



Profit engine: payments attract an increasing number of fans

Prescriptions for payments

Expert advice on tuning up a core earnings machine for maximum performance

Until recently, some bankers saw payments as needful but costly infrastructure that supported more lucrative activities such as wealth management or investment banking. Worldwide recession has changed their thinking. Far from being a mere chassis for transactions, payments have emerged as a profit engine in their own right.

Studies by leading consultancy firms underscore this turnaround. According to The Boston Consulting Group,¹ payments

revenues make up as much as one-third to one-half of total revenues at most banks. Further, payments are also considered the most attractive element of the business, thanks to high growth rates and low capital needs. In Europe, estimates McKinsey,² revenues from domestic payments (almost €180 billion) amounted to a quarter of total bank revenues and about one-sixth of total profits in 2006.

This rosy picture comes with caveats. First, the above estimates include not only transmission fees but also the cheap liquidity attracted by the payments business, such as funds on deposit and the 'float' enjoyed on money in transit. Secondly, payments are a heavily commoditized and competitive business, where transaction fees have long been under pressure. In Europe, BCG expects retail payments revenues per transaction to decline by about 4% yearly on average from now until 2016.

The pressure on payments revenue is set to continue. In Europe, migration to the Single Euro Payment Area has already cost banks and payment processors roughly €500 billion, BCG estimates, with €5 billion more spending due over the next two years. At the same time, a prolonged economic slowdown will erode transmission volumes and intensify competition for scarce liquidity. Thus both fees and ancillary revenues will suffer. McKinsey³ estimates that the damage to European bank revenues from this factor could amount to as much as €7 billion over the five years to 2013.

Cut costs, segment customers

All this amounts to a strong prescription for cost-cutting. BCG estimates that, to keep cost-income ratios stable, payments providers must first cut costs by between 10% and 35% by 2012. Cost reductions will not be enough. Banks will need to seek out additional revenues by cross-selling, offering higher value products, and improving their core transaction banking services. They will need to segment their customers accurately as they develop competitive services and pricing for specific sectors such as large multinationals, mid-caps, and retail clients.

When banks look for efficiency gains, they tend to reach reflexively for a technical fix, process re-engineering or an outsourcing solution. In capital-constrained times, however, a selective approach to such nostrums is advised. Every outsourcing possibility should be studied on a case-by-case basis, suggests BCG, to see whether scope for net synergies really exists.

McKinsey⁴ applies a similar logic to internal processes. Substantial efficiency gains can often be realized by streamlining workflows and cutting wastage, the consultants say. As an example of lean management, they cite the example of an operational group within Euroclear that raised its productivity by half within six months (as measured in the number of security code input per hour), with no significant IT investment and after cutting its headcount by 30%. In addition, IT investment will go further in a lean organization because waste will already have been removed and it will be clearer where automation could make a difference.

Such ideas draw heavily on practice in the manufacturing industry. Can payments too be industrialized? The following article shows how UBS is moving in that very direction.

Martin Hood
News for Banks
martin.hood@ubs.com

1 Weathering the Storm: Global Payments 2009, The Boston Consulting Group, March 2009

2 The hidden side of payments: harnessing the value of liquidity, McKinsey on Payments, November 2008

3 The changing European payments landscape: crucial trends to 2013, McKinsey on Payments, April 2009

4 The time is right for lean in payments, McKinsey on Payments, June 2009