

# Global Trends in the Payment Card Industry 2012: Acquirers

**Key challenges faced by card acquirers and their implications for the payment card industry**



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# 1. Highlights

“In the face of great change, merchant acquirers are preparing to rise to the occasion, leading the transformation toward a mobile- and cloud-based payments environment.”

**Rick Oglesby**

Senior Analyst, Aite Group

Despite uncertainties around global economic recovery, the card payments industry continues to show high growth rates globally<sup>1</sup>. Card transactions continue to increase, driven by consumer preference for non-cash transactions. Cards are now increasingly being used for low-value transactions, and with significant growth in online and mobile commerce, card payments are expected to continue to show growth in the near future.

The merchant acquiring industry, however, is undergoing a sea of change, mainly driven by several factors including: changing payment needs of merchants; consumer's preference to shop online; a rapid increase in mobile commerce; and the emergence of non-banking players. Acquirers are also facing regulatory compliance pressures, and fraud and security concerns continue to challenge the industry. In addition, advancements in technology have led to the emergence of new payment methods such as contactless cards and near field communication (NFC).

These prevalent market forces are driving merchant acquiring firms to review their existing business models and align their technology initiatives with their overall growth strategy. To meet consumer and merchant payment needs, acquirers are increasingly focusing on providing multi-channel payment options. Merchants are now seeking acquirers who can provide a single platform to support different payment options, which are in turn leading to multiple payment gateways becoming retail payment hubs.

Acquiring firms are increasingly using technology to differentiate themselves from their competitors and are exploring various technology implementation models. There is no consensus on which implementation strategy is best for the acquirers, as it depends on the size, business strategy, and the current state of technology systems of an acquiring firm.

Acquiring or forming a joint venture with innovative non-banking firms is one of the most favoured options for merchant acquirers, as it gives full control of the technology system to the acquiring bank, and reduces their go-to-market time. Other models acquiring banks are exploring include in-house platform development and outsourcing. Outsourcing technology projects to professional services firms can enable acquirers to focus on their core business activities, significantly reducing their investments. However, some acquiring banks still feel the need to have tighter control over their systems and opt for in-house development.

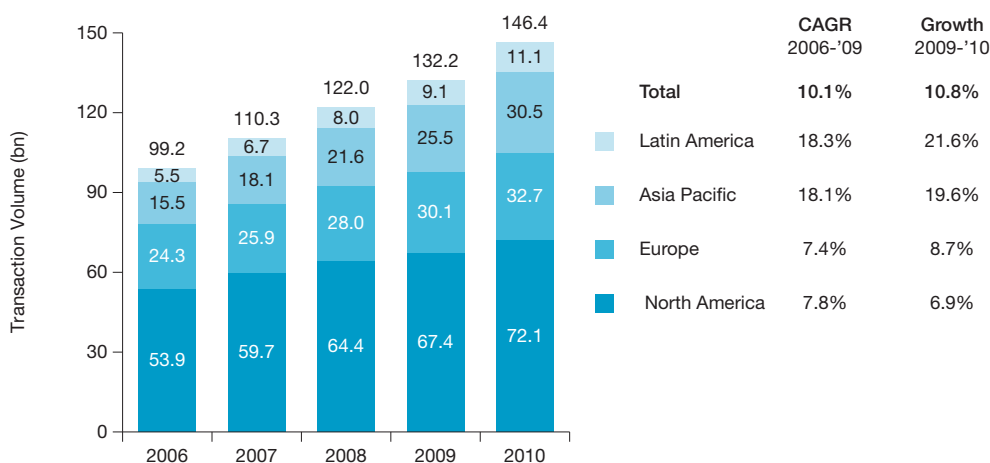
## 2. Introduction

### 2.1. Global Payment Card Industry Performance

According to the World Payments Report 2012 from Capgemini, RBS and Efma, cards usage across the globe gained momentum in 2010 after the financial crisis of 2008-2009. Card transaction volume grew at an annual growth rate of 10.8% in 2010, compared to 8.4% growth in 2009, as a result of signs of recovery across global markets, as well as a boost in consumer confidence. In 2010, cards were one of the most preferred non-cash payment instruments globally, with an estimated 55.8% of the global non-cash payments routed through cards. Some of the primary factors leading to the high growth of cards usage may include: increased acceptability of cards; growth of e-commerce; industry collaboration, and government support globally<sup>2</sup>.

In developed countries, the market trend of using non-cash payment instruments such as cards for lower value transactions has led to higher transaction volumes. In Europe, consumers have shown a greater tendency to use debit and prepaid cards versus credit cards for low value transactions. Based on a regional comparison, Asia-Pacific has been one of the fastest growing regions in terms of card usage as noted in the following exhibit.

Exhibit 1: Global Card Transactions by Volume (bn), 2006–10



Source: Capgemini Analysis, 2012; ECB; Red Book 2010; World Payments Report 2012, Capgemini, RBS and Efma

In 2010, the payments card industry witnessed strong growth in developing nations, and a relatively slower growth in developed nations. While the transaction volume growth in developed countries was modest, with the U.S. growing by 7.2% and the Eurozone growing by 8.6%, developing nations witnessed higher card usage, with China growing by 38.9%, Russia by 49.8%, and Brazil by 23.3% annually in 2010<sup>3</sup>.

In terms of number of transactions per inhabitant, North America had the highest prevalence of card usage globally. This trend is due to the high adoption of cards as the non-cash payment instrument. Emerging countries have a high growth potential and card usage could grow faster due to the growing culture of using plastic over paper money. Increased acceptance of cards at various points of sale (POS) units could also be the reason for higher volumes in most emerging countries.

<sup>2</sup> World Payments Report 2012, Capgemini, RBS and Efma

<sup>3</sup> Ibid

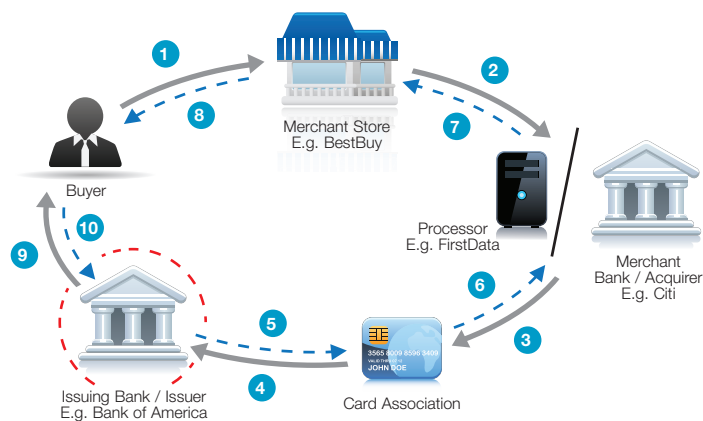
## 2.2. Key Payment Card Industry Participants

A simple card transaction between a cardholder and a merchant involves several players:

- **Card acquirers:** the merchants' banks.
- **Card processors:** third party organizations that aid in card authorization and settlement processes.
- **Card issuers:** the cardholders' banks that issue the card and maintain the customers' accounts.

Additionally, card association network providers—typically MasterCard® or Visa®—play an essential role in completing the card authorization and settlement cycle, as illustrated below.

Exhibit 2: Typical Card Transaction Flow Structure



- |  |  |
|--|--|
| <ul style="list-style-type: none"> <li>1 Cardholder uses a credit card to pay for a purchase transaction</li> <li>2 Merchant sends transaction information to the acquirer by swiping or manually feeding card information at the POS terminal</li> <li>3 The acquirer or third-party processor on acquirer's behalf sends the transaction information to the card association</li> <li>4 The card association sends the transaction information to the issuer for authorization</li> <li>5 Issuing bank pays the card association network once it validates the transaction (after deducting their charge)</li> </ul> | <ul style="list-style-type: none"> <li>6 Card association pays the acquirer processors on acquirer's behalf (after deducting their charge)</li> <li>7 Merchants account is credited for the transaction amount by the processor (after deducting their charge)</li> <li>8 Purchase transaction is completed</li> <li>9 Issuer bills the buyer for the transaction based on the billing cycle</li> <li>10 Buyer settles the bill</li> </ul> |
|--|--|

Source: Capgemini Analysis, 2012; www.yahoofinance.com, August, 2012

This paper focuses on the key trends that merchant acquirers have been experiencing and how the industry is responding.

### 3. An Overview of Emerging Trends in the Payment Cards Industry: Acquirers

With the emergence of new payment technologies and players, growing smartphone sales, and increasing adoption of online card payments, the merchant acquiring industry has moved away from traditional business models. Acquirers are realigning their market strategies with this new business environment and are adding new revenue streams to their existing business lines. Some of these additional revenue streams include providing value-added services and products to the merchants. Acquirers are also focusing their efforts towards increasing mobile payment acceptance, supporting merchants in managing risk, and enhancing customer experience—both online and offline at the point of sale.

In addition, regulatory changes and increasing competitive pressures are shaping the key technology investment decisions of merchant acquirers. The cards payment industry participants are increasingly seeing technology as a key differentiator from their competition. Acquirers are investing in technology enhancement projects to make card transactions more secure, faster, and easier to process. Furthermore, the entry of non-banking players in the cards payment industry has also forced acquirers to change their business model, evident from the fact that acquirers are now providing multi-channel payment option to merchants.

Due to increasing competition in the acquiring industry, acquirers will continue to focus on offering various value-added services to merchants. Acquirers are expected to continue to focus on regulatory compliance and adoption of global cards payment standard through mobile devices. However, merchant acquirers around the world are also directing their attention and investments towards two emerging market trends:

1. A focus on providing merchants with multichannel payment services.
2. Acquirers are now contemplating different technology implementation models as a key competitive differentiator.

Several trends that were covered in the 2011 *Global Trends in the Payment Card Industry* series are still relevant but are not discussed in detail again in this paper.



Global Trends in the Payment Card Industry: Processors



Global Trends in the Payment Card Industry: Acquirers



Global Trends in the Payment Card Industry: Issuers

# 4. Trend 1: A Focus on Providing Merchants with Multichannel Payment Services

“Over the past 12 months, we have seen a huge shift towards multi-channel retailing, with merchants eager to provide their shoppers with the best customer experience possible in a rapidly evolving payment landscape.”

**Shaun Wilson**

Managing Director - Sage Pay,  
Company Website

## 4.1. Background and Key Drivers

With advancements in technology, the growth in the number of mobile devices, and increased adoption of innovative payment systems, both offline and online merchants' payment needs and priorities are changing. Merchants are increasingly looking to provide their customers with multiple payment options and this is putting pressure on merchant acquirers to focus on meeting these payment needs.

Multichannel merchants are already facing a wide range of challenges regarding the different points of sale. These challenges are likely to grow with the increasing adoption of new technologies such as Near Field Communications (NFC). Merchants are seeking systems with robust platforms that provide cost-effective services for transaction processing and customer experience enrichment. Merchants are also using other channels, card not present<sup>4</sup>, for driving sales through both online as well as physical stores.

The key factors driving merchant acquiring firms to focus on providing multichannel payment services are:

- Global online and mobile commerce is growing at a fast pace and is expected to continue growing rapidly in the near future.
- Shift in merchants' focus to fulfill the multiple payment preferences of users.
- Advancements in technology such as NFC may revolutionize payments at the point of sale.
- Increasing competition in merchant acquiring space.

## 4.2. Analysis

Driven by high growth in developing economies, global e-commerce sales grew by 17.9% in 2011 and are estimated to grow by 20.7% annually through 2013 to reach \$963 billion<sup>5</sup>. Customers using mobile phones and tablets for payments are increasing at a rapid pace, forcing merchants to provide multichannel payment options.

In addition, with the rapid growth of non-banking players, traditional bank acquirers are seeing a radical change in the acquiring landscape. Payment Services Directive (PSD) has enabled non-banks to become payment institutions, thereby driving the competition in acquiring segment. Processors and other service providers have taken this opportunity to move up the value chain in card payments, and are providing merchants with seamless linkage to multi-channel payment system.

The card acceptance business is also undergoing changes due to innovation, and advancements in technology such as contactless and NFC. An increase in the adoption of new payment channels by consumers is forcing acquirers to consider adding these channels to their payment solutions for merchants.

Payment needs of merchants are becoming increasingly sophisticated. Therefore acquirers are focusing on delivering payment solutions which meet PCI standards and enable them to keep up with changing market dynamics.

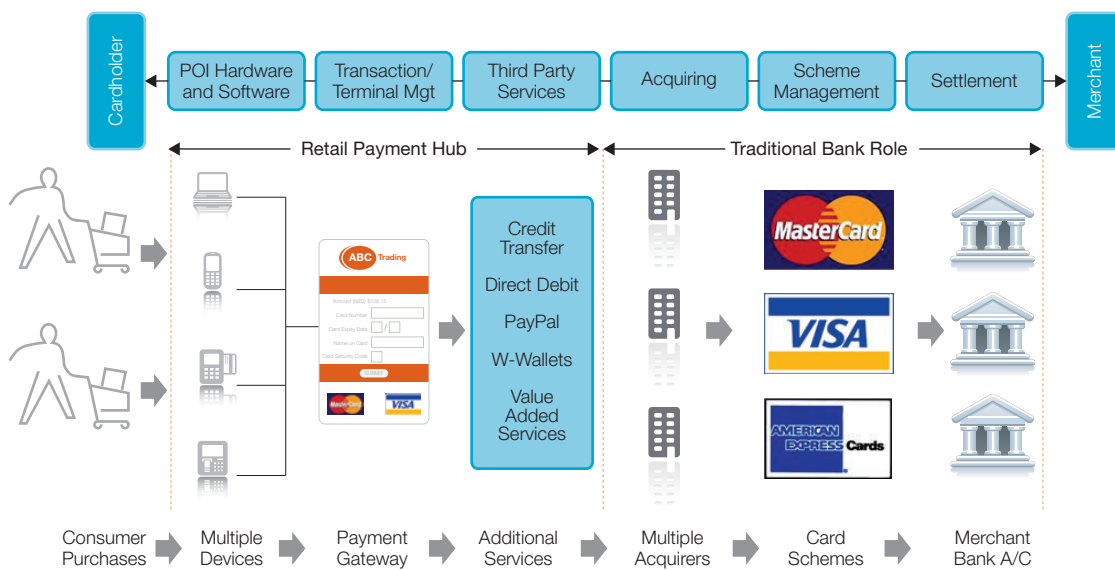
<sup>4</sup> A card not present transaction is a credit card purchase made over the telephone or over the Internet where the physical card has not been swiped into a reader

<sup>5</sup> Capgemini Analysis, 2012; "Goldman Sachs forecasts growth rate of global Ecommerce sales; Asia factors big," Kent Allen, Pitney Bowes, 21 March 2011

### 4.3. Implications

Prevailing change drivers have impacted the cards value chain and are altering the traditional relationship between merchants, acquirers, and other participants. Merchants' demand for multi-channel solutions, value-added services, and seamless integration with different technology systems will likely lead to the emergence of multi-channel gateways as payment hubs.

Exhibit 3: Multi-Channel Gateways Become Retail Payment Hubs



Source: Capgemini Analysis 2012; Technology M&A in Acquiring, PSE Consulting, The Merchant Acquiring Conference, 2011

In several European countries, gateway convergence is already occurring slowly. Merchants are now seeking acquirers who can provide a single platform to support different payment options—for both physical and virtual transactions.

Some large acquiring banks are still waiting to respond to the changing market conditions, but a majority of acquirers are now reviewing their approach to service merchants. Some acquiring banks are looking to form joint ventures or acquire non-banks to meet merchant needs and grow in this space. Acquirers with technical resources are investing in building new multi-channel gateway platforms and others are outsourcing it to third party integrators.



# 5. Trend 2: Exploring New Technology Implementation Models

## 5.1. Background and Key Drivers

Historically, acquirers have struggled to use technology as a competitive differentiator, mainly because of the following factors:

- The two-sided market<sup>6</sup> works against individual acquirer initiatives, so making a business case for any technological investment is difficult.
- Acquirers have preferred to leave innovation and R&D to card networks such as Visa and MasterCard.
- Very high costs are generally involved in implementing any change into old legacy platforms.
- Negative impact on bottom line due to high R&D costs and piloting.
- With the decay of the “Compete and Cooperate Model”<sup>7</sup>, acquirers are sceptical about inter-bank initiatives.

Non-banking players have been at the forefront of innovation in the acquiring space in card payments. However, traditional banks in the merchant acquiring business are now becoming more aware of changing market realities. With an increase in competition from non-banks, increasingly sophisticated merchant needs, and advancements in technology, acquirers are now looking at technology as a strategically important investment.

The key factors that are driving the current shift towards technology investments are:

- Increasing demand from customers and merchants for real-time and secure payments.
- Growing demand from merchants for a fully integrated, single platform, and multi-channel payment solutions.
- Increase in competition as non-banking players are increasing their market share in acquiring business due to innovative products and services.
- Customers’ rapid adoption of mobile and online payments, and other technologies such as contactless and NFC.
- Increased focus on enterprise level data and fraud management systems.

## 5.2. Analysis

Merchant acquiring firms are now reviewing their technology implementation models in order to provide their customers with seamless front and back-end integration. Acquirers are looking to align their business model with their technology implementation model and should be considering one of the following options:

- **In-house:** Large acquiring banks, who have technical capabilities and resources, are considering an in-house technology implementation model. This model enables firms to have a tighter control on system development and gives flexibility for any future changes. However, this model involves a high internal investment cost as well as a risk of failure to deliver in a timely manner.
- **Outsource:** Acquirers who want to focus only on their key business areas, are outsourcing their non-core activities—such as technology implementation—to third party vendors. This model involves a low cost of development and asset purchase and reduces go-to-market time. On the other hand, acquirers will have less or no ownership of IP and less control over the system.

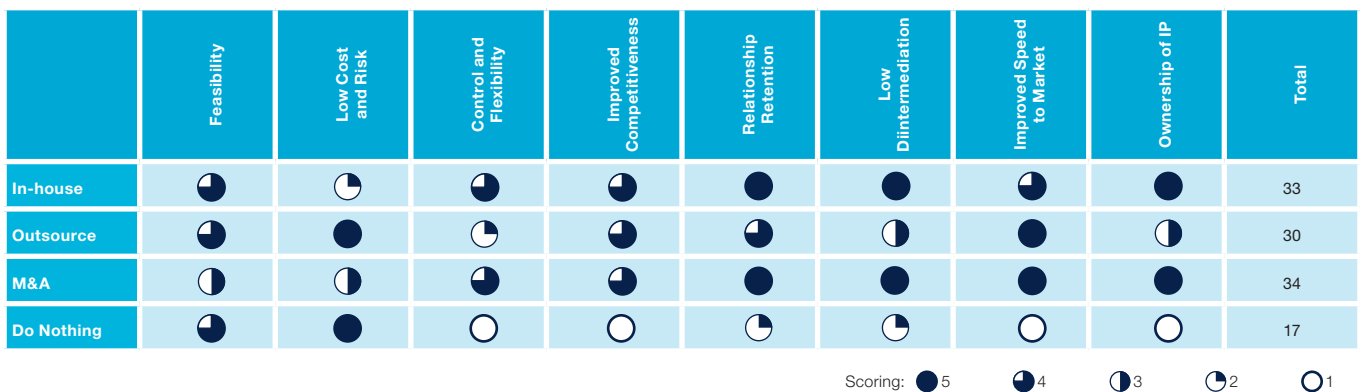
<sup>6</sup> Two-sided markets are economic platforms having two distinct user groups that provide each other with network benefit. Here acquirers and merchants are two sides, as new technology introduced by any acquirer has to be adopted by merchants to succeed

<sup>7</sup> In this model, two or more competing firms come together and cooperate in order to introduce an innovative product or system which will benefit the whole industry

- **Merger and Acquisition (M&A):** Merchant acquiring firms which cannot wait for long development time are looking to acquire or form joint ventures with innovative non-bank players. Advantages of this approach include a strong competitive edge, ownership of technology assets, and the availability of skilled resources. However, acquirers may have to pay a high price for a buyout and this may involve additional potential costs for further development.
- **Wait and Watch:** In this rapidly changing payments market, certain acquiring firms are waiting for the market to settle down and formulate a strategy once they have a clear assessment of the situation. This approach prevents an acquiring firm from taking any hasty investment decision and may help in developing a better informed strategy. However, acquirers adopting this approach may miss out on new revenue streams and will likely fall behind their competition.

In a survey conducted by PSE Consulting in 2011<sup>8</sup>, acquiring banks rated M&A as the best technology implementation approach, followed by in-house development and then by outsourcing. M&A is the most favored approach as it significantly improves the speed to market. The advantage of in-house development is that acquiring firms may not be comfortable diluting their ownership and control over the developed product or system. Outsourcing also scored high, at third place, as it enables firms to focus on their core activities, but was not the most favored option due to security concerns.

Exhibit 4: Technology Implementation Strategies for Acquirers



Source: Capgemini Analysis 2012; Technology M&A in Acquiring, PSE Consulting, The Merchant Acquiring Conference, 2011

### 5.3. Implications

As the card acquiring market is becoming more competitive, more and more acquiring banks are looking at technology as a key competitive differentiator. With technology becoming the focus area for acquirers, spending on IT implementation projects is expected to increase in coming years.

Since acquirers are using different technology implementation models, the impact of each model will be different. As noted, M&A is the most favored option for acquirers and this will lead to significant consolidation in the industry. This approach, if followed, will bring non-banks and traditional banks together. In-house technology implementation model will allow acquirers to have a complete control over their systems, but this approach will limit their innovation capabilities.

Outsourcing will help acquirers focus on their core business activities and will ensure timely delivery of robust platforms. The role of technology vendors and system integrators in the cards acquiring business is likely to increase in the future as more firms go with this approach to reduce investment costs.

<sup>8</sup> Technology M&A in Acquiring by Peter Jones, The Merchant Acquiring Conference, PSE Consulting, 2011

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