

Making Sense of Prepaid: The European Business Case

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Uncertainty over the business case for prepaid cards, particularly those with card scheme brands is a major concern for potential market entrants. Understanding the major cost and revenue drivers is instrumental to the successful launch of products in this nascent market

What is the business case for prepaid in Europe?

The Prepaid Business Case

As banks, processors, institutions and retailers continue to analyse and take up the opportunities presented by prepaid cards, questions still remain around the business case. How can these products be charged for? What costs can be expected? Where are the best opportunities? This paper seeks to identify the most attractive segments and the major revenue and cost elements associated with prepaid cards. Its aim is to provide high-level answers to these questions as players build their prepaid business cases.

Target Market Analysis

Identifying the most attractive products and geographies within the prepaid market must form the foundation of any business case. The diversity of products and functions currently being labelled as “prepaid” can frustrate this analysis. Figure 1 below indicates PSE’s review of the major areas of potential opportunity within the prepaid market.

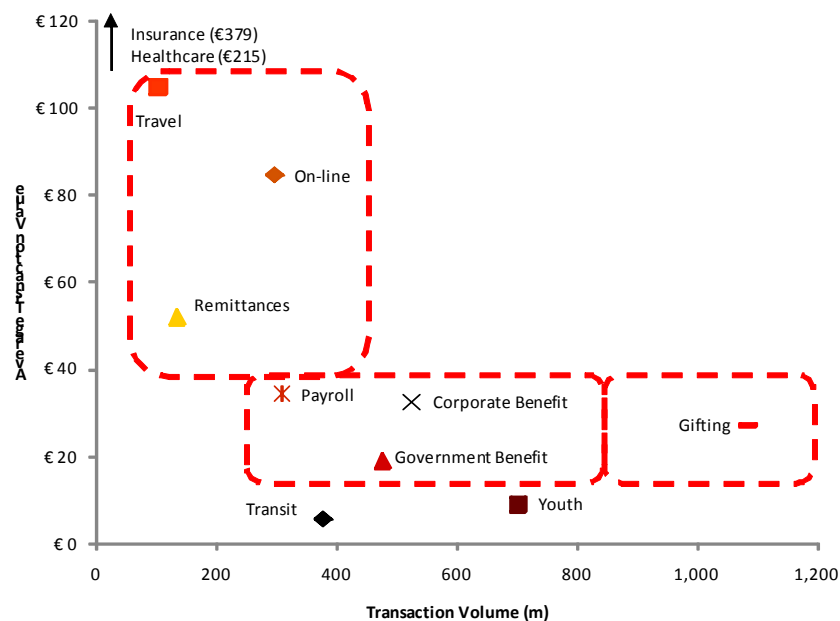


Figure 1: Anticipated Sources of Prepaid Opportunity by 2015 (€m)

Four major product segments emerge. Each requires a different revenue model. Each will require differing levels of investment. These favour particular players who are able to leverage their specific combination of knowledge, brand, channels, and relationships.

- **SEGMENT 1: Low volume business solutions** such as insurance and healthcare. These segments are unlikely to generate sufficient volume or revenue to justify substantial additional investment in product development, marketing or selling. This market is most likely to be

successfully addressed by current industry suppliers who can minimise the need for this additional investment.

- **SEGMENT 2: Direct to consumer offers** such as travel, on-line payments and remittances. These segments offer Average Transaction Values (ATVs) similar to current credit and debit products and therefore suit existing bank card (Merchant Service Charge/interchange) revenue models. This market is primarily suited to existing financial services players (banks, Post Offices, currency providers, etc.) with existing consumer brands, distribution channels and customer bases. For new entrants with untested brands and channels this can be a very competitive market with potentially high costs of entry. Gifting, meanwhile, now quite ubiquitous, remains essentially a closed loop product. Here retailers or shopping centres with existing gift programmes are likely to be most successful.
- **SEGMENT 3: High volume corporate solutions** such as benefits, gifting and payroll. Here the relatively lower ATV but higher volume favours a processing (per transaction or card) revenue model. Investment is most likely to focus on developing products that can support high volume retailer/corporate/government solutions. In addition, winning providers must invest in developing or maintaining strong corporate relationships and high value sales capabilities which can deliver to institutional customers both directly and in partnership. This segment is likely to represent the greatest opportunity for new entrants given the business case driven B2B environment where innovation as well as cost can differentiate service providers.
- **SEGMENT 4: Low spend solutions** such as youth and transit/micropayments. Here the very low ATV is likely to present a margin challenge to any provider wanting to offer prepaid solutions. For this segment the message is to “wait and see” and give such opportunities a low priority in the short to medium term.

The above analysis suggests gifting and corporate benefits emerge as two of the most attractive segments; however these opportunities are likely to be unevenly spread across Europe’s geographic markets. The variation in market attractiveness is illustrated in the following diagram.

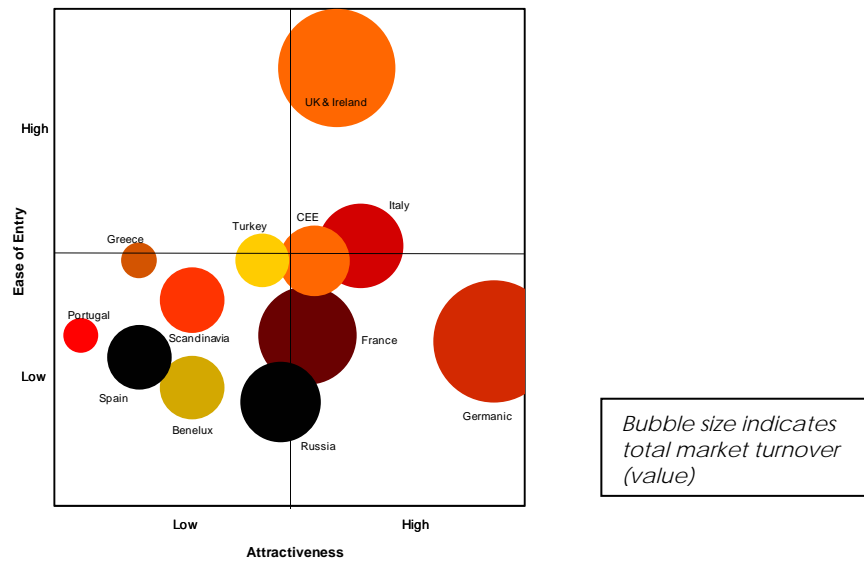


Figure 2 – Relative positioning of European markets

The UK, France, Germany and Italy all emerge as relatively attractive markets to pursue across the full prepaid product spectrum – supporting sufficient value and volume to attract even large scale banks and processors. France and Germany are, however, not always easy markets to enter. Other markets, such as Portugal and Benelux are only likely to attract smaller scale or existing domestic multi-payment product players, those that specialise in particular segments, or those that can enter new markets with relatively low marginal cost. The CEE also comes into play in the medium term in the institutional sectors of the market (payroll, benefits, etc).

Some notable differences emerge according to whether volume or value is analysed. Turkey, for example, represents an opportunity for a per transaction revenue model, but remains less appealing for one linked to value. However in France and the UK, for example, transaction value is more attractive, pointing to revenue models linked to card spend.

The Prepaid Revenue Model

Revenue sources associated with prepaid cards fall into three main types:

- **Issuance:** These include revenues linked to purchasing the prepaid product, registration and loading a balance into the card account.
- **Usage:** These could include revenues associated with either spending at merchants, cash withdrawal, or topping up the prepaid account.
- **Maintenance:** These are revenues associated with holding the card, running the account, providing support, and potentially renewing the card as it expires. Revenue can also be derived

from the outstanding balance on the card, as well foreign exchange revenue if the card is used outside its currency zone.

According to the nature of the prepaid product these revenues can be borne by either the cardholder, in the case of a consumer travellers' cheque card, by an institution in the case of a gift card, or corporate benefits card, or by the merchant in the case of an on-line spend card. Equally, this revenue will flow to the major players involved in the prepaid value chain: issuance fees may flow to the bank issuer, the prepaid processor, or the merchant who helped recruit or issue the card; usage fees may be attributed to the bank acquirer, the merchant providing the top-up service, or the prepaid processor.

EXAMPLE: TRAVEL

A non-bank prepaid travel product, distributed via travel agents, provides a useful example of the potential sources of revenue associated with prepaid products. When the card is issued at the travel agent's shop, the initial fees are likely to flow to the merchant for selling the product and loading the balance onto the card, the prepaid processor, as well as any brand owners. The merchant may then also receive revenue from the product if they are involved in ongoing top-up or customer support. The processor and brand owner may then derive revenue from the outstanding balance, foreign exchange margins, and potentially any direct charges for POS and ATM usage and account maintenance.

This revenue distribution is made significantly simpler if a bank distributes its travel card via its branches, with only itself and prepaid processor involved in revenue allocation.

A prepaid survey carried out by PSE in 2006 sought to identify which fee types were most likely to be acceptable to consumers. Typically, those questioned highlighted loss/new card issue, registration fees and unused balance charges on dormant accounts. Almost 20% believed these would be the most important sources of revenue. Alternatively, over 35% stated that consumer POS usage fees were least likely to generate fees with none of those interviewed believing that consumers would accept any form of POS fees, and only very limited charges for ATM usage and top-up..

Two years on a 2008 survey reveals a slightly changed situation. While registration and card issuance fees are identified as important revenue sources, unused balance fees are seen largely as insignificant. On the other hand Top-up fees, both at ATMs and POS, have been accepted by consumers. Current average consumer fees are shown below with Customer registration and replacement card issuance generally expected to be priced at €2-€3 and POS/ATM and top-up charges at €0.75-€0.85.

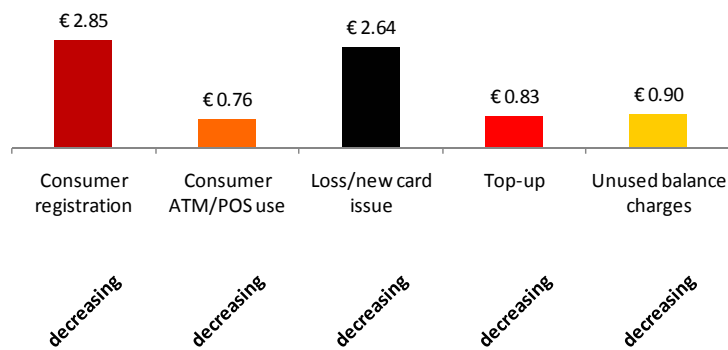


Figure 3: Average consumer Fees for Prepaid in Europe

The chart above disguises a wide variety of charges and charging structures with a range of €1-4 for consumer registration and €0.25-1 for ATM/POS usage and top-up.

One of the key issues in pricing, and its potential to impact the construction of robust business cases, is the general feeling/assumption that many fees will drop over time. Another is the ability of issuers to convince consumers of the benefits of transaction fees in those environments where consumers are not typically used to them or where the only fee paid (for say a debit card) is an annual one.

Developing revenue models in Europe is likely to require a differing approach to the US. For example the US under/unbanked business model is constructed in an environment where cheque payments often oblige workers to spend c.\$50 - \$60 per month on “check cashing” bills payment and remittances or c.\$200 per annum on a current account (if they are even allowed access). In Europe the dominance of electronic payment for both payroll and benefits, combined with the existence of free ‘basic banking’ products means the unbanked population is significantly smaller, as is the opportunity to charge for prepaid services. This concern was raised by the participants of PSE’s prepaid survey. Almost 30% of those interviewed believed that the prepaid revenue model in Europe will have to be different to that in the US, to reflect the differing cultural acceptance of charging and regulatory context.

“prepaid revenue model in Europe will have to be different to that in the US”

It is vital to recognise that the benefits side of the prepaid business case must take account of cost displacement and other positive externalities associated with card usage. These additional benefits will depend on the nature of the programme, the user, and the product it displaces. Youth products may be difficult to justify on a stand-alone basis, but may offer banks the ability to address the needs of future customers, or allow governments to deliver additional social services using the same infrastructure. Corporate benefit products on the other hand offer the ability to deliver incentives or salary components at much lower cost by displacing paper voucher disbursement and settlement processes. As banks and processors approach institutions and merchants with prepaid products they

will need to recognise that these non-revenue elements will also significantly influence the business case decisions of potential customers.

Prepaid Costs Elements

Marketing and education are likely to dominate the costs of running a prepaid portfolio in the short to medium term. In PSE's 2006 survey 42% of experts' responses focused in this area. Almost 20% of experts' scores were allocated to consumer marketing and promotion costs; 12% associated with general consumer education; and a further 11% linked to merchant communications. This has been born out by the latest research that shows that marketing and promotion is the top cost element, although its relative importance should fall over time as consumers become more comfortable with the product.

Incentivising merchants to support card acceptance and distribution must also be highlighted as an area of substantial cost. Using third parties to sell and support prepaid products undoubtedly adds to the cost of running a prepaid product. Sales assistants need to be appropriately trained and updated, taking into account staff turnover and the need to provide information on changes to products. The ability to leverage existing staff who are already experienced in selling financial products is likely to significantly reduce both set-up and ongoing maintenance costs. Using third parties to provide top-up is also likely to substantially add to the costs, with merchants likely to demand around 2% for balance top-up.

“Using third parties to sell and support prepaid products undoubtedly adds to the cost of running a prepaid product”

Those players who already have existing relationships with potential cardholders as well as distribution and support channels are therefore at a significant advantage. Such players are likely to fall into two major groups:

- **Existing Consumer Financial Institutions (FIs)** such as banks, merchants with existing financial services products, or travel money providers. Those players have a customer base to which they can directly market new prepaid products, leveraging existing brands and distribution channels.
- **Corporates** with existing financial relationships with employees or customers. Again these players have existing relationships and channels along which to distribute these products. Corporates have the added advantage of being able to build their business case by displacing more expensive payment mechanisms, as well as potentially mandating cardholder uptake.

EXAMPLE BOX: ONLINE-SPENDING

Prepaid products distributed to a FIs consumer database represent a potentially attractive solution which limits the need for additional investment. The FI can target existing consumers, using existing marketing channels. The product can leverage both existing issuance channels (such as the post, shops/branches or on-line) and support mechanisms (call centres, on-line, shops/branches). Top-up can also use existing channels, for example by creating links with existing current accounts where a direct debit transaction can be used to regularly top-up the balance to a predetermined amount.

Utilising the capabilities of prepaid processors offers a rapid route to market. Such relationships enable issuers to offer both closed and open products, and potentially offer multiple propositions on the same platform. In 2006 over a third of those interviewed stated that they believed it unlikely that existing FIs would offer products using existing in-house solutions. Almost a third also believed that merchants would offer their closed loop products using third party processors. This view remains largely intact with the views of those surveyed in 2008 being generally positive about the ongoing need for Programme Managers (70% believing they will have a role by 2015).

This analysis draws predominantly on two reports written by PSE on the European prepaid market entitled "Identifying the European Prepaid Business Case" and "The European Prepaid Market 2008". Both papers have been produced with the sponsorship of MasterCard Worldwide.

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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