

## Europe's Search for the Optimum Card Processing Model

Is Europe's plastic card processing business about to change? Does the recent launch of SiNSYS, a new pan European interbank processing company by Interpay, Banksys and SSB, set the scene for further structural change? Are the rigidities and barriers in mainland Europe's payments processing business about to be dismantled? Have Europe's processors at last identified the optimum card business model to deliver services across Europe?

The purpose of this article is to answer some of these questions and to examine the strategies that processing companies can adopt to win in a difficult and competitive market valued at over €2.0bn and handling 25bn transactions per annum.

So how have we got to where we are? If we look back over the 1970's, 80's and 90's over 40 European interbank owned processing companies emerged (see Table 1.1 below).

	British Isles	Benelux	France	Germanic D/AUT/CH	Italy	Nordic	Iberia	Total
Large TPPs	4 – 5		2	4	1	1		<b>12</b>
Medium/Small TPPs	1	2	3	4			1	<b>11</b>
Interbank ACHs only	1	1	1	9	1	1	1	<b>15</b>
Interbank Payment/ACHs only		3	1	4	4	5	4	<b>21</b>
Interbank ATM only	1 – 2				1	3		<b>6</b>
Major Banks as Processors	3	3	2	1	4+			<b>13+</b>
<b>Total Processors</b>	<b>11</b>	<b>9</b>	<b>9</b>	<b>22</b>	<b>11+</b>	<b>10</b>	<b>6</b>	<b>78</b>

Figures exclude:

- Polling agencies from UK/Germany
- RTGS from all countries

Source: European Payments Consulting Association (EPCA)

ECB Blue Book data

Figures are approximate

**Table 1.1 How Many European Processors Are There?**

In the plastic card sector well known names such, as 4B/CECA/Sermepa (Spain), Interpay/Banksys/Cetrel (Benelux), GZS (Germany), SIBS (Portugal), SSB (Italy) and PBS/CEKAB/Luottokonta/BBS (Scandinavia), were created because no single bank could afford the basic plastic card processing infrastructure cost.

A high proportion of these shared systems was designed to support a "Mainland European Business and Processing Model", a cross between a not for profit and almost utility company. The early model was built, in most countries, on a domestic debit card PIN-based

ATM and POS delivery platform. Typically, each processor was supported by a loosely-defined domestic card scheme, some with no interchange, some where the processor acquired contracting directly with the merchant. Finally, the scheme and platform structure often incorporated many business and technical complexities designed (either consciously or unconsciously) to make it difficult for bank and processor competitors to enter the market.

However, there were three notable exceptions. France adopted a uniquely French concept to support a deferred debit semi-offline product developed within the Cartes Bancaires structure. Germany developed a very low cost debit card model based on three parties. The British Isles adopted an "Anglo Saxon Model" initially focused on semi-offline credit card acceptance and, subsequently, a credit card look-a-like signature based debit card.

For card issuing across Europe, nearly all current account and debit card processing was in-house (the exceptions were the smaller co-operative/savings banks). The British Isles excluded, credit card issuer processing developed primarily in-house for most of the large banks and on a shared interbank/third party processor (TPP) platforms for the medium and small.

In summary, by the late 1990's several processing models had developed. The British Isles copied the USA. An easy market for USA processors to enter! The French model has been almost impenetrable to foreign acquirers. German debit has proved unattractive to acquirers and processors because of low margins. The rest of mainland Europe adopted interbank cost sharing models, each with widely different implementations and many barriers (see Table 1.2 below).

	British Isles	Benelux	France	Germanic D/AUT/CH	Italy	Nordic	Iberia
Scheme Rules	◆	◆◆◆	◆◆◆◆	◆◆	◆	◆◆◆	◆◆◆◆
Technical Standards	◆◆	◆◆◆	◆◆◆	◆◆◆	◆◆	◆◆	◆◆◆
Commercial Framework	◆	◆◆	◆◆◆	◆◆◆	◆◆	◆◆◆	◆◆◆

◆◆◆◆ = High Barriers

Source: European Payments Consulting Association (EPCA)

**Table 1.2 Analysis of Barriers to Entry by Region**

However, from 1997/98 Europe began to change. Sweden, Denmark and Belgium opened up. Pressure from regulators has driven changes in business frameworks. The concept of a Single Euro Payments Area (SEPA) and a Pan European Automated Clearing House (PEACH) have recently emerged. Banks have become less happy with inflexible interbank processing structures, objecting to high fees, slowness to market and the high cost of very old platform replacement. Product requirements have become more complex. Many banks now seek total outsourcing solutions; others want control and in-house operations; others recognise that cross border acquiring (CBA) has reached its limits and want processors to support all cards (particularly debit), all countries pan European acquiring services now that telecoms costs are much lower. Finally, new USA processor players have entered the market (Tsys and euroConex, the European subsidiary of Nova).

But Europe now has an over supply of processing solutions with most players intent on becoming pan-European providers. Volumes are still elusive. Three countries, France, Germany and the British Isles, represent 67% of European EftPos and 62% of ATM volumes. Too many companies are chasing too few processing opportunities. In the 80's/90's the key drivers were risk and cost sharing, building critical mass in card and POS, and keeping out competitors. The key drivers are now efficiency, cost reduction and solutions for Europe's multiple and expensive debit card schemes.

Given this complex situation, what are the strategic options for Europe’s processors? Is there a “silver bullet” strategy which will ensure success? Four possible scenarios are reviewed within the following paragraphs.

- **Scenario 1 – TPP’s Consolidate by Mergers and Acquisitions (M&A).** This scenario proposes that interbank and other processors will be sold. Consolidation will occur through M&A and the sale of “on risk” acquiring and card issuer portfolios. Large third party processors such as FDC, Atos, Tsys, are the main beneficiaries with 5 - 6 major players in (say) 6 - 7 years time. The end game is the consolidation of processing into one large central plant and the delivery of support through local centres.
- **Scenario 2 – Consolidation via Co-operation.** This scenario argues that long term domestic interbank processors cannot survive but the not for profit concept will continue for the next 5 – 6 years. They must co-operate, develop new common processing platforms, increase volumes, reduce costs and sell product across Europe. Under Scenario 2 regional interbank processors (Iberia, Scandinavia) and co-operative interbank “clubs” and associations may also emerge.
- **Scenario 3 – Consolidation via the International Card Schemes.** This proposes that co-operation moves from domestic to a European level. The domestic schemes have a limited life. There is no rationale for new investment. The plans for SEPA and the drive for a common infrastructure can best be delivered co-operatively through the international card schemes who would move up the value chain to become full service processor providers. The card schemes could at the same time become the basis for competing PEACHes.
- **Scenario 4 – Organic Growth and Diversification.** This argues that smaller interbank processors and TPPs must develop their own unique solutions to survive. Their strategy should be to focus on their domestic markets, building stronger relationships and specialising in the provision of niche products which can be offered across Europe.

Scenario 1 - TPPs Consolidate by Mergers and Acquisitions is an attractive concept for the largest merchants and banks. Five to six processors would deliver low processing costs through economies of scale. The approach best suits the consolidation of credit card processing and the acquisition of bank card issuer portfolios. Local needs can be met by satellite service centres. M&A rapidly builds market share compared with the high cost of organic growth. Finally, the large TPPs have a tested migration model which enables low risk conversion of processing operations.

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>• Builds volume, lower operational costs</li> <li>• Attractive for credit card issuer processing</li> <li>• Local interface/support meets domestic market needs</li> <li>• Builds market share</li> <li>• Faster than organic growth</li> <li>• Leverages large TPP business model</li> </ul>	<ul style="list-style-type: none"> <li>• Few major M&amp;A and portfolio sale opportunities and high prices</li> <li>• Few credit card issuer opportunities</li> <li>• Complex acquiring infrastructures (debit particularly)</li> <li>• Many business and technical barriers to overcome</li> <li>• Skills to support other payments processing</li> <li>• Interbank strategies and politics</li> <li>• Central bank control and governance issues</li> </ul>

**Table 1.3 Scenario 1 - TPPs Consolidate by M&A – Strengths and Weaknesses**

However, there are weaknesses. This strategy has been followed by FDC in Europe for the past 12 years with limited success. Outside the British Isles there have been few major M&A opportunities (<25 the majority medium/small in the past three years). Significant

opportunities have been in the CEE, with only one or two large European prospects which have failed to materialise. Within these bids, there have been few credit card processing opportunities. In many countries credit card transaction volumes are very low (Benelux 10%, France 5%, Nordic 7%). Competition has been intense with high prices paid for relatively modest opportunities. In fact, bank M&A has had by far the greatest impact on consolidation and has often resulted in the concentration of interbank company shareholdings into one reluctant bank, who often wants to sell.

Scenario 1 also needs a central platform to support all cards in all countries. The costs of adaptation will be high (between €400k to €1m per country). In many markets there are complex technical barriers (terminals, security and standards). In some, the domestic processor is also the automated clearing house (ACH), the provider of real time gross settlement (RTGS) and the paper clearing company, activities that can represent 30% of total turnover. Large processors, with their credit card focus, lack experience of mainland European debit and have little understanding of other payments processing activities. Last, and not least, there is the issue of politics. The managers of large interbank processors will resist sale to a major, will argue the case for the continuation of their almost public utility role. Central banks often see managing payments processing as their domain (examples are PBS Denmark 17% and APSS Austria 35% central bank owned) and may raise governance objectives to the sale of national assets. In addition, a sale to a USA or French processor could be politically unacceptable particularly if substantial redundancies followed.

Scenario 2 – Interbank Consolidation via Co-operation has many attractions and is best exemplified by the SiNSYS consortium, who will share ownership, risks and profits and mutually reduce operational costs. A common SSB platform will support processing in each country, saving Interpay and Banksys redevelopment costs. A key benefit is the continuation of local processing which enables service delivery and local relationship management. Although initially credit card only, the joint venture (JV) has the potential to build a European company, able to match the largest processors. If copied elsewhere, similar regional groupings could develop in Iberia and Scandinavia. In addition, broader pan European co-operation may develop with interbank companies sharing resources, skills and platform redevelopment costs.

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>• Shared ownership, profits, risks, lower costs</li> <li>• Retention of local ownership and relationships</li> <li>• European owned entity to match international processors</li> <li>• Common platform and shared implementation</li> <li>• Similar regional groupings develop</li> <li>• Interbank sharing/co-operation</li> </ul>	<ul style="list-style-type: none"> <li>• Different cultures, different styles, decision making</li> <li>• Lack of a clear business model/focus</li> <li>• Complexity of longer term consolidation</li> <li>• Lack of large scale processor culture</li> <li>• Over-expansion, delayed implementation</li> <li>• Limited benefits and interbank inertia</li> </ul>

**Table 1.4 Scenario 2 - Interbank Consolidation via Co-operation – Strengths and Weaknesses**

Scenario 2 has disadvantages. To the Benelux partners the venture could be perceived as the best of two unpalatable solutions. The alternative could have been the domination of credit card processing by Tsys, FDC or Atos. The partners must share a common vision; partners from widely different cultures may not work effectively together. Unlike the major TPPs, interbank companies have a domestic “not for profit” vision and may find it difficult to cut costs radically and reduce staff for the greater benefit of the partnership, particularly if staff reductions were unequal.

SiNSYS’s initial focus is credit cards only. Given the small size of the Dutch and Belgian credit card markets, transferring processing to SSB will have little impact on Interpay and Banksys operations. However, a move to fully share EftPos and debit processing would have far greater impact on the two minority partners. The consortium may also initially lack

the culture, skills and expertise to deliver solutions that match those of the largest TPPs. Finally, the rapid growth of the JV may place all parties at risk with delayed implementation in the short to medium term.

General European wide interbank “clubs” may also emerge. This concept has its limitations. Would three of the fiercely competitive processors in Iberia forgo their independence to enable one common processor? In addition, previous attempts at co-operation through “clubs” (CBA acquiring, e-commerce gateways and reciprocal ATM acceptance) have been eclipsed by international scheme initiatives. Clubs can become talking shops with everyone selling to each other and no one buying.

Scenario 3 – Consolidation via the International Card Schemes has many attractive features and is already a partial reality. It can be argued that European interbank development is the logical modern replacement for domestic co-operation and a long term route to deliver SEPA via competitive PEACHes. The most significant event (in terms of volume) was the 2002 decision of Switch, the UK domestic debit card to move its back-end switching and settlement to MCINet and to rebrand the card as Maestro. Other European domestic brands may also migrate to international Electron and Maestro brands. Visa is already offers a similar service for seven countries including the UK. Of equal significance will be the implementation of EMV which will enable common acceptance standards at the POS.

The international schemes handle massive volumes with low costs. They have invested heavily in developing new high performance platforms. Also, they have the best potential to deliver a common European solutions for domestic debit and overcome the barriers to entry (MasterCard’s recent alliance with e-funds, the new owners of Oasis, may be a pointer to future strategies). International schemes could also provide full service processing (Visa, who already provides merchant processing services – Vital - to USA acquirers, is known to be considering a similar strategy in Europe). Finally, this scenario removes the need for banks to re-invest in new domestic infrastructures.

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>• Logical match with domestic debit brand conversion (as Switch UK)</li> <li>• Interbank co-operation at a European level – long term route to PEACH</li> <li>• Lowest processing costs, high service levels, modern platforms</li> <li>• Potentially full end-to-end service offering</li> <li>• Greatest potential to resolve debit card processing</li> <li>• Domestic banks no need for re-investment in local infrastructures</li> </ul>	<ul style="list-style-type: none"> <li>• Need for separate EU entity</li> <li>• Complexity of delivering domestic solutions</li> <li>• Cost of developing full range of processing solutions</li> <li>• Competition with members</li> <li>• Competitors to PEACH</li> <li>• Cannot M&amp;A or takeover</li> <li>• Cannot offer “on risk” portfolio purchase</li> </ul>

**Table 1.5 Scenario 3 - Consolidation via International Card Schemes Strengths and Weaknesses**

However, this concept has weaknesses. For regulatory reasons separate arms length European based and owned processing companies are needed. Card Schemes operate standard processes, so delivering bespoke domestic POS and ATM solutions in several markets would involve radical changes. Also, to be fully competitive, the Schemes would have to offer a range of processing solutions, including merchant support and chargeback processing. PEACH is still a long term strategy and the domain of the wholesale bankers who will resist international card scheme competition. The Schemes would also have to overcome the objections of members who may also perceive them as competitors. In addition, the Schemes cannot operate in a fully commercial manner, cannot easily buy processors and move into “on risk” acquiring or issuing.

Finally, Scenario 4 – Organic Growth and Diversification is attractive to the smaller interbank processors and TPPs who would focus on delivering bespoke services to banks (PolCard in Poland and Transacty in Slovakia already follow this model). Smaller regional players are better placed to deliver tailored services to the smaller regional banks. Also, smaller players are more adaptive and can exploit European niche markets (good examples are euroConex for e-commerce and DCC, and Euronet for ATM service provision). New revenue streams would contribute towards the cost of old technology platform redevelopment. Finally, processors can build local barriers and lock-ins to avoid encroachment by the larger international processors.

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>• Attractive to smaller interbank/TPP processors</li> <li>• Banks have bespoke local services</li> <li>• Service and support regional banks</li> <li>• Exploit European wide niche sectors</li> <li>• Build barriers to exclude major processors</li> </ul>	<ul style="list-style-type: none"> <li>• Local banks do not support redevelopment</li> <li>• Low volumes, higher transaction costs</li> <li>• Loss of client base to large TPPs</li> <li>• Skills to develop and sell new services</li> <li>• High cost of redevelopment</li> </ul>

**Table 1.6 Scenario 4 - Organic Growth and Diversification – Strengths and Weaknesses**

This scenario has weaknesses. Interbank members (particularly regional banks) may not support platform redevelopment and expansion. They may prefer a focus on domestic needs. Lower volumes mean smaller processors costs will always be higher. Many rely on a few major clients who could migrate to larger TPP’s and the co-operative interbank consortia. Smaller organisations often lack the skills to build and sell new products and services outside the domestic market place. Finally, small players will continue to face high costs to replace old systems and meet scheme mandates, such as EMV.

So four different scenarios. Is any one the “silver bullet” solution for mainland Europe? Table 1.7 scores each solution.

Scenario	Sector Impacted	Credibility	Feasibility	Cost Reduction
1. Consolidation by TPP M&A	Large TPPs and Large Interbank Processors	●●	●●●	●●●●●
2. Consolidation via Interbank Co-operation	Domestic Interbank Processors	●●●●	●●●●	●●●
3. Consolidation via International Card Schemes	Major Card Schemes and Domestic Interbank	●●●	●●●	●●●●●
4. Organic Growth and Diversification	Smaller Interbank and TPPs	●●●	●●●	●

**Table 1.7 Summary Assessment of Processing Scenarios for Mainland Europe**

Major processor consolidation by M&A has long term potential but is unlikely to happen until the owners of the major interbank processors decide to sell, major banks decide to sell portfolios and central banks are satisfied that governance mandates can be met should ownership move to the non-banking sector. Opportunities for Scenario 1 are thus long term. Significantly many processors (LINK, BACS, PBS, Interpay and others) are separating their schemes from core processing reflecting pressure to deregulate. The resulting stand-alone processors thus offer potential for privatisation.

Consolidation by interbank co-operation is already a reality and despite some reservations, is undoubtedly a way forward. New partners may join SiNSYS or new similar ventures emerge. The jury is out on the benefits that interbank clubs can deliver. In some countries these new co-operative initiatives may stimulate domestic cost sharing, further encourage central bank ownership and possible moves to create nationally owned utility companies.

Consolidation via the international schemes is also underway and, given their power, influence and low cost base, means they will be a major future player.

Finally, for the smaller, organic growth and specialisation is an attractive medium term option, but in the longer term they will find survival difficult.

All four scenarios are feasible, are not mutually exclusive, and will co-exist in the market. However, market consolidation is the inevitable end game. The current over supply cannot be sustained in the long term.

***Peter Jones***  
***Director***  
***PSE Consulting***  
***+44 (0)20 8891 6244***  
***e-mail: peter.jones@pseconsulting.com***