

Win in the flat world

European Payments – Time to Step Up to the Customer Challenge

– Was Rahman and Priya Kurien

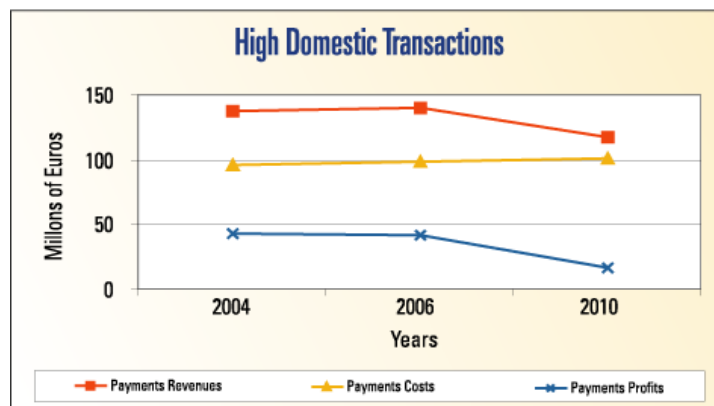
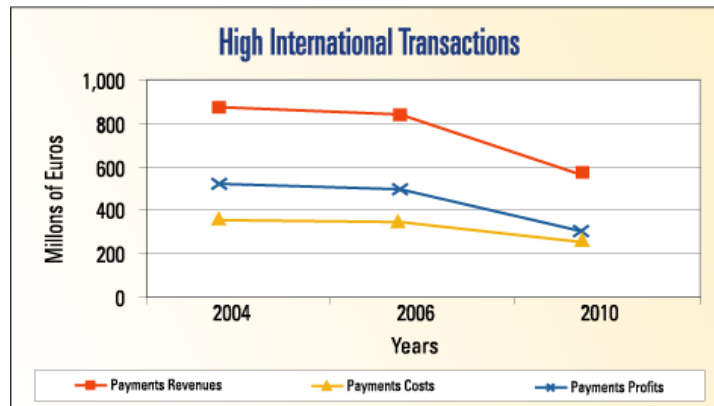
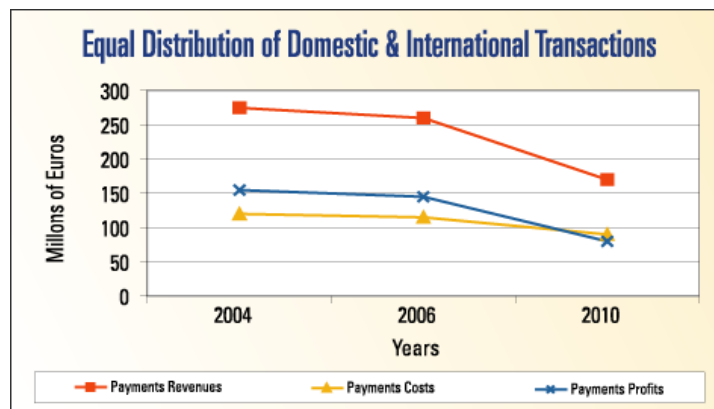
Bank's corporate customers have been talking for some time now of fundamental dissatisfactions with the services and value they receive from banks in the Payments area. This has become an increasingly strong driver for change in the Payments industry. However, at least in Europe, the focus of banks seems to have been more around SEPA, which we believe is distracting them from recognising the full potential impact on their Payments business of changing corporate customer needs and behaviours. Unless European banks respond quickly and effectively to these demands, they risk losing customers as well as existing levels of Payment revenues.



Payments Challenge for European Banks

Global payment transaction volumes are growing, but profit margins are generally acknowledged to be set to shrink. Most observers anticipate increased payment revenues arising from increased global trade, but there is also recognition of strong cost pressures including operational, technology and compliance costs.

However, the challenge facing European banks in particular is even greater: Infosys figures predict that European banks will see *revenues* eroding in absolute terms, not just profits. For example, a pan-European bank making approximately €275m Payments revenue, with an even spread of domestic and international transactions, will drop from €150m profit today to €80m by 2010 on less than €170m revenue. See graph for details.



Compliance as a Smokescreen

It is easy to treat the changes in the Payments industry as yet another regulatory problem, this time driven by SEPA. Unfortunately, many compliance projects start with laudable intentions of strategic value, but by implementation have just become “must-do” changes. We believe that by taking a regulatory approach to SEPA and payment transformation banks would miss the fundamental point that influential customers have been making for some time now – the perceived value that banks provide to corporate customers in the Payments area is very low. In contrast, corporate customers are used to real-time visibility of their transactions from other suppliers.

To quote Ivan Schneider from Banking Systems & Technology in an article interviewing Steve Kalkowski, GE Manager of Cash Management Systems¹: “GE does business with more than 100 banks around the world that differ widely in their ability to provide acknowledgement as to whether a payment instruction was received and executed.” “Some of the banks can send us those levels of acknowledgement, but some of the banks can’t” laments Kalkowski. “We have no idea what the status of those payments are.”

Frustration at the continued lack of visibility from banks translates into pressure such as the TWIST initiative and corporates joining SWIFT directly. Quoting Schneider again: “...the ability for banks to connect to corporate customers via SWIFTNet has become a competitive differentiator with regional implications.” “All of the banks in the U.S. that we deal with have really good models for acknowledgement,” Kalkowski says. “Europe is kind of a mixed bag - some are able to do that, some aren’t.”

This increased pressure from corporate customers, and consequential increase in competition (accelerated by SEPA), forms one half of an equation that is leading to an inexorable and significant change of the European payments landscape.

Enabling Payment Transformation

The other half of the equation explains why this transformation is ready to happen now, and why banks can treat this as an opportunity, even though the customer pressure is not new but just getting more intense.

The first enabler is the SWIFT IP network change. Many banks have simply looked at the migration from X25 to IP as a technical change that just had to be done. What they are overlooking is that they now have an underlying communications infrastructure that can be used to securely exchange files as well as text using industry standards such as XML. This opens up previously impossible opportunities in a single step.

The second key enabler is the emergence of cost-effective technologies supported by meaningful standards so that comprehensive automation and cost-reduction are now available and viable. Technologies such as web services, workflow and message brokers are now feasible, reliable and robust. The combination of XML and SWIFT-defined standards such as Exceptions & Investigations and Real Time Cash Reporting allow banks to automate activities which were near-impossible previously because of simple breakdowns such as lack of common enquiry messages.

Potential Bank Responses

The payments industry is being transformed from a highly lucrative, safe revenue stream into a highly competitive, commoditised business which may not even be viable for some banks in the future.

Banks that lead the way, using customer criticism to drive change, can continue the transformation further. We believe a transformed payments function can be used to increase both differentiation and retention.

A more predictable response could be to block change, lobby against regulation, and generally procrastinate. Most banks are more likely to play “wait and see”, moving only when the first customers really leave, or when profit gets significantly impacted.

Infosys believes that the next 6-12 months offer a window for change that leading banks cannot ignore, and others should monitor carefully. Regardless of chosen strategy, we believe all banks need a clear understanding of the true impact of the changing payments scenarios to their income, a technology blueprint of opportunities and process change, and decision criteria to evaluate when the time is right to stop watching the change and become part of it.

¹ “GE Brings SWIFT to Life” by Ivan Schneider, Bank Systems and Technology, September 2004.

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