World-wide trends in innovation on the acquiring side

CPSS-World Bank retail payments forum

Perugia, March 19th 2013
EDGAR, DUNN & COMPANY (EDC) is an independent global financial services and payments consultancy. Founded in 1978, the firm is widely regarded as a trusted advisor to its clients, providing a full range of strategy consulting services, expertise and market insight.

The financial services and payments industries are increasingly cross-border and global enterprises. EDC leverages its global footprint and 30+ years of experience to facilitate development and implementation of successful strategies for our clients that satisfy both their market-specific and global needs.

Today we serve clients in more than 45 countries on six continents from seven locations worldwide.
“We live in a society where technology is a very important force in business, in our daily lives. And all technology starts as a spark in someone's brain. An idea of something that didn't exist before, that once they have invented it —brought it into existence — could change everything. And that activity is generally one that's not very well supported.”

Nathan Myhrvold, CEO, Intellectual Ventures (HBR, 2010)
The rapid advancement of technology in payments is now a key focus in the payments industry.

What is the single most significant issue that you expect to face in your current organization over the next 3 years?

- Regulation: 39%
- Technology advancement: 28%
- Competitive Pressure: 18%
- Industry Mergers and Acquisitions: 11%
- Litigation: 2%
- Other: 2%

Increasing from 10% since the 2009 Survey

Source: EDC Advanced Payments Survey 2012
Acquiring is one of two domains in the 4 Party model

- Most payment cards work on the 4 Party System which consists of two “users” (cardholder and merchant) and two providers (card Issuer and merchant acquirer – usually both financial institutions)

- The providers work together to offer payment services to those who have a complete a payment transaction
The merchant acquiring space is becoming increasingly competitive, complex, and specialized

Over the past five years, numerous changes have significantly impacted the global acquiring industry

Consumer payment preferences are increasingly diverse and merchants are looking to accept all of the payment methods their customers prefer to use, and in the form factor they desire (e.g., mobile, contactless, e-wallet, etc.)

Merchant acquiring has increasingly become a commoditized business, and increased regulatory intervention has raised awareness of merchants’ payment acceptance costs leading to down-market margin pressures

Merchants demand for specialized value added services (VAS’s) has increased. This demand has in turn supported the growing specialization of VAR’s who focus on selling a focused suite of VAS’s to specific merchant segments

In addition to VARs providing value-added services, companies such as Square and LevelUp have challenged the underling business model of the entire industry
Acquirers are subject to various aspects of regulation

- SEPA Cards Framework
- Interchange regulation
- Payment Services Directive
- AML Directive
- E-Money Directive
- Security Standards
- Regulation
- Consumer Protection
- Durbin amendment
Payment acceptance costs have been the focus of significant regulatory oversight.

Regulators are seeking to reduce the cost of payment acceptance.

- **Australia** has one of the most heavily regulated payments environments. As a result, acquiring margins are razor thin and continue to fall.
- **China** is the only market where the actual Merchant Service Fee is regulated. Additionally, the distribution of that fee between China Union Pay, the issuer and the acquirer is also mandated.
- **Europe** has recently enacted legislation that requires offering unbundled merchant service charges to ensure greater pricing transparency.
- **The U.S.** recently enacted legislation to cap interchange rates for debit cards, and credit card rates may not be far behind.

Selected markets where legislation has had a significant impact in regulating the cost of payment acceptance.

Source: EDC research
How will the payment acceptance business evolve?

The acquiring business will be impacted by three key drivers and will adjust its business model accordingly

External factor 1: **Changing shopping behaviour** and the impact this will have on consumer payment preferences and merchant payment acceptance

External factor 2: **Provision of value-added services** to support merchants in their efforts to increase and optimise sales

External factor 3: **Integration of new entrants** to the acquiring space to offer a different proposition to merchants
External driver 1 – Consumer preferences

Acquirers are expected to provide cross-border and multi-channel solutions

- Convergence of transactions
- Standardization of technologies
- IP (Internet Protocol)
- No distinction between clicks or bricks
- Centralized Processor
External driver 1 – Consumer preferences (continued)


Physical  Online  Mobile
### External driver 1 – Consumer preferences (continued)

#### Alternative Payment methods offered by German E-commerce players (2012)

<table>
<thead>
<tr>
<th>Payment Method</th>
<th>Planned by End 2012</th>
<th>Not Planned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Transfer (in advance)</td>
<td>91.3%</td>
<td></td>
</tr>
<tr>
<td>PayPal</td>
<td>80.9%</td>
<td></td>
</tr>
<tr>
<td>Cash Payment at Outlet (at pickup)</td>
<td>62.0%</td>
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<tr>
<td>Invoice (pay after delivery)</td>
<td>58.0%</td>
<td></td>
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<tr>
<td>Cash at Delivery</td>
<td>54.8%</td>
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<tr>
<td>Credit Cards</td>
<td>51.4%</td>
<td></td>
</tr>
<tr>
<td>Sofortüberweisung</td>
<td>45.2%</td>
<td></td>
</tr>
<tr>
<td>Direct Debit</td>
<td>41.7%</td>
<td></td>
</tr>
<tr>
<td>Giropay</td>
<td>14.1%</td>
<td></td>
</tr>
<tr>
<td>ClickandBuy</td>
<td>10.7%</td>
<td></td>
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<tr>
<td>Checkout with Amazon</td>
<td>9.7%</td>
<td></td>
</tr>
<tr>
<td>Installment / Financing Option</td>
<td>9.0%</td>
<td></td>
</tr>
<tr>
<td>Trustee Service</td>
<td>8.1%</td>
<td></td>
</tr>
<tr>
<td>Skrill (Moneybookers)</td>
<td>7.7%</td>
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<tr>
<td>Prepaid Cards</td>
<td>3.1%</td>
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<tr>
<td>Google Checkout</td>
<td>1.1%</td>
<td></td>
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<tr>
<td>Mobile Payment</td>
<td>0.8%</td>
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</tr>
</tbody>
</table>

Source: E-Commerce Center Handel (ECC)
External driver 2 – Value-added services

There are two strategic options for an acquiring business

1. Acceptance (transaction) Development

   Key elements:
   - Transaction based product
   - Development of acceptance propositions in developing and under-developed markets
   - Development of co-ordinated and integrated acquisition propositions that encompass new payment types and new merchant types
   - Scale economies in processing and settlement of all card and related P.O.I. transactions

2. Merchant Relationship Management

   Key elements:
   - Provision of value-added services (VAS), such as bureau services, marketing packages, information management, consultancy
   - Focus on broader merchant needs and value management
   - Joint planning with key accounts re. major POS changes and international expansions
   - Transaction acquiring services as part of broader segmented merchant propositions
External driver 2 – Value-added services (continued)

- "Basic" card acceptance services: low-cost simple, transactional services for all cards
- "Enhanced" card acceptance services (e.g., multi-channel, DCC, advanced risk mgt)
- Packages for broader needs of specific merchant segments

Increasing Commodityisation

Increasing Merchant Relationship Management
Regardless of region, certain services are already considered imperative

<table>
<thead>
<tr>
<th>Value Added Service</th>
<th>UK</th>
<th>DE</th>
<th>AU</th>
<th>KR</th>
<th>US</th>
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<tbody>
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<td>✔</td>
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<td>Basic Loyalty Program Management</td>
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<td>Basic Online Transaction Reporting</td>
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<tr>
<td>Transaction Export Capabilities</td>
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<tr>
<td>Basic Data Analytics (by Industry)</td>
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<td>🔵</td>
<td>🔵</td>
<td>🔵</td>
</tr>
</tbody>
</table>

Service availability among acquirers:
- Widely available / Robust offerings
- Offered by few / Rudimentary offerings
- Pilot offerings / Offered by startups
External driver 2 – Value-added services (continued)

**Merchants can support consumers throughout the shopping process**

- **Awareness**
  - Geo-fencing & proximity marketing
  - Location based services
  - Digital signage

- **Engagement**
  - Kiosks
  - Mobile apps
  - Mobile barcode scanning
  - QR shopping

- **Conversion**
  - mPOS
  - NFC
  - E-receipts
  - Alternative payments

- **Loyalty**
  - Big data & actionable intelligence
The increasing complexity of the merchant acquiring business has led to the market entry of specialist players:

- **ISOs** often have the localised capability to identify and sell to merchants.
- **VARs** provide insight knowledge and products that acquirers can leverage for their merchant proposition.

Will these players have the ability to change today’s acquiring business?

**Examples**

- Independent Sales Organizations
- Value Added Resellers
- New Entrants / Disruptors
External driver 3 – New entrants (continued)

![LevelUp](image)

has the ability to fundamentally change the economics in acquiring... it is not about payments anymore !!!

Download the LevelUp app.  
Link a credit or debit card to get your LevelUp code.  
Scan your LevelUp Code to pay.

Payment processing costs 2%

When combined with advertising 0% !!!
There is a multitude of devices that offer payment acceptance to small and micro merchants

- Square is one of the most well-known examples of this trend (Chase Paymentech is the acquiring partner backing Square)
  - As of February of 2012, Square reported having over one million merchants in the U.S. actively using their mobile solutions to accept payments

- In Europe, numerous PIN-based EMV mobile POS solutions have recently emerged (Payleven, iZettle, SumUp, etc.), battling for market share

- As opposed to plug-in solutions, EMV compliant mPOS solutions work via Bluetooth

- Sold directly to merchants vs. acquirer alliance?
The Challenges of Innovation in Payments

Is regulation supporting innovation?

➢ Regulation, regulation, regulation* . . .
  ▪ A need to closely supervise those involved in payments to protect customer funds
  ▪ A desire to standardise and speed up the payments process to give greater certainty to customers about when payments would reach recipients
  ▪ A need to improve information given to customers about the payment service provided

➢ The need for interoperability
  ▪ Scaleable and standardised payment systems
  ▪ Fraud prevention tools

➢ Level playing field banks vs. new entrants ???

➢ The apparent dependency on technology as the basis of innovation ... how to regulate technology?

* Source: ‘Payments regulation and the (lack of) clear strategy forward, E-finance & Payments Law & Policy, Dec 2012
Most innovations, quite wisely, leverage the existing payments infrastructure.
What is innovation?

“The ability to continuously reinterpret assets, ideas and passions to deliver new process, products and services that are inherently attractive to the market”
Thank you!

For questions, please contact

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