



Case 11: Credit/Debit Card Processor

BACKGROUND

Firm: McKinsey & Company

Round: 2005 Summer, First

Content: Qualitative and quantitative

CASE TOPIC

Pierce Processing is a credit/debit card processor. It provides outsourced services to credit/debit card issuers. The issuer pays a percentage of transaction fees to Pierce for providing the following services:

- credit authorization,
- fraud detection,
- accounting and reporting.

Issuers outsource this function to companies like Pierce because of the high cost of maintaining their own IT systems to perform this function. Pierce has hired us to find ways to sustain its double digit growth that the company has enjoyed for the past 20 years.

INTERVIEWER BRIEFING

This case is representative of many of the prepared, McKinsey round 1 cases, in which the interviewer actively walks the interviewee through a set of qualitative and quantitative questions. The interviewer should “stick to the script” of questions. To the effect that the interviewee struggles, the interviewer can assist the interviewee to get back on track.

The interviewee should be structured in answering qualitative questions and crunch through any numbers thrown his or her way, always keeping in mind how they tie back to the larger issues.

CASE QUESTIONS

Interviewer: *What steps could Pierce take to keep a high growth rate?*

Interviewee: What is Pierce’s current market position in the credit card market?

Interviewer: *Pierce currently serves the 10 of the top 20 issuers of the country. The 20 top issuers comprise 90% of the credit card market. The 10 of the top 20 that are not Pierce’s customers either use Pierce’s competition or perform the function in-house.*

Interviewee: How fast is the credit card market growing?

Interviewer: *The number of credit card transactions is growing at 3% annually.*

Interviewee: How does Pierce price currently in the credit card market?



Interviewer: *Pierce earns a percentage of the transaction fee of each transaction.*

Interviewee: Is there any other revenue stream?

Interviewer: *Someone has suggested that Pierce could license its software as another business model, in addition to being the outsourced processor. In this case, the issuer would license Pierce software and process the transactions in-house. Pierce would get an upfront license fee and ongoing maintenance fee. What should Pierce consider in evaluating the software license model?*

Interviewee: Possible answers:

- Danger of cannibalization,
- Impact of new revenue source- upfront cash and recurring revenue stream
- Added cost of maintenance and support of this business model.

Interviewer: *Assume that if Pierce offered the software license model, 50% of its existing customers will switch to this model. 50% of the remaining 10 issues that are not currently Pierce customer will sign with Pierce. The revenue of providing outsourced processing is \$1M/year. The upfront fee of license model is \$3M and \$300K in annual maintenance fee. Calculate the impact on revenue for the next 5 years if Pierce offers this new licensing model (ignoring time value of money).*

Interviewee: Revenue is \$70M under new plan for the next 5 years, compared with \$50M if the software license model is not adopted.

Interviewer: *Good. What else would you like to know in order to reach a recommendation?*

Interviewee: What is Pierce's current market position in the debit card market?

Interviewer: *Pierce has 5% market share.*

Interviewee: Who are Pierce's main competitors in the debit card market? How much market share do they have?

Interviewer: *The market is very fragmented. No player has more than 10% market share. What can Pierce do to gain more market share in the debit card segment?*

Interviewee: Possible answers: acquire competitors, set up a partnership with a competitor, use innovate marketing schemes (e.g. incentives)

Interviewer: *There is another segment of the market, store value segment, where Pierce currently has no offerings. This is the market of store-specific gift cards, i.e. Starbucks card or GAP gift cards. This market is projected to grow at 50% annually over the next 10 years. What are some of the issues to consider in determining whether Pierce should enter this market?*



Interviewee: Cost of offering this new service vs. potential revenue, difficulty in setting up partnerships and Pierce's experience with this, complexity of a revenue-sharing scheme, "stickiness" of store-aligned cards vs. regular cards, potential cannibalization of regular cards

Interviewer: *Suppose we know that the total market of store value is \$1B today. The transaction fee is 1% of the total value. Processing firms, like Pierce, would earn about 10% of the transaction fees. What is expected revenue from this new segment this year?*

(Note to interviewer: See if the interviewee asks for a market share number. If asked, Pierce expects 30% market share.)

Interviewee: So Pierce would expect revenue of \$300K ($\$1B * 1\% = \$10M$ total transaction fees, X 30% market share = \$3M Pierce-related transaction fees, X 10% = \$300K Pierce take of the transaction fees).

Interviewer: *Suppose it costs \$1M to build the system required to process store cards. Assume 5-year useful life, what's Pierce's expected profit (accounting profit) in the first year?*

Interviewee: Answer: $\$300K - (\$1M/5) = \$100K$