Towards a solid payments strategy and implementation

On the right track for success

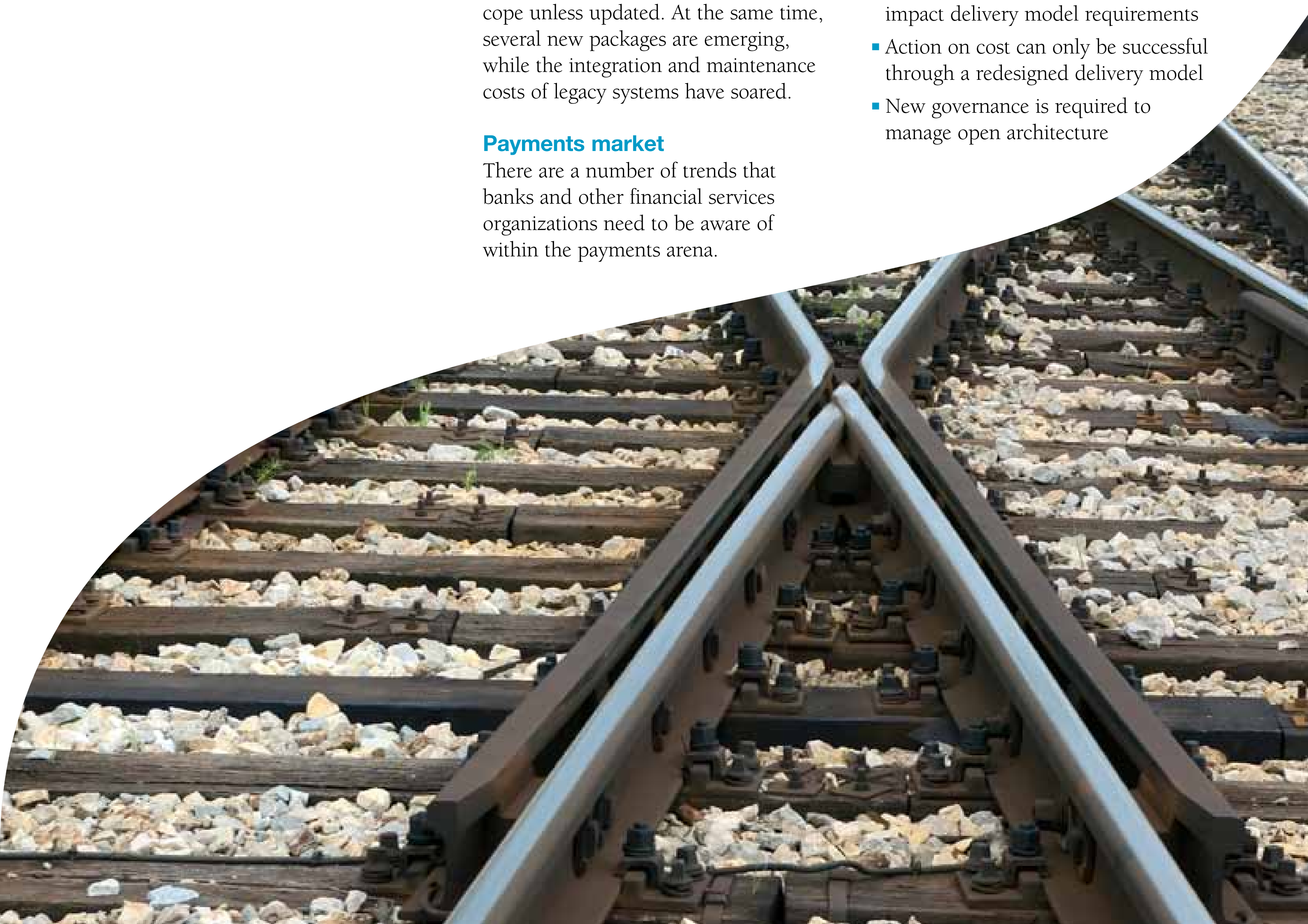
The market for payments systems is changing beyond recognition. For example discussions around SEPA 'end-date' will mean banks need to align themselves in a timebound manner if they are to be able to compete under this new regime. Existing payments systems, many of them decades old, will not necessarily cope unless updated. At the same time, several new packages are emerging, while the integration and maintenance costs of legacy systems have soared.

Payments market

There are a number of trends that banks and other financial services organizations need to be aware of within the payments arena.

These include:

- A growing market based on innovation and investments
- Compliance to the changing regulatory environment is a must
- SEPA is both a compliance and a strategic issue
- Strategic decisions on revenue will impact delivery model requirements
- Action on cost can only be successful through a redesigned delivery model
- New governance is required to manage open architecture



A growing market based on innovation and investments

The global non-cash payments market is estimated around 300 billion transactions in 2009, with after market volume growing by a steady 8% each year, far outpacing the average 2% growth in world gross domestic product during recent years. This is largely due to the wide range of key stakeholders in many markets, including banks, country authorities and corporations, keen to push towards more widely accessible, seamless and secure means of effecting non-cash payments.

The result is a rise in non-cash payments (primarily cards and direct debit), as well as extended reach into new geographies (developing markets experience double-digit growth rates) and new territories where traditionally cash-use prevailed (vending machines, person-to-person payments). New payment scenarios (merchant's web site, mobile transactions etc) have also arisen. All this has led to a substantial growth rate in all regions, even in mature markets.

Compliance to the changing regulatory environment is a must

Regulatory authorities are keen to see how a reduction in cash-in-circulation helps to address key issues such as reducing currency counterfeiting, money-laundering, fraud etc. As a basic requirement for participating in this market, payments services providers (mainly banks) need to fulfill a set of complex and changing regulatory requirements. Compliance is no longer optional.

Regulators also expect the wider use of non-cash instruments to create a more competitive payments landscape, a top-line goal for most financial services authorities. In Europe, SEPA aims to see all Euro payments in the Euro area treated as domestic payments under single standards, eliminating the current differentiation between national and cross-border payments. European banks involved in retail and transaction banking have no choice and need to ensure their compliance with the new industry standards, SEPA rulebooks based on ISO 20022 and XML standards and their new legal framework (Payment Services Directive).

SEPA is both a compliance and a strategic issue

For banks SEPA spells the end of country-based payments models. It also heralds the dawn of increased competition and even greater demand from customers for higher service levels, more efficient products and cheaper means of making payments. As demonstrated in previous Capgemini publications, by 2012 aggregate directpayments revenue among banks in Europe will decline by 38% to 62% in some parts of the market, although overall payments volumes will rise.

For Europe's banks, the net financial impact will depend largely on how quickly they can respond strategically and assert their individual competitive strength especially in reacting to the industrialization of non-cash payments. There are various strategic answers to the SEPA challenges depending on the specific situation, ambitions and means of each institution. In all cases, however, market stakeholders must address both the revenue and the cost side of their payments profit and lost.

Strategic decisions will impact requirements

From a revenue perspective, banks need to decide whether to go for volume (low cost producer), for value (niche player), or both-provided they are among the few leaders that can afford the investments. The ability of a bank to become (or remain) a top-tier player in the post-SEPA payments market depends primarily on it being able to grow transaction volumes.

Low cost operations offer a significant competitive advantage, but to be a major payments player a bank will need to be processing in the region of 5 billion payments transactions a year by 2012. Volume strategies would mean maximizing their share of existing markets, but also entering and winning additional markets directly or by the use of third party retailers. Of course, volume is achieved with the traditional success factors for mass delivery: resilience, innovation and low cost are a must. A value strategy would see a bank focusing on specific market segments and creating added value services that differentiate its payments business from ordinary commoditized payment services providers. In such a situation, client focus and speed-to-market will be key success factors.

Successful cost actions through a redesigned delivery model

Based on the advantage gained from their volume positions (measured in terms of their unit cost per transaction), most banks will adopt one of three strategies niche player, low-cost producer, or leader. Banks that cannot or will not execute one of these three strategies will need to outsource (parts of) their payments processing functions. The ensuing cost reductions following a drop in market prices will mainly come from the rationalization of the infrastructures, as payments is a fixed cost industry.

To support the selected payments strategy, each bank must examine its industrial processing from a pan-European perspective. Within the Euro zone, banks will move to single payment factories from which all clients will be served, irrespective of their country of residence and of what brand and legal structure the group dealing with them has. This model is also valid for other regions. The consolidation of processing within each banking region will be the only way to avoid duplications in investments, meet regulatory deadlines, satisfy client requirements and reduce and share total fixed costs. In particular, it will require the delivery organization and systems to be capable of supporting various brands and legislations: whilst the Payments Services Directive (PSD) creates a single legal framework for payments, other legislation (taxes or social) is still country based.

New governance is required to manage open architecture

Successful banks will convert their delivery models into open architectures. It will give them the flexibility to satisfy customer needs along the entire payments value chain, and it will help banks and their clients optimize their payments models. By doing so, they will not only provide payments services to other retailing channels (banking or non banking) but also incorporate into their own processes value-added services components from external processors. This must be done without a loss of control over the payments value chain control being understood in terms of operational trust (resilience), transparency of the service level and control over the costs to income ratio.

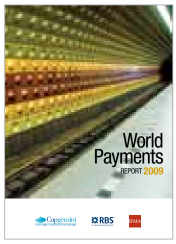
This trust can be achieved by a clear definition of the business objectives, the design of a coherent supporting delivery infrastructure and organization and the replacement of existing country-based payments systems, many of which are decades old. Conveniently, a new generation of packages is appearing that represents a credible opportunity for moving from ageing legacy systems, both in Europe and in all other regions where banks state their ambition to offer a robust, innovative, efficient and finally profitable payments business.

Successful implementation

In answer to these questions and challenges, Payments market leader Capgemini has developed a shared services model, based on centralized Payments Hubs and Cards. The services and delivery model offered must reflect the market positioning of the organization. This model will be implemented alongside a tried and tested roadmap:

Step 1: First we help you to formulate and challenge a sound Business and IT strategy for payments. This contains a

World Payments Report



From Capgemini, RBS and Efma, the *World Payments Report* for 2009 reports that non-cash payments transactions grew to 250bn and global transaction services remained a significant contributor to revenue. Covering Europe, North America and Asia, the report draws on 36 interviews conducted with 16 major banking players and 20 of their corporate clients.

clear decision on whether a bank wants to be a leader, a niche player or a low cost provider. Of course, Capgemini will use all the market insights collected and demonstrated with *World Payment Report* productions and during assignments with our clients. Next to that, a clear transformation methodology is required to be able to seamlessly change business, IT and organization.

Step 2: Then, from our expert views on the most efficient IT architectures for payments, we adapt to your business strategy and define an optimal Transformation roadmap. In this phase, Capgemini uses its own reference models for payments and cards, in order to speak the same language throughout business and IT. Furthermore, analysis of required services and how they collaborate is needed to create an optimal alignment between business needs and back office solutions. This also gives the opportunity to consider outsourcing of clearly defined services, thus significantly increasing the chances of success.

Step 3: When the road is clear, we offer an overview of package functionalities and link them with architecture and selection/ implementation methodologies. *Our Payments Systems Survey* gives an excellent overview of package functionalities, offers guidelines on how to select packages and defines critical success factors in implementing payment packages. Capgemini is product agnostic but has partnerships in place with the industry leaders that help us advise the best, most suitable product to our clients.

Step 4: Next step; the actual Global Payment Hub implementation itself and its integration in your environment, run by both onshore and offshore payment competence centers. Onshore, we have specific market and client knowledge available; offshore, we run a dedicated payment package delivery practice, to execute projects at acceptable cost. Based on the partnerships in place, we are able to accelerate implementations significantly due to our knowledge of products and, more importantly, of the optimal ways of integrating products into client environments.

Step 5: Once the Hub is up and running, we offer Business Process optimization and Compliance and Regulatory testing, including a Rightshore® component.

Step 6: Finally, we offer immediate application maintenance to lower your legacy costs during transformation and application maintenance for the new environment once it is operational.

Moving to this shared service model (with Payment Hubs) is the Capgemini answer to the current silo based, decentralized payment infrastructures within banks. The creation of a central service cross country and cross business line will deliver added value in terms of cost, flexibility and operational excellence. On top of that the client will also experience the same delivering payment transaction through different channels.

The actual delivery of these payments hubs can be done in-house or outsourced. The typical major transaction banks will have an in-house solution, even offering services to other Financial Institutions. Capgemini expects a further consolidation in the payment processing market resulting in a limited number of providers of these services.

Smaller banks or banks less specialized in payments will leave the running and processing of their payments hub with third party service providers or banks offering this service white labeled. Still, outsourcing of payment processing only becomes possible once the required services have been defined clearly.

With our combined consulting and implementations capabilities, we help banks all over the world to realize a competitive global transaction services strategy.

More information

To obtain more information on Payments and to download the World Payments Report, please visit **www.capgemini.com/payments** or e-mail **payments@capgemini.com**

COLLABORATIVE BUSINESS EXPERIENCE

About Capgemini and the Collaborative Business Experience

Capgemini, one of the world's foremost providers of Consulting, Technology and Outsourcing services, has a unique way of working with its clients, called the Collaborative Business Experience.

Backed by over three decades of industry and service experience, the Collaborative Business Experience™ is designed to help our clients achieve better, faster, more sustainable results through seamless access to our network of world-leading technology partners and collaboration-focused methods and tools. Capgemini utilizes a global delivery model called Rightshore® which aims to offer the right resources in the right location at competitive cost, helping businesses thrive through the power of collaboration.

Capgemini reported 2009 global revenues of EUR 8.4 billion and employs over 90,000 people worldwide.

More information about our services, offices and research is available at **www.capgemini.com.**

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