VISA

# The future of everyday payments in Europe

## Who cares?

# Who cares?

In this report, we consider the future of everyday payments in Europe – and we investigate the reasons why the evolution of our payment systems matter:

- To the European consumers who use them
- To the retailers who accept them
- To the payment service providers who deliver them
- And to the governmental bodies who regulate them

In doing so, we take stock of Europe's progress with the use of electronic payments, and we discuss what will need to happen in order to achieve new levels of convenience, speed, security and efficiency.

In particular we pay close attention to the evolving needs and attitudes of European consumers and the pivotal role they will play in determining the future development of everyday payments. But, clearly, we have to consider the commercial realities and motivations of both retailers and payment providers. We also have to consider the attitude and ethos of governmental bodies.

Our overriding contention is that, to enable and accelerate further development everyday payments, more innovation will be essential. But we use the term "innovation" in its broadest sense. In some instances a big, sweeping change may be necessary. More often, a small tweak or a minor calibration can pay huge dividends.

Our conclusions are based on a wealth of original research and analysis commissioned and conducted by Visa Europe, as well as the day-to-day experience of our relationship management and Visa Consulting teams who work with banks and retail groups across Europe. We also draw on a large body of research and analysis available in the public domain.

# Setting the scene

## Payments play a pivotal role in our economy

"Payment systems play a pivotal role in a modern economy, as most economic activity relies on them.[1]" This, the view of the European Central Bank, can hardly be contested.

For economic activity to take place, some form of payment is required. And the attributes of our payment systems – in terms of their respective levels of acceptance, security, convenience and cost – have a direct impact on the health and efficiency of our economy.

In order to fulfil the ideals of the Lisbon Agenda[2], and enable Europe to become "the most dynamic and competitive knowledge-based economy in the world", the region's payment systems must clearly be a fundamental consideration.

## The costs of payment are considerable

The costs of sustaining our payment methods are considerable. The European Commission, for example, has calculated that the total cost to society of all payment methods, including cash, cheques and payment cards, equates to 2-3 per cent of GDP[3] (to put this figure into context, it should be remembered that the entire EU agricultural sector equates to 2.1 per cent of GDP[4] – which means we spend more on payment than we produce in food).

The Commission attributes the vast majority of these costs to cash, which accounts for around two thirds of the total cost[5]. Similarly a pan-European study by McKinsey & Company[6] estimates that society spends around €200 per person per year to cover the costs of cash – whereas the Dutch Central Bank calculates a figure of €300 per family per year[7].

## Cash, our most prevalent payment method is also the most expensive and the least secure

Despite its considerable costs and inefficiencies, cash continues to be our most prevalent payment system – accounting for an estimated 80 per cent of all European retail payments by volume[8].

European citizens make an estimated 237[9] billion cash payments each year – equating to around a thousand transactions per person.

Aside from its direct costs, the excessive use of cash has many other negative consequences. It is inherently insecure, it is vulnerable to counterfeiting, and it helps to sustain Europe's grey economy – which is estimated at €2 trillion in total, and equates to some 40 per cent of GDP in certain EU countries[10].

For notes, turn to **Appendix p68**

## Fortunately, we do have a readymade solution

It is widely acknowledged that electronic payments in general and card payments in particular offer significant advantages over cash.

Many different studies have shown that card payments are far more efficient than cash[11]. It has also been shown that card payments have an important role to play in expanding the sales volume of goods and services, enabling remote transactions, reducing barriers to credit and liquidity, and easing geographic restrictions to trade and exchange[12].

What is more, Europe can be regarded as a global leader and pace-setter in the development of card payments. European banks and retailers have, for example, been the first to implement EMV[13] chip technology. They have also led the world in the authentication of e-commerce transactions. And Europe is home to many exciting deployments of advanced payment technologies (such as contactless and m-commerce payments).

It is estimated that Europe is already home to more than one third of the world's entire volume of non-cash payments[14]. Now, with the SEPA (Single Euro Payments Area) project and the implementation of the Payment Services Directive, the conditions are being established for a yet more open, competitive and dynamic European payments market.

## Its progress has been considerable – but its use is far from universal

Given these circumstances, it is hardly surprising that the aggregate volume and value of European card payments has grown strongly over recent years.

By 2008 726.6 million payment cards had been issued in the EU. In total, these accounted for 29.5 billion transactions, with an aggregate value of €1.68 trillion – and the use had been growing at an average rate of 12 per cent for each of the previous five years[15].

Even during the current economic downturn, the growth in transactions has remained strong. For example, Visa Europe reports that, in the twelve months to June 2009, the number of point of sale Visa transactions in Europe had grown by more than eight per cent – and that Visa cards now account for some 11.2 per cent of everyday consumer spending.

But, even so, this level of progress should be kept in context. Although the penetration of cards is near-to-universal, their use is heavily concentrated within certain consumer segments and retail sectors.

There are also stark contrasts between different countries. For example, the use of cards ranges from more than 200 transactions per adult per year in countries such as Finland and Norway, to less than 40 in Germany and Italy, to less than 20 in much of Central and Eastern Europe[16].

For notes, turn to **Appendix p68**

# So how do we accelerate progress?

To extend and accelerate the use of electronic payments it is necessary to innovate. In particular, it is necessary to align the interests of the respective participants (namely consumers, retailers and payment providers) – to the extent that each party demonstrates an explicit preference for electronic payments.

**This means that:**

- Consumers need to regard electronic payments as being preferable to cash payments (for example, in terms of their convenience, control, speed and security)
- Retailers need to be content that the price they pay to accept electronic payments is a correct reflection of the tangible benefits that they bring to their business
- Payment service providers need to have the motivation to invest (for example, by creating more targeted propositions and implementing more compelling payment solutions)

Of course, the situation is greatly complicated by the fact that the true costs of cash are hidden. The use and acceptance of cash is generally regarded as free (or close to free) and, like any free service, it tends to be over-used.

Whilst, from an economist's perspective, it may be logical to resort to cost-based pricing for cash, this is highly unlikely to become the norm. Instead, electronic payments will have to overcome the significant advantages enjoyed by cash. And, to enable progress, it will be necessary for governments and regulators to adopt a benevolent and progressive attitude towards electronic payments.

# Our main conclusions

1

## In order to extend and accelerate the use of electronic payments in Europe, more innovation will be necessary. However, this "innovation" could take many forms and come from many different sources. For example:

**Infrastructural innovation** – extending the reach and capability of the EMV infrastructure, and also continuing to expand the point of sale acceptance network

**Technological innovation** – the use of existing and emerging technologies to make electronic payments yet faster, more secure or more convenient

**Product innovation** – the creation of new products, targeted at particular consumer segments, to address their respective payment needs

**Marketing innovation** – the analysis of research data, transaction data and other such intelligence to develop new value propositions and create new partnerships; also the development of new advertising, promotions and other marketing communications, to reinforce the benefits of cashless payment

**Re-usable innovation** – adopting techniques and disciplines which have been successful elsewhere and applying them in new ways or additional markets

**Regulatory innovation** – the introduction of progressive public policy initiatives which encourage the use of electronic payments

2

## Three distinct stakeholder groups have a central role to play in determining the future, namely governmental bodies, retailers and payment providers.

Each of these stakeholder groups:

- Has a vested interest in the future of everyday payments
- Has much to gain from the development of cashless payments
- Is able to act as either an enabler for or a barrier to progress
- Needs to respect the everyday realities of the other stakeholders

3

**Without innovation (and active support from each of the three stakeholder groups) growth in electronic payments will inevitably plateau – it could stall altogether, or we could even see a reversion to cash.**

4

**The consumer is the ultimate decision maker. They generally have the casting vote on which payment method to use. Consequently, each stakeholder needs to take full account of their attitudes and expectations.**

# The evolution of everyday payments

## The “Mengerian” perspective

**Convenience, efficiency and security**

In considering the future of everyday payments, it is useful to consider how and why our existing payment systems have evolved in the way that they have.

In this context it is useful to take account of the work of Carl Menger, a late-19th century Austrian economist, who's thinking on payments has been highly influential – and has a direct bearing on today's circumstances.

Up until Menger's time it was widely assumed that money – and payment systems – had been invented and imposed by the state. No, he argued, payment is a social phenomenon. Just like language, money has evolved in order to facilitate interaction between real people.

Menger agreed that payment has its roots in the barter economy. Although very simple, the barter system was inconvenient and wasteful. In order to exchange the things they have for the things they want, people are inevitably forced to make a series of intermediate trades. But, to do so, they have to become an expert at valuing many different commodities. And, each step of the way, they waste time and they take risks.

People notice that they can avoid this cost and inconvenience by trading the things that they have for a commodity that is widely accepted, and then use that commodity to "buy" what they actually do want.

The commodity that is the most widely accepted eventually becomes the medium of exchange – namely money.

But this changes over time – because buyers and sellers have always gravitated towards the payment system which offers the optimum combination of high convenience, high efficiency, low risk and low cost.

In other words, the optimum payment system is not a matter for great intellects to plan and implement. It is not a matter for governments or bureaucracies to negotiate and legislate. It is not a static condition that persists once a state of economic equilibrium is achieved. Instead, it is a dynamic process, deeply intertwined with the human process of production. And, so long as the human condition continues to change, payment systems will continue to evolve.

With the technological resources now at our disposal, combined with the forces of globalisation, and the impact of a severe economic downturn, the human condition has changed significantly. It is therefore logical to assume that payment systems are set to evolve accordingly.

But this evolution will continue to be driven and governed by the same principles identified by Menger more than a century ago – namely convenience, efficiency, security and cost.

1

# Consumer
What will motivate change in behaviour?

**When it comes to payment, it is our contention that the consumer should always have the "casting vote" – it is they who should decide which payment mechanism to use in any given situation.**

Today, the option isn't always open to them. For example, a retailer may only accept one form of payment (such as a newspaper vendor with cash, or an e-commerce retailer with cards), or a retailer may demonstrate an overwhelming preference for a particular payment mechanism (perhaps by imposing a punitive surcharge on card payments). But, all other things being equal, the consumer is generally able to choose whether to pay by cash, by cards, or by some other means altogether.

For eight-occasions-in-every-ten, European consumers currently choose to cast their vote in favour of cash[1]. So, when considering the future of everyday payments, it is necessary to analyse the factors that will encourage and enable consumers to cast this vote in a different way.

To this end, Visa Europe conducts regular consumer research, including a major new "Consumer Payments and Borrowing Lens" survey among 22,000 banked adults in ten countries[2]. As well as providing a comprehensive picture of current European payment habits and preferences, the survey replicates a similar study from 2002, thereby providing useful comparative data.

So, what can we say about today's European consumers and the way they choose to use their casting vote?

For notes, turn to **Appendix p68**

## Financial attitudes have evolved considerably

The first point to note is that the financial attitudes of European consumers have evolved considerably over recent years. As indicated in Figure 1, (which highlights the changes between 2002 and 2008 across just three countries) traditional beliefs and behaviours are being challenged. As consumers become more self-reliant, they are taking greater personal responsibility for their financial decisions and they look to exercise greater control.

It can be seen, therefore, that consumer attitudes to money and payment are not "set in stone." There can be big shifts in a relatively short timescale (in this instance, just six years), and this is reflected in the changing attitude to card payments.

The question facing the payments industry is whether this trend is set to continue, and whether similarly dramatic shifts can be anticipated in the coming years.

We would contend that, yes, there is definitely room for attitudes and behaviours to continue to change, but this will not happen of its own volition. Instead, any meaningful shifts to cashless payments in the coming years will be dependent on the development and delivery of new innovations – such as the creation of new payment-related products and propositions, the development of new payment-related technologies, and wider acceptance of cashless payments.

## There has been a considerable shift from cash to cards

When questioned about their attitudes to cash, and asked about current payment habits, consumers from across Europe demonstrate a growing openness to card payments.

In several countries, the use of debit cards as an everyday payment mechanism has become truly habitual. And, in certain retail sectors (for example, travel and entertainment), credit and charge cards clearly fulfil a very valuable function.

But, as ever, progress needs to be kept within context.

As indicated in Figure 2, growth in the use of cards has been far from uniform, and neither debit nor credit cards can yet be regarded as truly relevant or fit for purpose across all retail sectors (consider, for example, the level of card use in the fast food sector). Figure 3 shows, on a pan-European level, the scale of the challenge ahead, and the extent to which this challenge differs by retail sector. For the most frequent form of consumer spending (top-up shopping[3]), cards are very much a minority player, and the same is true for several other frequent purchase types (including small items such as sweets and cigarettes, hairstyling and coffee or snacks in a café).

**1 Consumers' financial attitudes have changed considerably over the last decade**

| % agreement with statement | GERMANY | | | SPAIN | | | SWEDEN | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2002 | 2008 | Shift | 2002 | 2008 | Shift | 2002 | 2008 | Shift |
| **I prefer to pay cash for everything I buy** | 65 | 31 | ∨ | 69 | 33 | ∨ | 61 | 18 | ∨ |
| **I use payment cards more and more nowadays** | 47 | 64 | ∧ | 30 | 48 | ∧ | 58 | 62 | ∧ |
| **I prefer to never borrow nor lend** | 72 | 52 | ∨ | 71 | 63 | ∨ | 30 | 38 | ∧ |
| **I manage finances the same way as my parents** | 50 | 22 | ∨ | 44 | 26 | ∨ | 33 | 21 | ∨ |

Source: "Visa Europe Consumer Payments and Borrowing Lens" Survey

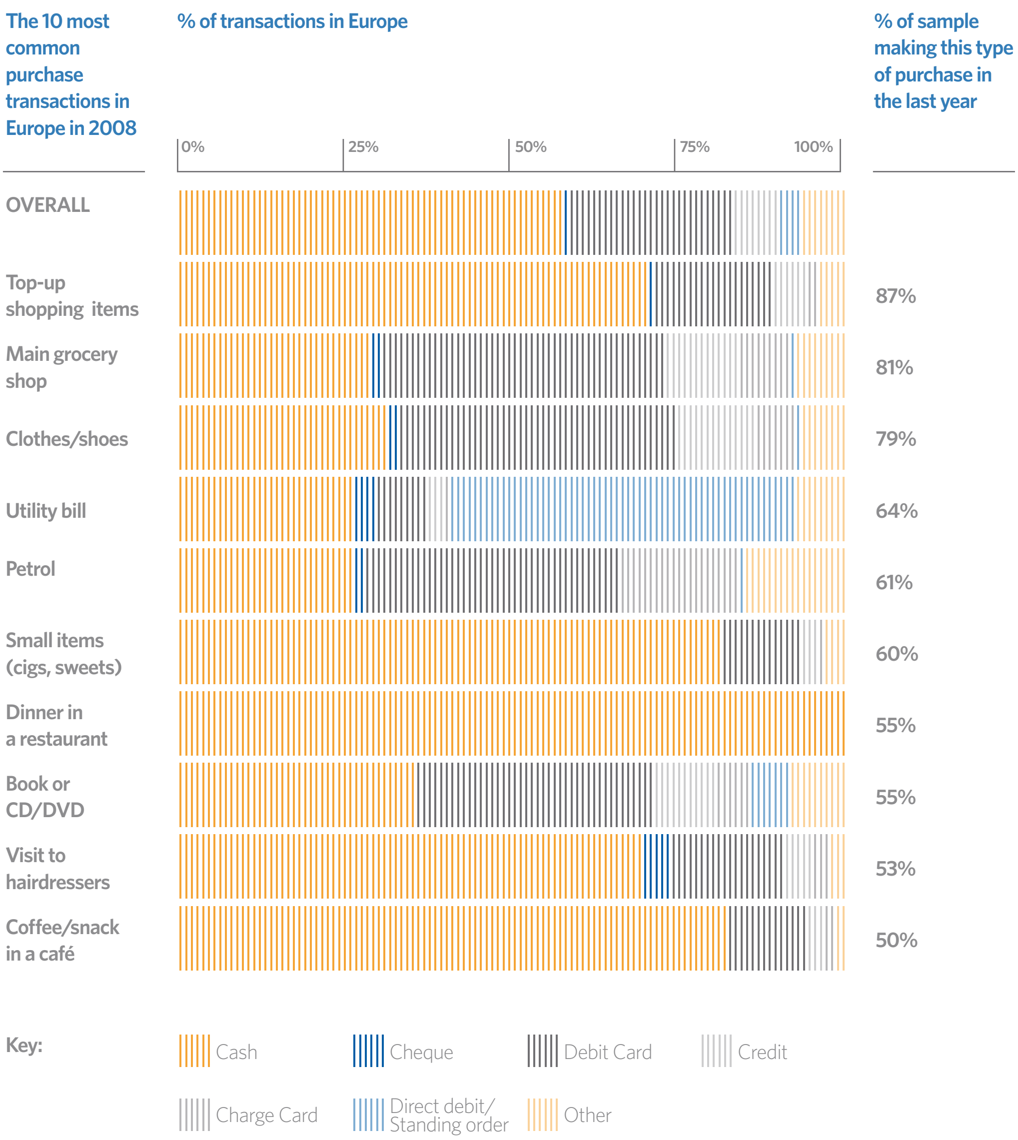
**2 There has been a marked shift in spending behaviour since 2002**

| Consumers' payment methods by percentage | | FRANCE | | | GERMANY | | | SPAIN | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | 2002 | 2008 | % Shift | 2002 | 2008 | % Shift | 2002 | 2008 | % Shift |
| **Main Grocery** | Cash | 15 | 5 | ∨ | 61 | 34 | ∨ | 82 | 14 | ∨ |
| | Debit Card | 56 | 70 | ∧ | 36 | 51 | ∧ | 12 | 45 | ∧ |
| | Credit Card | 1 | 3 | ∧ | 2 | 9 | ∧ | 5 | 25 | ∧ |
| **Holiday at travel agents or on-line** | Cash | 8 | 1 | ∨ | 23 | 8 | ∨ | 44 | 12 | ∨ |
| | Debit Card | 60 | 73 | ∧ | 31 | 22 | ∨ | 31 | 38 | ∧ |
| | Credit Card | 1 | 4 | ∧ | 8 | 31 | ∧ | 16 | 37 | ∧ |
| **Petrol** | Cash | 12 | 5 | ∨ | 54 | 26 | ∨ | 68 | 22 | ∨ |
| | Debit Card | 68 | 78 | ∧ | 36 | 40 | ∧ | 22 | 37 | ∧ |
| | Credit Card | 0 | 3 | ∧ | 5 | 21 | ∧ | 8 | 22 | ∧ |
| **Fast food** | Cash | 61 | 26 | ∨ | 97 | 98 | ∧ | 97 | 85 | ∨ |
| | Debit Card | 25 | 63 | ∧ | 1 | 2 | ∧ | 2 | 9 | ∧ |
| | Credit Card | – | 1 | | – | – | | 1 | 4 | ∧ |

**Key:** ∧ Increase ∨ Decrease

Source: "Visa Europe Consumer Payments and Borrowing Lens" Survey

## 3 Debit cards have overtaken cash in some common purchase types, but cash is still the dominant player overall




Note: Europe includes all the 9 European markets surveyed in 2008: Estonia, France, Germany, UK, Poland, Sweden, Spain, Italy and Turkey

Source: "Visa Europe Consumer Payments and Borrowing Lens" Survey

## But the specifics vary considerably – by country, and also by consumer segment

To complicate matters, consumer attitudes do vary considerably, both within and between individual countries.

Across Europe, 39 per cent of consumers say that they own at least one payment card and that they use it frequently (see Figure 4). But this figure varies dramatically by country. And, depending on the way a national payment market has evolved, different types of card are used to different degrees and in many different ways.

There are also stark behavioural differences within individual countries. In Figure 5 we begin to examine the behaviour of the five consumer segments identified by Visa Europe. In the UK, for example, the entire segment we call Financial Abstainers, accounting for nine per cent of the total banked adult population, never uses any type of card. By contrast, most of the Lifestyle Optimisers (75 per cent) are frequent users of debit cards and more than half (56 per cent) are also frequent credit card users.

In France, the picture is even more polarised. Again, no Financial Abstainers use debit or charge cards. For Pressured Jugglers, the use is also very limited. But for all other segments, the level of frequent card use is much higher than in the UK.

This analysis clearly demonstrates that, for large proportions of the population, the existing range of card propositions is not sufficiently compelling. In other words, they do not see any reason to change their existing payment behaviour.

**4 The level and type of card ownership and card use varies considerably by country**

| ANY CARD | % own | % own & use | % own & use often |
|---|---|---|---|
| UK | 95 | 88 | 74 |
| FRANCE | 91 | 82 | 62 |
| GERMANY | 85 | 70 | 46 |
| TURKEY | 73 | 72 | 57 |
| EUROPE | 83 | 74 | 39 |

| DEBIT CARD | % own | % own & use | % own & use often |
|---|---|---|---|
| FRANCE | 88 | 80 | 63 |
| UK | 84 | 77 | 56 |
| GERMANY | 78 | 64 | 41 |
| TURKEY | 28 | 28 | 15 |

| CREDIT/ CHARGE CARD | % own | % own & use | % own & use often |
|---|---|---|---|
| TURKEY | 62 | 62 | 49 |
| UK | 61 | 40 | 33 |
| GERMANY | 41 | 24 | 13 |
| FRANCE | 11 | 6 | 4 |

Note: 'Any card' usually refers to a combination of payment cards. In France debit card also refers to charge card
Percentage is based on 22,628 European banked adults, aged 16 – 65

Source: "Visa Europe Consumer Payments and Borrowing Lens" Survey

**5 The level and type of card ownership and card use also varies considerably by consumer segment**

| UK | DEBIT CARD | % own | % own & use | % own & use often |
|---|---|---|---|---|
| 9% | Financial Abstainers | 32 | 0 | 0 |
| 23% | Lifestyle Optimisers | 91 | 88 | 75 |
| 16% | Mature Planners | 90 | 84 | 61 |
| 15% | Pressured Jugglers | 80 | 70 | 55 |
| 37% | Cautious Followers | 91 | 89 | 56 |

| UK | CREDIT/CHARGE CARD | % own | % own & use | % own & use often |
|---|---|---|---|---|
| 9% | Financial Abstainers | 22 | 0 | 0 |
| 23% | Lifestyle Optimisers | 91 | 83 | 56 |
| 16% | Mature Planners | 79 | 60 | 50 |
| 15% | Pressured Jugglers | 74 | 65 | 28 |
| 37% | Cautious Followers | 38 | 29 | 19 |

| FRANCE | DEBIT/CHARGE CARD | % own | % own & use | % own & use often |
|---|---|---|---|---|
| 10% | Financial Abstainers | 32 | 0 | 0 |
| 28% | Lifestyle Optimisers | 97 | 96 | 84 |
| 34% | Mature Planners | 93 | 87 | 73 |
| 7% | Pressured Jugglers | 78 | 40 | 24 |
| 21% | Cautious Followers | 99 | 99 | 65 |

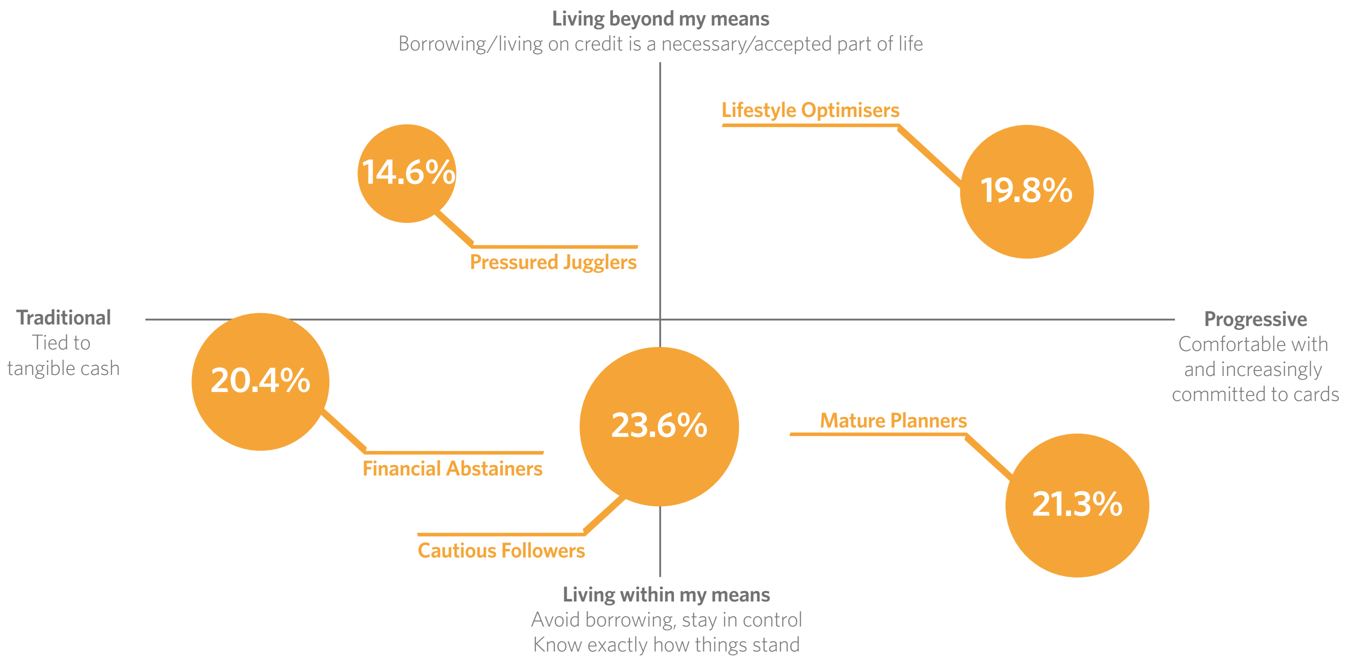
| FRANCE | CREDIT CARD | % own | % own & use | % own & use often |
|---|---|---|---|---|
| 10% | Financial Abstainers | 1 | 0 | 0 |
| 28% | Lifestyle Optimisers | 27 | 16 | 9 |
| 34% | Mature Planners | 9 | 4 | 3 |
| 7% | Pressured Jugglers | 6 | 2 | 0 |
| 21% | Cautious Followers | 2 | 1 | 1 |

Note: In France, charge cards are perceived as debit cards. Therefore, debit card figures in France include also charge card figures

Source: "Visa Europe Consumer Payments and Borrowing Lens" Survey

# Understanding the attitudes and behaviours of specific consumer segments

**Visa Europe consumer segmentation model**



In order to understand the attitudes and motivations of different types of consumer, Visa Europe has used a range of different research studies to develop a behaviourally-based segmentation model (that is, the model is based on the things that people say, do and think with regards to payment cards and personal finances, rather than by their social class, income, etc).

This has enabled the categorisation (or segmentation) of five behaviourally distinct consumer types (or segments). Each of these segments can be identified in every European country, but will account for a different proportion of the population in each country.

The five segments identified by Visa Europe are:

## Financial Abstainers

Accounting for around a fifth of the European population, Financial Abstainers have few financial services products and, in terms of payment, they tend to make an active choice to use cash. They tend to be relatively young and, financially, they manage quite well. But they are simply not engaged or interested in personal finance products.

## Lifestyle Optimisers

Accounting for almost 20 per cent of the European population, Lifestyle Optimisers will tend to hold an array of financial products (spanning both saving and borrowing). They tend to be relatively well off and to come from higher social classes. Generally, they attempt to balance their spending with their earnings, so their level of borrowing tends to be quite measured.

## Pressured Jugglers

Accounting for almost 15 per cent of the European population, Pressured Jugglers tend to have quite high levels of borrowing (either through choice or necessity). They will tend to be relatively low-income earners, who are working full-time and have children at home. They may often feel that they are struggling financially.

## Cautious Followers

Accounting for almost a quarter of the European Population, Cautious Followers tend to be relatively younger consumers with relatively low incomes, who are keen to stay within their financial "comfort zone". Consequently they hold a select number of financial products, and spend time controlling their finances in order to avoid debt. To maintain control, they are wary of using credit cards, but are relatively open to the use of debit cards.

## Mature Planners

Accounting for a little more than 20 per cent of the European population, Mature Planners tend to be relatively older consumers with higher levels of disposable income. They are likely to hold saving and investment products, and feel fully in control of their finances. They are also avid users of payment cards. Many use credit cards, but are likely to repay their balances in full every month.

The segmentation model enables Visa Europe and its members to gain clearer insights into peoples' relationship with financial services products and the reasons why they choose to use (or not to use) cards. Drawing on such insights, the development of new products, propositions and acceptance solutions can be more "scientific" and fact-based.

**6 The attributes that people want from a payment method – and the way that cards measure up**

| | UK | | | SWEDEN | | | SPAIN | | |
|---|---|---|---|---|---|---|---|---|---|
| | Cash | Debit Card | Credit Card | Cash | Debit Card | Credit Card | Cash | Debit Card | Credit Card |
| **Speed** | 392 | 109 | 57 | 299 | 235 | 29 | 408 | 125 | 34 |
| **Acceptance** | 417 | 82 | 53 | 379 | 131 | 49 | 464 | 63 | 41 |
| **Least Hassle** | 224 | 195 | 92 | 236 | 272 | 40 | 363 | 133 | 57 |
| **Habit** | 157 | 247 | 139 | 136 | 375 | 55 | 238 | 222 | 109 |
| **Portability** | 115 | 315 | 149 | 122 | 398 | 67 | 139 | 319 | 105 |
| **Security** | 148 | 135 | 172 | 257 | 233 | 38 | 113 | 104 | 291 |
| **Sellers preferred method** | 297 | 159 | 60 | 136 | 379 | 47 | 461 | 82 | 37 |

**Key:** Index 120+ Index 100-119 Index 80-99 Index <80

Note: Credit card includes charge cards

Source: "Visa Europe Consumer Payments and Borrowing Lens" Survey

## Back to basics – what do people actually want from a payment mechanism?

In order to understand payment behaviour, it is necessary to understand the attributes which consumers actually want from a payment mechanism – and to plot perceived attributes of each payment method in delivering on their needs.

The fact is that, in every purchase situation, different people choose from a whole hierarchy of different requirements. At the top of the list will be the highly practical considerations, like speed, acceptance and hassle avoidance. Down towards the bottom will be more nuanced, but nonetheless powerful considerations like status, liquidity and privacy.

The importance of these considerations will vary by consumer segment and also by purchase type. And, clearly, each payment method will perform differently against each consideration. In Figure 6 we examine the situation in three particular countries: Spain, Sweden and the UK. This shows that debit cards are approaching parity with cash on each of the key consumer needs, reflecting the perceived suitability of debit for widespread, everyday purchases. By contrast, credit cards are seen to have very different attributes (such as the ability to smooth spending, or to make unexpected purchases), consequently their use tends to be more focussed and specialised.

So, depending on who we are, where we are and what we are buying, we will typically conduct a quick subconscious cross reference of our needs, and present what we believe to be the most appropriate payment mechanism.

Whilst the consumer will generally have the casting vote on which payment method to use, the attitude of the retailer (whether real of perceived) will also play a very significant role. Across Europe, the seller's "preferred payment method" is a top ten consideration for the majority of consumers – and one where both debit and credit cards do tend to lag some way behind cash.

## Owning and using cards – identifying the barriers and triggers

By going down to another layer of detail, we can begin to appreciate the triggers which encourage people to own and use cards. We can also understand the barriers which prevent them from doing so.

In the three countries highlighted in Figure 7, the triggers for using debit cards are relatively consistent. Indeed, for frequent debit users, their card can be regarded as the "modern cash" – it is seen as fast and convenient and it is habitually carried. However, the barriers to debit use are quite diverse from country to country.

With credit cards, the picture is even more fragmented. Those people who habitually carry and use a credit card enjoy its speed, its convenience and, in many cases, the rewards package that comes with it. But for people who don't yet have a card, the barriers vary very considerably by country. Often they simply don't perceive that a credit card delivers any benefit at all.

There is, of course, plenty of scope for payment providers to address the various barriers (both through the development of new propositions and the refinement of communications and educational messaging) – but this clearly needs to be done on a very targeted and country-specific basis.

## 7 The triggers and barriers to owning and using cards

| | UK | | ITALY | | FRANCE | |
|---|---|---|---|---|---|---|
| **Triggers to using a debit card (based on those who own & use it)** | Habit | 16 | Quickest way to pay | 14 | Habit | 27 |
| | Portability | 10 | Habit | 14 | Quickest way to pay | 18 |
| | Quickest way to pay | 10 | Portability | 9 | Acceptance | 9 |
| **Barriers to using a debit card** | I wanted to complete the transaction there and then | 18 | I wanted to complete the transaction there and then | 16 | I forgot to bring it with me | 13 |
| | It wasn't the sort of purchase | 15 | It wasn't the sort of purchase | 14 | There was a minimum purchase price | 12 |
| | I wouldn't have got any rewards/points | 12 | Seller didn't have the facilities | 9 | Seller didn't have the facilities | 11 |

| | UK | | ITALY | | FRANCE | |
|---|---|---|---|---|---|---|
| **Triggers to using a credit/charge card (based on those who own & use it)** | Rewards | 19 | Habit | 18 | Habit | 36 |
| | Habit | 12 | Quickest way to pay | 12 | Acceptance | 34 |
| | Acceptance | 7 | Portability | 7 | Speed | 34 |
| **Barriers to owning a credit/charge card** | Different card better meets needs | 38 | Different card better meets needs | 34 | Different card better meets needs | 50 |
| | Worry about keeping track of balance | 11 | Worry about debt | 11 | Worry about getting into debt | 25 |
| | No perceived advantage | 11 | Worry about keeping track | 8 | No perceived advantage | 15 |

## The big challenge – breaking out of the "heartlands"

This analysis helps to qualify the success of the payment card industry, and points to the challenges ahead.

In broad terms, our existing debit and credit card propositions have been very successful in attracting some specific consumer segments. These consumers have been using their cards within some specific retail sectors. And the increase in transactions over recent years can be largely attributed to "organic growth" or "snowballing" within these clearly defined segments and sectors (which we refer to as the payment card heartlands).

As Figure 8 and Figure 9 demonstrate, there is certainly room for some further growth within these core consumer segments and retail sectors. But, in order to fulfil the ideal of a truly universal cashless payment system, considerable work remains.

## How best to "move the dials" in the future

In order to extend and accelerate the use of card payments it is clear that some serious innovation is required. This is not just about technical innovation. It is also about product innovation, marketing innovation and business process innovation.

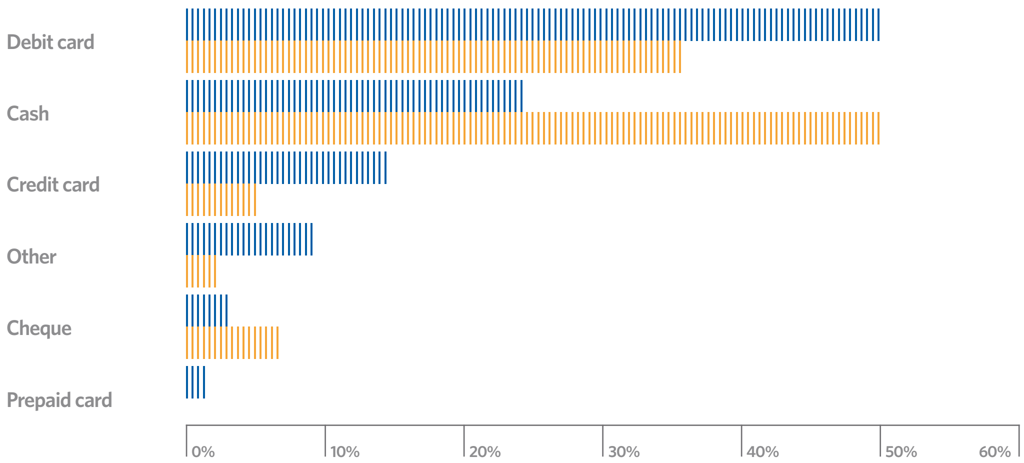
New ways must be found to target and engage with those consumer segments that remain unconvinced by the benefits of cards. They might want more control; they may want more anonymity; they may see cards as too much hassle; they may believe that retailers prefer to be paid by cash; they may even see cash as a status symbol. Whatever the specifics, our propositions and the accompanying messaging need to be configured accordingly.

Similarly, new acceptance solutions must be sought in order to make cards more relevant within those retail sectors where cash still predominates. In some instances, this means that cards will need to outperform cash on issues such as speed. In other instances it means overcoming the perception that the retailer would prefer to be paid in cash.

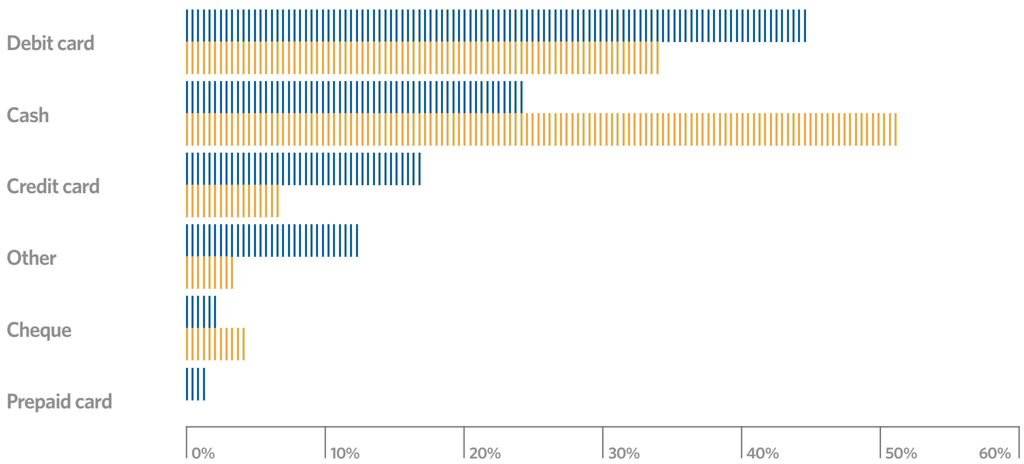
Across the two dimensions – the use of cards and the acceptance of cards – there is a need for payment providers to have a better understanding of customer needs, as well as the ability to respond directly to those needs.

## 8 The extent of card use in the "heartlands" retail sectors

### Consumer transactions on main grocery across Europe




### Consumer transactions on petrol across Europe

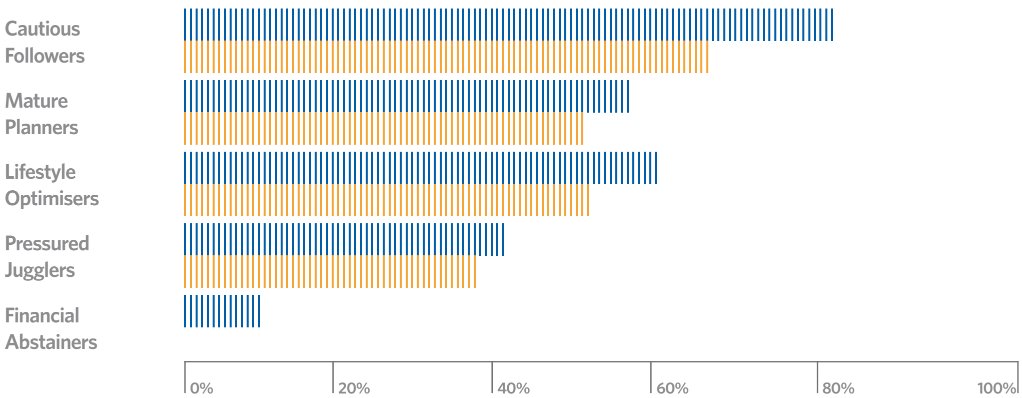



Key: 2008 2002

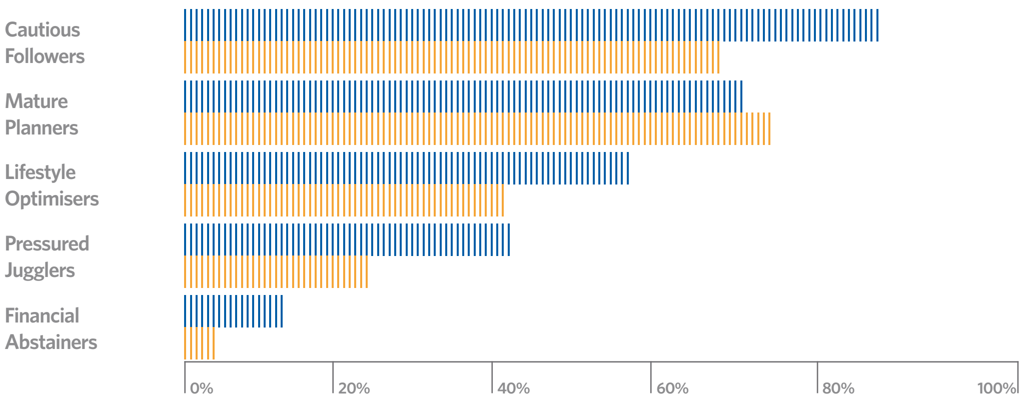
Note: Europe includes all the 6 European markets surveyed in 2008: France, Germany, UK, Sweden, Spain and Italy

## 9 The level of card use by consumer segment in "heartlands" retail sectors

### Consumer transactions of main grocery on debit card in Sweden




### Consumer transactions of petrol on debit card in France




**Key:** 2008 2002

Note: Europe includes all the 6 European markets surveyed in 2008: France, Germany, UK, Sweden, Spain and Italy

# The innovation imperative

## A perspective from Visa Europe

"One size does not fit all". It may sound like a cliché but, like many clichés, it is based on a fundamental truth – and a truth which is particularly relevant in today's payment market.

In the past, many banks offered one standard debit card. They may have been more adventurous with their credit cards (offering, for example, a standard and a premium flavour) but, even so, the thinking was based on a customer's affluence rather than on their attitudes and perceptions.

This is not to denigrate the industry's achievements. We have been supremely successful in building a cashless payments system, which has already brought about a significant, secular change in consumer behaviour. But, the fact is, a large proportion of European payment cards are rarely used (in fact, by some estimates, 40 per cent of debit cards are never used at the point of sale). And cash continues to be Europe's favoured way to pay.

The challenge is very easy to frame: more cards, used by more people, for more purchases, in more places, across more channels, more often. To deliver on this challenge, serious innovation is required. But the necessary innovation could take many different forms and come from many different sources.

**Innovation in products and propositions**

With a better understanding of people's core values and beliefs, it becomes possible to develop products that meet their needs. If, for example, people want more control, then how about SMS text alerts to keep them up to date with their spending and their available balance? If they want more security then how about a "cast iron" insurance package plus stronger authentication for e-commerce spending? If they want greater speed and convenience then, surely, contactless has to be a winning solution.

The challenge is to find that "sweet spot", where a viable business opportunity intersects with a particular unmet need. Easier said than done but, for many consumer segments, unquestionably achievable.

### Innovation in marketing and communications

In many respects, we are pushing at an open door. There are plenty of people who are receptive to the benefits that cards could bring, but simply haven't made the connection between the two. This is particularly the case with debit because, in truth, many banks have never really worked to communicate its benefits or incentivise its use. Also, for many purchases the only reason a consumer hasn't used their card is because they forgot to take it with them (so why not reinforce the message that you should never leave home without it, whilst also emphasising its portability?).

Here, the challenge is to integrate truly targeted communications into a disciplined card lifecycle management programme – actively encouraging, enabling and, where necessary, incentivising people to start to pay by card, and continue to pay by card.

### Innovation in borrowing and lending

It is not just about debit. There are still real opportunities for everyone to benefit from credit (banks, retailers and, most important of all, consumers). At some stage in their lives, almost everyone will want or need to borrow money, but, right now not all segments see the benefits of using a card to do so. Our belief is that, if you give them the right "type" of borrowing, they could see the benefit of using a card.

This is partly about developing a wider range of propositions – so that the traditional revolving credit models are supplemented by instalment models and/or charge card or deferred debit models and/or a multi-function card (where a line of credit is incorporated into a debit card). It is also about the positioning or repositioning of card-based lending – as a useful tool within a smart, safe, sensible money management repertoire.

### Innovation in acceptance

Of course, it is not just about the consumer per se. It is also about the retailer. Do they accept cards at all? What, in truth, is their attitude to accepting cards? And what is it that would make them keener on cards?

If they don't yet accept, what can be done to persuade them? In fast food for example, the consumer's desire to pay by card is there, but the infrastructure isn't. So how do we quantify the benefits of acceptance (in terms of better service, increased footfall and higher transaction values)?

If they do accept and they are happy to accept, then simply making their decals more prominent can have an immediate and surprisingly significant impact (reminding consumers that they can pay by card and reassuring them that they have the retailer's "permission" to do so).

Then of course there are new acceptance solutions – like contactless, like self-service payments, like m-payments – which, as well as improving the purchasing experience, can lie at the heart of wider check-out or check-through propositions.

All of these considerations are discussed within the retail chapter of this report

### Innovation in public policy

Whatever the changing dynamics in consumer attitudes and behaviour, there will still be some consumers who always prefer cash, irrespective of what we as an industry try and do. But we can still aim for wider societal, governmental or infrastructural changes. If, for example, social welfare benefits were distributed via prepaid cards, or cards were the preferred means for collecting public payments (such as taxes or fees for public services), truly fundamental change would be a realistic aspiration.

Again, such considerations are discussed within the government chapters of this report.

The Visa Europe consumer payment and borrowing lens, combined with the market knowledge of our respective members, helps to reveal the boundaries we can push to bring about shifts in behaviour.

2

# Government and Regulators

## Why and how to support electronic payments?

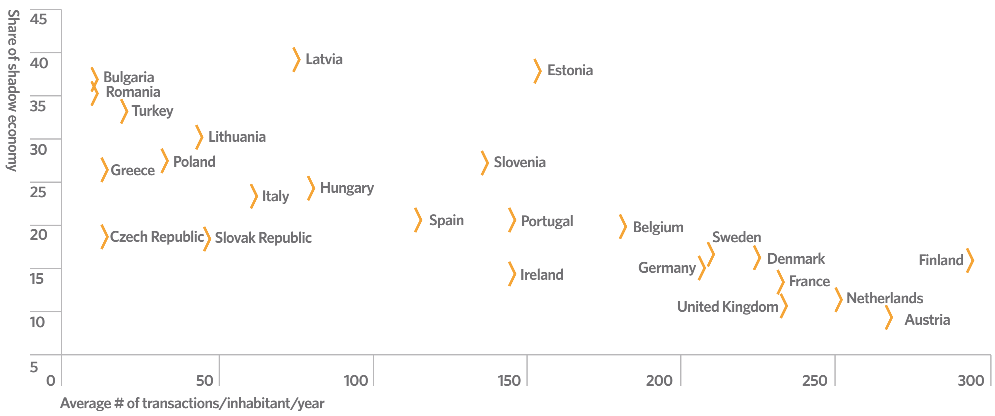
## Governments and regulators have a big stake in the future of payments

As argued in the introduction to this paper, an efficient and dynamic payment system is a necessary pre-requisite for an efficient and dynamic economy. It is therefore our contention that payments should be high on the public policy agenda – and that governments and regulators should adopt a progressive attitude to electronic payments.

## A compelling vision – but some counterproductive policies

The EU authorities do have a compelling vision for electronic payments. In particular, the SEPA project, the Internal Market for Payments and the Payment Services Directive (PSD) pave the way for a more open, competitive and dynamic payments market. Yet, certain policies and approaches do threaten to be counterproductive. There is also much more that governments could do to promote and "normalise" the use of cashless payment.

**1 Correlation of shadow economy and the number of electronic payments**




Note: EU-27 (no data available for Cyprus, Luxemburg, Malta) plus Turkey

Source: ECB, Prof. Schneider, A.T. Kearney analysis

For notes, turn to **Appendix p69**

## Why it is important

There are many compelling reasons why governments and regulators should favour cashless payments and actively promote their use. For example:

### The costs of cash

As set out in the introduction to this paper the societal costs of cash are considerable. Again, the European Commission has calculated that the total cost to society of all payment systems, equates to 2-3 per cent of GDP, with cash being responsible for the vast majority of these costs[1].

So, if the use of cash is reduced, the societal costs will tend to fall commensurately.

### Considering the shadow economy

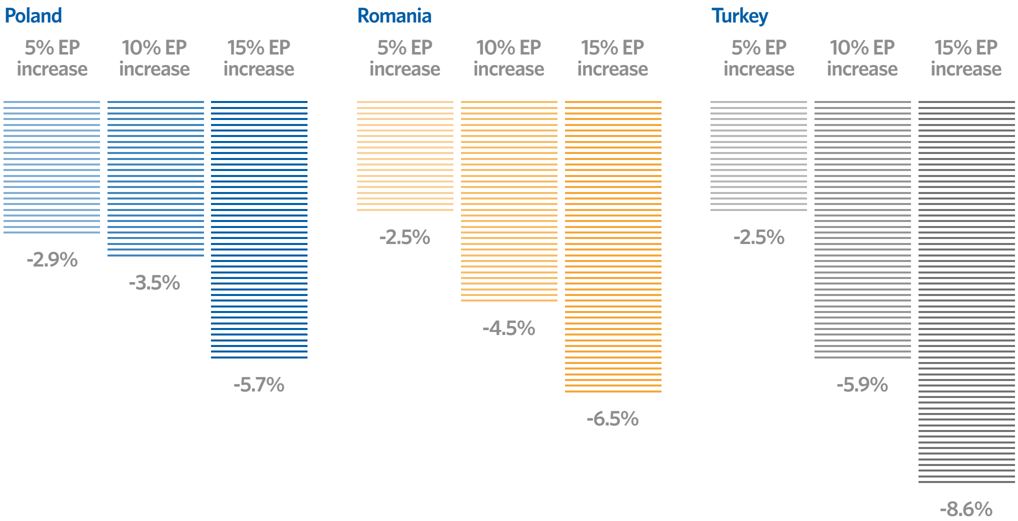
"The shadow economy is neither small nor benign." This is the conclusion of an in-depth supplement in the Economist magazine[2], which emphasises the true costs of the shadow economy – in terms of lost tax revenues, reduced protection for workers, lower productivity for companies and, ultimately, slower rates of economic growth.

In the face of the current economic climate, the weakened fiscal position of many countries provides a compelling incentive to fight cash circulating in the shadow economy.

Analysis from A.T. Kearney reveals a strong correlation between the prevalence of electronic payments in a country and the size of its shadow economy (see Figure 1.).

Clearly, it is cash-based transactions which provide the opportunity to participate in the shadow economy. And, in a business to consumer (B2C) context, it is generally the underreporting of cash transactions which presents the biggest issues. Recent analysis from Professor Schneider of the Johannes Kepler University of Linz has quantified the impact of an increase in electronic payments on the shadow economy in three countries: Poland, Romania and Turkey. As indicated in Figure 2 a 15 per cent increase in the uptake of electronic payments can reduce the overall size of the shadow economy by up to 8.6 per cent.

**2 Average annual impact of an uptake of electronic payments (EP) per capita* on the size of the shadow economy**




*Simulation for 4 following years; average of the year-on-year changes

Source: Simulation results Prof. Dr. Schneider, 2009

**Contributing to economic growth**

As well as addressing the costs and risks of cash, electronic payments can also make a definite contribution to economic growth – by expanding the sales volume of goods and services, enabling remote transactions, reducing barriers to credit and liquidity, and easing geographic restrictions to trade and exchange.

Analysis from Global Insight suggests that any increase in the share of electronic payments automatically leads to an increase in consumer spending. Based on an analysis of 50 countries, it was found that a one per cent shift in electronic payments will potentially contribute a 0.5 per cent increase in consumer spending.

More specifically, Global Insight examined 21 European countries with a collective consumer spending of €4.44 trillion. It was calculated that, if the share of electronic payments could be increased by just two per cent, this would potentially contribute around €21.9 billion in incremental consumer spending[3].

Consideration should also be given to the fact that, with card payments, sellers typically receive guaranteed payment within a four-day timescale. Recent analysis from Intrum Justitia[4] estimates that, across Europe, average payment timescales exceed 55 days and, in some countries, the norm exceeds 90 days. As well as bringing additional liquidity into the economy, payment by card can therefore alleviate cash flow pressures for smaller businesses. Indeed, the European Commission has suggested that, across the region, one-business-insolvency-in-every-four is a direct result of late payment – leading to the loss of some 450,000 jobs each year[5].

**Avoiding the risks of counterfeit currency**

It should also be acknowledged that the amount and the value of counterfeit currency within our economy are growing rapidly.

Whilst the euro area is justifiably proud of the fact that counterfeit rates are relatively low, the picture is beginning to change. Indeed, according to the European Central Bank, the number of counterfeit euro notes jumped 17 per cent in the first half of 2009[6] compared to the previous six months.

In other EU Member States, the picture can be yet more alarming. In the UK, for example, official figures indicate that one-in-every-fifty one pound (£1) coins is now counterfeit, with some authorities suggesting that the true figure may be closer to one-in-every-twenty[7]. In relative terms, the rate of fraud experienced by the payment card system is negligible (For example, in 2009, Visa Europe reported that the overall fraud-to-sales ratio was holding steady at 0.056 per cent[8]).

## So what can governments do to promote cashless payment?

An economist's solution to the over-use of cash would be very straightforward – to price cash according to its true costs, and thereby steer consumers and retailers towards more efficient payment mechanisms.

Whilst this is an intellectually appealing argument, its application is hardly straightforward. In an environment where the free and unlimited use of cash is generally seen as a right of citizenship, few politicians are willing to endorse the introduction of higher charges. And, from the banking industry's perspective, the subsidisation of cash is deeply interwoven into its wider business models and pricing structures.

In other words, it is not feasible for the banking industry to act in unison in introducing realistic charges for the use of cash. And it would be commercial suicide for a single bank to introduce such charges unilaterally. Nonetheless, there are a range of public policies which could discourage cash use in favour of electronic equivalents.

For notes, turn to **Appendix p69**

### Supporting the introduction of targeted charges

Whilst it is perhaps inevitable that cash use will continue to be subsidised, some countries have begun to take steps to address its over-use. In Norway, for example, the central bank, Norges Bank, has adopted policies whereby the use and availability of cash is treated "in a manner that promotes an efficient overall payment system"[9].

In particular, Norges Bank has assumed a "wholesaler" role in cash supply, which gives the country's banks greater responsibility for its handling and redistribution. In practice, this means that the banks have been able to introduce fees which discourage the over-use of cash – such as fees for the payment of bank giros in cash, fees for cash withdrawals from other banks' ATMs, and fees which all businesses must pay when they deposit cash with banks.

These measures have doubtlessly contributed to a decline in the value of cash in circulation in Norway – where cash as a share of means of payment (M1) is around a half of that for the euro zone[10].

### Actively discouraging the use of cash payments

In an explicit effort to fight the underground economy through the reduction of cash payments, some countries have adopted radical measures. In South Korea, for example, retailers pay less VAT if they accept card payments. This measure is thought to have led to a net increase in tax revenues, whilst the share of cash payments fell from 40 per cent in 2002 to 25 per cent in 2006[11].

It seems unlikely that governments in Europe will follow this example but, even so, there are many measures which could be taken to increase financial inclusion, to encourage retailers to accept cards, and to stifle the supply of cash to the shadow economy. Consider, for example, that as of autumn 2009, there were around 550 million €500 banknotes and 170 million €200 banknotes in circulation[12].

On a more pragmatic level, the Italian Government has mandated all tobacconists in the country to have a point of sale terminal installed in order to process card payments. It has also backed the Italian Banking Association in running a mass market public and retail education campaign to promote the benefits of card payments.

**Implementing card payments within their own operations**

It should also be remembered that the public sector is, in itself, a significant economic agent, which could make a big contribution to the "normalisation" of card payments.

Consider that public sector organisations often act as:

- A recipient of consumer payments – through, for example, the collection of payments, taxes, fees and fines
- A distributor of public funds – including the remittance of benefit payments
- A buyer of goods and services – with public sector procurement equating to 16 per cent of European GDP[13]
- A sizeable employer – employing more than 20 per cent of the total workforce in several EU states[14]

By making full use of card payments and actively avoiding the use of cash, public sector organisations could enjoy considerable efficiencies. In the UK, for example:

- The Government Procurement Card (GPC Visa) is used by more than 1,300 public sector organisations, to spend £935 million annually – representing a £165 million monetary saving and energy savings equivalent to 227 tonnes of $CO_2$[15].
- Based on the success of London's Oyster Card programme, the government plans to introduce a national smart ticketing system based on contactless bank cards and mobile phones – and anticipates an annual saving of £2 billion[16].
- Several local governments are encouraging the use of cards to pay for all local services, taxes, fees and fines. Others have used prepaid card systems for the distribution of benefits to vulnerable citizens. Kent County Council estimates that such a scheme has liberated annual savings of £2 million[17].

Aside from the automatic efficiency benefits, such initiatives can promote the acceptance of cards by more businesses, and encourage the use of card payments among more citizens.

## Potential barriers to progress

There are, of course, certain areas of regulatory intervention which threaten to have a negative impact on the evolution of cashless payments in Europe. The most obvious is the downward pressure on fees, particularly interchange fees. The other is the question of whether merchants should be entitled to impose a surcharge on card payments.

**Squeezing the economics of the cashless payment system**

Considerable uncertainty over future fee levels for payments has perhaps been the greatest barrier to progress over recent years. It has been widely accepted that average fee levels will reduce, but the extent of the reduction has been far from clear.

Without knowing how much they can realistically expect to earn from their payment services, banks have been understandably reluctant to invest in their payment products and services. And, without knowing how much they will be expected to pay, retailers have been cautious to invest in new acceptance solutions.

Regulatory pressure on fees comes in two forms.

On the one hand there is continued pressure on incident fees (such as those charged for insufficient funds, or the issuance of new PINs). McKinsey & Company estimate that, due to regulatory concern and action, banks stand to lose €8 billion a year in revenue from these fees, mostly concentrated in France, Italy and the UK[18].

Of more concern is the pressure on multi-lateral interchange fees (MIFs) as the result of recent and on-going anti-trust investigations and a concerted lobbying campaign by the European retail community.

In its dealings with the payment card industry, the European Commission has indicated that it wishes to use the so called merchant indifference test[19] as a basis for setting MIFs. It has also indicated that the same approach could be applied by national competition authorities within the respective EU Member States.

For notes, turn to **Appendix p69**

Now facing a rate of 0.2 per cent for immediate debit cards and 0.3 per cent for credit and deferred debit cards, MasterCard is reportedly contesting the Commission's decision at the European Court of First Instance[20]. Visa Europe, meanwhile, is defending a Statement of Objections from the Commission and arguing the merits of its own revised rates (namely €0.18 for immediate debit cards and 0.61 per cent for credit and deferred debit). In other words, the industry may be faced with a long, protracted legal process in order to safeguard a commercially realistic interchange level which, if significantly reduced, could have serious consequences for banks and consumers[21].

Visa Europe's position with regards to interchange has been fully communicated (see the Visa Europe Interchange White Paper, 2009). In essence this argues that:

- Interchange fees are a vital component of the four-party payment system
- A reduction in interchange fees will mean that more costs will be passed to consumers, and will prevent card issuers from investing in innovation
- Following regulatory intervention in Australia (where interchange rates were forced down to 0.5 per cent) banks increased cardholder fees and interest rates and cut back on rewards programmes

Countless other commentators have reached similar conclusions, for example:

- CapGemini reports "The four-party business model appears to cause faster and broader market development...The four-party model also allows participants to specialise according to their expertise, and in this way brings greater efficiency and broader reach... To develop a four-party card payment market, a delicate balance must be maintained between the interests of cardholders, issuers, acquirers and merchants. This interchange rate is critical to the equilibrium among stakeholders."[22]
- The Economist magazine concludes that "because finding the right mix of charges is so crucial to a successful two-sided business, regulating prices could upset a delicate balance. It is hard for firms to know what the "right" prices are in two-sided markets. Cut charges on one side and it will raise them on the other, chasing customers away and making the business shrink."[23]

There is also ample evidence to suggest that those domestic systems which operate without an explicit interchange fee should not be regarded as an appropriate model for the future. Quite apart from instances of limited functionality and inadequate security, these systems tend to make a net loss. For example, a study by McKinsey & Company revealed that, in 2005, Dutch banks lost an aggregate €101 million on debit cards, or €0.08 cents per transaction[24].

A draconian reduction in fees would doubtless have far reaching impacts. As Professor Leo van Hove, a respected authority on payment systems points out in an article in the Wall Street Journal, "Reducing fees might eliminate undue profits if there are any, but the resource costs are real and need to be covered. Consumers would then be forced to pick up some of this cost burden from the retailers. Given that cash is (just about) free for consumers, chances are that they would revert to using cash – lowering the efficiency of our payment system."[25]

By undermining the economic model of our non-cash payment system, this type of intervention could also make the market unattractive to new entrants and specialists – that is the type of organisation that the PSD seeks to attract.

Whatever the eventual outcome may be, the extreme level of uncertainty surrounding interchange has a truly stifling impact on payment systems development and investment – for banks and retailers alike.

**Assuming that all prices will converge to the lowest levels**

With the creation of SEPA, there is a general assumption that payment prices will converge – and, in many cases, an assumption that all such prices will gravitate towards the region's lowest prevailing levels.

However this assumption overlooks (perhaps conveniently) the sheer diversity of European banking models – in terms of the way different banks in different countries generate their revenues, define their products and manage cross subsidies across the various parts of their payments business.

As A.T. Kearney puts it, "A debit card transaction in Denmark is free to the merchant, while in some other countries merchants are charged a service fee of up to 1.5 per cent. In most countries, debit cards are either free [for the consumer] or carry a low annual fee (from €5 to €10), while in France the annual fee is between €30 and €40. In Italy, direct debits are priced in euros, while in Germany and the Benelux countries debits are priced in €-cents."[26]

The same paper goes on to argue that "SEPA investments will certainly come at a cost, and the low price of domestic instruments might not always be sustainable in light of the new investments. Encryption, fraud detection and other twenty-first century standards are costly, and for SEPA to be successful, selective price increases might be required. This is particularly obvious in cards. No one can operate a pan-European infrastructure without a certain transactional fee."

**Sending mixed messages with surcharging**

Regulators have often questioned the so called "no surcharging rules", which seek to prevent retailers from imposing surcharges on card transactions. For example, Article 52.3 of the PSD addresses the issue of surcharging, and provides guidance to each Member State:

> The payment service provider shall not prevent the payee from requesting from the payer a charge or from offering him a reduction for the use of a given payment instrument. However, Member States may forbid or limit the right to request charges taking into account the need to encourage competition and promote the use of efficient payment instruments.

Experience demonstrates that any surcharge, regardless of the amount, reduces the attractiveness of cards to consumers. Even when the practice of surcharging is limited, the very risk of surcharging has profound effects on the reputation of the payment card system and also on the reputation of those retailers that impose such surcharges.

A recent pan-European survey of 7,000 consumers[27] demonstrates extreme sensitivity to transaction-based fees. Even modest charges have the effect of sending people to ATMs to obtain cash, irrespective of the inconvenience which may be entailed. Some 60 per cent of consumers said that they would be willing to withdraw enough cash to finance all of their monthly card transactions. And 40 per cent said they would be willing to incur higher costs taking out cash in order to avoid a surcharge.

For notes, turn to **Appendix p69**

One recent example of the impact of abolishing no surcharging rules is the experience in Denmark following changes to the Danish Payment Act. From 1 January 2005, retailers were permitted to impose a surcharge on Dankort (the Danish national debit system) transactions. Although only a minority of retailers imposed a surcharge, the impact was nonetheless considerable:

- The total number of Dankort transactions fell from 42 million in January 2004 to 33 million transactions in January 2005
- The average number of Dankort transactions per card fell from 175 in 2004 to 167 in 2005

Due to opposition from cardholders, stoked up by pre-election media scrutiny and political debate, there was intense pressure to reverse the legislation. As a result, surcharging has been prohibited on Dankort transactions since March 2005 and on all other Danish-issued cards since June 2005. Although the Danish Competition Authority estimated that only around 19 per cent of retailers (mainly the very large ones) imposed a surcharge, the effect on cardholders across the board was substantial. In other words, the removal of the no surcharging rule resulted in a loss of certainty among cardholders, and resulted in considerable damage to the reputation of the payment card system.

When it is in the public interest to promote cashless payments, it would seem perverse for governments to explicitly sanction and enable retailers to impose surcharges. Unless Member States make an active decision to prevent surcharging, the PSD therefore has the effect of discriminating against cards in favour of cash. Unfortunately, it does nothing to prevent retailers from imposing excessive surcharges and it provides no guidance regarding the transparency surrounding surcharging.

In summary, there is much that governments and regulators can do in order to benefit more fully from the potential of cashless payments. If they adopt a progressive approach, they can have a very significant and positive impact on development and innovation. Conversely, if they undermine any of the central principles of the payment card system (such as its economic model, or its consumer protection measures), they can easily halt or stifle progress.

3

# European Banks
## Why invest and innovate?

## All change for European payments

For Europe's banks, payments are most definitely under the spotlight.

- The current economic downturn has focussed attention on payments – in terms of the costs they consume, the stability of the revenues they generate, and also the role they can play in cementing customer relationships and attracting much needed liquidity.
- The current regulatory developments (for example, the creation of SEPA and the implementation of the PSD) paves the way for more openness and dynamism in the European payments market, put significant downward pressure on fees, and enable non-banks to become established as payment institutions.
- There is an emerging recognition that the profit potential from payments growth and innovation (through, for example, cash displacement and the delivery of value added services) remains largely untapped.

Consequently, banks from across the region are reassessing their payment operations and reconsidering the strategic significance of payments to their wider business.

Although payments have always been an integral part of the retail banking business (and a core service by law in many countries), they have not always received concerted board level attention. In the past, many European banks have considered payments as a cost driver and, as a consequence, payment professionals have tended to be preoccupied by transactions and their costs rather than the revenue-generating account balances and services that lie behind them.

A further complication is the way that many banks have traditionally structured their operations. If all of the different payment functions (such as debit, credit, cash handling, ATM management, cheque processing and so on) are run separately, it can be difficult for a bank to achieve visibility across the whole.

The focus is now shifting, with particular attention being paid to the card payment system and the way in which it is set to evolve over the coming years.

But, as the consumer section of this report clearly indicates, the growth and development of the card payment opportunity will not happen under its own volition. In order to engage with more consumer segments, and to make cards relevant across more retail sectors, payments innovation is a pre-requisite.

For notes, turn to **Appendix p69**

## Tracking the changes "on the ground"

This shift in emphasis is clearly demonstrated through the work of Visa Consulting[1] and the changing nature of the assignments which it undertakes. As indicated in Figure 1, greater operational efficiency and risk management of card payment systems has become a rising priority for banks, at the expense of new customer acquisition and new product development. And, as regards the mid-term future, the trend is towards operational effectiveness, based on better-informed decision making.

Overall, there has been a trend away from credit card assignments towards debit card assignments. Even well established credit card issuers with large, profitable portfolios are beginning to appreciate that debit cards can be a more appropriate means to engage with certain customer segments or to capture a higher proportion of everyday spending.

Also, several issuers are embarking on assignments which cover both their credit and their debit card operations in order to maximise the synergies between the two.

In numerical terms, debit related assignments accounted for some 60 per cent of Visa Consulting projects in 2009 (up from 40 per cent in 2008).

**1 Banks' focus**

### 2 years ago – new customers

- Growth (customers, revenue, spend, market share)
- Higher marketing budgets
- Customer acquisition, usage & New Product Development

### Now – optimise profitability

- Profit focus
- Retaining existing customers
- Risk management & operational effectiveness
- Reduced marketing budgets

### Mid term future – effectiveness

- More informed decision making
- Innovation for growth
- Justified business cases for product & marketing
- Tighter use of reduced marketing budgets

Source: Visa Consulting

## Acknowledging high transaction costs

The sheer cost burden of managing payments should not be underestimated.

The management of payment transactions is probably the most visible and obvious service which a bank delivers to its customers – yet it is an area that has always been incredibly difficult to price.

As McKinsey & Company argues, "This visibility is precisely what makes it difficult for banks to determine the pricing of transaction services. Consumer and merchant actions are hampering their efforts to raise transaction and account prices even marginally, not only in markets where fees are high, but also in countries where current retail pricing levels are close to zero."[2]

The same paper from McKinsey & Company goes on to explain the obvious consequences, "Transactions generate only a little over a third of payments revenues, but a full 90 per cent of payments costs. Not surprisingly, transactions generate losses across virtually the whole of Europe... In 2006, transaction-related results ranged from a small profit of €13 per capita in Hungary to a major loss of €205 per capita in Germany."

The cost of processing cash is, of course a major component. On a pan-European basis, McKinsey & Company puts the annual cost to the industry at €26 billion, representing around 18 per cent of the combined operational cost base. For some banks the costs are much higher. A large retail bank, for example, may spend as much as 15 per cent of its operating cost base on cash-related operations[3].

Under these circumstances, banks have little option but to maximise the cost efficiency of their payments business, to encourage customers to use more efficient payment methods (such as cards), and also to consider the wider benefits which payments may be able to bring to their business.

## Improving transaction efficiencies

Given the scale of the costs, an important consideration for banks is the efficiency of their payment operations. Analysis from A.T. Kearney suggests that, for some banks, there could be considerable room for improvement. In its Card and Payments Benchmarking Study[4], it found significant efficiency gaps – with banks in the most efficient countries able to process an electronic payment at 1/30 of the cost of banks in the least efficient countries.

Looking at the performance of individual banks, A.T. Kearney went on to calculate that "leaders process payments and cards between 50 and 90 per cent cheaper than laggards, and laggards are between two and ten times more expensive in processing payments and cards than leaders."[5]

In this respect, the SEPA project is set to pay particular dividends (at least in the longer term) through the increase in standardisation, the demise of the remaining national "walled gardens", and the increased competition within the processing sector.

A particular matter for the industry to resolve is how many parallel processing institutions (particularly inter-bank processors) it wishes to sustain, and how these institutions can bring optimum value. Gartner suggests the following decision-making criteria: "Banks must make decisions about which processes they should keep in-house and which processes would benefit from sourcing. The right mix of in-house and outsourced operations will vary from bank to bank. And, to determine which processes to outsource to inter-bank processors, banks should evaluate each payment process against three criteria: differentiation (to what extent does your bank differentiate with each process); customisation (how differently does your bank execute this process from other banking organisations) and total cost of ownership (what is your bank's total cost of ownership for a given process or set of processes relative to industry peers)."[6]

For notes, turn to **Appendix p69**

## Using payment services to re-build trust

It will take some considerable time to assess the true impact of the financial crisis on the reputation of the banking industry, and consequent impact on consumer behaviour. However, it would appear that payment services, and particularly card payments services, present themselves as an opportunity to re-build trust.

In its annual analysis of the 100 most valuable brands, Millward Brown calculated that, between 2008 and 2009, the total brand value in the financial services category had fallen by 11 per cent. For those bank brands directly associated with the crisis, the fall was much, much larger. But, says Millward Brown, "Payment cards in general are doing better than banks. Determined to gain better control of their finances, consumers are increasingly relying on debit cards"[7].

A recent pan-European stakeholder survey, conducted on behalf of Visa Europe paints a similar picture. Overall, favourability for banks had fallen from 66 per cent to 55 per cent, whereas favourability for payment cards had dipped from 84 per cent to 80 per cent[8].

Analysis from Gartner brings added credence: "The financial crisis has spurred consumer dissatisfaction and lack of trust with banks. However Gartner data shows that consumers generally trust their debit and their credit card providers to support their payment needs... Retail payments are, therefore, a foundation to demonstrate value to retail banking customers and to build back consumer trust in the bank."[9]

## Generating much needed liquidity

When considering the value which payments bring to any bank, it is vital to acknowledge the liquidity that accompanies them.

As McKinsey & Company puts it: "Users can make payments only if they have liquidity at hand, in the form of balances on accounts – whether positive or negative (overdrafts) – and revolving credit balances on cards. Many professionals pay little heed to this side of payments, which they see as following automatically from the provision of payments services. Yet this "invisible" business generates almost 65 per cent of revenues against only ten per cent of costs and thus sustains the entire transaction business."[10]

Visa Consulting approaches debit card profitability and performance from a similar standpoint. It works with individual issuers to quantify and qualify those current account parameters that are directly influenced by the debit card, and which can be shifted through the more disciplined management of debit card portfolios. When assessing the true value and the profit contribution of the debit card business, any card and transaction fees should therefore be considered alongside the full range of current account income drivers – particularly the float revenues (which will tend to be higher if the debit card is actively used), plus overdraft fees and also any account fees.

The number of assignments of this type had grown to account for 30 per cent of Visa Consulting projects in 2009 (up from 20 per cent in 2008).

Payment products can therefore play an important role in encouraging customers to open an account with a particular bank and to bring their liquidity with them. More specifically, compelling value propositions, which are appropriately priced and configured, can be used to attract and then retain customer balances.

## Contending with a new breed of competitors (or partners?)

Of course, one of the most significant consequences of the PSD is the ability of non-banks to become established as payment institutions or e-money institutions – and payment systems such as Visa Europe will be required to enable such institutions to participate.

How this situation will evolve is a matter of some debate. However it appears likely that the initial effects will be felt in the acquiring market (where, for example, large retailers or groups of retailers may decide to set up acquiring operations, or existing commercial processors may extend their scope into acquiring).

The impact on the issuing side is less clear (partly due to the regulatory pressure on fees and the paucity of profitable opportunities to participate in this side of the business).

In the short term, it is likely that the biggest impact will be in the prepaid cards market where, already, many such programmes are managed and delivered by a specialist processor or programme manager (and where the "issuing bank" acts purely as "sponsor)." It would therefore be a relatively small step for such organisations to become established as card issuers.

In the medium-to-longer term, it is clear that large telecom operators and existing e-commerce payment systems could have much to gain from more active participation in the payment card systems. Similarly, those merchants that already offer co-branded cards (currently in collaboration with a bank partner) could take fuller control of such programmes.

So, whilst the PSD paves the way for a more competitive payments landscape, it also offers up opportunities for additional partnerships and joint ventures for the banking community.

## Providing a privileged perspective on everyday consumer behaviour

It should also be acknowledged that a by-product of electronic payments is the richness of transaction data which is generated. The providers of electronic payment services (and, more particularly, payment cards) therefore have privileged insights into everyday behaviour – with a direct line of site to people's habits and preferences.

And, as card payment volumes increase, the pictures painted by this data become ever-more comprehensive.

Clearly, this type and level of data has significant commercial value. It can be used by banks themselves and fed back into relationship management, thereby enabling the more effective cross-selling of other products and services. It can also be used to develop closer and more productive relationships with, for example, retailers or consumer goods companies.

The big caveat here is, of course, the related data protection and privacy issues. In making use of this data it is vital to work well within the confines of existing legislation and pay full account of customer attitudes.

## Moving beyond the theoretical – by driving innovation in payments

We have looked, in some detail, at the strategic significance of card payments and the value that can be derived from them. But, unless cards are actively and widely used, this value remains largely theoretical.

As of 2006, adults in Western Europe made an average of just 70 card payments a year (less than two each week)[11]. In countries such as Germany and Italy, the average was well below 40 transactions a year[12]. And, in Central and Eastern Europe, the corresponding figure was just six payments per adult per year[13].

A.T. Kearney adds that as many as 40 per cent of debit cards in issue in Europe are never used at all[14]. So what can be done to ensure that more cards are used more widely and frequently?

For notes, turn to **Appendix p69**

As indicated in the first chapter of this paper, a significant acceleration and extension of card use requires payment providers to continue to innovate – by finding ways to meet more consumer needs, and by making card payments yet more attractive to the retail community.

**Evolving the debit model**

The first priority, and perhaps the biggest opportunity, is for more banks to evolve the traditional debit model – by breaking the positioning of debit as a low-price commodity and presenting it as a real "product" for customers.

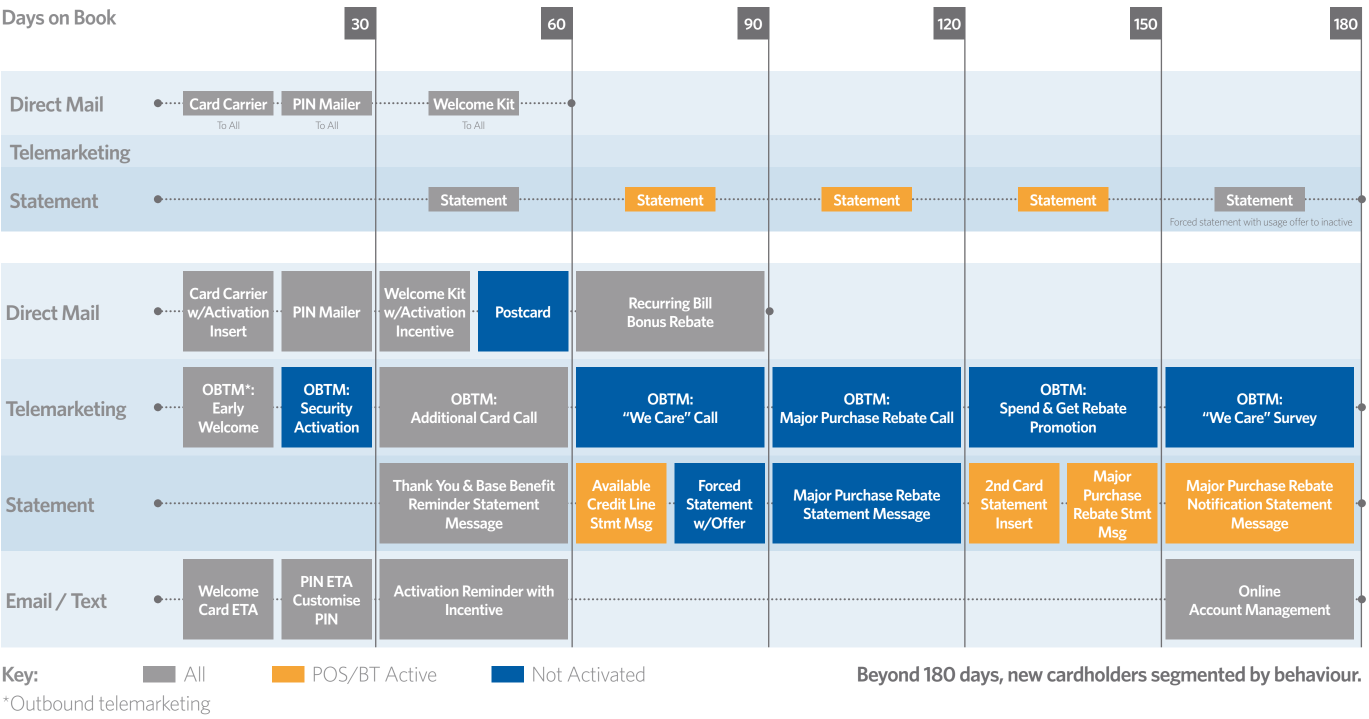
In truth, banks have never really worked that hard to promote the benefits of debit nor to incentivise its use. It has been left largely to fend for itself. Yet, over the past decade, it has typically delivered compound annual growth rates of around ten per cent. For a fee-based business, with low operating risk which requires little equity, that has to be seen as a solid, stable figure. And it is worth considering how much more could be achieved if debit were to be given more management focus.

For example, there is a clear opportunity for more debit card issuers to apply the type of card lifecycle management disciplines that have been successful in the credit card world – with proven tools and techniques available to cover the various product lifecycle stages (such as cardholder acquisition, card activation, card use and cardholder retention).

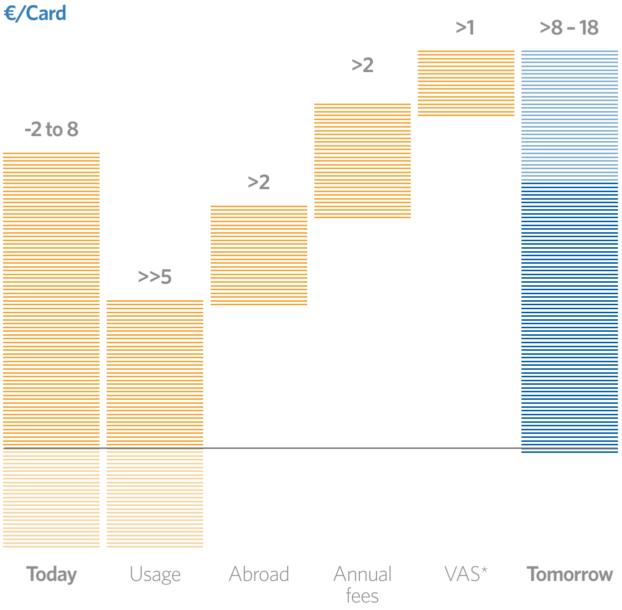
In particular, experience from Visa Consulting suggests that cardholder behaviour within the first three months of issuance plays a vital role in determining future performance – and Figure 2 indicates the array of "early days on book" techniques that can be used to drive activation and initial usage.

Also, banks could learn from other industries that segment customers based on their needs, rather than by more traditional characteristics. The Visa Europe consumer research reviewed within this paper demonstrates, very clearly, that different consumer segments have distinct needs regarding their choice of payment instruments and their attitude to their finances.

**2 "Early days on book" Marketing Techniques**



## 3 Debit card profitability perspective




Source: A.T. Kearney analysis
*Value Added Services

## 4 The importance of security as a key driver of payment choice

| EUROPEAN RANK | TOP DRIVERS | ESTONIA | FRANCE* | GERMANY | ITALY | POLAND | SPAIN | SWEDEN | TURKEY | UK |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Speed | 4 | 1 | 3 | 1 | 1 | 2 | 2 | 2 | 1 |
| 2 | Acceptance | 3 | 2 | 4 | 4 | 4 | 3 | 4 | 3 | 2 |
| 3 | Least hassle | 9 | 4 | 1 | 2 | 9 | 4 | 1 | 9 | 3 |
| 4 | Habit | | 3 | 2 | 3 | 7 | 1 | 3 | | 4 |
| 5 | Keep track | 1 | 10 | 10 | | 2 | 10 | | 1 | 10 |
| 6 | Security | 8 | 5 | 5 | 7 | 8 | 6 | 6 | 4 | 6 |
| 7 | Portability | 5 | 8 | | 5 | 10 | 5 | 5 | 6 | 5 |
| 8 | Seller preference | 6 | 6 | 6 | 9 | 5 | 9 | | | 8 |
| 9 | Intelligent | | 7 | 7 | 6 | | | 7 | 7 | 9 |
| 10 | Seller gets paid | 7 | 9 | 8 | | 6 | | | | 7 |

Note: A blank cell indicates that the driver is out the top 10 drivers of payment choice for that specific country
Base: 22628 European Banked Adults Age 16-65. Q17 Can you tell me the reasons you chose to pay with.... *In France, debit card includes charge cards

For notes, turn to **Appendix p69**

In particular we see a definite opportunity for more segmented account packages or bundles, which have a clearly differentiated debit or deferred debit product at their heart. What is more, these bundles can be configured in a way that encourages customers to use the most efficient channels and payment products.

We also see there are a myriad of ways in which debit products can be differentiated, such as:

- The provision of new, more secure ways to pay when shopping on the internet (perhaps by offering dynamic authentication, or by providing a ring-fenced companion product[15])
- Using SMS text messages to confirm transactions and available balances – providing more convenience and certainty
- The provision of insurance services, which address specific customer concerns and promote particular types of usage (such as overseas usage)

This is before we consider newer technologies and opportunities such as contactless (see below), mobile payment solutions and the ability to offer several payment applications on a single multi-function chip card.

Also, with the creation of SEPA, banks in several European countries are no longer tied into one particular debit solution. Instead, banks have easier access to a complete range of debit platforms (in the case of the Visa Europe portfolio, for example, banks can choose from options such as V PAY, Visa Classic, Visa Gold, Visa Platinum and Visa Infinite).

In Figure 3 and also on pages 52–53 is A.T. Kearney's own analysis of how an evolution of the debit model could feed through to the performance and, ultimately, the profitability of European debit cards.

**Leveraging the industry infrastructure**
As outlined in the introductory section, the European industry has been the global pace setter in the implementation of a consistent EMV-based payments infrastructure.

As well as being far more secure than the legacy technology, EMV is also far more capable (enabling, for example, innovations such as self-service payments, contactless payments and multi-function card programmes).

In other words, the European banking industry has already established a technological platform for innovation. The infrastructural challenges for the industry include:

- To finalise the EMV migration programme
- To take fuller advantage of the greater openness enabled by SEPA
- To extend the acceptance infrastructure in less developed markets
- To begin to exploit the true capability of EMV technology

**Outperforming cash**
As has been covered extensively within this paper, the biggest opportunity – and the biggest challenge – relates to those low-value payments, where the use of cash is so prevalent.

As indicated in the Visa Europe "usage and activation" research programme, this is an area where cards are not currently seen as particularly relevant, and where cash is generally perceived to be faster, more convenient and more acceptable to retailers.

It is in this context that "tap and go" contactless payments (such as Visa payWave) offer so much promise. Since payments are instantaneous, cards have a highly tangible advantage over cash for consumers. And, in busy, high-volume retail environments this also translates into tangible business benefits for retailers.

Contactless payments have now been commercially launched in several European countries (including Turkey and the UK), and the wider industry is closely following their progress. By August 2009, nearly 2.5 million contactless Visa cards had been issued in Europe – a figure that was forecast to rise to 6.6 million cards by the end of 2009.

**Investing in security**

The implementation of EMV chip and PIN technology has brought a step change to the security of the European payment card system – but clearly, vulnerabilities do remain, and security is a matter of concern for consumers, retailers and regulators.

In the "Visa Europe Consumer Payments and Borrowing Lens" survey, security emerged as a "top ten" payment requirement. As indicated in Figure 4, the importance of security ranges from the fourth to the eighth most important driver of payment choice – ranking as the sixth most important overall.

In terms of e-commerce spending, security concerns are particularly important. For example, Figure 5, from research in the UK[16], suggests that, for online shoppers, the security of payment and personal information is by far the most important payment related consideration.

Under these circumstances it is perhaps little surprise that banks are now using security as a source of competitive differentiation. For example, some issuers of V PAY are promoting the card's chip-only configuration as a distinct advantage over other debit platforms. Similarly many credit and charge card issuers are offering ID theft protection and zero liability as either a standard or a premium service. And some issuers promote SMS text alerts as a method of identifying and addressing fraud.

This trend is probably set to escalate in the future with, for example, more issuers offering dynamic passcode authentication (applied via the existing 3-D Secure authentication architecture).

Of course, banks are not the only organisations that have security and ID concerns. There could therefore be a strategic opportunity to position bank-driven authentication technologies, and bank-issued tokens as a more generic or universal authentication method for any e-services.

**Meeting more borrowing needs more effectively**

Although the debit card opportunity may have come to the fore during recent months, the continuing potential of credit and charge cards should not be overlooked.

This is, of course, one area of the payment card industry that has been particularly exposed to the economic downturn[17]. For example, many issuers have been tightening their risk controls, and consumers have been less inclined to make use of their revolving credit facilities. But, looked at in a broader context, there is considerable scope for issuers to evolve the traditional credit card model.

For example, it should be recognised that, in many countries, the credit card outperforms all other payment mechanisms on a wide range of different attributes – such as security, the ability to cover large or unexpected purchases, the ability to make spontaneous purchases and access to the rewards programmes.

Figure 6 provides a graphic illustration of those attributes which are associated with credit cards – and, interestingly, it shows that credit cards are associated with a broader range of attributes in those countries where the credit card market is most developed.

Whilst these attributes may not be significant enough to figure in consumers' everyday spending behaviour, they are vitally important in certain purchasing situations. As a consequence, heartland credit card spending tends to be much more focussed and specialised than for debit cards[18] – and credit cards can be seen to play an important role in the overall payments repertoire of many consumers.

For notes, turn to **Appendix p69**

## 5 Security is, by far, the most important payment related consideration for online shoppers

| | | |
|---|---|---|
| **Security** | **83.6%** | Card details and personal information are completely safe |
| **Trust** | **7.6%** | The payment process will work and that any problems will be resolved |
| **Simplicity** | **2.9%** | The checkout process is easy to use and takes just a few clicks to complete the transaction |
| **Speed** | **2.4%** | It is possible to make the transaction quickly |
| **Ubiquity** | **1.8%** | Can use preferred payment method on many sites |
| **Choice** | **1.8%** | The site offers a good choice of payment options |

Source: Visa Europe Holden Pearmain, 2008

## 6 The hierarchy of benefits of credit/charge cards

| EUROPEAN RANK | DRIVERS | TURKEY* | UK | SPAIN | ITALY | SWEDEN | GERMANY | ESTONIA | POLAND |
|---|---|---|---|---|---|---|---|---|---|
| 1 | Speed | ● | | | | | | | |
| 2 | Acceptance | ● | | | | | | | |
| 3 | Least hassle | ● | | | | | | | |
| 4 | Habit | ● | ● | ● | ● | | | | |
| | | | | | | | | | |
| 6 | Security | ● | ● | ● | | | | | |
| | | | | | | | | | |
| 9 | Intellgent | ● | ● | ● | ● | ● | | | |
| | | | | | | | | | |
| 13 | Enable purchase | ● | ● | ● | ● | ● | ● | ● | |
| | | | | | | | | | |
| 18 | Access to funds | ● | ● | ● | ● | ● | ● | | |
| | | | | | | | | | |
| 21 | Juggle funds | ● | ● | ● | ● | | ● | | |
| 22 | Rewards | ● | ● | ● | ● | ● | ● | ● | |
| 23 | Discounts | ● | ● | ● | ● | ● | ● | | |
| | | | | | | | | | |
| 25 | Waiting for funds | ● | ● | ● | ● | ● | ● | ● | ● |
| 26 | Manage the unexpected | ● | ● | ● | ● | ● | ● | ● | |
| 28 | Smoothing | ● | ● | ● | ● | ● | ● | ● | ● |
| 29 | Forget spend | ● | ● | ● | ● | ● | ● | ● | |
| 30 | Status | ● | ● | ● | ● | ● | ● | ● | |

Note: Data ranked in order of overall importance across all markets. Highlighted bullets show the markets in which this benefit is attributed to credit/charge card on or above the European average for all payment mechanisms.
A blank cell indicates that the reason/driver for credit card use scored below the average across all payment mechanisms for that specific country. *Credit card only in Turkey. Base: 22,628 European banked adults, aged 16–65.

Source: "Visa Europe Consumer Payments and Borrowing Lens" Survey.

Taking an even broader view, it should be remembered that, in total, the size of the European unsecured lending market is €800 billion[19], yet just €150 billion is currently served by credit cards[20]. This leads one to the conclusion that the remaining €650 billion is currently being served by alternative products which are better at meeting the needs of certain consumers.

In every European country covered by the "Visa Europe Consumer Payments and Borrowing Lens" survey, less than half of adults claimed to have a credit card, yet a large majority of them choose and use some form of borrowing product. As indicated in Figure 7, the product they do choose and use varies considerably by segment – and it also varies by purchase type.

So, taking a strategic, long-term view, a key objective is to flex the traditional revolving credit model. In other words, credit cards, as a concept, have to become more adaptable. Propositions have to become more targeted. So, for example, if people want better control, they should be able to get it from credit; or, if they want greater freedom, they should be able to get it from credit; or, if they want more relevant rewards, they should be able to get them from credit.

Against this background, the future winners are likely to be creative issuers, who can successfully differentiate, and can do so at low cost. Figure 8 and Figure 9 illustrate the way that such issuers are now translating the core value drivers of specific customer segments into their product development processes.

**Developing more productive retailer relationships**

As clearly stated in the introductory sections, the retail community is a key stakeholder in the payments market and (intentionally or not) has a big influence over the consumer's choice of payment method. In order to extend and accelerate the use of electronic payments, there is undoubtedly a need for closer partnerships between payment providers and retailers.

It would probably be true to say that, in the past, a focus on cost has obscured the strategic, operational and customer service benefits which the card payment system can deliver to the retail community. It could also be argued that the payment card industry has not done enough to understand the retailers' priorities nor to talk in their language. As a consequence cards are often portrayed by retailers as a necessary evil rather than a value-driver.

In general, retailers look to their suppliers for highly tangible business results, something which the payment card industry should regard as a definite opportunity. For example, what quantifiable impact can card payment acceptance have on the level or the value of a specific retailer's sales? Or the level of employee fraud and petty theft? Or the speed of checkout? Or the true costs of handling cash?

There is also an opportunity for the payment card industry to think, not just about the payment function in isolation, but about payment as one relatively small component of the wider checkout process.

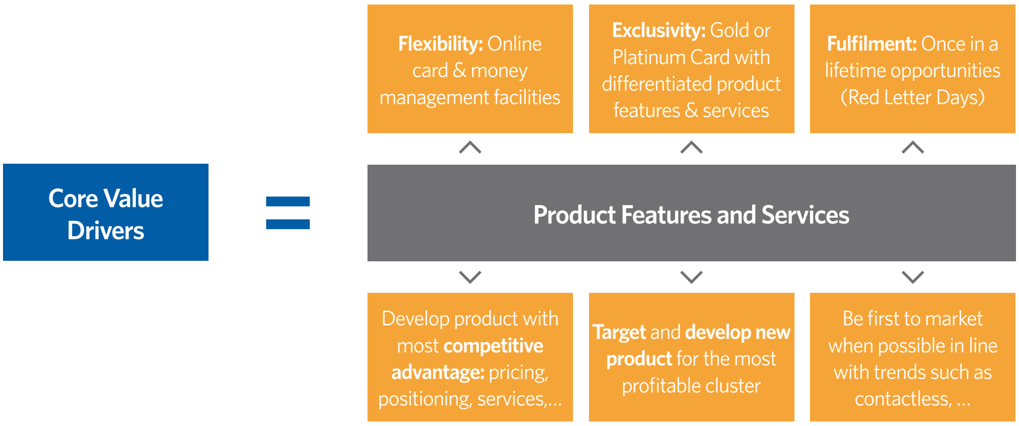
A significant challenge and opportunity for the future, therefore, is for the payment card industry to develop more productive retailer relationships – an issue which will be explored in more detail in the following chapter.

For notes, turn to **Appendix p69**

**7 Propensity to borrow varies by segment – as does preferred borrowing mechanism**

| (SWEDEN) % | % Population | Credit Card | Bank Overdraft | Bank Loan | Retail Store Card |
|---|---|---|---|---|---|
| Financial Simplifiers | 14.0 | 1.3 | 11.2 | 4.5 | 7.1 |
| Lifestyle Optimisers | 28.9 | 60.5 | 38.1 | 67.5 | 35.3 |
| Mature Planners | 17.1 | 31.1 | 7.1 | 23.3 | 30.7 |
| Pressured Jugglers | 9.1 | 20.0 | 34.4 | 54.4 | 14.2 |
| Cautious Followers | 30.9 | 4.2 | 4.4 | 7.4 | 7.0 |

**8 Prioritisation and Optimisation: Define what the core value drivers mean in terms of products and services**




**9 10 steps to a winning proposition**

1. Understanding the **market environment**
2. Understanding the **cardholder needs and wants**
3. Understanding the **competition**
4. Understanding **how the customers choose** their cards
5. Identifying how the market is **segmented**
6. Setting the **objectives** for issuing the card
7. Selecting the **target market**
8. **Specifying** the new **"different"** card product
9. **Developing, testing and launching** the product
10. Managing the **product life cycle**

Source: Visa Consulting

# Shifting gears for growth and innovation

## A perspective from A.T. Kearney

Cards and payments account for at least ten per cent of the revenue pool for European banks, and suppose a €70 billion opportunity for payment providers. Return on equity is high, and both volumes and revenues have proven to be comparably stable even during a downturn.

But regulators question the established economic framework; SEPA is increasing competition across individual markets; and much more competition from non-banks is expected on the back of the Payment Services Directive and E-Money licenses.

So is the outlook for cards all gloomy?

First of all, the potential for electronic payments in general and cards in particular is far from exploited. While a European citizen pays up to 1,000 times a year, only a fraction of this is transacted on cards. Roughly 80 per cent of purchases are still paid in cash. This is especially true for lower value payments (where retailers in some countries even reject cards), and also for international payments. While cross-border trips are the norm, many cardholders are not aware that there is not generally a fee attached to paying abroad, and prefer to take cash with them.

Secondly, consumers are much more comfortable with technology in general. Around 50 per cent of all consumers are online banking users, ATMs and card payments enjoy widespread acceptance, and there are now more mobile phones in Europe than fixed lines. But consumers have also become more critical with technology, and particularly with respect to security, transparency and control. This opens an interesting field for banks to innovate and offer new solutions.

Thirdly, card businesses can adapt to changes in the economic framework if there is a general support for electronic and card payments. Sweden and the Nordic countries in general are good examples of acknowledging the cost of cash and the value of paying electronically. General support also by public entities for card payments has helped to drive card payments beyond 100 per capita per year. Other countries have consumers paying for cards and additional services, for instance in the Benelux or France. And some of the Mediterranean and Eastern European markets lead the way in top-up services both on cards and the point of sale terminals, ranging from bill payments or remittances to POS loans.

The case for cards, and more particularly for debit which accounts for the bulk of European card numbers, is essentially built on three pillars:

**Capturing more everyday payments**
By specifically addressing payments below €15 to €20 and allowing cardholders to pay at convenience stores, cafés, pharmacies and small food retailers, for instance, card usage could be doubled in the next 4-5 years across Europe. This would account for an additional €5 revenue per card per year at low transactional fees.

**Paying by card abroad**
If every European travelling abroad would make two card payments per trip rather than withdrawing cash (often at home), banks would gain another €2 per card from transactional fees and ATM cost savings.

**Segmentation, differentiation and enrichment of card functionality**
Evolving the traditional debit models could add another €3 or more from payment and service commissions (from bill payment to remittances), assuming that every fifth cardholder takes up such offers.

All of this will require payment providers to innovate, for instance in payment convenience (e.g. contactless). But it also requires a broader appreciation of cards as a product rather than a utility. Cards are a great tool for segmentation, providing rich information about customers, and a platform to make people's lives easier in their everyday needs and transactions. Taking up the challenge from a changing economic framework certainly makes the card business more demanding, but it can also bring banks closer to their customers and changing needs in terms of convenience and security.

4

# Retailers
Why favour cards over cash?

## How does the European retail community view payment cards?

In such a large, diverse and fragmented sector, it is little surprise that there are plenty of conflicting views out there. But, right now, the focus does seem to be on the cost of cards, rather than the value they can bring. For example, the retail lobbying groups have been prime players behind much of the regulatory scrutiny into the payment card system. Also, the retailers themselves tend to be coy about the true costs of processing cash or the level of benefits they receive from cards.

There are some exceptions. For example, Svensk Handel, the Swedish retailer organisation has argued that consumers should be charged higher prices for using cash in order to encourage greater use of payment cards[1].

If we are to see a more concerted move away from cash then, clearly, all of the major stakeholders must agree that cards are a superior solution. But, as McKinsey & Company puts it: "This consensus will be hard to reach, as the parties involved do not agree on the true costs of cash and the other payment instruments involved".[2]

To complicate matters, there is considerable variation between the different estimates on the costs of accepting cash. For example, the British Retail Consortium suggests that, within the UK, "the average cash transaction costs two pence" (€0.023)[3]. By contrast a Swedish Central Bank Study puts the average cost of a cash transaction at SEK2.61 (€0.25)[4]. Yet another calculation, this time from McKinsey & Company suggests that, for retailers in Europe, the cost of cash equals, on average, 1.3 per cent of the value of each cash transaction.[5]

Under these circumstances, PricewaterhouseCoopers suggests that the payment card industry should engage in a more proactive and convincing programme of education: "Retailers need to be educated in the pricing mechanisms and the financial benefits of card payments over cash. The cards industry also needs to explain to retailers more clearly the full costs of cash (such as theft, additional security, point of sale hardware, reconciliation and so on) in order to give them a truer comparison."[6]

For notes, turn to **Appendix p70**

## Acknowledging the current value of cards – as well as their future potential

Payment is about much more than a simple exchange of value. In any transaction, there are a whole range of additional factors to consider. And, compared to cash, the payment card system already delivers very significant benefits to retailers:

- Rapid settlement (retailers typically receive funds from their acquirer within four working days) and guaranteed payment[7]
- Reduced costs relating to cash handling, fraud prevention, fraud losses, robbery as well as reduced opportunities for staff errors or pilferage
- Increased opportunities for sales, by giving consumers easy, immediate access to their liquidity (in terms of the funds they hold on deposit and also their available credit)
- Quicker transaction times, enabling a more efficient throughput of transactions
- The ability to provide cash withdrawal services (cash back) to customers, further reducing the costs and risks of cash handling
- The ability to trade across multiple channels (such as the internet and mail order), and to introduce pre-booking services
- More efficient accounting and book keeping (particularly for smaller businesses)

Then of course there is the matter of customer satisfaction – with retailers able to offer a popular payment service which so many customers find to be easy, convenient and secure.

With credit and deferred debit cards, there is also the ability for consumers to access additional funds and to make more spontaneous purchasing decisions – which simply wouldn't be possible with other forms of payment.

We therefore contend that, as a consequence of accepting cards, sales tend to be higher, customers tend to be happier, and retail businesses tend to run more efficiently. We also contend that there is much more potential to be fulfilled. Sector-specific payment innovations can do much to improve the purchasing experience for customers, and bring tangible value to retailers.

## Connecting to and convincing the right people at the right levels

There are many conflicting agendas at play, not just across the retail industry, but also within individual retailers. For example, most of the direct relationships between the payments industry and retailers tend to be through the Treasury and IT functions – who are generally concerned with cost management and reliability, not innovation and growth.

On the other hand, those people within retail businesses who are in a position to innovate do not necessarily appreciate the opportunities presented by the payment card system outside of what they already know. In other words, payments are often seen as a commoditised function, which are low on the strategic agenda.

Often it is only a "forced" change or a heavily "incentivised" change (such as the move to EMV chip and PIN or the implementation of authenticated e-commerce transactions) which demonstrates potential. Consider, for example, the following excerpt from a recent UK research report from RBS WorldPay, a leading European acquirer and provider of payment processing services:

"More than half (52 per cent) of retailers surveyed admit upgrading their card payment solutions has had a positive impact on their business – in fact making improvements to payment systems increases profits by an average 18 per cent. One in four claims profitability has increased between 25 and 50 per cent, with some retailers claiming even greater profit growth due to improvements to payment systems.

"Despite these proven benefits of improvements to payment systems, one in five professionals in the industry claim they don't undertake any research to find the right payment system for their business and half do not think there is anything they could do to improve the payment technology they offer consumers."[8]

A further complication is that, culturally, retailers can be somewhat different from the people they deal with in the payment industry. They tend to worry about different things, they move at a different pace, they focus on different cost and revenue issues and, consequently, they speak a different language. Clearly, there is more for the payment industry to do in overcoming this hurdle.

## Preparing for greater levels of "participation" in payments

The Payment Services Directive (PSD) gives non-banks the option of becoming established as payment institutions giving them, for example, a legal right to participate in payment card systems. This, in turn, will mean that retailers will have a new range of payment-related options and possibilities available to them.

For notes, turn to **Appendix p70**

**In acquiring**
As discussed in the previous chapter, large retailers or groups of retailers may decide to set up acquiring operations, or existing commercial processors may extend their scope into acquiring.

The driving force for any such change is generally assumed to be the search for scale and process benefits. However, there is also opportunity for retailers to reassess the wider value that an acquiring function can bring to the table – such as the ability to handle and analyse large amounts of data, implement complex technology, comply with changing security requirements, and support customer activity at the point of sale.

**In issuing**
Equally, there is an opportunity for retailers to become more involved in the issuing side of the business. Already, this trend is well advanced, with many retailers having moved their private label cards to co-branded relationships with international systems.

As McKinsey & Company observes: "By 2007, roughly 20 per cent of [Europe's] "pay later" cards were co-branded with a retailer or affinity group, with usage being 25 per cent higher than the traditional bank-issued pay-later card. If we assume comparable future growth, the share of co-branded cards would increase to 40 per cent in Europe, in line with U.S. levels."[9]

**In cash disbursement**
At the same time, Europe's retail groups are becoming significant providers of cash disbursements, through the use of cash back services. For example, Norwegian consumers already withdraw 60 per cent[10] of their cash at merchants, and the service is being rapidly implemented in many more countries.

Across each of these dimensions, there is the option for retailers to either:

- "Go it alone" by establishing and operating their own payment institutions
- Partner with newly established payment institutions
- Strengthen their partnerships with the traditional payment providers.

Either way, there is a golden opportunity for retailers to think long and hard about payments, the value currently being derived from them, and the incremental value which could be derived in the future.

As PricewaterhouseCoopers puts it, "Before the PSD, the concept of payments was often regarded primarily as a banking activity. However this was an oversimplification and ignored important sectors of the payments market. As a result it created artificial barriers to entry to the market which, with the creation of the PSD no longer apply."[11]

## So, what more value could be derived?

As mentioned above, those within the retail community who are responsible for innovation do not necessarily appreciate the opportunities presented by the payment card system outside of what they already know.

So what payment-related possibilities should be on their radar?

We would contend that, for the consumer, payment is a "moment of truth" that colours the entire retail experience. We would also contend that the potential benefits of the card system extend well beyond the actual moment of payment.

Examples include:

**Gaining deeper insights into consumer behaviour**
One option is to gain more mutual benefit from the transaction data that is automatically generated and captured by payment card systems. This is especially true for overall household and lifestyle data which is difficult to build reliably and falls well outside the line of sight of most retailers. Without good customer data, retailers have difficulty in developing targeted promotions and creating loyalty strategies. By working more closely with the payment industry, retailers could integrate payment data into the delivery and management of their customer loyalty programmes.

**Improving the retail experience**

Payment technologies that clearly outperform cash on speed and convenience are now emerging – and provide scope for retailers to deliver a superior customer experience (thereby increasing footfall and reducing queues).

One obvious example is the contactless payment technology now being introduced in several European countries. For the retailer, this offers quicker service, reduced queues, lower cash-handling costs, higher transaction values and less opportunity for losses. And, as PricewaterhouseCoopers puts it: "Contactless is one area where the customer experience has directly affected the product development strategy. The convenience of using contactless over cash and the reduction in queuing times has a direct impact on turnover. In particular, it is becoming apparent that smaller basket value and higher volume retailers will find contactless more compatible with their operating models."[12]

Another example is the increasing prevalence of self-service, self-checkout and vending solutions – which have been made viable by chip and PIN technology.

In each case, new innovations enable a complete change, not just to the payment itself but to the wider check-out or check-through process.

**Benefiting from sector specific solutions**

At the same time, the industry is continually developing new sector-specific solutions. One example is the abundance of cashless parking solutions, which often use the mobile phone networks to authorise payments. Another example is "pay at gate" ticketing solutions for mass transit operators. A whole range of cashless self service solutions are also available for specific retail environments (such as universities, launderettes, petrol stations, campsites and marinas).

With the progressive convergence between payment technologies and mobile phone technologies, the opportunities for value creation can be expected to escalate.

For example, in trials where contactless payments have been conducted using NFC-enabled mobile handsets, levels of consumer enthusiasm have been spectacularly high. Also, there are options to create extremely targeted and interactive promotions, which are integrated into the payment functionality of a mobile phone.

Although we are still some way from achieving the true promise of mobile payments, there is nonetheless a high level of "creeping convergence" which can sometimes be overlooked. Consider for example: the way that mobile phones are used to initiate payments for parking; the way that pre-paid top ups are initiated via the payment card system, or through ATM networks; the way that some prepaid card programmes are linked directly to a mobile phone account; and the way that SMS text messaging is increasingly used to enhance payment card propositions (by, for example sending fraud alerts or low balance alerts).

## Recognising the balance between "Big Retail" and "Mom & Pop"

When considering the future of everyday payments, consideration should of course be given to the structure of the European retailing market.

**"Big Retail"**

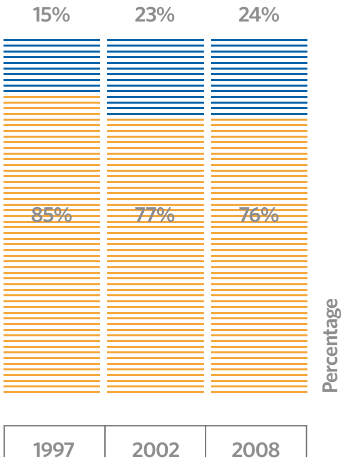
Across Western Europe, the top ten retailers now account for almost a quarter (24 per cent) of net retail sales (up from 15 per cent a decade previously). And, within each domestic market, the top five retail groups control, on average, more than 65 per cent of sales (as seen in Figure 1, this ranges from 90 per cent in Finland to 19 per cent in Turkey)[13].

Since they are responsible for such a large proportion of sales, these retail groups can play a decisive role in determining the evolution of our payment systems.

For notes, turn to **Appendix p70**

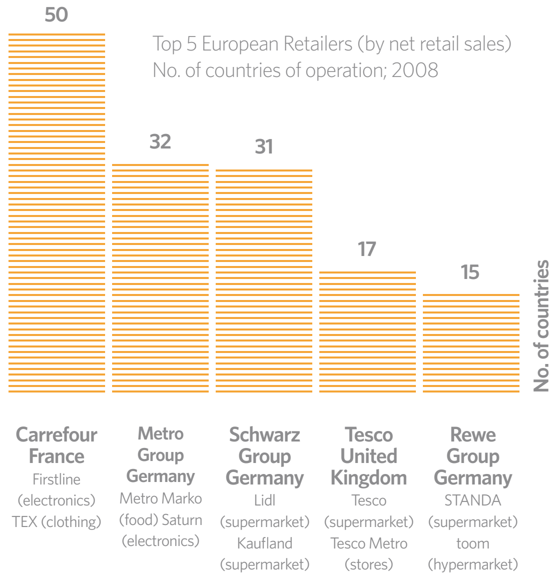
## 1 Large retailers continue to grow across Europe

**Across W. Europe, the retail space is becoming increasingly consolidated**

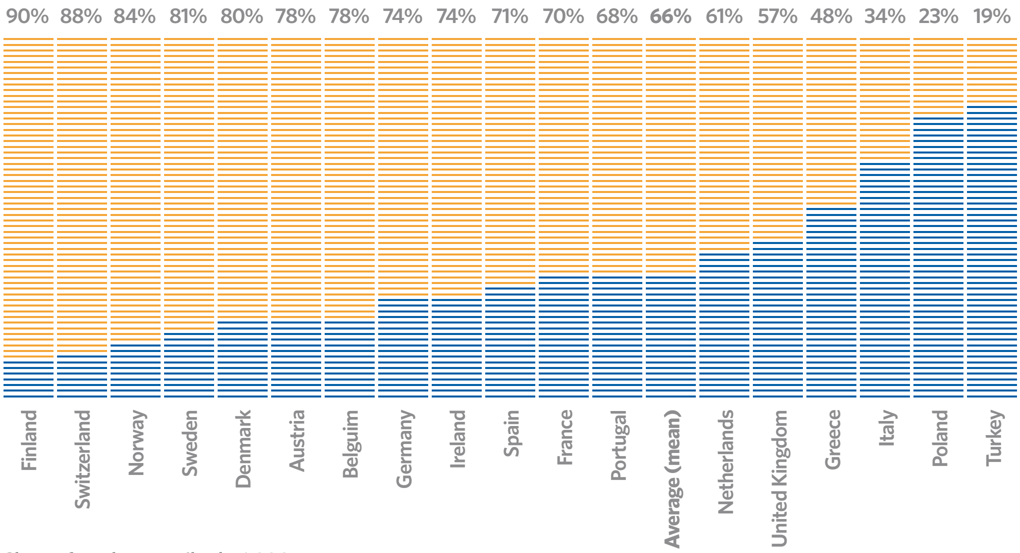



Key: Rest of market; Top 10 Retailers

**The largest pan-European retailers have substantial scale and operate in a large number of countries**




**Within Western Europe, the top five retail groups control more than 65 per cent of their domestic markets**




**Share of total net retail sales* 2007**

Key: Rest of market; Top five Retailers

Note: *Includes supermarket, hypermarket, discount stores, convenience & forecourt stores and cash & carry warehouses; sales are net of carriage inwards. Source: Planet Retail, 2008; Deloitte analysis

However, in order to bring more value to these large groups, it is necessary for the payments industry to understand and respond more effectively to the nuances of the respective retail environments and business models. Consider, for example the innate differences between a fuel station (where the convenience of a pay-at-pump solution may be appealing), a town centre supermarket (where speed of checkout is vital) and a discounter (where end-to-end efficiency tends to be the overriding factor).

**"Small Ticket"**
At the other end of the scale are the smaller retailers – which often account for lower value payments, and tend to have the greatest predilection for cash.

Analysis from McKinsey & Company (based on research in France, Germany, Italy and the UK[14]) confirms that such retailers do have an implicit preference for cash, but suggests that this preference is based on flawed logic. In particular, these retailers tend to view cash as more practical, cheaper to handle and (bizarrely) more secure. Yet:

- **Practicality** – with more habitual use of debit cards among consumers, and the advent of new technologies such as contactless payment, the perception of cash as practical is at last being challenged.
- **Cost** – smaller merchants tend to overlook (or simply absorb) the excessive amount of time it takes to count ("cash up"), reconcile and deposit cash. They also underestimate the costs of the built-in risk which cash entails. And they are often oblivious to the costs of interest foregone. McKinsey & Company concludes that "Taking all the costs into account, the cost of using cash turns out to be equal to (or in the UK, higher than) the cost of using debit cards: 1.3 per cent of transaction value
- **Security** – similarly, smaller retailers overlook the risk cost for cash. These are estimated at 0.1 to 0.2 per cent of transaction value compared to 0.02 to 0.1 per cent for cards.

The challenge for the industry is to understand and address the needs of these smaller retailers. One way to do that is to emphasise the risk differential between cash and cards, while also pointing out the laborious nature of cash payments. As McKinsey & Company puts it: "The mission is worth pursuing now, as alternative payment technologies are growing fast and becoming profitable from the provider's perspective, cheaper, safer and more practical from the merchant's point of view, and convenient and quick for customers.[15]"

For notes, turn to **Appendix p70**

**2 There are substantial retailer based barriers to debit card use**

| % AGREE | ESTONIA | FRANCE | GERMANY | ITALY | POLAND | SPAIN | SWEDEN | TURKEY* | UK |
|---|---|---|---|---|---|---|---|---|---|
| Gave any retailer/POS reason for non-debit card use | 20 | 25 | 25 | 22 | 38 | 20 | 18 | 20 | 17 |
| Seller said they didn't want | 4 | 7 | 5 | 5 | 9 | 5 | 5 | 6 | 4 |
| I thought seller wouldn't want | 3 | 7 | 10 | 6 | 9 | 7 | 4 | 7 | 8 |
| Seller didn't have facilities | 13 | 11 | 10 | 11 | 20 | 8 | 9 | 7 | 5 |

Source: "Visa Europe Consumer Payments and Borrowing Lens" Survey

## Doing the simple things well – a huge opportunity in itself

Irrespective of which particular retail sector or segment we are considering or the payment technologies being deployed, the rate of cash displacement will be largely determined by one fundamental question.

Would the retailer prefer to be paid by cash or by card?

If the answer is by card, then simply demonstrating this preference can have a very significant impact. As indicated in Figure 2, from the "Visa Europe Consumer Payments and Borrowing Lens" survey, the perceived attitude of the retailer can be one of the single biggest factors contributing to the consumer's payment choice.

This perhaps explains why one of the most effective means of increasing card payments within a particular retail location is to make acceptance decals more visible – both at the entrance to the store and at the point of sale.

These decals perform the dual role of reminding consumers that they can pay by card, and demonstrating that retailers are happy to accept cards (a fact that needs to be underlined even in environments which are well terminalised). Recent research commissioned by Visa Europe showed that, across most retailers tested, the mere existence of decals provide a stronger encouragement for consumers to make card payments than either a bank based or an in-store promotion.

Simply displaying decals, or displaying them more prominently, is one "innovation" which could, in itself, pay enormous dividends.

# Card payments and retailers

## A perspective from PricewaterhouseCoopers

Traditionally, innovation in the card payments world has been confined to a simple repackaging of existing features with different limits or scaling, with the brand continuing to act as the main differentiator. Consequently, the driving force behind the retailer proposition has had little to do with the impact on variable customer cost profiles, on customer point of sale efficiencies, or on customer point of sale productivity.

This utility-type business model has worked effectively for the last couple of decades but the result is a 'weakness' in the ability to develop new products or significant customer value propositions. Also, the financial services industry has benefited from benign conditions, so the need for a significant contribution from operations, in terms of productivity and efficiency gains, has lagged. In the new market, revenue growth will diminish and operating model/product design weaknesses will be exposed.

Card propositions are clear across all parts of the supply chain but the product-centric utility focus needs to shift to a retailer/consumer-centric model. Retailers and fast moving consumer goods (FMCG) businesses already do this for the most part, but not yet when it comes to payments. The wealth of real-time, consumer/product specific transaction data along the entire supply chain should be leveraged to drive insight into new consumer propositions and define new revenue streams.

In addition, as consumer purchasing habits change in line with new expectations and new technology, the point of sale environment will continue to evolve. There will be a constant dichotomy of investing in major industry innovations that drastically change the consumer experience and performance/efficiency based innovations that drive volume/value sales per unit of time. There is, without question, a need for a major burst in intellectual horsepower to support retailers with innovation and, crucially, the analysis of data to define new value propositions that are relevant for modern consumers.

Presently, cards (whether they be debit or credit) are the most convenient payment method at the point of sale and have a critical mass in the market. The internet may have enabled this proliferation, but the mobile channel will take the mantle of driving and proliferating consumer payments in the coming years. In the near term, evolution of the mobile device will be driven by the desire to enhance efficiency – for example, one major European retailer estimates that every second saved in the payment process is valued at £1m (€1.1m) in revenue across the entire suite of stores. Therefore a reduction in queuing time and ability to enhance the volume of sales per unit of time are the immediate requirement. With time, the mobile channel may support the ability to make debit and/or credit payments either directly through NFC technology, via the mobile account or via a PayPal-type mechanism. Cards themselves may disappear.

The case for consumer-relevant innovation is not new in the retail market but the connection with banking and financial services is only just emerging. How do retailers take current customer trends to develop a sustainable payments environment? How can the major theme of consumer/retailer personalisation be incorporated into a new payments environment. Self service tills and internet payments have enhanced the point of sale in recent years, so what next?

Take the mobile phone as a payment instrument, a payment channel or both? Retailers need to put the consumer at the heart of their business model which will, implicitly, place the customer at the heart of the entire cards supply chain. To this end, retailers will expect to leverage transaction data from the supply chain to draw insights and develop new customer value propositions. In defining the strategy for innovation there will be a balance between the ongoing need for efficiency gains and more disruptive, industry shaping innovations that offer modern consumer experiences and drive competitiveness. This will likely see the separation of the payment product from the payment experience, and we anticipate the evolution of mobile devices to offer payment methods for consumers. The customer pull will be driven through analysis and insight into the behavioural footprint of different consumer segments based on detailed transaction history. In depth analysis will lead to an more detailed understanding of customer purchasing habits which will lead to the definition and assessment of an increasing array of 'points of personalisation'.

Only in this way will new customer value propositions be defined, which will increase the likelihood of payments and increase the volume and value of payments needed to drive revenue and profitability throughout the supply chain.

# Appendix

## Introduction
### Setting the scene

[1] European Central Bank, Blue Book, 2002

[2] The Lisbon Agenda, also known as the Lisbon Strategy or Lisbon Process, is an action and development plan for the European Union. Its aim is to make the EU "the most dynamic and competitive knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment". It was first set out by the European Council in Lisbon in March 2000 and progress is formally reviewed every three years.

[3] Commission Staff Working Document. Annex to the proposal for a Directive of the European Parliament and of the Council on Payment Services in the Internal Market. Impact Assessment, COM (2005) 603 final.

[4] Eurostat, 2009

[5] Commission Staff Working Document. Annex to the proposal for a Directive of the European Parliament and of the Council on Payment Services in the Internal Market. Impact Assessment, COM (2005) 603 final.

[6] McKinsey & Company, Reducing the Cost of Cash, 2007

[7] A figure cited by Professor Leo van Hove, Why Should Cash be Made More Expensive, 2008

[8] McKinsey & Company, Reducing the Cost of Cash, 2007

[9] McKinsey & Company, ATMs: Complex Weapons in the Fight Against Cash, 2008

[10] A.T. Kearney, Johannes Kepler Universitat, The Shadow Economy in Europe, 2009

[11] For example, an Interim Report into payment cards, published by European Commission Directorate General for Competition in April 2006 stated "Several important conclusions may be drawn from this study (A study of the cost of different means of payment in the Netherlands by Brits and Winder) …the lowest average costs per transaction were, in ascending order, on e-purse payments, debit card payments, credit card payments, and cash payments"

[12] Global Insight, Electronic Payment and Economic Growth, 2003

[13] EMV is a global standard for credit and debit payment cards based on chip card technology. EMV chip-based payment cards, also known as smart cards, contain an embedded microprocessor, a type of small computer. The microprocessor chip contains the information needed to use the card for payment, and is protected by various security features. Chip cards are a more secure alternative to traditional magnetic stripe payment cards. The name EMV comes from the initial letters of Europay, MasterCard and Visa, the three companies which originally cooperated to develop the standard

[14] A.T. Kearney, The SEPA Shakeout, 2008, estimates that Europe (the EU27) accounts for 74 billion non-cash transactions, and that the total global volume is 197 billion

[15] European Central Bank Blue Book, November 2008

[16] Retail Banking Research, Payment Cards Western Europe 2008 and Payment Cards Central and Eastern Europe 2008

## 1 Consumer
### What will motivate change in behaviour?

[1] McKinsey & Company, Reducing the Cost of Cash, 2007

[2] This study was designed to provide an overview of the consumer payment and borrowing market. It was conducted in nine European countries and also the US, with fieldwork taking place during September 2008. The study spoke to more than 22,000 banked adults aged 16 to 65 (2,200 in each country), which has created a database of 293 million data points, which can be analysed in many different ways. The study was designed and analysed by The Value Engineers, and fieldwork was conducted by TNS Global.

It should be noted that the fieldwork was conducted at the height of the financial crisis (following the nationalisation of Northern Rock and acquisition of Bear Stearns and at the same time as the Fannie Mae, Freddie Mac and AIG rescues, the Lehman Bros bankruptcy filing, the Lloyds TSB take over of HBOS, the partial nationalisation of Fortis and Bradford and Bingley and the rescue of Dexia. Consumer confidence had therefore been dropping across all countries prior to the research, and the research picked up consumer caution. Whilst there may have been some further changes since the fieldwork was conducted, the underlying behaviours and attitudes will still prevail.

[3] By "top-up shopping", we mean quick, everyday visits to "local" or "corner" stores to buy necessary household provisions such as milk, bread, eggs, cleaning products, etc

## 2 Government and Regulators
Why and how to support electronic payments?

[1] Commission Staff Working Document. Annex to the proposal for a Directive of the European Parliament and of the Council on Payment Services in the Internal Market. Impact Assessment, COM (2005) 603 final.

[2] Economist, In the Shadows, June 2004

[3] Global Insight, Electronic Payment and Economic Growth, 2003

[4] European Payment Index, Intrum Justitia, May 2009

[5] According to Françoise Le Bail, director-general and SME envoy at DG Enterprise, part of the European Commission

[6] European Central Bank, July 2009, http://www.ecb.int/press/pr/date/2009/html/pr090713.en.html

[7] As reported in the Daily Telegraph newspaper, April 2009, http://www.telegraph.co.uk/finance/economics/5125687/One-in-20-1-coins-could-be-fake-experts-say.html

[8] Visa Europe, Evaluating the Integrity of Consumer Payment Systems, April 2009

[9] Norges Bank, Annual Report on Payment Systems, 2008

[10] Norges Bank, Annual Report on Payment Systems, 2008

[11] McKinsey & Company, The Changing European Payments Landscape, 2009

[12] European Central Bank, 2009

[13] European Commission, The Power of Green Procurement, 2009

[14] OECD Working Papers on Public Governance No. 8

[15] GPC Visa Annual Report, 2008

[16] UK Department for Transport, 2009

[17] Presentation to the Socitm 2008 conference

[18] McKinsey & Company, The Hidden Side of Payments, November 2008

[19] The 'merchant indifference theory' was developed by two French economists, Jean-Charles Rochet and Jean Tirole, and originally outlined in a working paper for De Nederlandsche Bank (the Dutch National Bank) in January 2007. In brief, the theory looks at the costs to merchants of accepting cards (irrespective of the wider benefits they may bring) – and suggests that interchange fees should be set at a level at which a merchant is indifferent as to whether a customer chooses to pay by card or by cash.

[20] As reported by Reuters (amongst others), April 2009, http://www.reuters.com/article/businessNews/idUSTRE53026S20090401

[21] Lafferty Publications has calculated that, if a rate of 0.3 per cent were imposed upon all EU credit and deferred debit card issuers, "they may lose €2.6 billion in credit card interchange revenue and more than half of their profit per credit card."

[22] CapGemini, World Payments Report, 2008

[23] The Economist, Two Sides to Every Story, 2009

[24] McKinsey & Company, Fighting Cash Not SEPA, 2007

[25] Leo van Hove, Regulating in the Dark, Wall Street Journal Europe, January 2008

[26] A.T. Kearney, The SEPA Shake-Out, 2008

[27] A programme of research commissioned by Visa Europe and conducted in partnership with the Brattle Group, 2008

## 3 European Banks
Why invest and innovate?

[1] Visa Consulting operates as part of the Visa Europe relationship management function. Its aim is to improve the commercial results of individual members by getting more value from their Visa portfolios.

[2] McKinsey & Company, The Hidden Side of Payments, 2008

[3] McKinsey & Company, Reducing the Cost of Cash, 2007

[4] A.T. Kearney, The SEPA Shake-Out, 2008

[5] A.T. Kearney, The SEPA Shake-Out, 2008

[6] Gartner, Banks Must Invest in Payment Systems to Win Back Consumer Trust, 2009

[7] Millward Brown Optimor, Brandz Top 100 Most Valuable Global Brands, 2009

[8] IPSOS Mori European stakeholder survey, 2009

[9] Gartner, Banks Must Invest in Payment Systems to Win Back Consumer Trust, 2009

[10] McKinsey & Company, The Hidden Side of Payments, 2008

[11] Retail Banking Research, Payment Cards Western Europe 2008

[12] Retail Banking Research, Payment Cards Western Europe 2008

[13] Retail Banking Research, Payment Cards Central and Eastern Europe 2008

[14] A.T. Kearney, The SEPA Shake-Out, 2008

[15] We use the term "companion product" to refer to a secondary payment card or cards, which a consumer would use in combination with their main card (perhaps for a certain type of spending which they want to keep separate from their day-to-day finances)

[16] Research commissioned by Visa Europe and conducted in the UK by Holden Pearmain in 2008. The sample consisted of 800 people who shop online and 100 people who use the internet but do not shop online

[17] For example, for the 12 months ending June 2009, the number of Visa credit cards and the level of their use across Europe remained relatively constant compared with the previous year (with a negligible drop in total card numbers and a slight increase in the number of point of sale transactions). These figures do mask some strong gains in several countries (particularly the Nordics and Central and Eastern Europe). Equally they obscure a definite slowdown in some of the more traditional credit "heartlands" countries (primarily Ireland and the UK).

[18] There are, of course certain exceptions, such as credit card use in Turkey where, due to a range of historical factors, credit cards are well established as an everyday spending mechanism. Also, among certain more sophisticated consumers – the so called mature planners – credit cards are used as an everyday spending card (and balances tend to be paid in full each month)

[19] European Credit Research Institute, Consumer Credit in Europe 2008

[20] Datamonitor, European Consumer Credit 2008

## 4 Retailers
### Why favour cards over cash?

[1] See article from January 2009, http://www.e24.se/pengar24/dinekonomi/artikel_986183.e24

[2] McKinsey & Company, Fighting Cash Not SEPA, 2007

[3] British Retail Consortium, March 2009

[4] M Bergman, G Gabriella and S Bjorn, The Costs of Paying, 2007

[5] McKinsey & Company, Complex Weapons in the War on Cash, 2008

[6] PricewaterhouseCoopers, 2009

[7] So long as they abide by the Visa Europe business rules, all retailers can automatically benefit from a valuable payment guarantee. If these rules are disregarded, or in the case of higher risk transactions (such as unauthenticated e-commerce transactions), the right to this payment guarantee is forfeited.

[8] RBS WorldPay, Is the retail sector stuck in a payments rut? 2008.

[9] McKinsey & Company, The Changing European Payments Landscape, 2009

[10] McKinsey & Company, The Changing European Payments Landscape, 2009

[11] PricewaterhouseCoopers, 2009

[12] PricewaterhouseCoopers, 2009

[13] Deloitte and Visa Europe analysis, 2009

[14] McKinsey & Company, Mission Impossible? The Cashless Payments Proposition for "Small Ticket" Merchants, 2008

[15] McKinsey & Company, Mission Impossible? The Cashless Payments Proposition for "Small Ticket" Merchants, 2008

# About Visa Europe

**Visa Europe is the European payment system, owned and operated by its 4,600 European member banks and financial institutions. Although a participant in the global Visa network, Visa Europe is a privately owned, incorporated company, with an exclusive, irrevocable and perpetual licence in Europe.**

**As a European company**
Visa Europe has a European product development and innovation function to focus on the distinct needs of European banks, retailers and consumers. For example, V PAY is a made-for-SEPA, chip-only debit solution for Europe. Similarly, the Visa Europe processing platforms are designed in Europe, for Europe.

**As a membership association**
Each of Visa Europe's members has a direct proprietary stake in the organisation. Through a range of national and regional governance bodies and forums all members can participate in Visa Europe's decision making, and have ultimate control over its strategic direction, its investments and its innovations.

**As a not-for-profit entity**
Visa Europe operates a low-cost business model. All services are delivered "at cost" to members, and the organisation is closely focussed on their respective business priorities. Visa Europe never seeks to make a profit – only to ensure that it is adequately capitalised as a business.

For more information about Visa Europe, please visit www.visaeurope.com.

# Visa Europe offices

**Head office**
PO Box 39662
London W2 6WH
United Kingdom
Tel: +44 (0)20 7937 8111
Fax: +44 (0)20 7937 0877

**Belgium**
Rue du Luxembourg 3
1000 Brussels
Belgium
Tel: +32 (0) 2 501 0844
Fax: +32 (0) 2 501 0850

**France**
3rd floor
21 Boulevard de La
Madeleine
75001 Paris
France
Tel: +33 (0) 1 53 05 3939
Fax: +33 (0) 1 53 05 3907

**Germany**
Visa Europe
Schillerstrasse 19
60313 Frankfurt
Germany
Tel: +49 (0) 69 920 11 210
Fax: +49 (0) 69 920 11 222

**Greece & Cyprus**
12 Posidonos Avenue
GR-17455 Alimos
Athens
Greece
Tel: +30 212 984 8850
Fax: +30 210 984 5580

**Italy**
Largo Augusto 7
20122, Milano
Italy
Tel: +39 02 76 2901
Fax: +39 02 76 29020

**Netherlands**
Atlas Complex
Africa Building
Hoogoorddreef 9
1101 BA Amsterdam
Netherlands
Tel: +31 20 312 0557
Fax: +31 20 312 0444

**Nordics**
Hamngatan 13
SE-111 47 Stockholm
Sweden
Tel: +46 (0) 8 440 3570
Fax: +46 (0) 8 611 9018

**Poland**
LIM Centre
Al.Jerozolimskie 65/79
00-697 Warsaw
Poland
Tel: +48 22 630 6801
Fax: +48 22 630 6806

**Portugal**
Avenida da Liberdade
180 E – 2 Direito
Tivoli Forum
1250-146 Lisbon
Portugal
Tel: +351 21 358 4500
Fax: +351 21 358 4550

**Romania**
3rd floor
6 Maria Rosetti Street
Bucharest 020485
Romania
Tel: +40 31 225 0525
Fax: +40 31 225 0501

**Spain**
Torre Picasso – Planta 17
Plaza Pablo Ruiz Picasso, s/n
28020 Madrid
Spain
Tel: +34 91 418 9200
Fax: +34 91 597 3326

**Turkey**
Beybi Giz Plaza
Meydan Sk.No: 28
Kat: 30
34398 Maslak
Istanbul
Turkey
Tel: +90 (0) 212 290 2230
Fax: +90 (0) 212 290 2246