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McKinsey on Payments

Contents

3
Innovations in European card processing

11
The return of the domestic scheme

18
The new wave of gateway acquisitions

23
Payment disputes: A pathway to deeper customer relationships

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Foreword

Welcome to the 26th issue of *McKinsey on Payments*, timed to coincide with the 2017 Sibos gathering in Toronto. Our first article, "Innovation in European card processing," is based on a recent McKinsey survey of card issuers and processors in Europe. This is a healthy market: cards account for more than 50 percent of non-cash payments in Europe, and earned €24 billion in profits in 2016. Furthermore, respondents to our survey expect card transaction volumes to grow by 10 percent annually in the coming years—and McKinsey's view is that these targets are within reach, *assuming* providers respond to a number of shifting dynamics, including regulatory initiatives (e.g., PSD2, open banking) and the incursion of non-bank players into payments. On the latter front, banks—which today gather roughly two-thirds of card revenues—could see their share diminish unless they expand their offering more broadly into the customer shopping experience. McKinsey's view is that partnerships will be key to achieving the necessary levels of sophistication and agility; and the article explores seven partnership models, ranging from customized outsourcing arrangements to white-label agreements for fully standardized services.

Our next article looks at the return of the domestic card scheme. While these networks lost their leadership position to the big international players years ago, they are finding new relevance by turning their local coverage into an advantage. Domestic schemes offer value in several areas: First, they embed new features that respond to the needs of local cardholders. Second, their domestic status provides them with stability when it comes to regulatory changes in the broader market. Third, because of their focus on building local solutions, domestic networks are often able to streamline investments and operate with more focus and efficiency.

Given the resurgence of the domestic network, firms across the payments spectrum should be thinking strategically about the impact on their business. The article lays out a number of key questions that issuers, acquirers, global networks, and domestic schemes themselves should be asking as they plan for the future.

We next examine the recent surge in M&A activity in the gateway arena—more than 48 deals were completed between January 2016 and August 2017, with a combined value of $5 billion—and consider what the future may hold for the businesses in this market. Gateways are in a position to take advantage of the explosion in retail and commercial electronic transactions, and to address the increasing complexity of merchants' needs as they move toward digitally based omnichannel services. As the market evolves, we expect more acquisition activity, particularly among the gateway providers that serve mid-tier merchants. Gateways with strong positions in the small-business or large-merchant segments are likely to be on the offensive as consolidation continues.

Our final article, "Payments disputes: A pathway to deeper customer relationships," is a close look at how banks can find the silver lining in critical customer interactions. As the authors state, this area is particularly relevant today, as increasing numbers of customers move away from cash toward electronic payments. The challenges for payments providers include the following: most have complex operating models and disjointed ownership of the overall experience; they lack sophisticated triage, applying the same process to disputes with widely varying dollar amounts; and they neglect to manage performance. The solution is a move to a simpler, integrated operating model that can reduce costs and financial losses, and lower regulatory risk.

We hope you find the articles in this issue thought-provoking and informative, and as always we welcome your feedback at *paymentspractice@mckinsey.com*.

Innovations in European card processing

In 2016, Europeans completed 58 billion payments transactions with a card. Accounting for more than 50 percent of non-cash payments, cards are the single most important payments instrument in Europe, earning €24 billion in profits in 2016. While industry leaders expect cards to continue their robust growth, regulatory challenges and the cost of technology innovations are driving massive change in every aspect of the business. To meet these challenges, issuers and processors must identify new sources of efficiency while also taking decisive steps to head off new competitive threats. This article examines the industry's strategic priorities for growth and the increasing importance of collaboration among specialized organizations with the technological and cultural flexibility required to respond promptly to fast-evolving customer expectations.

Thomas Birkebæk

Tobias Lundberg

Federico Marafante

Albion Murati

Strong growth led by digital innovation

A recent McKinsey survey of 31 European card organizations (12 issuers and 19 processors) shows that well over half (58 percent) of processing executives anticipate that card transaction volumes will grow by more than 10 percent annually in the coming years. Projections among issuers are more cautious, with three-quarters of card executives at issuing banks expecting volumes to grow by at least five percent each year.

According to our analysis, the higher targets are within reach, provided banks and processors respond carefully to the important challenges and opportunities ahead. Over the mid-term, three main factors are likely to push card usage even higher than it is today: First, European consumers are expected to keep spending more, with digital sales growing faster than traditional retail channels; second, cards will continue to displace cash at the point-of-sale, with broader consumer adoption and merchant acceptance; and third, emerging innovations will enhance the functionality of cards and extend the utility of the card rail to new types of payments in new ecosystems.

Regarding this third factor, recent innovations in card functionality fall into one of three categories: (a) tactical innovations and value-add services (e.g., loyalty programs, tokenization, card management solutions); (b) infrastructure innovations supporting digital payments, including cards-on-file, 3D Secure, and scheme-hosted wallets (e.g., V.me, MasterPass); and (c) growth in card-based digital payments revitalizing domestic schemes (e.g., MobilePay, MobilDankort, and apps by Bancontact and Multibanco). These innovations, combined with solid economics, position the card industry for continued strong growth.

While market fundamentals support a strong outlook for cards, the road ahead is fraught with risks for both issuers and processors.

Challenges and opportunities

While market fundamentals support a strong outlook for cards, the road ahead is fraught with risks for both issuers and processors. The large majority of issuers cite regulatory impact as the biggest of a number of challenges. In particular, open banking, the Second Payment Systems Directive (PSD2), and other regulatory changes opening the payments system to new competitors could threaten the position of cards in the overall payments landscape (Exhibit 1).

Open banking poses three significant risks: First, strong card economics are attracting new non-bank competitors; for example, data aggregators obtaining the status of account information service provider (AISP), fintech innovators and online specialists accessing the payments system by becoming a payment initiation service provider (PISP). Second, high economics entail high costs, and PSD2 will make it easier to shift card-based transactions to other payments rails. (This threat, however, may be delayed temporarily, as settling rules and technology constraints must be addressed in order to unleash competition with the card rail.) Finally, broader access will trigger a new battle for the end customer, with banks potentially facing challenges from processors, and incumbent payments service providers—banks and processors—defending against attacks from fintech innovators and digital platform owners.

Today, two-thirds of total card revenues accrue to banks (mainly as maintenance fees and net interest income); the remaining third flows to processors in the form of transaction fees. Banks' share could shrink unless they are successful in adjusting the scope and core offering of their payments business, integrating the transaction and related services throughout the broad customer shopping experience. McKinsey research shows that executives are divided in their views of how this battle for the customer will play out, with one group expecting the current pace of evolution to continue, another seeing a moderate disruption where account-to-account (A2A) transactions gain a significant share, and a third anticipating a full disruption where margins collapse and new closed-loop systems dominate.

Technology innovation and growth strategies

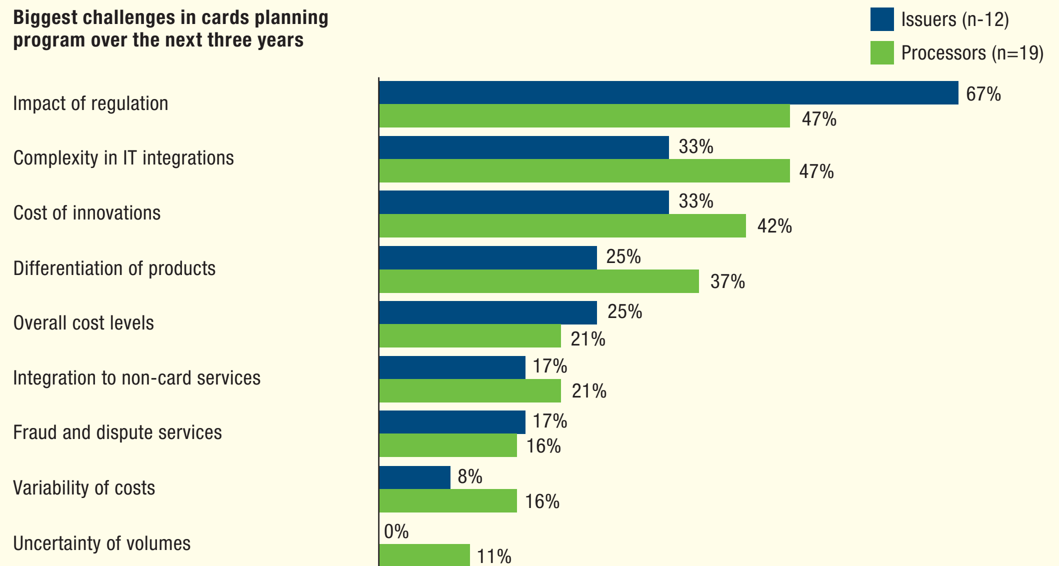
Banks and processors alike must weigh their options carefully and decide how to get the biggest firepower from technology investments. Among the organizations surveyed, the prevailing approach for growing the business is to expand card functionality, but banks and processors tend to differ in how they address the market and extract value from new functionality. Processors tend to look for growth on the basis of technological innovations to build revenue from new services (e.g., virtualization, tokenization). Banks, focusing on core strengths, emphasize cards as a source of consumer finance as well as a payments instrument (with contactless as a main driver). Security and fraud are also top concerns, and many processors identify tokenization as a priority growth driver over the next three years (Exhibit 2, page 6).

Achieving new efficiencies

In addition to strong growth in transaction volumes, industry executives also expect significant gains in profitability. The majority of processors McKinsey surveyed anticipate continuous reduction in cost levels over the next three years. While most issuers anticipate processing costs to rise, they also expect revenue to grow faster than costs. There is more agreement among issuers and processors on the direction of margins: slightly more than half of respondents expect EBITDA margins to remain unchanged or increase by between one and three percentage points in total over the coming three years; a third expect margins to increase by more than three percentage points.

Exhibit 1

Regulatory change is the top challenge for issuers; processors point to regulation, integration and the cost of innovations



Source: McKinsey survey

Our analysis suggests that growth in transaction volume alone could bring €14 billion in additional profits, which in itself would mean an improvement of between eight and ten percent in margins across the industry. European banks and processors could also reduce card processing costs by €2.5 billion by working more closely together to process at scale, sharing the cost of innovations and modernizing their technology (Exhibit 3).

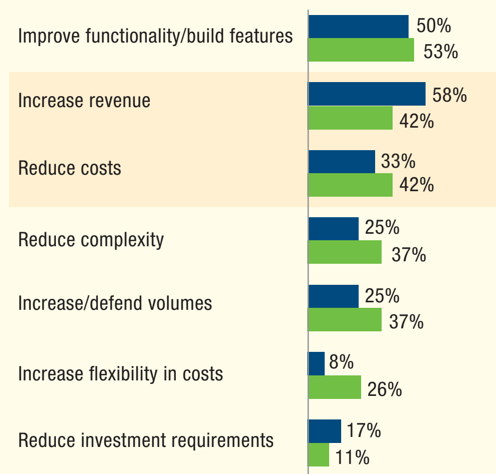
Today, only 50 percent of European card transaction volumes is outsourced by banks, and much of this is on sub-scale or multi-platform setups. Volume efficiencies on card platforms are high, and additional volumes lower the cost-per-transaction considerably for platforms processing less than two billion transactions. At the same time, a significant share of outsourced volumes is processed on high-cost legacy platforms.

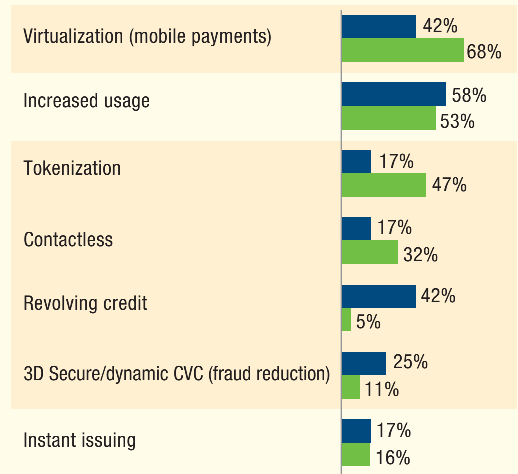
As Exhibit 3 shows, the adoption of modern technology offers the biggest potential for cost savings: Organizations using legacy platforms could reduce costs by up to 70 percent by upgrading their systems. Cloud-based applications would also reduce significantly the cost of onboarding new volumes. While legacy platforms may generate satisfactory returns for the time being, the technological requirements for handling fast-growing digital payments will eventually make it impossible for these organizations to compete.

The European card industry could further reduce operating costs, even within current setups, by harmonizing vendors across setups and developing platform strategies to avoid duplication of costs. This would help push current scale curves down across volumes. In addition, the use of machine

Exhibit 2

Processors are targeting growth through secure mobile payments and services; issuers through increased card usage for payments and finance





Source: McKinsey survey

learning for automated testing as well as to support sales, service, and problem resolution can reduce costs, shorten time to market and strengthen customer loyalty. (For more on the current application of machine learning in payments operations, see “Beyond the buzz: Harnessing machine learning in payments,” *McKinsey on Payments*, September 2016.)

If card executives meet their own projections and achieve the new levels of efficiency outlined above, the cards profit pool has the potential to grow by more than €16 billion by 2021 in Europe.

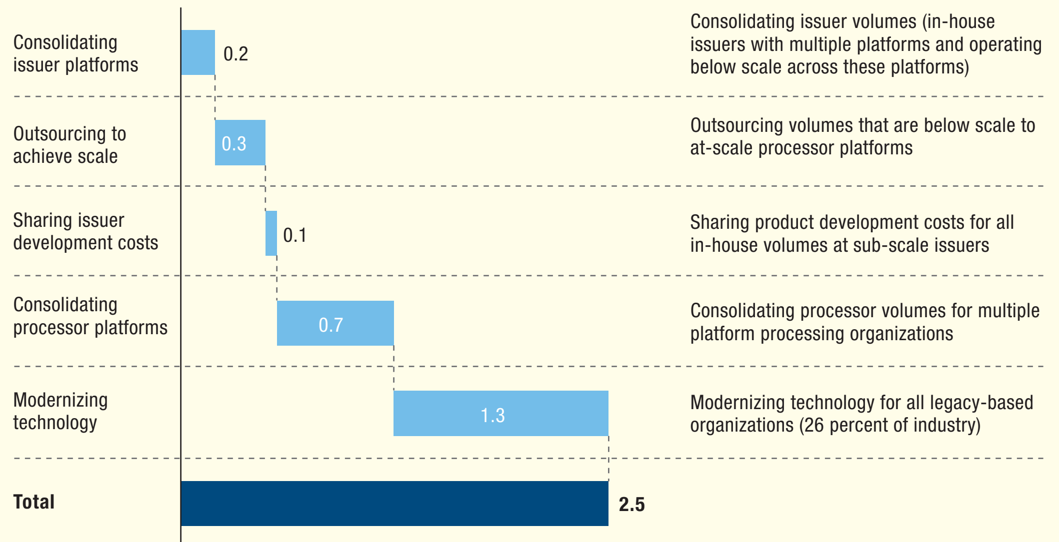
Diversified offering will require nimble infrastructure

In order to keep pace with fast-changing customer expectations, card organizations require flexibility in platform design and agility in product development. As in other areas of banking, issuing banks and card processors are developing new models of mutualized collaboration to bring innovations to market more rapidly and at lower cost.

The partnership models observed in the market today range from fully customized outsourcing arrangements to white-label agreements for fully standardized services. Recently emerging models enable issuers to adopt separate software stacks for different segments of processing volumes, giving the issuer increased control of value-added functionality while also replacing capital investments with outlays for operating expenses. These various outsourcing models have not only enabled issuers to reduce organizational and technological complexity but also to increase market share with

Exhibit 3

European banks and processors could reduce card processing costs by €2.5 billion



Note: Issuer minimum efficient scale at ~500 million transactions.

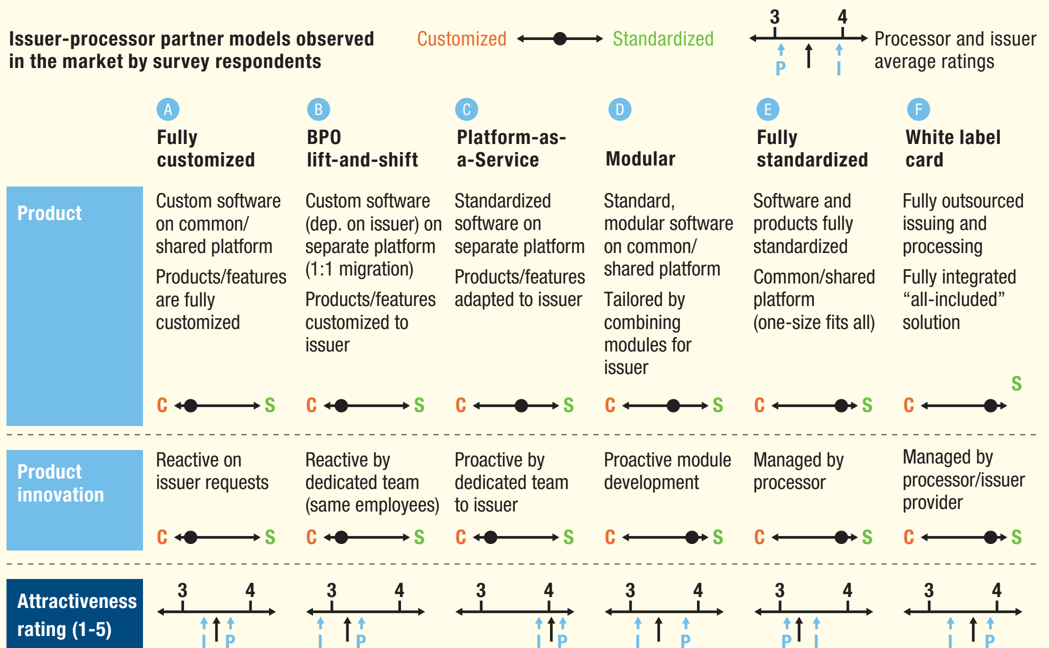
Source: McKinsey Card Processing Service Line analysis

services that enhance the resilience of customer relationships.

The fully customized model (Model A in Exhibit 4) uses tailored software running on a shared platform. This well-established model affords issuers maximum control in designing products and features. Conversely, it requires the processor to be highly flexible in its operations and pricing. The business process outsourcing (BPO) model runs custom software on a dedicated platform. Though far less common, BPO still has significant advantages, including the opportunity to translate capital expenses into operating expenses by shifting all processing operations (and associated FTE) to the partner. In Model C, platform-as-a-service, standardized software running on a separate platform dedicated to the issuer affords the issuer moderate flexibility to adapt products and features. The modular architecture of platform-as-a-service allows the bank to clean up its internal IT stack. While it is a recent innovation, this model has already attracted widespread attention. By contrast, the more traditional modular setup generates far less interest, which may be due in part to the fact that it entails higher switching costs than the migration to a fully modernized stack. (Indeed, these switching costs can exceed total annual savings in operating costs.) The fully standardized models and white-label solutions enable banks to manage the costs of delivering services required by critical customer segments but restrict their ability to distinguish their offering. These long-established, highly standardized models are still widely used.

Exhibit 4

An increasingly broad range of commercial partnership models are being applied in the industry



Source: McKinsey Card Processing Survey N=31

With the exception of the fully customized Model A, these models forgo the customary three- to five-year tendering process to pressure prices in favor of a mutualized model where both processor and issuer share benefits. Different processors and software providers are offering distinct yet complementary business models to deliver these benefits, which also include optimized cost sharing and new approaches to ownership and financing.

By selecting the right combination of partnership models, banks and processors can achieve the potential €2.5 billion in system cost-savings faster and with higher certainty of hitting their targets.

By selecting the right combination of partnership models, banks and processors can achieve the potential €2.5 billion in system cost-savings faster and with higher certainty of hitting their targets. Additionally, partnerships enable issuers and processors to prepare for a future where cards and A2A transactions become increasingly interchangeable as a highly automated and nearly invisible event within the broader spectrum of retail consumer activity. Processors can take a leading role to ensure the continued relevance of the card infrastructure even before PSD2 takes full effect.

Recommendations

McKinsey expects the trend of increasing variety in processor-issuer partnerships to accelerate as platform choices become less rigid. There are three key steps issuers and processors should take to derive these benefits in the near term. Issuers and their technology partners should evaluate these steps jointly to ensure that the potential benefits are fully realized.

1. **For issuers:** Do not build the sourcing strategy around a single model, but evaluate different models against carefully defined business objectives (e.g., positioning and target segments). Similarly, for processors: Do not re-purpose go-to-market plans merely to offer one model, as this will not suit all relevant issuers. Instead, engage with issuers to define the most appropriate models to offer.

2. **Define fully the objectives of optimization, going beyond the traditional cost-per-transaction as the only metric.** Introduce as well metrics that link business objectives more closely between processors and issuers. Reporting should include, for example, fully loaded revenue per card, profit excluding interest fees per card, and release cycle times.

3. **Do not underestimate the future of cards and the momentum this rail carries, and, conversely, do not underestimate the impact that open banking and innovations based on real-time clearing will have for channel convergence with other payments rails.** With the introduction of new collection

models and new digital payments types, these different rails will most likely become more integrated and fluid depending on business purpose and urgency.

* * *

Competition around payments and related data streams will intensify significantly as the digital economy expands and new competitors take advantage of PSD2. Issuing banks and card processors must plan carefully to extend the dominance of cards as Europe's most popular payments instrument. In addition, as specialization and core strengths increase in strategic importance, it is critical to leverage partnerships to optimize resources. Banks can no longer afford to evaluate processors as purveyors of a commodity but should collaborate as partners in a joint business model built on a shared architecture.

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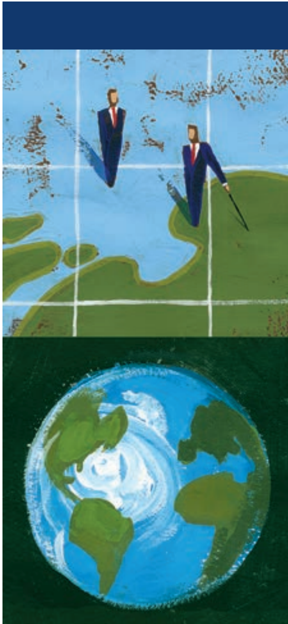


The return of the domestic scheme

Domestic card schemes defined the early days of electronic payments across Europe, Asia, and much of the rest of the world, springing up from ATM networks as the main drivers of card usage. Later, global networks expanded from North America to other regions and began to compete by offering credit products and international acceptance. This approach brought issuers higher returns and allowed cards to be used beyond home markets. Confronted with growing pressures for internationalization and additional issuer revenues, domestic schemes proved slow to respond and their position as leaders was gradually eroded. Indeed, some countries abandoned local brands altogether.

Olivier Denecker

Jason Hanson

Flavio Litterio

Katelyn McCarthy

Recently, though, domestic schemes have staged a comeback. They are finding ways to meet local market needs, cater to local consumer preferences, comply with local regulations, adapt to local technology demands, and serve the interests of local card issuers. In short, they are satisfying needs that global networks often fail to recognize or leave unmet.

So what role do domestic schemes play in the consumer-card landscape? In some local markets, they are the most recognized payments brand for households and merchants alike. Their cards—many of which are co-branded with the logos of the main global networks to support acceptance outside home markets—are carried by more than 2.5 billion customers. At a conservative estimate, domestic schemes represented 12 to 15 percent of the $26 trillion in worldwide credit and debit point-of-purchase payments in 2016. This global share masks considerable variations across regions, from relatively low market shares of around 11 percent in North America, Asia, and Central Europe to shares approaching 40 percent in Australia and New Zealand (Exhibit 1, page 12).

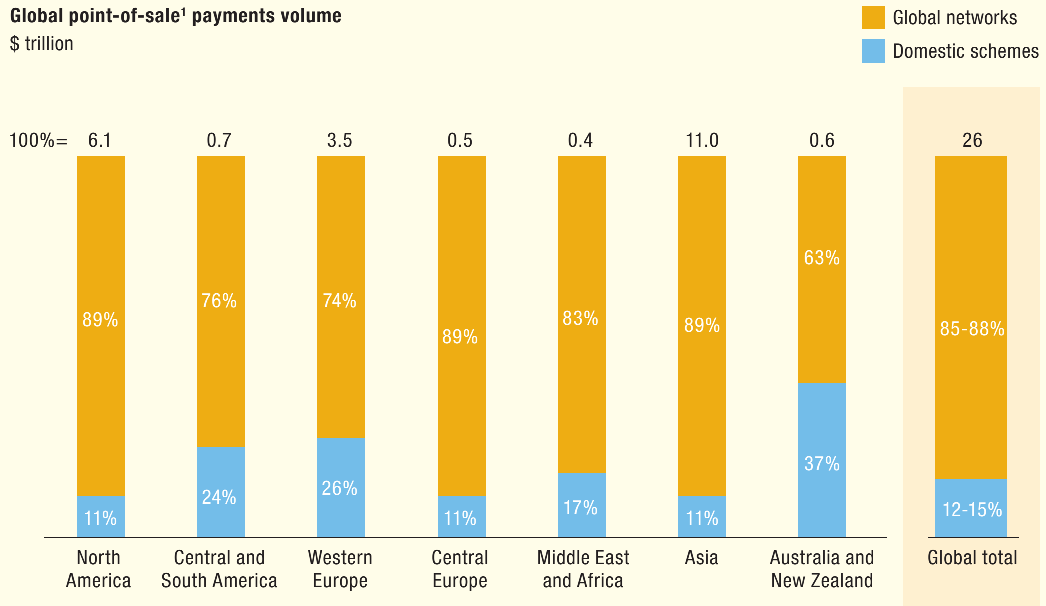
Regaining confidence

After a period during which local schemes were overshadowed by their global counterparts, a number of factors have contributed to their resurgence—which even extends to the launch of new local networks in markets that have never seen them before.

First, local schemes are seeking to satisfy unmet market needs and establish a response to local requirements. Second, issuers and acquirers are looking to create more control over local cardholders and economics as international networks have transformed into

Exhibit 1

Domestic schemes represented an estimated 12 to 15 percent of the $26 trillion in worldwide credit and debit point-of-purchase payments in 2016



[1] Point-of-purchase includes domestic payments made through debit, credit, and charge card at point of sale and online

Source: McKinsey Global Payments Map; Euromonitor: RBR

public companies focused on meeting profit goals. Third, local merchants are seeing the benefit of collaborating with local schemes on go-to-market efforts. Fourth, some governments have introduced policies encouraging the growth of local schemes as a means to exert more control over local payments systems. Finally, local schemes are working to enable acceptance beyond local markets through reciprocal agreements with other domestic schemes and global networks such as Discover and JCB.

This new drive has enabled mature domestic networks such as Cartes Bancaires in France and China UnionPay to strengthen and reinforce their legacy position by intensifying their marketing and innovation efforts, building product awareness and brand equity, and adopting emerging mobile and digital applications for card payments. Some local issuers have gone a step further by setting up consortiums to develop new national card brands, such as Brazil's Elo and Turkey's Troy (see sidebar, "Building domestic card schemes: Two leaders share insights").

A brief world tour

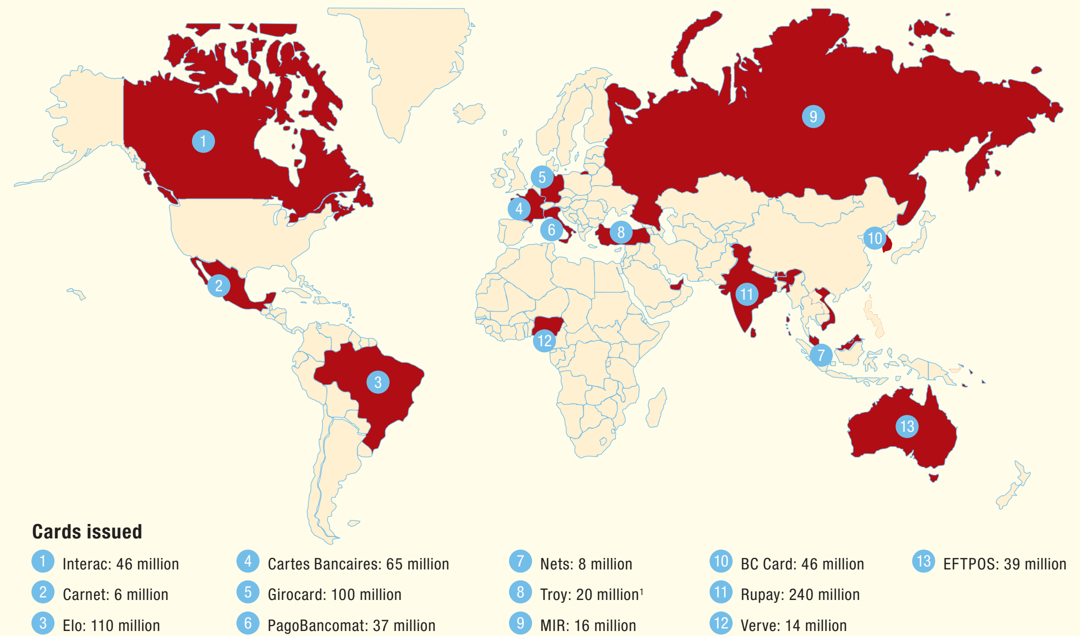
Influenced by these factors, new types of schemes, in a variety of models, are emerging across the globe (Exhibit 2).

In Asia, regulation by the Malaysian government supporting local competition prompted the launch of MyClear. Similarly, the Central Bank in India spurred the launch of RuPay to offer a less expensive, more cost-effective network and respond to local regulation promoting digital payments in preference to cash. And in China, UnionPay is expanding global acceptance, while online payments brand Alipay is moving beyond online and mobile to point-of-sale acceptance both at home and abroad.

Exhibit 2

Domestic schemes around the world

Not exhaustive



[1] Three-year estimate

Source: Euromonitor; RBR; McKinsey Payments Map

In Latin America, domestic schemes are a top-of-mind topic for many local issuers. These are markets in which most banks are local or regional, card transactions are processed in-country, cross-border transactions are less common, and the bulk of growth comes from middle-class consumers who do not travel abroad. In Brazil, for instance, three of the top five national banks created Elo in an effort to gain more control over the payments market. Elo reached break-even in 2012—its second year of operation—and has self-funded all its investments ever since.

In Europe, well-established debit schemes such as Dankort in Denmark, Bancontact in Belgium, and Multibanco in Portugal are at the vanguard of mobile innovation, reinventing themselves as drivers of digital commerce and tapping into consumers' and merchants' emotional attachment to local brands. So far, they have outpaced global technology and mobile attackers in capturing new opportunities in home markets and have proven successful enablers for payments innovations by local banks. Meanwhile, in Switzerland—a market whose original debit-card scheme was discontinued decades ago—banks and merchants have launched TWINT, a national mobile wallet scheme, to lay the foundations for a new local brand in payments issuing and acquiring.

In Turkey, BKM, a partnership between 10 public and private banks, recently launched Troy, a payments scheme issuing locally branded cards. Having gained acceptance at all the country's terminals within a year of launch, Troy is positioning itself to foster innovation in Turkey's payments system.

In Africa and the Middle East, domestic card schemes are emerging in some of the largest card markets. These schemes often

Building domestic card schemes: Two leaders share insights

To understand what it takes to launch a new domestic scheme, McKinsey asked Eduardo Chedid, CEO of Brazil's Elo, and Soner Canko, CEO of Turkey's BKM, about their recent experience. Their individual perspectives shed light on the challenges domestic schemes face and the role they are likely to play in the evolving payments landscape.

Elo was formed in 2011 as a partnership between Banco do Brasil, Bradesco, and Caixa Economica Federal to create the first wholly Brazilian network. Since launch, it has issued more than 110 million cards across multiple debit and credit products, including the recent Elo Global Card for high-spending Brazilian travelers and online shoppers.

BKM was launched in 1990 by a group of Turkish banks as a service provider for clearing and settlement. Since then, it has evolved to also act as an incubation center for the industry, seeking to support the future of cashless payments by providing seamless, secure solutions including transportation payments, digital-wallet capabilities, and Troy, Turkey's first and only national payment scheme.

McKinsey on Payments: What prompted you to begin as a domestic scheme, and how far have you traveled in your journey?

Eduardo Chedid, Elo: Visa and MasterCard had dominated Brazil's card networks for decades, and issuers had spent years discussing the possibility of launching a domestic scheme. They wanted to create an alternative where they could control technology, operate more flexibly, create products geared toward local conditions, drive costs down, and be part of a profitable network. At the same time, the Central Bank of Brazil expressed the desire to foster local processing and domestic schemes. So three of the five largest banks in Brazil—Banco do Brasil, Bradesco, and Caixa—launched Elo in 2011. After six years, the scheme has reached 113 million cards issued, an acceptance network of 4 million merchants, and an 11 percent market share.

Soner Canko, Troy: Until recently, only international card schemes operated in Turkey, which is the largest market in Europe, with 186 million cards in circulation. Yet domestic transactions make up 97 percent of card transactions, and 91 percent of cards are never used abroad. So Turkish banks joined forces to create a solution that would drive innovation and growth, address local requirements, accelerate go-to-market time, and boost cost-effectiveness.

Today Troy has 26 financial institutions as members and covers almost 100 percent of the market. Our cards are accepted by all the terminals, POS machines, and e-commerce sites in Turkey. After putting the necessary infrastructure, standards, and regulations in place, we launched Troy to consumers in May 2017 with a nationwide campaign. We have an ambitious target to reach 20 million cards in three years.

MoP: What is distinctive about your offering, and how do you plan to stay relevant?

Eduardo Chedid: For issuers, our goal is to establish close partnerships, help them advance their project pipelines, be flexible, and contribute innovative ideas. For example, we introduced a simple pricing structure with no hidden fees that eliminates the friction in day-to-day relationships. Our brand speaks to Brazilian customers and helps issuers sell their cards. Our value proposition was crafted with input from our three founding banks, and our story resonates with smaller issuers such as retailers and mid-sized banks.

For cardholders, we want to have a product that matches alternatives in terms of acceptance, is easier to use, has a modern feel, and offers benefits that Brazilian consumers value. For instance, Wi-Fi is offered as standard with most Elo cards to appeal to customers who find Brazilian cellphone data plans expensive.

Soner Canko: We believe the core of our offering for payments providers is our ability to develop innovative solutions aligned with the needs of the Turkish market and to bring these solutions to market in a fast and cost-effective way. We have an innovation center to spearhead the development of new solutions and products, and we hope to inspire Turkish fintechs to create global brands.

As for the service we provide to card users, we are working to add worldwide acceptance to our value proposition by allying with an international card scheme. We also aim to create value more broadly by contributing to the Turkish economy, helping to increase per capita GDP and raise standards of living. Our other goals are to increase financial inclusion among Turkey's 23 million unbanked people

(43 percent of the bankable total) and to improve the financial literacy of the population in general.

MoP: What were the biggest challenges you faced in developing your strategy and delivering your value proposition?

Eduardo Chedid: The toughest challenge was reaching scale in cardholders and merchants. We had to build an acceptance network before banks would start issuing cards, but it's hard to convince merchants to include a new payment brand at their checkouts when there aren't enough cards on the street for them to feel the pain of lost sales. Once we established a reasonable acceptance network and reached a good number of cards issued, it transformed the game.

Another big challenge was getting international acceptance for our cards. It was never a problem for debit cards, but credit is different: even customers who don't travel abroad expect global acceptance for buying online. So after four years we partnered with Discover,[1] and our cards are now accepted in 185 countries. That unlocked the issuance of credit cards at scale.

The third key challenge was introducing a new payment brand in a market dominated by two global giants. We invested heavily in marketing and will continue to do so. The results have been good, but it's a continuous effort that shouldn't be underestimated.

Soner Canko: As with any domestic scheme, our biggest challenge was to achieve acceptance at all payment points: 2.4 million POS machines and more than 49,000 ATMs in Turkey, as well as e-commerce sites. But this task was made much easier by Troy's status as a strategic initiative supported by all banks, and the scheme is now accepted at every payment point in the country.

On the consumer side, the greatest challenge has been the low levels of awareness about card schemes. To combat this, we recently ran a month-long nationwide campaign explaining what Troy is and what it does for card payments. We've had some positive reactions: people were proud of the fact that Troy was developed in Turkey by Turkish specialists.

MoP: What role do you see domestic networks playing in the future of payments?

Eduardo Chedid: They are definitely on their way back around the world, whether it's for business reasons, because of regulatory pressure, or to provide flexibility in serving local needs. I think they will play a much larger role in future. Successful domestic schemes are emerging in every continent, and will empower and motivate more to come.

Soner Canko: I think that in emerging markets especially, national payment schemes are the most effective mechanism for increasing financial inclusion among unbanked populations. They are better at addressing local needs and quickly delivering products suited to local markets. With that in mind, Troy's growth strategy focuses not on taking a share of the current market but on making it bigger. As a domestic scheme, we want to be instrumental in penetrating the unbanked population and driving healthy growth in the market.

MoP: What future trends are likely to affect the success of domestic schemes?

Eduardo Chedid: Two things are vital for the future. One is keeping up with new technologies. Elo was born with no legacy systems and had a flexible architecture from the beginning, but the pace of innovation is accelerating in payments globally, so it's definitely a challenge. We have to be more nimble and targeted in our investments. I'd like to see local schemes form an alliance to cross-pollinate innovation, establish minimum interoperability standards, and reduce costs.

The other thing we must do is prepare for cyber-attacks; it's a matter of survival for financial institutions, and central to the value proposition of payment schemes. Investment shouldn't be spared in that area.

Soner Canko: First and foremost, the global push for digitization will not only transform everyday life but will drive the future of payments, acting as an engine for growth, especially for local schemes. Mobile will be critical as it offers opportunities for national schemes to differentiate themselves by offering value-added services beyond cards.

Other trends likely to change the way business is done in payments and the financial sector in general include regulatory changes, disruptive technologies, and concepts such as cryptocurrencies. The Turkish payments industry has been good at adapting to the new regulatory environment and emerging technologies, and I believe Troy is poised to leverage this dynamism to drive innovation and become a benchmark for other national payments schemes.

[1] Discover Global Network, which includes Discover Card and Diners Club International.

grow out of ATM networks such as SPAN in Saudi Arabia, Verve in Nigeria, and CMI in Morocco. In markets where all consumers may not have access to credit, local debit and prepaid solutions can act as a basis for broader financial inclusion.

Even in North America, the home of global networks, local schemes thrive. Interac in Canada and over a dozen debit networks in the US, such as PULSE, have maintained positive momentum in a highly competitive card market.

Opportunities to create new value

Domestic schemes offer four sources of value that are propelling their growth:

Tailored innovation: In mature markets, domestic schemes are delivering new solutions and technologies for local issuers with a responsiveness that others cannot match. Even in relatively small national markets, domestic schemes are developing and embedding attractive new features that meet local cardholders' preferences and needs. In Denmark, Danske Bank used the rails of the national Dankort network to launch the MobilePay peer-to-peer money-transfer app, which has grown into a regionally recognized brand name. Meanwhile, TWINT in Switzerland and Swish in Sweden are showing that local mobile-wallet schemes can become ubiquitous whether they are based on cards or instant payments.

Stability: Local schemes provide a stable environment for processors and issuers by managing local regulation and merchant needs effectively and coping with unpredictable changes in rules and regulations. As cards and electronic payments grow in importance, and banks and regulators recognize the need to manage solutions within their jurisdiction, domestic schemes increasingly represent a systemically important payments system. They also overcome the chief drawback of participating in global networks subject to non-national regulators: the risk of issuers abruptly losing access. After a group of Russian banks were denied service following sanctions imposed by the US Treasury in 2014, for instance, the Central Bank of Russia created an alternative payments system, Mir, which launched in 2015.

Cost-effectiveness and efficiency: Domestic networks are generally more effective at operating locally and are less expensive. Many continue to follow a cost-recovery model, and even those set up as profit-making enterprises tend to offer cheaper solutions than alternatives. Because domestic schemes focus on building local rather than global or regional solutions, they are able to streamline investments and operate with more focus and efficiency. Finally, the way that many local schemes work across the payments landscape in sync with local interbank transfer solutions makes for an efficient approach as payments clearing systems become increasingly fungible.

Control: Local schemes are enabling local banks to take control of their own destiny, capture more value, and maintain independence in their home markets. For example, issuers in emerging markets are setting up local networks to capture payments growth and fuel further industry growth themselves rather than cede these opportunities to others. Issuers also want to preserve their governance in local markets by exerting control over promotions, bank identifier codes (BICs), and card routing to reduce their dependence on global networks. Local schemes also offer issuers cheaper solutions and new features that

allow them to diversify their portfolios and strengthen their negotiating position.

Key questions for issuers, acquirers, and networks

The resurgence of domestic networks is benefiting a wide range of stakeholders. Local economies gain access to customized solutions that meet their needs and provide greater convenience. Issuers are capturing value by creating their own domestic networks to gain autonomy and more control over local payments flows, as well as the ability to offer interesting solutions to cardholders. At the same time, regulators are finding it easier to exert influence over policy and operations as domestic schemes are more adaptable and better able to support local rules.

Every participant in the payments value chain must reflect on its value proposition and rethink its strategy.

As momentum builds, more and more markets, especially in large emerging economies, are likely to take the opportunity to create their own domestic schemes. To keep up, every participant in the payments value chain must reflect on its value proposition and rethink its strategy.

Issuers must ask themselves: How can we re-segment our product portfolios to capture broader sets of consumers? Is the global network offering an integral part of our value proposition to all consumer segments, or can a domestic scheme create valuable alternatives? If we create our own card offering, is our brand strong enough to capture and maintain our customers' attention?

Acquirers must seek to understand if domestic schemes can help create differentiated offerings for merchants, especially in mass-market locations that are less well served by credit-card solutions? Can the distinctive economics and technical specifications of domestic schemes enable them to capture small merchants or increase demand for card acceptance in target markets or regions?

Global networks must consider: What characteristics or offerings should we pursue to compete with domestic schemes? How should our go-to-market approach differ in markets where local schemes have a strong presence or good prospects? Is a pure competitive model preferable to one based on cooperation and co-badging? How can we direct our R&D investments to create lasting benefits?

And finally, domestic schemes must ask: How do we continue to offer a competitive set of products and services to local issuers and cardholders? How do we deepen our understanding of local market and consumer needs to further differentiate our value proposition for issuers? How do we increase global acceptance at the lowest possible cost?

* * *

The payments landscape continues to evolve for all involved. Undoubtedly, domestic schemes around the world will continue to seek ways to increase their participation in local markets and shape local payments trends.

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The new wave of gateway acquisitions

Three years ago, we published an article predicting that payments gateways "will need to merge to drive efficiency in a crowded landscape," and that "gateway companies whose primary value lies in connectivity will be under pressure to justify their role and may become acquisition targets for upstream or downstream players." (See "Innovation and disruption in US merchant payments," *McKinsey on Payments*, May 2014.) Recently, we have started to see these predictions play out as gateways consolidate and strategic and financial operators pursue acquisitions.

Puneet Dikshit

Kevin Mole

Today the gateway market is in the midst of an acquisition wave as institutions seek to gain a foothold in the sector or to broaden their capabilities. More than 48 deals were completed between January 2016 and August 2017, with a combined value of $5 billion (Exhibit 1, page 20, highlights important examples from 2017). Gateways themselves were responsible for the largest share of acquisitions in this period, with 38 percent of deals, followed by private equity firms, with 33 percent, and merchant acquirers with 29 percent.

Among all this activity, two prominent acquisitions were Paymetric, announced by Vantiv in April 2017, and CardConnect, announced by First Data in May 2017. Both deals feature a strongly differentiated gateway that operates in a specialist area of the US market. Paymetric provides business-to-business card-based payments acceptance and operates as a plug-and-play solution by integrating into major enterprise resource planning (ERP) systems and acting as an intermediary with processors, enabling businesses to reduce switching costs. CardConnect provides enterprise-payments solutions and incorporates invoice-to-cash processing capabilities that integrate with ERP systems, allowing companies to optimize workflows and reduce costs.

The recent surge in M&A activity can be expected to continue. This article looks at the role of gateways, surveys the competitive landscape, and considers what the future may hold for the businesses operating in this market.

The rise of omnichannel

Omnichannel can be expected to evolve rapidly in the near future as purchases initiated by connected devices such as Alexa, OK Google, and Amazon Dash transform customer payments, customer identification, payments confirmation, and other functions. McKinsey estimates that 55 percent of retail growth between 2015 and 2022 will be driven by digitally influenced offline sales. Indeed, more than 70 percent of the global merchants surveyed by ACI Payments in 2016 had already completed an omnichannel deployment or intended to do so within the next two years.

Gateways are responding by building capabilities to meet the need for global omnichannel services. In the next three or four years, they are likely to evolve as platforms delivering an ecosystem of payments solutions that link online and physical shopping, purchasing, returns, and customer relationship management capabilities for a seamless user experience across channels. They also have opportunities to serve consumers seeking a broader range of payments options for their growing use of marketplace platforms such as Amazon, Uber, Instacart, Etsy, and Airbnb. A case in point is Stripe's Instant Payouts, which allows marketplaces to make immediate payments to sellers and service providers on their platforms.

The evolving role of gateways

Payments gateways first emerged during the dawn of e-commerce, with the arrival of companies such as CyberSource in 1994 and Authorize.Net in 1996. Initially, gateways offered merchants a means to connect their websites or point-of-sale software to various payments processors. Since then, they have grown rapidly by taking on multiple roles, including bundled processing, fraud- and analytic-based services, and specialist services such as cross-border payments, protection of sensitive payments details (through tokenization, for instance), and integration into core systems like ERP platforms. The next stage in their evolution is being shaped by merchants' increasing focus on deploying an omnichannel experience that allows consumers to make purchases across multiple countries and channels (see sidebar, "The rise of omnichannel").

The reason for the recent wave of acquisitions is not hard to find. Gateways are in a unique position to take advantage of the explosion in retail and commercial electronic transactions, and to address the increasing complexity of merchants' needs as they move toward digitally based omnichannel services. Gateways help improve connectivity across the payments value chain, enabling merchants to meet consumers' increasing expectations for instantaneous payments processing from any location. And they are on a healthy growth trajectory, with revenues growing at a compound annual growth rate of 27 percent between 2012 and 2016, and a projected 20 percent from 2016 to 2020.

Meeting merchants' emerging needs

Almost all gateways meet a basic set of merchant needs, including processing capabilities, fraud detection and prevention, and data-driven insights. Beyond that, value propositions vary considerably in terms of functionality, speed to market (including onboarding time), supporting ecosystems (acquiring license, local bank partnerships, and so on), and technology.

Many gateways focus on specific customer segments, whether large multinational

Exhibit 1

Gateway acquisitions multiplied in 2017

Deal announced, 2017	Target	Acquirer	Reported rationale
January	Sterling Payment Technologies	EVO Payments International	Enhance existing integrated payments offering and extend distribution capabilities across industry verticals.
January	BC Technologies, NAMS, ANARAQ	Clarus Merchant Services	Acquisition of North American Merchant Services (NAMS), BC Technologies, and payment-processing assets from ANARAQ (specializing in e-payment technologies) expands US presence by widening provision of future-proof payments products.
February	TIO Networks	PayPal	Access to 14 million customers who pay their utility and cable bills at 65,000 kiosks.
March	Acculynk	First Data	Enhance e-commerce capabilities with debit routing with lowest-cost rails, government bill pay system, peer-to-peer offering, and others for fraud and settlement.
April	Paymetric	Vantiv	Enhance e-commerce technology capabilities and expand into high-growth channels and verticals.
May	CardConnect	First Data	Add immediate capabilities in ERP-integrated payments solutions and accelerate FDC's ISV initiative to focus on B2B payments.
July	Digital River	Wordline	Expand global reach by providing access to merchants in Brazil, US, and European countries.

Source: Dealogic; Capital IQ; press reports; McKinsey Payments Practice

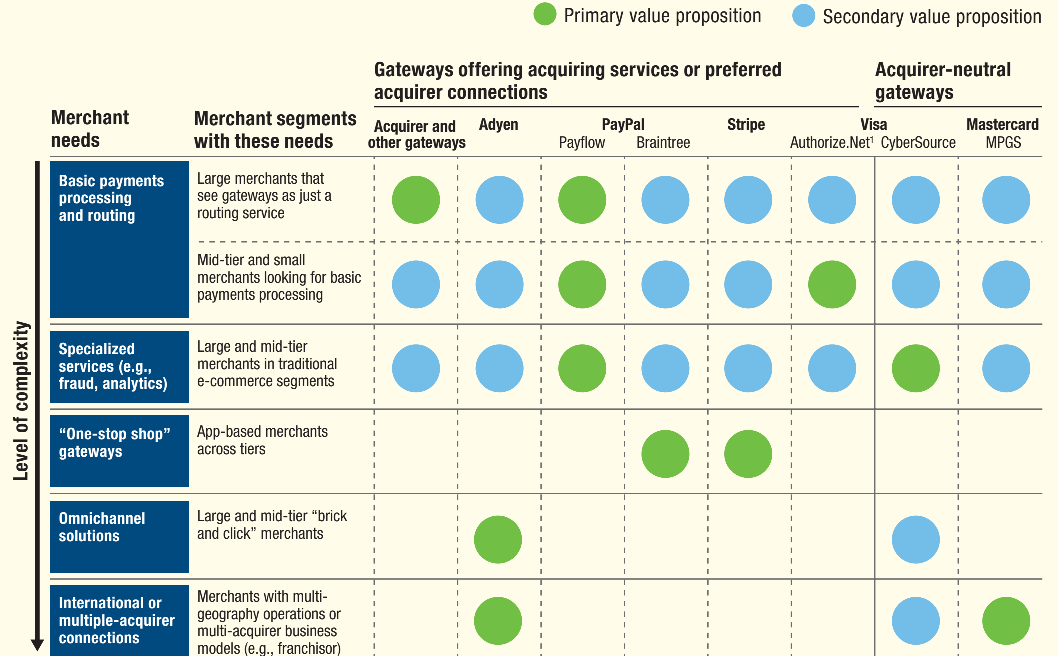
corporations or small and medium-size enterprises looking for a one-stop shop. For instance, Stripe and PayPal's Braintree provide easy-to-integrate, full-service platforms for app providers. Adyen, meanwhile, provides omnichannel capabilities for merchants looking to combine their brick-and-click workflows. Finally, some merchants pursuing multiple acquiring relationships look to payments gateways as a means to integrate their operations across acquirers (Exhibit 2). They may be seeking to drive down acquiring costs by playing acquirers off against one another, operating across multiple markets, or working in a franchisor/franchisee relationship.

More than two-thirds of the payments volumes handled by gateways comes from large merchants with in excess of 20 million transactions per year. These clients have highly sophisticated needs and require omnichannel functionality and multi-acquiring capabilities. The next-largest market segment, with some 17 percent of payments volumes, consists of small merchants with fewer than one million transactions per year that are looking for a one-stop-shop payments gateway. Mid-tier merchants, the smallest segment with about 14 percent of volumes, are following the same trend as larger merchants, with needs in omnichannel and multi-acquiring (Exhibit 3).

Much of the estimated 20 percent annual increase in the size of the payments gateway market over the next five years is likely to be driven by strong growth in digital channels, which are expected to fuel 60 percent of new purchase volumes. Most of this growth will

Exhibit 2

Current value propositions vary based on the needs of the target merchant segments

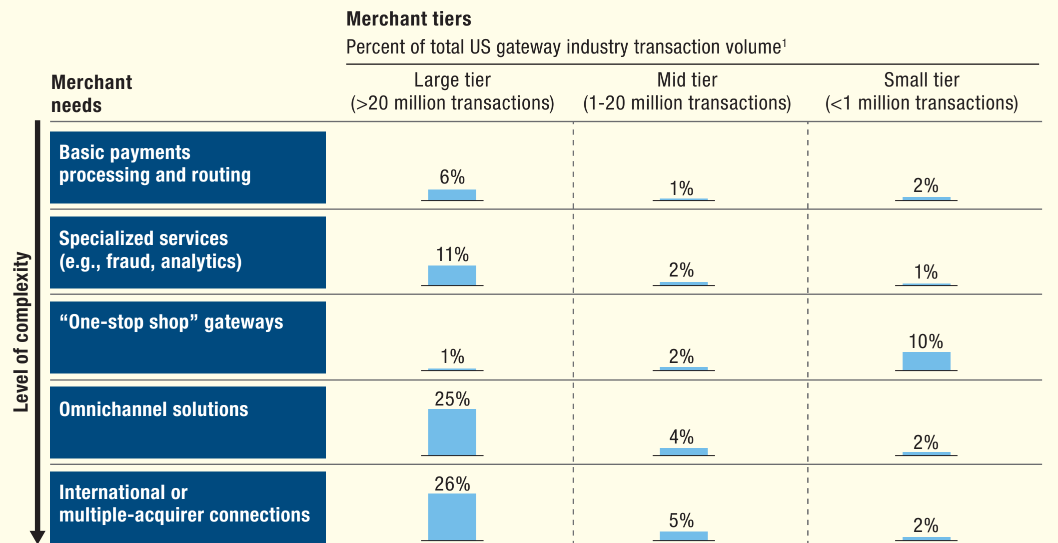


[1] Offers Global Payments Merchant Account to customers at sign-up

Source: McKinsey Payments Practice

Exhibit 3

Gateways can meet merchant needs for omnichannel and multi-acquirer solutions



1 Does not include Amazon, Apple iTunes and Google's transaction volume.

Source: McKinsey Global Payments Map

The growth of business-to-business payments gateways

To reduce costs and improve efficiencies, businesses are increasingly integrating accounts payable and accounts receivable into their systems. That in turn is driving the digitization of commercial payments as companies increasingly turn away from paper checks and favor electronic clearing via automated clearing house (ACH) for settling their transactions. Between 2011 and 2015, the share of domestic B2B payables settled in the US via ACH increased from 14 to 20 percent, while checks fell from 63 to 57 percent. Part of the decline in check usage can be attributed to commercial cards, which are growing at 7 percent per year according to McKinsey's US Payments Map.

As more countries make the transition to real-time payments systems, cross-border commercial payments will benefit. The accelerating speed of transactions and the rich data they yield will drive companies to look for processing solutions that integrate seamlessly with their systems. This will allow them to capture operational improvements by reducing manual reconciliation and human intervention. They will also be able to take advantage of information flows as invoice and other data is "attached" to the payment itself.

Most B2B payment gateways fall into two categories:

Gateways owned or led by acquirers or processors include Element, owned by Vantiv, which offers merchant-acquiring services and ERP integration functionality; Paymetric, also owned by Vantiv, which targets mostly SAP ERP customers; InstaMed, which focuses on healthcare and processes for Elavon; CardConnect, which offers solutions for both enterprise and small and medium-size business payments; and BluePay, which targets smaller companies within niche segments such as accounting.

Specialized players include TrustCommerce, which focuses on hospitals, and Delego, which targets ERP customers that use SAP.

come from "in-app" transactions—an increasingly important channel for traditional retailers—and from merchants' increasing deployment of omnichannel solutions that require the support of digital specialists. Material growth and acquisition activity are also evident in business-to-business (B2B) gateways as businesses increasingly integrate payments into their systems (see sidebar above).

* * *

As the market continues to evolve, more acquisition activity can be expected, particularly among the gateway providers that serve mid-tier merchants. These gateways tend to fall between the meaningful value propositions of serving small businesses at one end and larger merchants at the other. As such, they are likely to be subsumed into other gateways or adjacent providers in the payments value chain. Processors are likely to move forward in the chain, acquiring gateway players to do so; conversely, software providers will move backward, also by acquiring gateways. Gateways with strong positions in the small-business or large-merchant segments are more likely to be on the offensive when it comes to consolidation.

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Payments disputes: A pathway to deeper customer relationships

Card-related payment disputes between customer and merchant occur in fewer than one percent of transactions, but these moments can have an outsized impact on bank-customer relationships. The cornerstone of these relationships is trust—trust that customers' deposits are safe, and that they can dispute a charge or transaction and get a quick, factual answer.

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For customers, disputes can be a source of frustration and inconvenience. For banks, disputes are expensive to resolve. If banks treat disputes simply as issues to be minimized, they can miss the silver lining—that is, the opportunity to strengthen their relationships with customers.

This point is particularly important today. Globally, customers continue to move away from cash and checks toward electronic payments (Exhibit 1). Overall, this trend is a positive development for banks and card issuers, but as card transactions grow, so does the number of disputable transactions (and the incidence of fraud), putting pressure on dispute processes that often are already over-extended, and leading to increases in operating costs of hundreds of millions of dollars.

As they benefit from growth in credit and debit card use, in other words, banks and card providers must ensure that the customer experience is not degraded. A number of banks are therefore rethinking the way they manage disputes with an eye toward maintaining and even strengthening their trust-based customer relationships—all while processing disputes more cost-efficiently, at lower regulatory risk.

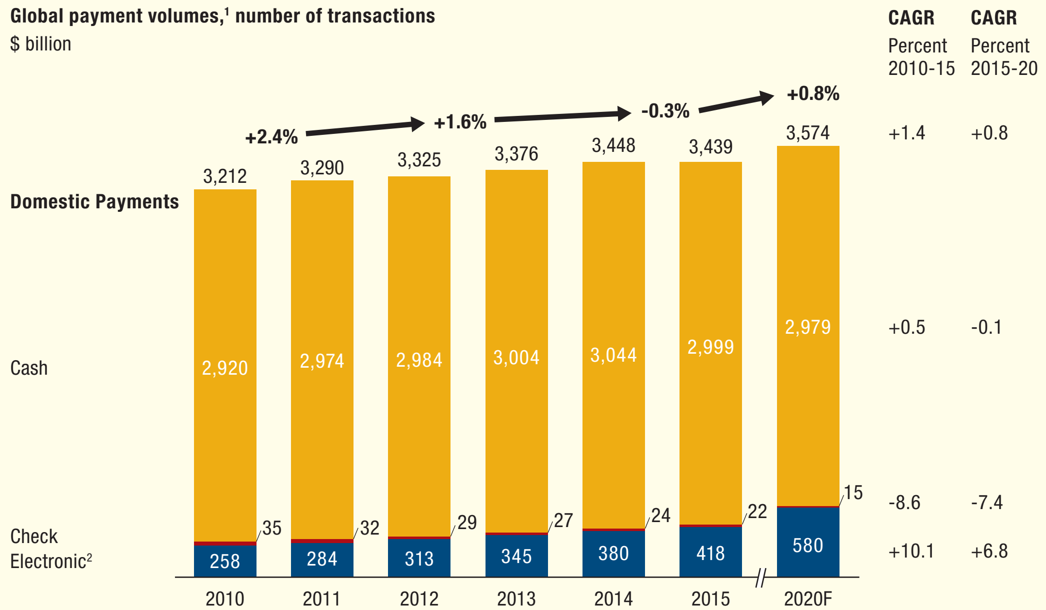
Complex operating models and other obstacles

Today, most banks face a number of costly obstacles as they seek to address a rising number of card disputes:

- **Complex operating models.** Most banks' traditional, budget-controlled functional structures lack a clear, end-to-end chain of responsibility for the disputes experience. The operating model's complexity obscures distinct ownership of the client experience, and in some cases there is a definitive separation among the functions required to take in and resolve disputes

Exhibit 1

Electronic payments continue to gain share, increasing the pool of payments that can be disputed



[1] Cash deposits and withdrawals are not included.

[2] Includes direct debits, credit transfers, and card transactions.

Source: McKinsey Global Payments Map 2015

(e.g., the call center, dispute research, and the back office). This disjointed model leads to more customer pain points and delays in time-to-credit and overall dispute resolution. To exacerbate matters, most dispute organizations are scattered geographically—some US-based banks have as many as 15 dispute resolution locations—which intensifies operational complexity.

- **Over-processing of disputes.** Banks and issuers usually process all disputes above $25—irrespective of dollar amount, customer, or the merchant's dispute history—and apply the same process across the board. This lack of triage allows dispute volume to rise and puts pressure on dispute teams to process disputes quickly to save costs and avoid regulatory infractions.

- **Long, complex research process.** In most banks, the dispute process involves multiple IT systems and tends to be driven by the technology the bank has rather than the technology it needs. In some cases, banks must turn to third parties to conduct additional research on fraud. For example, banks usually have a case management system to make decisions about disputes, but analysts often have to leverage other systems to access information needed for the decision (e.g., ATM camera recordings, ACH platforms).

- **Ineffective quality assurance.** At some banks, the process of reviewing dispute decisions is overly focused on checking regulatory boxes rather than on the overall accuracy of the decision. Banks and issuers thus miss the opportunity to catch and fix incorrect decisions. This problem

is especially prevalent at larger institutions, where intense regulatory scrutiny often inadvertently makes compliance a higher priority than quality control. Instead, leading banks are now embedding regulatory checks into more effective dispute processes.

- **Inadequate performance management.** Process complexity of the kind that characterizes dispute resolution at most banks results in highly variable individual performance. As mentioned, banks are often overly focused on preventing regulatory violations—at the expense of performance. McKinsey has seen differences in productivity of more than two and a half times between the top and bottom quartiles of dispute research analysts who process disputes. Limited use of metrics, a lack of individual and team performance targets, and a dearth of fact-based coaching to improve individual performance and identify problems all exacerbate the challenge.

- **Over-reliance on the case management system.** Years ago, many institutions implemented case management systems for dispute resolution with the expectation that the technology would drive down costs. However, most realized only marginal improvements in efficiency and speed of resolution. In McKinsey's experience, case management systems deliver full value only when they can integrate effectively with the various systems used to investigate disputes—fraud prevention, ATM, and transaction history systems, for example—and can follow a streamlined process to resolve them. Typically, the handle time for resolving a case does not go beyond an hour, but it can take up to five days to provide an answer to the customer.

- **Increasing regulatory focus.** Customer-protection regulations—such as Regulations E and Z in the US—tighten the timelines for banks to resolve disputes and raise the pressure on teams to process disputes and provide credit faster. However, while providing credit faster alleviates one pain point, many card providers see it as a simply a Band-Aid, leaving the underlying issue unresolved.

Simpler, smarter processing

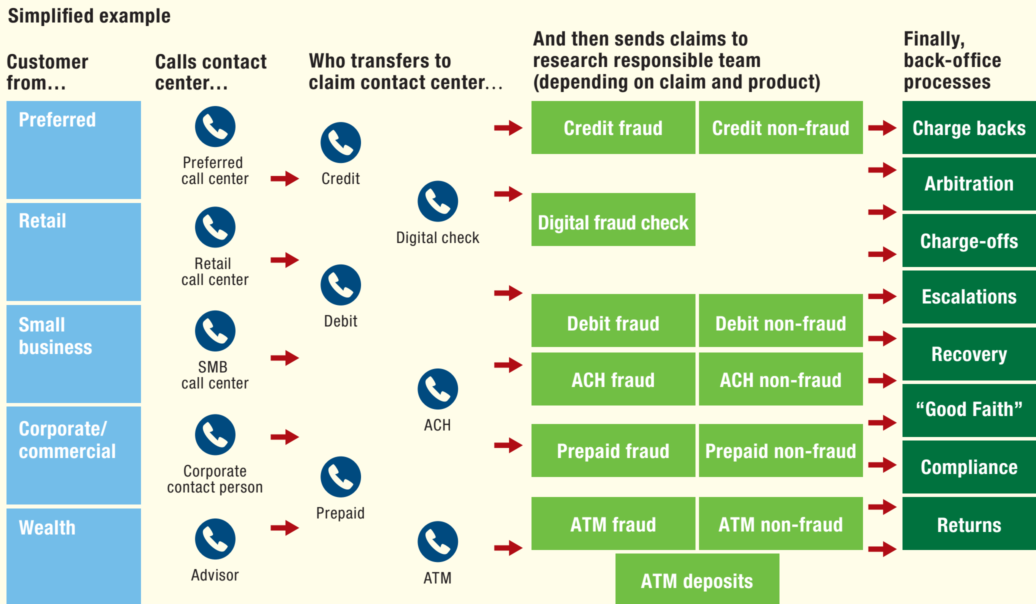
New insights, tools, and capabilities are emerging that enable banks to address many of the obstacles they currently face in the dispute resolution arena. An integrated, next-generation operating model based on these new capabilities improves the customer experience (providing 100 percent of customers with real-time, provisional credit decisions), reduce costs (with efficiency gains of 30 percent or more) and financial losses (by up to 5 to 7 percent), and lower regulatory risk (reducing customer-impacting errors by 80 percent). To achieve these results, banks and card issuers can focus on five imperatives (Exhibit 2, page 26):

1. Digitize the dispute resolution process

Digitizing the dispute process dramatically reduces the time and effort required for a customer to file a dispute and for the bank to take in the dispute. Best-in-class institutions are simplifying their intake process—taking a customer-centric view—to the point where customers can file disputes in a couple of minutes on their mobile devices (compared

Exhibit 2

At most banks, silos result in limited end-to-end ownership of the disputes experience



Source: McKinsey & Company

to the ten minutes it takes to do so speaking on the phone). Banks are also streamlining the research process by providing a set of questions that customers must answer up front. Call center agents and customers no longer have to plow through a questionnaire to understand or explain the dispute.

2. Redesign the process with lean principles

Traditionally, banks have sought to improve the dispute process through technology investments and process tweaks—leading to only marginal gains. Only banks that have conducted a “zero-based” design of the entire dispute process have achieved dramatic change. Designing a new dispute process from scratch is the only way to truly simplify dispute research policies and requirements. Some banks have increased productivity quickly by categorizing disputes according to their complexity (e.g., number of transactions, number of different systems required to decision).

3. Apply advanced analytics

Some banks and issuers are leveraging advanced analytics and machine learning (in which computers “learn” patterns from examples and apply the insights to new data) to predict disputes and fraud (e.g., letting a customer know that a suspicious transaction has occurred and giving them the option to decline it). While fraud detection has leveraged neural networks for the last two decades, the next generation of models are substantially more powerful, leveraging more data within shorter timespans. These processes work by using dozens to hundreds of variables to determine whether provisional or final immediate credit is the optimal strategy for resolving a particular

dispute. Banks are also using analytics to estimate the amount of effort required to research a dispute, based on the customer's history and the merchant profile. The value of such an approach is significant; consider that one regional US bank was conducting a complete research process for all disputes before providing provisional credit, despite the fact that it approved final credit in 98 percent of cases. Advanced analytics also dramatically improves the customer experience by expediting time-to-funds, and it frees up research capacity to focus on more complex and higher-impact disputes.

4. Employ intelligent process automation

Intelligent process automation (IPA)—or robotics—is used to automate aspects of the end-to-end dispute-processing value chain. IPA reduces dispute resolution cycle times, boost operational efficiency, and improve overall customer experience. The most common use cases include:

- *Fraud prevention.* Advanced analytics flags potentially fraudulent transactions and address them before they become disputes. For example, McKinsey has worked with QuantumBlack to develop a model that uses machine learning and a random forest model to flag potential fraud cases based on 13 months of transaction history.
- *Intake review.* Machine learning identifies the type of dispute (e.g., fraudulent vs. non-fraudulent, PIN-based vs. non-PIN-based).
- *Dispute management.* Advanced analytics is used to separate complex disputes from simple ones and assign them to the appropriate analyst. For example, a US bank used an algorithm to identify complex disputes and matched the dispute to an analyst based on analyst's skill set and the other disputes they were working on that day. The result was less "context changing" and a 10 percent increase in productivity.
- *Dispute processing.* Banks use robotics to collect information automatically and prepare cases for human processing.
- *Post-dispute processing.* Robotics is used to process credits and to send notifications and status alerts to customers.
- *Post-dispute QA on fraud.* Machine-learning is used to identify paid dispute cases that need to be audited.
- *Dispute support.* Cognitive agents and robo-chat functionality can answer customer queries during the dispute research process.

5. Strengthen management systems

While new technologies offer banks the opportunity to re-envision and redesign dispute processes, there is no substitute for best-in-class management systems. Banks and card issuers that excel at dispute management usually take an end-to-end approach to managing the dispute process. They assign a product owner to the entire dispute process for each product or claim, and that owner is responsible for—and compensated for—delivering better customer experience, quality, and efficiency across intake, research, payout, and communication. Clarity in expected customer outcomes and strong key performance indicators—such as KPIs that measure the process from end to end, or KPIs that assess performance from the customer's perspective—help staff to focus on the right goals.

A disputes transformation

A top-20 US bank recently simplified its disputes process from end to end. Before this effort, the bank's operational costs were rapidly growing while customers were forced to go through lengthy processes to resolve their disputes—attracting the growing scrutiny of regulators. As part of a bank-wide transformation of the customer experience, the bank decided to deliver a next-generation disputes experience to its customers.

The bank focused on three areas: dramatically enhancing the customer experience, simplifying the process to improve speed and quality, and reducing costs. The transformation started with a map of internal and external pain points based on customer insights, front-line interviews, and cross-functional focus groups. The bank then redesigned the end-to-end process to reduce steps and to limit the information needed, installed an advanced analytics model to determine the likelihood of dispute pay-out so that more customers could be given immediate credit, and installed a new operating model in the dispute research areas. A management system that drives continuous improvement supports the new operating model. These initiatives were piloted with a group of 150 employees for two months before being rolled out enterprise-wide.

The transformation resulted in a 25 percent increase in productivity after two months. About 500,000 customers benefited from immediate credit provisioning, error rates dropped by 80 percent, and the number of customer complaints resulting from disputes dropped by 20 percent. Invigorated by this success, the management team has leveraged this same approach to transform other key customer processes across the bank.

Making the most of disputes

Transforming the dispute resolution process provides banks with an opportunity to solidify bonds with their customers while driving down costs. The benefits can be grouped into three broad categories:

- Strengthening trust. A quick resolution—and provisional funds when appropriate—can turn a negative customer experience into a loyalty-building moment. Loyal customers tend to feel that their bank "has their back"—but it often takes a dispute for them to reach that level of comfort.
- Cutting operating costs. McKinsey estimates that the top 15 US banks spend approximately $3 billion each year, combined, on disputes processing. (About 50 million to 100 million disputes occur annually in the United States, with a cost per dispute ranging from $10 to $50.) Implementing the next-generation operating model reduces these operating expenses by 25 to 40 percent.
- Improving quality. Given the complexities in the dispute research process and the pressure to resolve disputes quickly, quality can suffer. McKinsey has seen banks where 10 percent of dispute outcomes were incorrect (both in favor of and against customers). Simplifying and automating the process leads to better decisions.

* * *

The disputes process is often overlooked as a chance to build trust with customers. This is a missed opportunity, as the tools and capabilities that will enhance the customer experience can also improve bank outcomes and reduce costs. As banks seek to improve the dispute process, they should look beyond traditional incremental changes and reimagine the process from start to finish. This will not be simple endeavor, but the rewards can be significant.

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