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Show me the money

Insights into global payments

The financial crisis has had less impact on the payments business than on other parts of banking. However, a recent KPMG International survey does reveal some significant changes in emphasis. Investment projects face greater risks and tighter criteria for returns. There is a widespread fear of substantial increases in regulation, which is already affecting banks' behavior and investment plans. Mobile payments continue to offer great opportunities – but only in certain regions. **Oliver Kirby-Johnson** and **Steve Blizzard** argue that distinctive and definitive business models will be key to future success.

A recent KPMG International survey of industry regulators, major banks and financial technology companies explores how changing economic conditions have affected the outlook for the global payments industry and the factors likely to drive change over the next five years¹. Payment processing is a fundamental function for banks; as the cost of capital increases and returns elsewhere are constrained, banks will be looking to squeeze more out of payments and enhance returns from basic transaction processing. Many payment strategies are possible, but a clear customer focus and benefit are needed to succeed against the competition.

Banks need to attract deposits in order to bolster their balance-sheets and liquidity ratios. To a customer, the bank relationship is not about balances, it is about how well and easy the bank makes or receives a timely, effective payment. Only a rich palette of payment types attracts high-quality deposits, while mass-market deposits must be served by the most efficient payment services possible in order to keep costs down. Achieving this is going to require innovative approaches to business models at the same time as regulatory constraints are tightening.

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Investment in payments

Banks are continuing to invest significant sums in payments, but the vast majority of discretionary investment is aimed at increasing efficiency rather than introducing new products or services. The emphasis is on achieving efficiency through scale and by eliminating paper. Even small changes (such as eliminating non-standard account numbers) have a high priority if they have a positive effect on efficiency. Shared services projects, previously abandoned, are being reconsidered, and many banks are reviewing carefully the markets they wish to serve, directly or indirectly.

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A rapidly-growing area of focus is intra-day and counterparty risk. The liquidity crisis which struck in 2008 brought home to many banks the fact that they did not understand in sufficient detail exactly what their position was at any particular point. When an institution fails, payments can seize up, and gains and losses can be frozen unpredictably. Increasingly, banks are realizing the need to invest in measuring intra-day risk across different channels and instruments. In a similar shift in emphasis, regulators are also realizing the need to control these risks, and will be imposing relevant requirements on banks.

Nevertheless, some banks are holding back on investment because they fear that they could be swamped by regulatory changes in the coming year.

Regulation and competition

More regulation will inevitably lead to increased costs, but may bring few real benefits for customers.

Many more services will be brought into the scope of regulated activities. Central banks will demand much more reporting of liquidity. Banks and their customers will have to provide more information on the other side of transactions, especially for securities and financial instruments. This will help to manage risk and identify illegal and shadow economy transactions, and should also help in the management of fraud and money-laundering.

However this kind of reporting conflicts with the desire for privacy, and growing levels of conflict are likely between bank regulators on the one hand and competition authorities and privacy commissioners on the other.

Mobile and contactless payments

In emerging markets, especially, mobile payments are continuing to receive significant attention and investment support. In countries with poor fixed telecommunications infrastructure and low rates of access to banking services, mobile payments offer far more benefits to most people and small businesses than conventional payment types.

Many people have access to a mobile phone. Mechanisms that allow them to pay bills, send money to family

or simply deposit a pay packet for safety offer huge benefits. Mobile payments may be the key to formalizing the market and offering banking services to large swathes of the population. Many mobile telephone companies (telcos) are keen to offer such services. Business models that allow cooperation between banks and telcos, with the telco managing the customer relationship but the bank managing the funds and risk, are gradually emerging.

In several Asian countries (including China, Korea and Singapore) Government initiatives exist to promote e-payment and these are expected to lead to a rapid decline of other instruments. In cards, there is a move from ATM cards to scheme-based debit cards, and considerable interest in contactless and mobile payments; customers in this region have shown a remarkable willingness to embrace new instruments and payment structures.

While conventional technology developments addressing contactless cards and Near-Field-Communications (NFC) devices are no longer seen as urgent in Europe or North America, there is likely to be continued growth in this area in South Asia.

Payments in a new context

Internally, some of the best opportunities come from bringing together common payment functions into a single, high-efficiency and high-availability engine that serves multiple business areas. Convergence and standardization of payment classes still offers good returns in the medium to long term, particularly with the introduction of ISO 20022 and xml messaging. In many banks, there is still room to eliminate non-standard processes and paper, and to reduce repair costs for cross-border transactions, which will yield good returns in the shorter term.

Payments remain one of the most profitable activities within the banking sector. Cash management and corporate treasury functions, once seen as boring and unworthy of senior management attention, are now among the most reliable revenue opportunities for banks. However, seizing the opportunities this offers requires a major shift in thinking for many senior executives.

About the report

To find out more, or get copies of the report *The beating heart of banking: Insights into global payments*, please visit www.kpmg.com

Distinctive business models

With this variety of emphases in different areas of the payments industry, the need for clear strategic focus has never been greater. It is no longer enough simply to seek to manage greater volumes with greater efficiency. Institutions need a more discriminating approach, and the development of a distinctive business model in which they can pursue competitive advantage. This may be in a particular client sector, or a specific currency or a leading technology. For example, national government payments offer bulk and scale in individual currencies; as we have seen, mobile payments offer similar large-scale entry opportunities in emerging markets.

Those payment service providers that most successfully grasp the opportunities available will be those which pursue the most thoroughly-articulated and distinctive business models – whichever sectors of the market they focus on.

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1. *The beating heart of banking: Insights into global payments*, KPMG International, June 2009.