

Making Sense of Prepaid: Who will win?



Chris Jones September 2006

Prepaid: Who will Win?

To date media and bank interest has focused on the consumer side of prepaid. However, ignoring the corporate and public opportunities will place players at a disadvantage

Who will win in the prepaid market in the long term, and can banks respond?

Introduction

Initial reluctance to engage with prepaid is gradually giving way to acceptance, and to cautious investment. Banks are beginning to become actively involved in the market place, gradually following the lead of niche issuers and full service processors. However the overriding focus of both banks and the media has been consumer and issuer lead. Recent analysis of the prepaid market by PSE Consulting (PSE) indicates that while this approach may succeed in the short term, it will leave the banks vulnerable as the market matures. The greatest challenge will come from processors and other non-banks who are already involved in corporate and public prepaid programmes and who are well positioned to exploit the market over the next five years and into the next decade.

The European Prepaid Market by 2010

The European prepaid market is currently in its infancy. Card base figures range widely, but current estimates indicate 40m-60m cards, over 90% of which are closed loop. As banks, processors and retailers begin to expand their offering, this will change rapidly. Growth rates are likely to exceed 110% per annum for the next five years, lifting the card base by the end of 2010 to over 360m cards, generating 2.3 billion transactions and €75 billion in turnover, with the split between sectors shown in Figure 1.

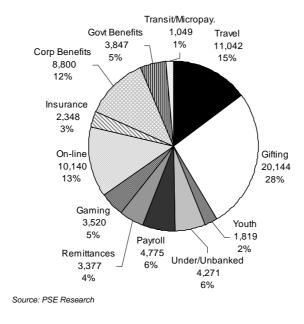


Figure 1: European Prepaid Market Segment Turnover by 2010 (€m)

Most activity is set to occur within the gifting sector, which will generate around €20 billion in spend and continue to represent 90% of the card base, since nearly all will be disposable. Other consumer products such as travel cards, or those designed for spending on-line, are also likely to drive prepaid

turnover. A similar picture emerges when looking at transaction volumes, with gifting accounting for approximately 25% of the 2.3 billion prepaid transaction expected by 2010.

Analysis of the split between open and closed loop, consumer and corporate/institutional prepaid programmes provides a useful summary of the structure of the market. Open loop cards are defined as those which carry card scheme brands and can be used at any merchant accepting scheme brands; closed loop are programmes where cards can only be used within one retailer or a "walled garden" of participating institutions. These segments have substantially differing characteristics, with the Average Transaction Value (ATV) on open loop cards set to be almost four times that on closed loop by 2010. Corporate/institutional products are defined as those provided by corporates or public institutions to employees or citizens on either a mandatory or voluntary basis and encompassing payroll, corporate benefits, or insurance; consumer products are those targeted at, and chosen by, the cardholder, like gifting, remittances, or on-line payments.

Figure 2 indicates the expected market structure by 2010, with 41% of turnover predicted to occur within the open loop consumer environment, accounting for around €31 billion in turnover. In total,

2010	Open Loop	Closed Loop	Total
Corporate/ Institution	12	8	20
Consumer	31	23	54
Total	43	31	74

Source: PSE Research

Figure 2: Split of Prepaid Turnover 2010 (€bn)

72% will be driven by consumer spend, with a quarter being driven in the corporate/ institutional environment. Open loop cards are also likely to have an edge by 2010, accounting for almost 60% of card spend.

Bank versus Non-Bank Positioning in 2010

How well are banks and other financial institutions positioned to exploit this emerging market? Their armoury includes strong consumer brands and substantial customer pools which can be exploited to market new prepaid products.

A number of banks are already involved in developing travel, gifting and youth products, although the majority are still at a pilot stage. Their initial concerns over the business case for prepaid products are

gradually being addressed as travel products, such as that offered by the UK Post Office or the basic bank account from Poste Italiano, prove popular. A significant proportion of the large retail banks now have a strategy towards prepaid that will get them involved in the market over the next 12-18 months; however, to date, bank focus has been very much consumer and issuer lead.

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Issuing departments regard prepaid as an opportunity to address untapped segments of the population, particularly the under/unbanked and youth markets. As a consequence, there has been relatively little interest in corporate/institutional opportunities from either the corporate or acquiring

functions within most banks. In addition, acquiring departments tend to have many other priorities such as PCI/DSS, EMV and SEPA.

This approach may suit market developments up to 2010, and banks will win a significant share of the €31 billion spend in open loop consumer segments. However the question remains, does this approach best position the banks for the long term penetration and growth in prepaid?

Whilst many recognise that the banks have been relatively slow in entering the prepaid markets, are the processors and other non-banks better placed? Both niche prepaid players like Advanced Payments Solutions and BlueCorner, and full service processors like TSYS and First Data International, have been operating in the market for some time. They support closed and open loop offerings in both the consumer and corporate environments, delivering services to brand owners, retailers, banks and public institutions.

Their potential weakness – lack of a consumer brand or an existing consumer base - have been more than compensated by their willingness to partner with third parties to deliver programmes across the prepaid spectrum. They are building knowledge and expertise in the closed loop and corporate environments and are therefore more able than their bank counterparts to exploit the expanding markets and new opportunities.

The European Prepaid Market Beyond 2010

Although the next five years will see a rapid expansion in prepaid turnover, card base and transaction volume, the majority of the addressable market is set to remain untapped. Analysis by PSE indicates

that the prepaid market will only achieve about 10% of its potential by 2010; prepaid cards are then expected to account for around 5% of European credit and debit card payments and 3% of transaction volume.

"The prepaid market will only reach 10% of its potential by 2010"

The "steady state" prepaid market that should gradually emerge beyond 2010 is predicted to be substantially different to that emerging in the interim period. In a more saturated environment (which could emerge over the next 10-20 years) prepaid transactions could account for just under 40% of total (credit, debit and prepaid) card transaction volumes, and 23% of turnover.

The total addressable European spend on prepaid cards is anticipated to be over €700 billion. Potential sources of turnover and penetration rates of the addressable market achieved by 2010 are shown in Figure 3.

Segment	Addressable Turnover (€m)	Penetration by 2010
Travel	44,166	25%
Gifting	32,230	63%
Youth	17,225	11%
Under/Unbanked	44,037	10%
Payroll	174,693	3%
Remittances	22,656	15%
Gaming	43,039	8%
On-line	106,262	10%
Insurance	12,613	19%
Corporate Benefits	145,351	6%
Government Benefits	32,526	12%
Transit/Micropayments	37,442	3%

Source: PSE Research

Figure 3: Split of Addressable Prepaid Turnover and Penetration by 2010 (€m)

A glance at the penetration figures indicates how the structure of the market is set to change very substantially as prepaid reaches maturity. Segments which are still relatively nascent in 2010, particularly transit and micropayments bundles, are set to account for very substantial proportions of final turnover. Payroll and corporate benefits also stand out, also with anticipated penetrations rates of under 10%.

Others, such as gifting or travel, are set to see their share of the market fall substantially, from 28% and 15%, to 5% and 6% respectively. In addition, fierce competition in these segments is likely to see margins fall rapidly as the product commoditises.

Carrying out the same simplified analysis on the addressable market further emphasises the differences between the two stages of market development (see Figure 4). In this market (of say 2020

Addressable	Open Loop	Closed Loop	Total
Corporate/ Institution	294	107	402
Consumer	252	56	309
Total	547	164	712

Source: PSE Research

Figure 4: Split of Addressable Prepaid Turnover (€on)

and beyond) closed loop volume drops to below a quarter of the whole market, although it still accounts for just under half of the number of payments. It is also worth noting that the ATV for closed loop cards will decline from €23 to €11, while the open loop ATV will remain at just over €40.

The changes in the corporate and consumer mix are equally stark. The share of volume of corporate prepaid programme changes from only 28% in 2010 to almost 60% in a saturated market beyond 2010.

Bank versus Non-Bank Positioning Beyond 2010

So who is best placed to exploit the prepaid market as it accelerates beyond 2010? Given banks' current focus on consumers, there is a danger that they will miss out on open loop corporate and

institutional opportunities because they do not have tested products and delivery platforms in these segments. Their addressable market share may fall from 41% in 2010 to around a third in a future saturated market. As a consequence, two thirds of a future prepaid market remains unaddressed by banks' current strategy. On the other hand, processors and other non-banks will have been operating in the

"Two thirds of a future prepaid market remains unaddressed by banks' current strategy"

corporate space, in closed and open loop environments, from the outset. They will have built strong relationships, sales forces experienced in delivering in a business case focussed environment, and tested corporate solutions.

Will banks find it easy to displace these incumbents, or will they have to accept competition from non-bank players who are also showing themselves capable of delivering other bank services such as corporate treasury or merchant acquiring?

Potential Strategic Responses

Meeting the challenges presented by the prepaid market will require the banking community to adopt business strategies which may be unfamiliar and, at least initially, unique to the prepaid market. Some options are summarised below:

- Sales Partnerships: Banks are already familiar with using third party processors (TPPs) to support their operations. However, delivering (for example) a sales force incentives solution needs a strong understanding of current corporate processes and cost structures and is likely to require partnering with a corporate benefits processor experienced in the sales environment. This type of partnership enables banks to leverage existing external skills and knowledge. For non-banks it provides additional credibility, but also access to margins in the higher spend categories of prepaid, bearing in mind forecast ATVs on open loop cards almost four times those on closed loop. This model is already working well in a number of segments and geographies. TSYS and RBSG, for example, already have a close working relationship.
- Merchant/Corporate Partnerships: Banks need to adapt their view of merchants and corporates from that of arms length customers to that of partners. Strong brands and large customer/employee bases create substantial opportunities to exploit the consumer prepaid market jointly. This is particularly relevant in segments where bank offers have traditionally been less strong, such as youth and the under/unbanked.
- Cross-Functional Teams: Banks will need to co-operate internally. They will need to bring together traditionally siloed parts of the organisation – consumer and corporate and issuing

- and acquiring. Prepaid products need to leverage the skills and capabilities located in each of these areas. Failure to co-ordinate could lead to duplication and missed opportunities.
- Test and Learn: In order to build knowledge and experience in the myriad of prepaid segments, banks should be willing to pilot solutions in multiple areas. These should include segments such as youth or under/unbanked, which are within the bank's comfort zone, as well as corporate benefits or incentive schemes, which will require banks to operate innovative business models. Selecting the most attractive segments should be based on direct experience rather than defined by the scope of consumer or corporate's traditional area of operation.

As banks, processors and other non-banks offer prepaid products, they must be very conscious that the market is undergoing rapid development. Segments like gifting or travel which may appear attractive in the short term may not offer sustainable long term revenue streams. Failure to appreciate these changes will create strategic threats, not only within prepaid, but also to other aspects of merchant and corporate relationships.

About PSE Consulting

PSE Consulting is a leading European payment business and technology consulting organisation. The company was founded in 1991 by Peter Jones and operates from offices in London.

PSE Consulting is a founder member of the European Payments Consulting Association (EPCA), an association of like consultancies operating in six European nations.

PSE Consulting provides independent advice to many of the European institutions mentioned within this article and to many other players who are currently shaping the European debit market place.





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Office: +44 (0)20 8891 6244 Fax: +44 (0)20 8891 6245 info@pseconsulting.com