choice of payment based on cost. If these tests are applied to the core eurozone cashcentric nations, several achieve low scores. These nations would benefit from the lessons learned by the best performers.

However culture, style and preferences are important influences. Citizens in France, UK, Benelux, Scandinavia and Portugal have migrated to cards primarily on the basis of a 'convenience proposition' and have broadly accepted that it is easier to pay with cards. However, in many nations, for historical and other reasons, consumers feel more confident with cash. Populations in these nations may only change their behaviour as a result of strong incentives, widespread communication campaigns and government and public authorities phasing out of the use of cash for transport, bills and welfare payments.

An important factor that influences the future of displacement are the divergent views within the banking community. The cashcentric view of payments is supported by some smaller banks, some savings/co-operative banking groups and some mutuals who fear that further

displacement will damage cash revenue streams. They also fear card acquiring competition from Europe's largest universal banks. Others fear that co-ordinated displacement will deliver the wrong message to the powerful merchant sector lobby. The cashcentric lobby is also supported by the Cash in Transit (CIT) cash carriers, the cash equipment providers and cash departments in banks and central banks. Their argument for continued use and growth rests on their belief that cash is inherently lower cost than the modern alternatives and for certain values there is evidence to support their views.

Cashcentrics put forward four principal arguments. First, the general consensus is that cash breaks even with the cost of debit between €11 to €12 (see Table 3).



**Table 3: Variable Costs per Transaction for Cash, Debit, Stored Value – Central Banks in Belgium and Netherlands**

Below this the cash is lower cost. However cardcentrics argue that the average EU debit card payment value is €53 so for most transactions the savings are significant. In addition with the introduction of contactless payments (and longer term mobile) break even may fall significantly to encompass many low value payments.

The second cashcentric argument is the high cost of the infrastructure required no matter the volume (ie. cash distribution centres and note and coin processing equipment). However cardcentrics state that a similar case could have been argued against cheque displacement where the costs of central equipment were equally high. As events have shown the case to retain the cheque has been lost.

The third cashcentric proposition is the potential to improve the distribution network, the handling of cash and thus reduce costs. Undoubtedly savings can be made, double handling removed, improved sorting and checking equipment installed and a more open market developed for cash distribution. However the cardcentrics believe the savings are modest in the major EU nations.

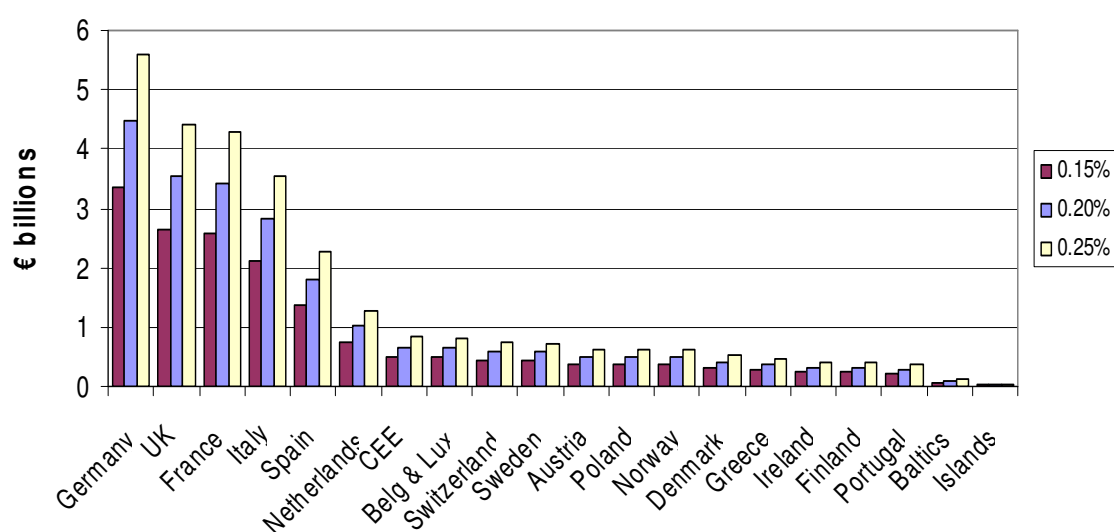
The fourth argument relates to the economic benefits of displacement. This issue is at the heart of the efficiency improvement debate. Broadly the low benefit school relies on studies conducted by the Central Banks of Belgium and the Netherlands and the cash supplier sector. The cardcentrics point to positive studies conducted by Central Banks of Sweden, Portugal and several academics (see Table 4).

## Key Cash and Card Research

- **The Cost of Paying – Private and Social Costs of Cash and Card Payments;** *Bergman, Guibourg, Segendorf; Sveriges Riksbank, September 2007*
- **Retail Payment Instruments in Portugal Costs and Benefits;** *Bank of Portugal, July 2007*
- **Issues of Efficiency in the Use of Cash and Cards;** *DeGrauwe, Rinaldi, Van Cayseele; University of Leuven, 2006*
- **The War on Cash and its Spoils;** *Leo Van Hove; Vrige Universiteit, Brussels; 2006*
- **Costs of Cash and Cashless Payment Instruments in Germany;** *PaySys Consultancy for Giesecke & Devrient; 2006*
- **Costs, Advantages and Drawbacks of the Various Means of Payment;** *Quanden; National Bank of Belgium; 2005*
- **Payments are No Free Lunch;** *Brits and Winder; De Nederlands Bank; 2005*

Table 4: Sample of EU Cash Cost Studies

Cashcentrics claim the low benefits studies argue the case for the continued use of cash. The cardcentrics argue the positive studies show the potential for significant efficiency savings particularly when the combination of debit plus contactless and future mobile payments are modeled. Using the more positive research the cardcentrics argue that savings of between 0.15% to 0.20% of GDP are feasible, or between €20 billion to €30 billion each year (see Table 5). Cardcentric savings assume that with strong banking leadership and a concerted EU wide 'War on Cash' the current level of EU cash usage could fall from 85%-87% to 75%-77% within five to seven years. This vision also assumes consumers within the core cashcentric nations change their behaviour and move rapidly out of cash.



Source: PSE Consulting calculations

Table 5: Cash Displacement Benefits at 0.15%, 0.20% and 0.25% of GDP in 5 to 7 years

So what is to be concluded? On balance, based on the latest research, the lessons learned from cardcentric nations, the breakeven point between cash and debit, plus the new payment products for low value, it appears a good case for cash displacement can be made. Similarly, a case can also be made for modest investment to improve cash handling and opening up the EU cash distribution markets.

Where do we go from here? The banking sector has two very different perceptions of the way ahead. The ECB's [Gertrude Tumpel-Gugerell, UK Financial Times, 29<sup>th</sup> January 2008] recent guidance is "SEPA will not automatically change payments habits but it provides a chance to address the issue. Cash use not only carries security risks but is expensive for banks".

However is ECB exhortation sufficient to shrink the eurozone's cash mountain?

Clearly the EU needs greater leadership but this is unlikely to come from the banking sector because of a lack of consensus. A SEPA vision for cash displacement will struggle to emerge. Primarily it is up to the two international card schemes (Visa and MasterCard) to argue the case that cash displacement will improve efficiency. They are strongly motivated and are highly likely to press their views as part of their response to DG Competition's new interchange evaluation criteria.

It is also up to the banking associations in the core cashcentric nations to recognise they have under utilised investments in eftpos and cards and that their payments efficiency needs to improve. These nations also need research to understand what will motivate and incentivise customers to use alternatives. They also need to construct national cash displacement strategies. Finally, the European Commission and the European Central Bank can also help to build a consensus through leadership and by encouraging displacement in the public sector and by corporates.

So will the EU win the 'War on Cash' and achieve improved efficiency in payments? Without focus and leadership this appears unlikely. Fragmentation will grow as will the eurozone's costly cash mountain. Sadly the indications are Europe's payments sector productivity will take years to achieve best in world performance.

## About PSE Consulting

PSE Consulting is a leading European payment business and technology consulting organisation. The company was founded in 1991 by Peter Jones and operates from offices in London.

PSE Consulting is a founder member of the European Payments Consulting Association (EPCA), an association of like consultancies operating in six European nations.

PSE Consulting provides independent advice to many of the European institutions mentioned within this article and to many other players who are currently shaping the European debit market place.



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