



# Heading for the future

## SEPA IT implementation strategies for banks.

### → 1. Today's situation



In the year 2002 the European Payment Council (EPC) introduced the idea of a "Single Euro Payment Area" (SEPA) to establish single, harmonised standard payment schemes that will remove the technical, legal and commercial barriers among Europe. Like the successful launch of the Euro as the common currency within the Euro-zone, SEPA is another step towards a single European market. It will affect the Euro-zone and all European Union (EU) countries plus Norway, Iceland, Lichtenstein and Switzerland.

To achieve its goals SEPA introduced three standard schemes.

- One for SEPA credit transfer (SCT) to move money within the SEPA zone faster and more cheaply
- One for SEPA direct debit (SDD) to deliver European-wide direct debit between companies and individuals
- Several card payment schemes based on SEPA card framework (SCF) for better, more secure and cheaper acceptance and interoperability between all card systems

Six years later SEPA will become reality. Beginning on 28<sup>th</sup> January 2008, SEPA credit transfer (SCT) will be available in the SEPA zone as the first of the three standard schemes. SEPA direct debit (SDD) will be implemented only in 2008 or 2009 because some mandatory issues remain to be clarified. Introduction of the SEPA card framework (SCF) will also be late; though the framework has been established, the rulebook has not been released until now.

As a major change in the European payment system SEPA will have strong impacts on payments: How to prepare for the opportunities and challenges SEPA poses? How to transform existing payment infrastructure? How to be ready for European-wide competition? How will the IT of, for example, Automated Clearing Houses (ACH) change? Will local schemes (e.g. cheques) remain or decline?

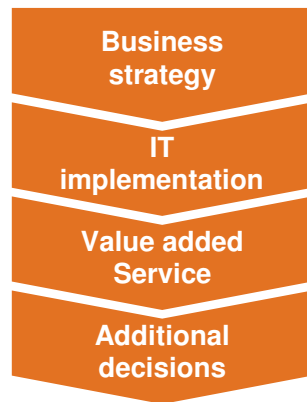
All these questions need to be answered. From today's perspective it is not clear what specific changes SEPA will cause. Nevertheless, it is obvious that banks especially need to invest in their IT to provide SEPA standard schemes, to be competitive and to exploit all opportunities of SEPA.

Different sources estimate that investments of between € 5.0 bn and € 7.7 bn needed to be made - as much as banks invested for the introduction of the Euro. But how should banks invest to challenge SEPA and be among the SEPA-winners?

The EPC and the European central bank (ECB) defined SDD and SCT at the beginning of 2006. Banks faced and are still facing the challenge of implementing SDD and SCT as quickly as possible under their self-regulatory obligation to provide SCT, for example, from 28<sup>th</sup> January 2008.

Most banks are or will be SEPA-compliant in 2008. As a result of the late definition of SEPA standard schemes, banks were not able to develop a long-term strategy and therefore implemented only short-term solutions in order to be SEPA-compliant. After taking this first SEPA step of being compliant, banks have become aware of the necessity of developing long-term strategies to ensure that they will benefit from SEPA.

The long-term strategy must be developed carefully. This development will take place on several levels and will include several decisions.



Firstly, banks must decide on a general business strategy for SEPA. After that banks must define an IT implementation strategy that is consistent with the business strategy. Banks need to find new ways to generate additional revenues. To increase revenues banks have a variety of possibilities; for example, value-added services or cost reduction. Lastly, banks have to think about the time after SEPA and make further decisions about how to become SEPA winners. With the wide range of decisions at each level, each bank can create its own specific strategy that meets its requirement.

In developing their long-term strategies banks must take into consideration the fact that each decision is built up on previous ones and is closely linked to them.

**Figure 1:** Steps to a SEPA long-term strategy

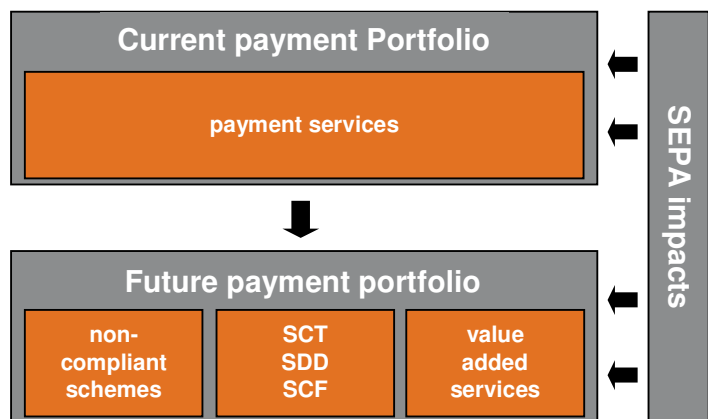
In the following we will give an overview of possible decisions on each level, trying to help you to establish a suitable long-term strategy for SEPA.

## → 2. Business Strategy

Before focussing on implementation strategies, a bank necessarily needs to define a general business strategy for SEPA and its impacts. This strategy will give an overall direction in which the bank – in the matter of payments – will head in the forthcoming years.

SEPA will have major effects on banks' future service portfolio in payments. To explain these effects the future portfolio must be divided into three sub-portfolios.

The first sub-portfolio will contain SEPA non-compliant services. These payment services - for example, cheques - cannot be transformed into one of the SEPA standard schemes. The second sub-portfolio will contain the three new SEPA payment instruments. So called value-added services (VAS) will create a third sub-portfolio.



**Figure 2:** SEPA caused portfolio changes

Each group of services is affected by SEPA in a different way. Therefore banks need to decide which kind of strategy they will choose for each sub-portfolio.



The decision that banks must make for the first sub-portfolio is whether they want to abandon these services or continue to provide them to their customers in the future. Economies of scale could make these services profitable in the future, but only a few banks will be able to in-source payments. In most cases, maintaining two payment systems – one for the SEPA non-compliant and one for SEPA-compliant services – will be too expensive.

The German market is a good example of this. Currently three of the five biggest German banks have outsourced their domestic payments to one competitor. This reflects their will to focus completely on SEPA standard schemes and value-added services. On the other hand it also indicates that few banks will be in-sourcing domestic payments. A similar development is taking place in France; big French banks are looking for corporations outside France for payment matters.

Although the decisions about how to proceed with this first sub-portfolio of services are important, decisions about the second and third service sub-portfolios are more important because they will generate the basic business strategy for SEPA.

Because all banks in the SEPA area will soon provide SCT, SDD and later on SEPA cards, they will not differentiate themselves in the second sub-portfolio. Moreover, banks will be able to compete effectively with each other in the SEPA area. This fiercer competition will consequently lead to decreasing revenues. It is likely that banks will generate a negligible margin on SEPA standard services.

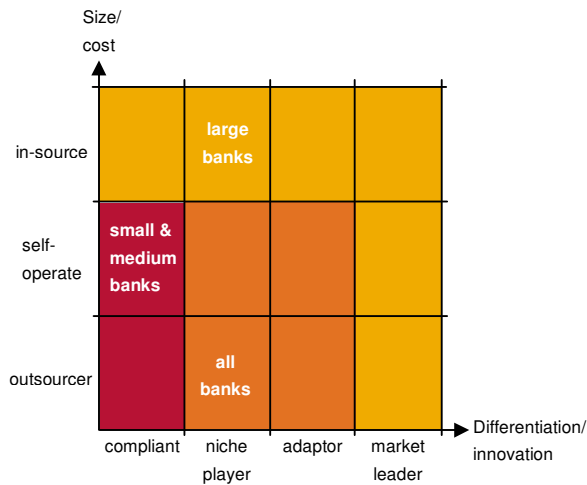
The second service sub-portfolio will be driven by cost-efficiency and scale. Banks must decide how they want to achieve cost-efficiency. To do so, a bank can reduce the costs of its own process, outsource it or seek economies of scale by increasing its number of transactions by either acquiring new customers or in-sourcing payments.

The third sub-portfolio is the most important. As in every market, players must differentiate themselves from their competitors. In the SEPA world, this differentiation will be established by value added services. Value added services are non-core payment services provided by the bank. In this sub-portfolio banks can choose from four different strategies:

Strategy	Description	Strength	Weaknesses
<b>Market leader</b>	<ul style="list-style-type: none"> <li>Developing value added services for SEPA</li> <li>Large investment are necessary</li> </ul>	<ul style="list-style-type: none"> <li>Gaining market share</li> <li>Creating additional revenue</li> </ul>	<ul style="list-style-type: none"> <li>New products may not be accepted</li> <li>Inadequate ROI</li> </ul>
<b>Adaptor</b>	<ul style="list-style-type: none"> <li>Copying services of a market leader</li> </ul>	<ul style="list-style-type: none"> <li>Less cost-intensive than market leader approach</li> <li>Creating additional revenue</li> </ul>	<ul style="list-style-type: none"> <li>Levelling off market share</li> <li>Recognition in the market due to brand of market leader</li> </ul>
<b>Niche player</b>	<ul style="list-style-type: none"> <li>Focussing on few areas to develop value added services</li> </ul>	<ul style="list-style-type: none"> <li>Lower cost than market leader approach</li> </ul>	<ul style="list-style-type: none"> <li>Limitation in potential customers and revenues</li> </ul>
<b>Compliant</b>	<ul style="list-style-type: none"> <li>Only necessary investments to be SEPA compliant</li> </ul>	<ul style="list-style-type: none"> <li>Low risk</li> <li>cost-saving</li> </ul>	<ul style="list-style-type: none"> <li>Leak of business opportunities</li> </ul>

The final business strategy will be created by making two single decisions - one in the SEPA standard scheme service sub-portfolio and one in the value added service sub-portfolio.

It must also be mentioned that the possible strategic business decisions are limited by various factors, amongst them established strategies and size.



A large bank will be able to adopt a market leader strategy for value added services a lot more easily than a regional savings bank, taking their budget into consideration. As mentioned above, big German banks have outsourced their payments in order to have more freedom to develop a market leader strategy for the value added service sub-portfolio and to set up a platform for processing their own SEPA standard schemes and perhaps in-sourcing SEPA payments from other banks.

**Figure 3:** IT strategies for banks

A bank is unlikely to move from a market leader position to a niche player strategy after investing in an infrastructure that has enabled it to adopt a market leader strategy.

Moreover the strategies are not mutually exclusive. A bank could adopt a market leader strategy for corporate clients and on the other hand provide no value added services to retail customers. This strategy also reflects a clear focus on a target market.

As the strategies are not mutually exclusive they are also alterable. Banks can start with a minimum strategy (compliant strategy; see p. 3) and then enlarge their SEPA service portfolios until they become one of the market leaders within the SEPA service market.

Lastly, the time to establish the new long-term SEPA strategy is critical. Unlike the introduction of the Euro or the year 2000 adjustment, implementation of SEPA takes at least two years. Moreover, until now SEPA has had no target for completion of implementation. Now it should be at the end of 2010, when the “critical mass” should be reached, though today it seems unlikely that this target will be achieved.

So when should banks introduce their SEPA strategy?

There is no specific point in time at which it is best to introduce a new SEPA strategy. The question is - more or less – whether banks should introduce their strategy at the beginning of SEPA or postpone it. Generally, the moment is specific to the strategy and the bank, but each bank needs to take into consideration the consequences of timing.

Banks establishing their strategic decision in the beginning of SEPA will have a competitive advantage and will gain more experience in SEPA. On the other hand, they will not be able to take into consideration changes in regulation that will emerge - for example, adjustments of the SEPA direct debit scheme. This is the main advantage of postponing the final introduction of a long-term SEPA strategy.

Banks will have to decide when they want to establish their strategy. As stated above, the point in time for introducing the new strategy will be unique to every bank, but the business strategy will determine the timing of implementation. For example, banks considering a market leader strategy will have to launch their strategy earlier than banks taking an adaptor approach.

### → 3. Implementation strategies

In order to become a SEPA winner a bank must decide how it wants to change or adjust its current IT. The way in which banks implement the new IT infrastructure is partly depending on their business strategy.

For example, banks that focus on niche markets will be more likely to develop their own software and IT tailored to their need than banks that want to be only SEPA compliant and not to invest more money than necessary.

To establish an appropriate IT implementation strategy banks must answer a few questions.

- Replacement strategy? Will the current IT no longer be used and a completely new IT established, or will the bank replace only a few parts of its IT depending on the business strategy?
- Build or buy? Will the new IT be based on either self-developed software or available software provided by third parties?
- Software strategy? If a bank does not develop its own software, which kind of third parties' software will it use? Will it choose software that covers the whole payment life cycle or just a few parts of it?
- Key factor? What will be the key factor in defining a bank's new IT strategy?
- Ways to invest? Will banks spend their SEPA budget mostly in the first year of implementation or split it into smaller amounts over several years?

#### → 3.1 Replacement strategies

The first important decision that banks will have to make is how their IT will be changed in general. Will they replace their full IT in use or only several parts of it?

To answer this question banks must evaluate their IT by answering many further questions, such as: How up-to-date is the existing IT? Which parts of the payment lifecycle generate revenue? Can current interface problems be solved by replacements?

So, when it is advisable to replace the whole or major parts of the existing IT and when not?

Banks developed their IT step-by-step. Most of them add a new IT layer to their existing IT when it is required. The main reason for replacing the whole IT infrastructure is that a new layer – required to become SEPA compliant – can be added but would restrain the future developments around SEPA. In this case SEPA can be an initiator to replace the whole IT. Another reason for a full replacement could be a strategic reorientation. Moving from a niche player strategy to a market leader position introduces new, different IT requirements.

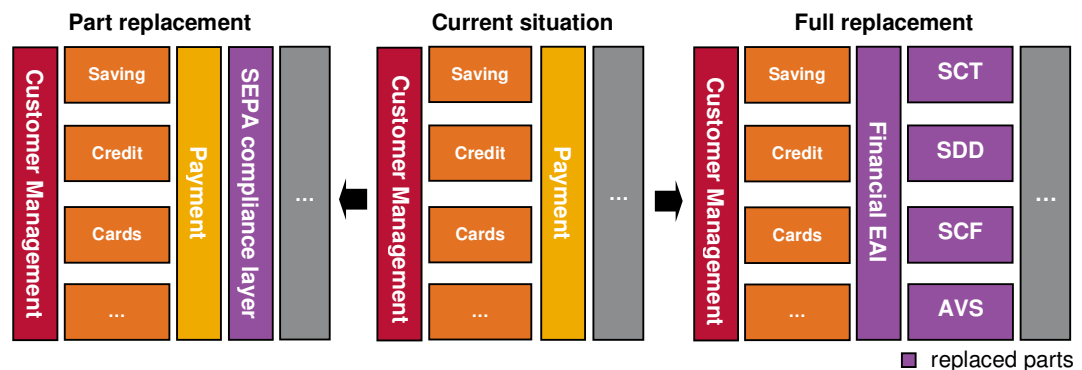


Figure 4: Layer replacement



To make only minor adjustments to IT would be sufficient if a bank could clearly identify its value drivers and decide to focus on these in the future. A full replacement would be a waste of money. By doing so banks can establish competitive advantages.

Of course both possible decisions have strength and weaknesses. They are displayed in the table below

Strategy	Strength	Weaknesses
<b>Full replacement</b>	<ul style="list-style-type: none"> <li>• Updating the whole IT at once</li> <li>• Introduction of new technologies (SOA, ...)</li> <li>• Consistent payment process</li> <li>• Consistent payment applications</li> </ul>	<ul style="list-style-type: none"> <li>• Cost</li> <li>• Time-intensive</li> <li>• Teething problems possible</li> <li>• Higher proportion of risk</li> </ul>
<b>Part replacement</b>	<ul style="list-style-type: none"> <li>• Focusing on value driver</li> <li>• Cheaper than full replacement</li> <li>• Individual benchmarks for process steps</li> <li>• First step for outsourcing</li> </ul>	<ul style="list-style-type: none"> <li>• Risk of focussing on the wrong process steps</li> <li>• Interface problems between new and old IT</li> </ul>

As already mentioned, SEPA has huge impacts on banks' current IT, and so it is likely that many banks will tend to choose a full replacement or to adjust most of their IT to the new needs of SEPA and other requirements.

One example of a whole replacement (or nearly full replacement) plus a reorientation is a big German bank. This bank has outsourced its old national payment system and is now developing a new system for SEPA. By developing new IT the bank will substitute its current IT and undergo a strategic reorientation.

The decision whether to replace the full payment IT or only parts of it depends on the business strategy that a bank chooses. A niche player will be more eager to adjust only few parts of its payments lifecycle than a bank focussing on a leader strategy within the SEPA area.

➔ **3.2 Build or buy**

Another question for banks is whether they want to develop their IT including software for their services by themselves. The other option would be to buy standard software which is available on the market.

Decision	Strengths	Weaknesses
<b>Buy</b>	<ul style="list-style-type: none"> <li>• Cheaper than build decision</li> <li>• More rapid implementation</li> <li>• Easier roll-out</li> <li>• No teething problems</li> <li>• Normally updates available</li> </ul>	<ul style="list-style-type: none"> <li>• Dependency on third party</li> <li>• Contract specifications</li> <li>• Compromise for the needs of many banks</li> </ul>
<b>Build</b>	<ul style="list-style-type: none"> <li>• Tailored to the specific needs of a bank resulting in a competitive advantage</li> <li>• Independence from third-parties</li> <li>• Customer information remain within the bank</li> </ul>	<ul style="list-style-type: none"> <li>• Relatively cost intensive               <ul style="list-style-type: none"> <li>○ Development</li> <li>○ Updating</li> </ul> </li> <li>• Teething problems</li> </ul>

Of course, a mix of buy and build is possible. Banks that have evaluated their payments lifecycle carefully may have decided to replace several parts of their IT with third party software and other parts with self-developed IT. Closely connected to this option is the "buy to build" decision. In this case a bank would buy software as a basis for its future IT and develop specific software for its services around this software.



But banks will not be totally free to choose whether to buy or build new IT for their needs. In particular, banks that adopt a market leader or niche player strategy will have to develop their own software. For both strategies it will be hard to find standard software, as a niche player will have highly specialised requirements and a market leader will be highly innovative. Standard software does normally not have these attributes; it is designed to be used by as many banks as possible, and therefore can provide only standard features rather than highly specialised ones. Banks following a compliant or adaptor strategy will find it easier to rely on standard software.

Banks that develop their own software will have more freedom of choice. These banks can independently decide how they want to change their IT. By contrast, banks that choose to replace their software with third party products will rely on the market and the available products.

### → 3.3 Software decision

The availability of software products determines the build or buys decision. Therefore it is prudent to have a look at the different standard software types and their advantages and as well their disadvantages.

Currently there are two types of standard software available on the market. One type - comprehensive software package - is designed to cover the whole payment process and the other type - stand alone software - is intended to process parts of it.

	Advantages	Disadvantages
<b>Comprehensive software package</b>	<ul style="list-style-type: none"> <li>• Compliant in itself</li> <li>• Cheaper than replacing the whole cycle by single standard software</li> </ul>	<ul style="list-style-type: none"> <li>• Buying a package (non-necessary parts included)</li> <li>• SEPA compliance</li> <li>• Target groups: big banks</li> <li>• Costs</li> </ul>
<b>Stand alone software</b>	<ul style="list-style-type: none"> <li>• Focus on one process step and more specific</li> </ul>	<ul style="list-style-type: none"> <li>• Interface problems</li> </ul>

The strengths and weaknesses mentioned in the table for both software types are more general. The comprehensive software package market will be discussed more deeply in the following sections.

As mentioned before, over recent decades, banks have used mostly their self-developed IT, and rarely stand alone software and even more rarely comprehensive software package. This raises the question how mature the market is. At the moment there are only a few products on the market. None of them predominates as other comprehensive software package like SAP predominates in the automotive industry. So there is no clear standard available. In addition, the software currently available is not always focussed on the European market and therefore time-to-market is longer. But software providers are currently focussing more on the European market.

At the moment it seems that the comprehensive software package market is not mature, but banks must monitor it because they can benefit from mature comprehensive package software.

The stand alone software market offers many products. It is more fragmented and therefore each bank has to evaluate many potential solutions to its specific needs. But one fact must be mentioned: the focus of the stand alone software market is much more domestic. Generally, this poses no problem because the domestic market of each bank offers the critical mass of payments required to support local solutions. But a domestic focus has also weakness; there might be problems connecting software designed for one domestic market to software designed for other domestic markets.

This fact banks must keep in mind. Currently all banks – including large ones – can be considered as “national banks” concentrating on their domestic markets. SEPA opens the doors to business throughout Europe. If a bank is trying to develop itself into a European player or even further, it has to have software consistent with its strategy.



### → 3.4 Key factor: Flexibility

As mentioned above, the consequences of SEPA are not clear from today's perspective. The fact that its impacts are not predictable is one major problem that a bank will face establishing its new IT and creating a long-term SEPA strategy.

One of the most likely responses to this uncertainty is to stay flexible for future decisions and developments. SEPA forces a bank to adopt a more flexible IT architecture than its current one.

A flexible IT architecture enables banks to react to any changes in the demand of customers or changes within SEPA regulation. Moreover, flexibility can result in a competitive advantage.

Currently, the IT industry has several ways to establish a flexible IT architecture: One of them is a Service Orientated Architecture (SOA). SOA is the practice of segregating the core business functions into independent services that do not change frequently.

Establishing an SOA could be one way to help banks to address the impacts of SEPA.

### → 3.5 Ways to invest

Another point to think about is the way in which investments will be made. Will there be one huge investment in the beginning and afterwards only small adjustments, or will banks invest step-by-step?

Obviously, the way SEPA investments will be made is related to strategic decisions made beforehand. Banks that decided on a market leader strategy or a full replacement must invest more money at the beginning than banks that want only to be SEPA compliant. Others that have selected a "part replacement" strategy will have more freedom in timing their investment.

So what are the strengths and weaknesses of the two ways of investing the SEPA budget?

Spending a large sum of money at the beginning can create an exceptional competitive advantage for a bank. The bank will be amongst the first to offer SEPA products and services to customers and, for this reason, will have the chance to acquire a bigger market share.

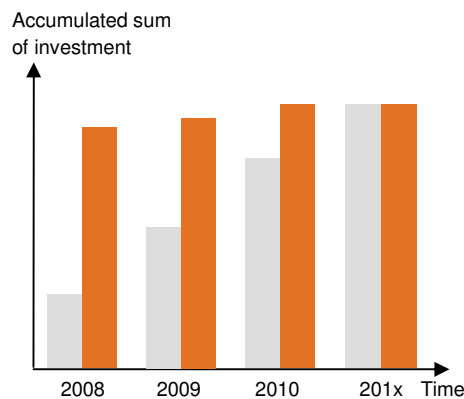


Figure 4: Investment strategies

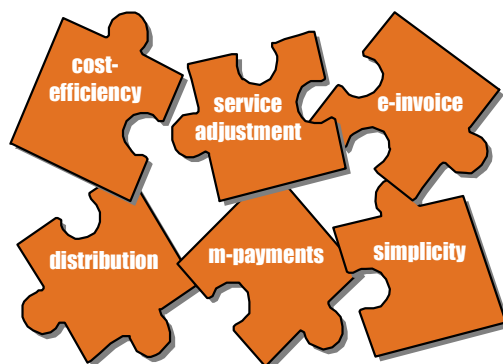
The greatest risk of this proactive strategy is a mistaken investment into SEPA services. Establishing services that customers do not want or accept could put the return on investment at risk.

The step-by-step strategy seems to be less risky. By establishing the new IT in this way, investments can be refined more appropriately and decisions made on more available information.

But one risk will still remain with it. Banks that operate a reactive investment plan will face the issue of acquiring new customers and market share while competitors have already developed more mature products and have

created a strong brand in the market. Another threat is losing market share to other financial solution provider that has specialised on one of the current SEPA standard schemes. SEPA will enable and encourage more market players to provide SEPA products.

## → 4. How to re-increase revenues



**Figure 5:** Possible actions and services for re-increase

As mentioned before, SEPA will have huge impacts on the payments revenues of banks. SEPA enables banks to compete with each other within the whole SEPA zone. This will lead to fiercer competition among banks and revenues will decrease as a result. Estimated losses of payments revenue exceed 50% of current levels. But at the same time all SEPA reports declare that SEPA is a real chance for banks. Nearly all predict that - provided banks establish an adequate SEPA strategy - revenues could be recovered and even increased.

The important question is: Which actions or services will help banks to increase their revenues? From today's perspective there are many possible actions a bank could take and many conceivable services that a bank could introduce. In the following sections some of these opportunities will be described.

### → 4.1 Cost-efficiency

One of the obvious ways to increase revenues and compensate the losses caused by SEPA is to enhance cost-efficiency. The most common ways to do so are outsourcing and reducing fixed costs per transaction. The latter can be done in different ways; for example by economies of scale or by process re-engineering to remove paper-intensive tasks.

But can improvements in cost-efficiency recover the losses? To reiterate, revenues are expected to halve. An increase in cost-efficiency is naturally limited. Therefore, it is unlikely that improved cost-efficiency is an approach that alone can recover and enlarge revenues. It is one of several steps that a bank must take to increase revenue.

### → 4.2 E-invoice

Another topic connected to SEPA is value added services. One of the most likely value added services that will be introduced in the context of SEPA is e-commerce, and especially e-invoice. The European Commission (EC) has also identified e-invoice as a new SEPA service. With representatives of all important stakeholders, a special task force has created the European Electronic Invoicing (EEI) Framework.

E-invoice is a reliable, secure, cost-efficient and practically paperless method of handling and processing invoices. The invoice is created electronically and is sent to the recipient via the internet. E-invoice is a way of invoicing that is applicable to all kinds of companies as well as to private individuals.

Electronic invoicing is not completely new in the European Union. E-invoice is a success story in the Scandinavian countries and is in widespread use as a result of legislation promoting e-invoicing. For example, Finland is one of the leading nations in e-commerce and especially in e-invoicing. Therefore, the finished SEPA migration report mentions replacing SDD with e-invoice.

But what are the benefits of e-invoice?

E-invoice can reduce costs by improving the ratio of paperless processes. The reduction in invoicing costs can be up to 50%. Moreover e-invoicing - as part of e-commerce - is a step towards standardised processes and straight-through-processing (STP).

Apart from that, e-invoicing makes it easier to handle invoices. Distribution, approval and filing will be more user-friendly - very attractive for many customers.

→ 4.3 Mobile payments



Another value added service could be mobile payments (m-payments). M-payments are payments for products or services between parties for which a mobile device - for example, a mobile phone or a personal digital assistant (PDA) - plays a major role in the execution of the payment.

M-payments are not completely new. A market in micro-payments - payments less than € 10 - has developed in recent years. Buying ring tones and games for mobile phones or a train ticket are just

two examples from the current market for m-payments.

So how can m-payments help banks to increase their revenues?

Generally, by providing m-payments banks will be adding a new service to their service portfolio. This service will generate extra revenue. Moreover, as a less work- and paper-intensive process, m-payments will help banks to reduce their costs. This is especially interesting in micro-payments.

But m-payments have more benefits than just additional revenue and cost savings. These payments will enable a bank to offer its customers a more interactive service. Two examples of an interactive service are credit advice or notification of incoming bills on a mobile phone.

Moreover, as m-payments are much faster than paper-based payments, m-payment could be one step towards a real-time account for customers.

Hence, banks can benefit from m-payments in two different ways: reducing costs and strengthening customer relationships.

As mentioned above, the m-payment market for micro-payments is quite mature. By contrast, the m-payment market for macro payments is not. In this market banks will have a great potential for development and generating additional revenues.

But banks must ensure that m-payments are secure, customers are to accept them especially in the new market for macro payments.

→ 4.4 Distribution

Although much of the additional revenue will result from improved cost-efficiency and value added services, there are more ways to generate extra revenue. A way to boost revenues is to increase sales. But how can banks increase do this?

Banks have two ways to improve distribution of their services. The first is to change the environment in which they sell their services.

Normally, customers do not stay longer in a bank branch than absolutely necessary. Branches are often sterile and cold, and customers simply do not want to be in them. They enter a branch to do what they have to do there and then leave immediately. As a result, banks rarely have the chance to advise their customers of new products, special offers or other opportunities.

Banks could improve distribution by changing the environment of their branches. In recent years retailers have started to co-brand their services. The best example are bookshops. More and more bookshops have a coffee bar inside, creating a more customer-friendly environment. As a result customers linger longer in the shop and eventually buy more products.



The variety of possible changes in the environment of branches is huge. To incorporate a coffee bar is just one example. But banks need to select a co-branding partner carefully to ensure their reputation is not damaged.

The second way in which banks could improve their product distribution is by adjusting distribution to the customers' financial behaviour.

Banks have a huge data base about the financial behaviour of their customers. By providing a payment system, banks have access to valuable information about customers' payment habits. These data are the real asset of a payment system. Other businesses have to use loyalty cards or surveys to learn their customers' habits.

Currently banks do not use these existing data to adapt and target their services to their customers although they could boost their sales figures by recognising the habits of particular customer groups and providing special offers for them.. By doing so they could sell more products and increase revenues.

#### → 4.5 Service adjustment

All possibilities mentioned in this section focus on increasing revenues and generating extra revenues. Of course, banks are keen to compensate revenue losses caused by SEPA and therefore try to find ways to generate additional income. But banks must also be aware of another fact.

SEPA directs banks' attention to these additional revenues, but banks must also think of their current customers and their requirements. If banks lose contact with their customers and their needs they will cause additional losses.

Therefore banks must adjust their services for two reasons. Firstly, bank customers are reluctant to change their bank without a good reason, because moving an account from one bank to another entails paperwork: standing orders need to be revised, direct debit authorisations renewed, *etc.* If a bank provides nearly the same services as its competitors, its customers will be unlikely to leave it. In this way, the bank's current revenues will be retained.

But maintaining customer relationships is even more important because of another fact. It is easier to sell new services to an existing customer than to a new one.

Service adjustment can increase revenues as well as maintain customer relationships. There are several examples in the financial market in which players have focussed on a specific target group and provided specific services to it.

Currently one financial service provider in the market has specialised in transferring money from one country to another - mostly third-world - country. Its service is used mainly by people working and living abroad and away from their families. The company's service is not the cheapest, but it is branded as reliable, secure and simple, so it clearly meets the customer requirements. This is the competitive advantages that makes it valuable.

This example reveals one common misconception, that retail customers are only cost-orientated. Service cost is only one of many criteria for retail customers but it is one of the most important. Another important criterion is security of payments. Even more customers request simple and easy-to-use services.

By adjusting their services to the specific needs of their customers banks can generate additional revenues.

This shows that service adjustment is a very important topic on the banks' SEPA agenda. It can help to maintain customer relationships and even generate additional revenue.

When banks adjust their services they should be aware of the different requirements of corporate and retail customers.



## → 5 Think about

The implications of SEPA are wide ranging. After implementing a long-term strategy for SEPA, banks will consider further steps to make SEPA a success story. This Section will give you a few questions that will be worth thinking about.

### → 5.1 Corporate clients and SEPA

In order to make SEPA an outstanding success, all customers need to accept and - even more - use SEPA standard schemes. Nearly all national SEPA migration plans mention that the “critical mass” of SEPA payments should be achieved by the end of 2010 or 2011. But banks should aim to achieve their “own” critical mass earlier. A large number of SEPA payments is equivalent to low fixed costs and the possibility of high revenues.

But which customer group is the most important in the specific critical mass of payments?

Generally, three groups of customers can be distinguished: corporate clients, public authorities and retail clients. The first two groups initiate the most payments. Public authorities will play an important role within SEPA migration but will use SEPA standard schemes because the implementation of SEPA is supported by all national governments. So banks need to convince corporate clients to use SEPA standard schemes.

Currently some companies - varying from country to country - seem to be reluctant to invest in adjusting their payment systems to SEPA. Some of the latest surveys reveal that more than 70% are currently not considering any steps regarding SEPA. These businesses like to avoid investments and therefore want to use the current domestic payments schemes in the future.

But corporates must be naturally attracted by SEPA. Decreasing transaction costs, new SEPA services - for example, e-invoice - and opportunities in cash management are just three of the benefits that SEPA provides especially to companies.

Until now banks have failed to persuade corporate clients to use SEPA standard schemes in the future and thereby benefit from it. Banks must proactively push these corporate clients towards SEPA solutions.

If banks manage to move all groups, especially corporate clients, towards SEPA, both sides - banks and all clients - will benefit.

### → 5.2. How to reduce cash handling

Another question that was raised is the cost-efficiency of banks or how banks can reduce costs. One opportunity for banks to improve their overall cost-efficiency is reducing cash. By reducing cash banks will also increase the number of payments and will gain more income by payments.

Latest evaluations show that the use of cash is increasing than rather declining. Banks must reverse this trend.

Currently most banks provide their customers with free cash withdraw from their Automated Teller Machines (ATM). Changing this fact could be one way of reducing cash and increasing payments. Another way of reducing cash handling is the introduction of new services that replace cash payments. One example - m-payments - was mentioned above.

Customers are very sensitive to the reduction of cash and therefore any step taken must be carefully analysed.

Achieving a cash reduction - in any way - would be a real benefit for a bank.

→ 6. Conclusion

SEPA will dramatically change the nature of the payments industry and the banking and payment market. It will have huge impacts on all stakeholders especially banks. Fiercer pan-European competition among them, revenue losses in the beginning, introduction of new services and alteration of business strategies are just a few of them.

Banks need to adjust their payments services to the new situation. This means establishing a long-term strategy for SEPA. The long-term strategy will be made up of several decisions on different levels. Banks need to think about a suitable business strategy - for example, niche player or market leader - how to implement a new IT structure and how the services portfolio should be adjusted to the needs of customer groups.

Each bank will have a variety of ways of adjusting its business to SEPA and its impacts. As a result, it is possible to establish a SEPA solution that is specific to the bank's requirements. But having a wide range of possible decisions is also a risk. Therefore each bank has to take all possible impacts of a decision into consideration.

If banks carefully establish a suitable long-term strategy, SEPA will be not only a cost driver but a real possibility to generate extra revenue.



But what is SEPA really? Is it just another change in payments or more?

SEPA is one of the biggest opportunities in recent years for banks to prepare themselves for the future. It is stimulating trend-setting decisions and activity to address issues - such as cash-handling - that could not be resolved in the past. SEPA simply accelerates the development in payments.

Banks that comprehend SEPA as an opportunity will be amongst the SEPA winners if they make all necessary changes.

All in all, SEPA is a chance and not a threat to banks. Those who consider SEPA as this and are SEPA ready will be ready for the future.



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As an end-to-end IT services provider, Steria offers its customers (European companies and public authorities) products and services that combine functional and technological expertise in a bid to align information systems with strategic objectives and run the associated services.

The pertinence of this offer, focussing on dynamic markets – public services, banking, insurance, telecommunications, utilities, transport – is confirmed by the Group's organic growth and profitability, which are among the highest in the sector. In 2006 Steria booked a revenue of €1.3 billion for an operating margin of 7.1%.



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