There are a number of prohibitive factors working against the full scale development of cross border and centralised merchant acquiring.

These range from various political barriers and multiple domestic debit schemes to the different interchange rates which reduce the benefits of volume pricing for merchants (figure 1). To date, there are only a handful of true cross border and central acquirers. However, the tides are now turning with the onset of the Single European Payments Area (SEPA) and the introduction of the European payments regulations.

As a result, opportunities are emerging, allowing the large European banks to ‘un-bundle’ themselves from the domestic payment consortium and establish independent, fully fledged cross-border merchant acquiring operations.

Based on this trend, Capco has studied the European merchant acquiring industry and has developed a number of SEPA strategy studies for top and middle tier banks in Europe. On the basis of these studies we believe there are significant opportunities for the industry.

While scale is a pre requisite, there is a question over the direct correlation between scale and enhanced profitability. Only with comprehensive strategic planning, a clear vision of the provision from the outset together with a strong value proposition can you hope to exploit the synergies with the established small business and corporate banking customer and achieve a credible ROI.
Market background

Cross border acquiring developed in the late 1990’s to meet the needs of the airline industry for a single merchant acquiring supplier. To date, only a handful of industries have demonstrated an interest in such a provision; mainly the oil and internet retailing industries. Cross border merchant acquirers have been, so far, unable to penetrate the large players in other industries.

Capco research estimates that over three fifths of Eurozone card payment transactions took place by debit cards with the remaining by credit and charge cards. Western European domestic debit payments are made mostly by domestic schemes. These schemes, made up of banking consortiums, behave like monopolies in each country and are serviced by just one or a very limited cartel of domestic debit processors. National interchange rates for international cards and the different interchange rates for the various domestic debit schemes have made it difficult for merchant acquirers to take advantage of centralised acquiring.

For the merchants themselves, it reduces the advantages of cross border price negotiation tiered to volumes, as acquiring will always be subject to domestic rules, centralised or not.

Centralised acquiring opportunity

Cross border acquiring currently stands at 6% of the total European acquired turn over, according to recent analysis by the European Commission.

There has been significant growth in the market between 2002 and 2004 with the proportion of cross border merchant acquiring increasing by over 50%. This rapid growth can be attributed in part to the development of the oil and e-commerce industry.

UK based merchant acquirers hold the lion’s share of this cross border turnover at 73%. Unsurprising when you consider that this is a market characterised by the presence of some of the largest merchant acquirers in Europe. These include RBS Streamline and Barclaycard Business with the addition of some of the more developed value proposition (e.g. Dynamic Currency Conversion platforms, typically located in the UK or Ireland).

As card payment volumes grow in the domestic markets and European banking groups expand their presence across borders, there is a significant business case for some players. Conditions are such that they could leverage their cross border presence through central operations as a direct acquirer.

This is in a climate where national monopolies and barriers to entry are dissolving under the European commission’s efforts to open up the domestic markets to competition. The ambitious SEPA will fundamentally change the Eurozone payments landscape. Other regulatory initiatives addressing interchange fees are shaking up the Western Europe card payment businesses in general. As a consequence, the central acquiring value proposition is becoming more feasible and attractive for acquirers and merchants alike, as pricing becomes more uniform across countries.

However, while the opportunities are significant, development of the value proposition and subsequently setting up the operations, presents a significant challenge to the banks. They will need specialist knowledge of the industry to develop a detailed business case that relies on low margins and high volumes.

<table>
<thead>
<tr>
<th>Country</th>
<th>Average MSC Credit</th>
<th>Average MSC Debit</th>
<th>Domestic debit scheme</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>2.40%</td>
<td>1.14%</td>
<td>Bancomat/Maestro</td>
</tr>
<tr>
<td>Belgium</td>
<td>1.60%</td>
<td>0.09%</td>
<td>Bancetact/McCash (to be migrated to Maestro)</td>
</tr>
<tr>
<td>Denmark</td>
<td>0.95%</td>
<td>0.050%</td>
<td>Dankort</td>
</tr>
<tr>
<td>Finland</td>
<td>1.20%</td>
<td>0.080%</td>
<td>Panniskortt</td>
</tr>
<tr>
<td>France</td>
<td>0.70%</td>
<td>0.700%</td>
<td>CB</td>
</tr>
<tr>
<td>Germany</td>
<td>1.72%</td>
<td>0.242%</td>
<td>Easy Cash Karte</td>
</tr>
<tr>
<td>Greece</td>
<td>2.500%</td>
<td>2.000%</td>
<td>Electron/Maestro</td>
</tr>
<tr>
<td>Ireland</td>
<td>1.860%</td>
<td>0.180%</td>
<td>Laser (to be migrated to Maestro)</td>
</tr>
<tr>
<td>Italy</td>
<td>1.650%</td>
<td>0.670%</td>
<td>Bancomat</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1.600%</td>
<td>0.060%</td>
<td>PIN</td>
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<tr>
<td>Poland</td>
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<td>2.100%</td>
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<td>Portugal</td>
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<td>1.420%</td>
<td>Multibanco</td>
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<td>Spain</td>
<td>1.670%</td>
<td>1.670%</td>
<td>4B, CEECA, ServiRed</td>
</tr>
<tr>
<td>UK</td>
<td>1.600%</td>
<td>0.160%</td>
<td>Maestro / VISA Debit</td>
</tr>
</tbody>
</table>

Average interchange rates in Europe (source: European Card Review 2004)
Capco proposition development methodology

A cross border merchant acquiring proposition could be driven by both revenue growth and cost reduction. Cost reduction can be realised when existing infrastructure is leveraged to create greater economies of scale. Whether this proposition is developed as a start-up or as an extension of existing operations, the steps to size the opportunity and to develop the strategic and operational plans are the same. Capco’s approach and methodology are therefore relevant to both propositions.

This methodology is split into two phases as illustrated in figure 2: ‘Strategy development’ and ‘Implementation’.

**Phase 1: Strategy development**

**Strategy assessment**
- Conduct a feasibility assessment of the proposed business and its alignment to the overall group strategy.
- Identify and assess all relevant internal resources which could be considered.
- Identify key target markets and develop a project plan with high level risks relevant mitigation strategies.

**Market and operations appraisal**
- Perform an in-depth appraisal of the target markets (including; competitors, existing value propositions, merchant segments and needs, pricing, key market trends, the impact of SEPA and other EC directives/regulation, suppliers and operators within the merchant acquiring value chain).
- Perform an in-depth investigation into the internal operations and resources to be leveraged.

**Phase 2: Implementation**

**Operations and implementation plan development**
- Develop operational and infrastructure requirements.
- Define the target operations models for growth and expansion and conduct operations sizing for ongoing merchant acquiring activities and operations.
- Develop business and technical requirements and conduct vendor selection.
- Develop low level entry and implementation plans.

**Pilot project**
- Conduct a limited pilot project to support the development of the operations and to verify its feasibility within a low risk environment. This could be limited to geography, value proposition or certain sections of the value chain in scope.
- During this phase, risk and risk mitigation should be further refined and a contingency plan created.

**Full roll out**
- Ensure robust programme and project management support for the full roll out of the cross border merchant acquiring expansion.
Advantages of Capco methodology

Capco’s transactional banking team includes card payments experts with hands on experience in the merchant acquiring business across many top tier banks and other leading industry organisations. They combine their in-depth analytical capabilities with leading edge knowledge of the card payments industry and of the merchant acquiring business.

Using a fact based, structured approach and methodology provide some unique advantages to our clients:

- Ensures alignment of the new operations to the overall banking group strategy.
- Maximises the value to the bank by developing competitive value propositions supported by the most suitable and economically sustainable target operating models.
- Controls and reduces risks by using a thorough analytical approach on the basis of industry experience and comprehensive knowledge of the business.

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Capco is a leading global provider of integrated transformation services and solutions designed specifically for the financial services industry. These services - consulting, processing services, and technology solutions - leverage Capco’s deep expertise in the corporate and investment banking, asset management, hedge fund and retail financial services segments. For more information, please visit www.capco.com.