

**Financial Services  
Banking**

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# **Riding down the Cost Curve**

**High Impact Pricing in the Payments Business**

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## Challenges in the payments market

The German payments market is undergoing a structural change as the usage of payment instruments has changed heavily in Germany during the last 5 years. The number of cheque transactions for example has declined by 25% every year since 1999. In contrast to that, the number of credit card transactions has been rising by 20% annually. The number of debits has been rising dramatically as well with a growth of 24% compared to 1999.

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### Growth in a stagnating market

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Even though the German central bank Deutsche Bundesbank reckons that the number of cross-border payments has increased by 25% since 1999, domestic payments still take a lion's share of the payments market and their growth has been flat at 0.2% p.a.

In other words, the key success factor in the payments business is managing in a stagnating market. This finding is even more alarming as the processing of payments is driven mainly by economies of scale. This paper mainly concerns the transaction service providers. However, its core notions can easily be transferred to the payments business with corporate clients.

As transaction service providers operate on extremely high fixed costs and very low marginal costs, the business model calls for an ever increasing utilisation of existing processing capacities. Hence, the current stagnating market environment fuels intensive price competition in the payments sector in Germany.

A decreasing price is in itself not a particular point of concern as the business model calls for decreasing prices along with lower costs from better efficiency. The real problem is that banks do not possess proper pricing systems that differentiate the price decrease so that customers can be systematically rewarded for their contribution to the overall flow of payments. Furthermore, most banks are lacking a clear value added strategy that can leverage strengths in other sectors of the banking business to lock in the customer and add value to the payments business by offering services the customers really appreciate. This lack of stra-

tegy unnecessarily intensifies a bank's exposure to price cuts.

This analysis implies three key objectives of successful pricing in the payments sector:

1. An intelligent and differentiated approach to reducing prices is necessary in order to develop maximum growth impact on the business using available funds wisely.
2. A pricing system must be developed that is so transparent that the customer easily understands the price reductions to their benefit. This system has to be fully performance-driven so that customers have clear incentives for shifting most of their payments business to the provider.
3. Value added services need to be introduced in order to ease some of the price tension. Although transaction processing itself is a commodity, there are many elements around the core service that can add value.

## Professional pricing in the payments sector

Figure 1 outlines the approach to developing a pricing system that encompasses these objectives.

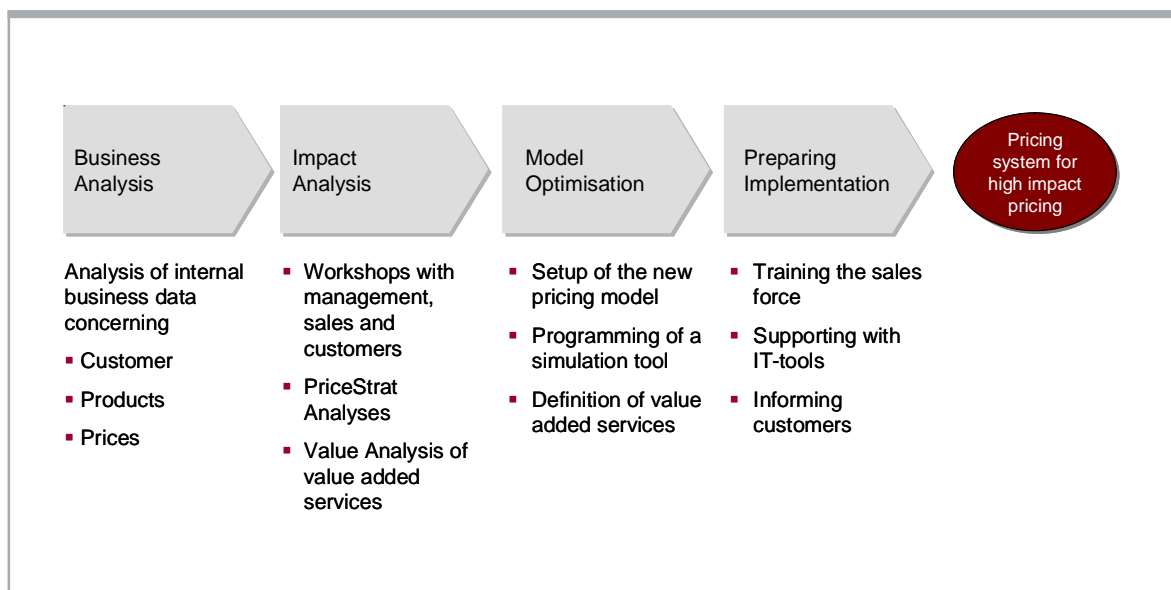


Figure 1. Approach

## Business analysis

The current status of the business has to be worked out. It is essential to know which customer pays which price for which product. Normally, banks have this information but in most cases the information is allotted throughout the company's IT-landscape. Hence, it takes a lot of time to collect all of the necessary facts and figures. But this fact can also be beneficial as management then realises that the current way of data management has to be revised to make successful price management possible.

## Impact Analysis

The data has to be supplemented with the knowledge of experts which is made possible through workshops with the management, sales and distribution and selected clients.

It is essential to involve the sales force as early as possible in the project as they will have to fight for the new system in the marketplace. It is also reasonable to involve clients in the project process so that you can benefit from first-hand information and easier implementation. Asking selected customers for their view does not only help improve the pricing system but also provides valuable insights into what to communicate in the implementation stage.

Using the PriceStrat System developed by Simon-Kucher and Partners, it is possible to estimate the clients' and the competitors' reaction to price changes. This method makes it possible to analyse the opinions of involved experts, make them transparent, discuss them and give recommendations according to an estimation of the price elasticity, the key measure in quantifying the relationship between price and volume. Even though personal opinions are involved in this systematic process, validation studies show that precise recommendations concerning pricing are possible.

Workshops with clients and sales and distribution as well as benchmarking of existing services can be helpful when it comes to the decision of which value-added services should be offered. The following three core questions should be

taken into consideration:

1. How can we help the customer to understand his payments stream better?
2. How can we support the customer in controlling his business?
3. Which instruments can we offer the client to help him enlarge his payments business?

## Model optimisation

Key to setting up an optimised pricing model is determining what to reward in a customer's business and how to reward it. As the aim is to retain and grow volume, volume and its growth will be pivotal elements of the new pricing system. Criteria could be the number of transactions, avoidance of cherry picking individual services, growth, share of wallet and others.

### Rewarding growth

These types of customer behaviour can be rewarded by intelligent discount and pricing schemes that lock in the customer at his present level of business and steer him into expanding his business.

Discounts offer a direct advantage for the client and guarantee a stable calculation basis but do not necessarily force the customer into delivering his contribution to the quid pro quo situation.

The best way to reward and control the volume component of the business is to implement a two-part rate including a fixed rate plus a price per transaction. The idea behind this is that the customer can choose the package of fixed and variable price taking into consideration that the higher the fixed price, the lower the price per transaction. This approach considers individual customer preferences as the fixed costs offer planning security and the variable costs offer flexibility. In addition, this pricing represents a simple yet powerful principle - customers who contribute large volumes to the processing systems consequently need a lot of payment transaction-related services, hence the fixed component is high. On the other hand, their contribution allows for significant cost digression, hence the variable com-

ponent is low.

As a transaction service provider's business is scalable, it makes sense to process as high a share of all customers' transactions as is possible. This is why the pricing system should reward clients that refrain from cherry-picking or dividing their business by multiple providers. Loyalty bonuses reward those customers who buy many services. Furthermore, customers that grow their business volume contribute further to declining costs and can be rewarded accordingly. Thanks to the combined reward of size and growth, big and fast growing customers will benefit from best conditions. Also, smaller clients with fast growth and big clients with low growth are still rewarded in the system with incentives.

Applying this concept results in a differentiated setting of incentives for customers that allocates the price decrease a transaction service provider wants to put into the market to the most valuable customers.

## Preparing implementation

In order to generate maximum impact in the market, the sales force and the customers have to be acquainted with the advantages of the new pricing system.

The sales force has to be trained diligently concerning principles, elements and mechanisms underlying the new pricing approach. This support should not be limited to the implementation phase but needs to be extended to the daily business. A structured document of FAQs and arguments for the new system should be given to the sales force. An IT-tool that allows the management of the customer relationship should also be provided so that the sales person is capable of showing the customer the features of the new system in order to reap as much additional volume as possible.

With regards to communicating the system to the market, an escalating approach is advisable. The guiding principle is that the more important the customer, the earlier he should be informed. While the important customers should be vis-

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**Diligent  
communication**

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ited personally, it may suffice to inform smaller customers less directly, as long as there are too many smaller customers to justify personal communication.

During the personal visit, the IT-tool should be used to calculate different business scenarios with the customer and demonstrate the benefits for the customer of growing the business.



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*Simon ♦ Kucher & Partners is an international consulting firm with a focus on strategy, marketing and sales. We are one of the world's leading organizations in the field of pricing. The Professional Pricing Society in the USA, Business Week and The Economist call Simon ♦ Kucher & Partners "the leading pricing experts in the world".*

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