

# Payments Strategic Sourcing

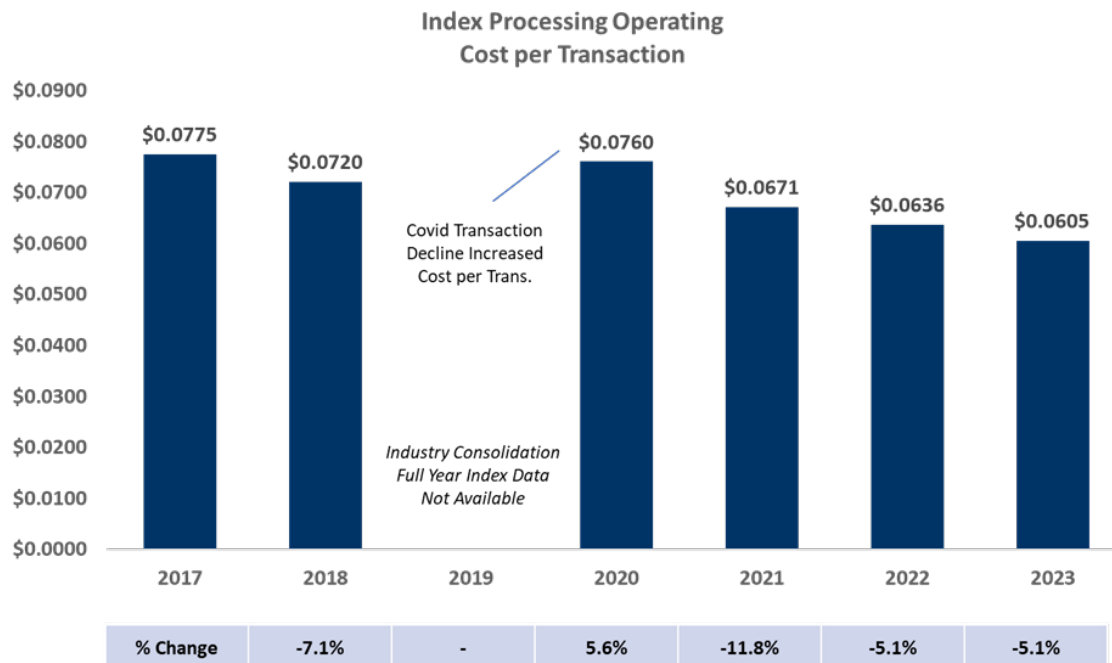
Industry Insights

June 2024

## Even in “Challenging” Conditions, Processors Continue to Reap the Benefit of Platform Leverage.

McGovern Smith updated its Processor Cost Index<sup>1</sup> for 2023 and the results show that processor operating costs per transaction fell by 5.1%. This is the second straight year that processor operating costs per transaction fell by a healthy amount and were not otherwise influenced by Covid-19.

While every processor has its own unique situation or challenges, the index measures the per transaction decline in operating costs across an index of card processors. The analysis remains consistent from year-to-year and provides a relevant fact-base to issuers as they approach contract renewals or competitive selection processes. Processors effectively managed total operating costs associated with card processing platforms with 2023 the lowest year-to-year increase since 2018 and a continuation of the downward trend since 2021. Most processors expanded operating margin / platform profits as transaction-based revenue grew much faster than costs in 2023.



The underlying health of issuer processing platforms is quite strong and largely unaffected by economic headwinds or those headwind “challenges” communicated by processors to clients; although we recognize some services (e.g., back-office servicing) do have their challenges for processors. A review of Q1 2024 company earnings and related analyst discussions forecasts that platform health and leverage will remain quite strong throughout 2024.

So, what does this mean for card issuers? Since credit and debit card processing and related services

<sup>1</sup> Index measures third party card issuer processing and related services (e.g., ATM driving, EFT network, back-office, etc.) operating expenses per transaction. The Index is derived from SEC filings, industry statistics and other public information. 2020 % Change is measured from 2018 data.

are predominantly priced variably (i.e., per transaction), card issuers should attempt to mirror the decline in processor operating costs over time in their renewal or sourcing processes.

At a minimum, issuers that executed contracts in or around 2018 should target **unit cost savings of 16.2%** today to mirror the decline in processor operating costs per transaction 2018 to 2023. However, we believe issuers should be more aggressive and consider forecasted 2024 results in their targets; particularly with potentially dramatic changes to debit card interchange (the Federal Reserve is proposing a nearly 28% decline in maximum allowable interchange for covered issuers) and changes to credit card interchange with the pending Visa and MasterCard merchant settlement.

McGovern Smith forecasts processor operating cost per transactions will decline by 4.5% in 2024, conservatively assuming an uptick in total operating cost growth to 3% and similar transaction growth of 7.8%. Using this forecast, we believe issuers should at a minimum target **unit cost savings of 20%**. Furthermore, the data suggests that issuers should strongly push back on most fee escalators pursued by processors tied to CPI or other factor – even if they are included in current agreements.

**Select Data<sup>2</sup>**

% Change	2018	2019	2020	2021	2022	2023	2024E
Total Operating Expense	0.8%	-	11.6%	4.2%	3.3%	2.3%	3.0%
Total Transactions	8.5%	-	5.7%	18.1%	8.8%	7.8%	7.8%
Operating Cost per Transaction	-7.1%	-	5.6%	-11.8%	-5.1%	-5.1%	-4.5%

While the index results and forecast should be targeted by many institutions for their respective businesses, individual savings results will continue to be influenced by a variety of factors, including current or baseline pricing, mix of services (including FTE-based such as customer service), program size, the process employed (competitive RFP processes tend to drive better results than renewal or renegotiation processes), the amount of premium or value-added services, and others. With that said, processor operating expense per transaction continues to fall since the time issuers executed current agreements with incumbent providers and should be effectively considered/targeted in go forward renewal or competitive selection processes.

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**McGovern Smith Advisors - Payments Strategic Sourcing Offerings**

Card Brand / Network	Processing / Related Services	Back-Office / Other
<ul style="list-style-type: none"> <li>• Consumer/Small Business Credit</li> <li>• Commercial Card</li> <li>• Signature / Prepaid Debit</li> <li>• EFT - Issuing (PIN-POS &amp; ATM)</li> <li>• EFT - ATM Acquiring</li> </ul>	<ul style="list-style-type: none"> <li>• Credit Card Processing</li> <li>• Signature &amp; PIN-Debit Processing</li> <li>• Commercial Card Management</li> <li>• ATM Driving / ATM as a Service</li> <li>• Merchant Acquiring / Servicing</li> </ul>	<ul style="list-style-type: none"> <li>• Customer Service</li> <li>• Fraud Detection &amp; Operations</li> <li>• Dispute Processing</li> <li>• Collections</li> <li>• Application Processing / Bureaus</li> </ul>

<sup>2</sup> 2020 % Change is measured from 2018 data.