Balancing Cooperation and Competition in Retail Payment Systems

Redefining the Landscape of Payment Systems
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A. Why is this issue relevant?
   I. Importance of Cooperation versus Competition

B. Retail Payment Markets
   I. Payment Instruments and Services
   II. Market Structure and Dynamics
   III. Behavioral Patterns
   IV. Main Drivers of Cooperation and Competition

C. Policy Issues
   I. Public policy objectives and goals
   II. Guidelines
A.I IMPORTANCE OF COMPETITION VERSUS COOPERATION

- Accessibility and affordability of payment instruments is a function of the level of competition and cooperation.

- Starting point: ”upstream cooperation combined with downstream competition”

- However, IO literature raise issues on conventional wisdom of competition on access services vs. cooperation on infrastructure:
  - Monopolistic pricing
  - Incumbents may create barriers to entry
  - Effects of transfer pricing in two-sided markets

- The CPSS (2003) defined public policy goals and the World Bank a Reform Agenda but there is no clear framework on the nature and extent of public intervention to balance cooperation & competition.
Network of competing and complementary services that facilitates transactions

- Payment instruments (cash, non-cash, paperless)
- Services (access, messaging, clearing, settlement)
- Processes (differ by type of instrument and system)
- Key players (end-users, service providers, authorities)

Significant contributors to the effectiveness and stability of the financial system

- confidence in money (as link to commodity became weaker, need to underpin confidence via regulation/oversight)
- functioning of commerce (banks achieved efficiency gains by pre-depositing or by a system of credit among them)
B.1 PAYMENT INSTRUMENTS AND SERVICES

Payments Services

Payors and Payees (Persons, Firms, Governments) → ACCESS

Payments Instruments (Financial Institutions) → MESSAGING

Payments Instructions (Message Carriers and Direct Clearers) → CLEARING

Processed Payments Obligation (Clearinghouse) → SETTLEMENT

Discharge Obligation (Settlement Bank)
Economies of scale in messaging, clearing and settlement services due to infrastructure fixed costs

- Internet payments may change the scale dynamics

Economies of scope in clearing and settlement services due to technology flexibility

- Different instruments can rely on the same infrastructure

Network externalities in messaging, clearing and settlement services are due to complementarities of users and/or products and compatibility of products

- The more participants in a payments network, the higher the utility to the users
B.II MARKET STRUCTURE AND DYNAMICS

- Retail payment systems structure is a determinant of the level of competition and cooperation
  - Competition across retail payment instruments (e.g., cheque vs. electronic transfers)
  - Competition across payment system providers for the same instrument
    - among platforms (e.g., visa vs. mastercard)
    - within platform between service providers (e.g., cards issuers vs. acquirers)

- Market dynamics can generate
  - Tendency of the network to grow (e.g. tipping, critical mass)
  - Lock-in to obsolete instruments, standards or technologies (e.g., switching costs, excess inertia, path dependence)
  - Fidelity to a single provider (e.g., multihoming and stickiness)
B.III BEHAVIORAL PATTERNS

- No perfect competition (e.g., two sided markets)
- Concentration of platforms:
  - Take advantage of economies of scale/scope and network externalities
  - May hamper product differentiation
- No conclusive evidence on pricing and innovation
Main drivers

- Environmental, legal and legacy factors
- Governance
- Access
- Pricing

Policy Response

- Oversight and Cooperation
Payment instruments (vehicle to transfer value):
- Cash
- Non-cash (paper-based, paperless)

Payment services:
- Access
- Messaging
- Clearing
- Settlement

Market conditions
- Market structure
- Market dynamics
- Competition at different levels:
  o Across instruments
  o Among and within platforms for the same instrument

Behavioral patterns:
- No perfect competition (e.g., two sided markets)
- Concentration of platforms:
  o Take advantage of economies of scale/scope and network externalities
  o May hamper product differentiation
- No conclusive evidence on access, pricing and innovation

Main drivers of cooperation and competition:
- Environmental, Legal and Legacy factors
- Governance
- Access
- Pricing

Policy Response
- Oversight and Cooperation
Efficiency and reliability are the general policy objectives. In addition, at least three policy goals should be considered:

- Achievement of a socially optimal use of payment instruments
- Deployment of an efficient infrastructure to support payment services
- Affordability and easiness of access to payment instruments and services
Guideline 1. Market complexities need to be recognized and analyzed in detail before any action is decided and implemented

- Environmental, legal and legacy factors are important issues shaping the evolution of retail systems
- Governance of the infrastructure has a significant impact on cooperation and competition
- Gaining access to messaging, clearing and settlement services is of capital importance for the ultimate success of new entrants in the market
- Pricing of some retail payment systems are subject to network economies (e.g., two-sided markets) and traditional cost structures are not appropriate to analyze these markets as pricing structures matter
Guideline 2. Policy trade-offs are relevant in this domain. Therefore, policy priorities will have to be determined and the type of public intervention should depend on the main public objective(s) pursued

- Public policy objectives in retail payments systems are multiple
- The justification for intervention depends upon the main public policy objective(s) pursued and upon evidence of perceived market failure
- An ex-ante and transparent determination of policy objectives clarifies actors’ roles and avoids mistrust in the development and operation of the infrastructure
- Market transparency is key to promote competition and dispel mistrust among market players
- Any policy solution should be considered in a dynamic rather than static context
Guideline 3. Effective Oversight of retail payment systems by the central bank is crucial to balance cooperation and competition issues

- Effective oversight is the main tool to achieve an appropriate balance between cooperation and competition.

- Central banks are the natural overseers and should play a central role due to their stake on the confidence in money and functioning of commerce.

- Other authorities have an important role due to multiple implications of retail markets (e.g., competition authorities, financial supervisors, Ministries of Finance, etc.).

- The oversight function scope should be broad to ensure that new instruments and players are covered.

- Oversight instruments range from regulations/incentives (including on access and pricing) to moral suasion and policy dialogue, from antitrust enforcement to structural measures (e.g., government-owned service provision).
Guideline 4. Institutional mechanisms to promote cooperation and information sharing are essential

- Policy making is complex due to the institutional fragmentation of relevant policy makers as well as by the different – and sometimes overlapping – scope of their mandates.

- Sometimes authorities have already established cooperative arrangements but normally with a narrow scope that has to be broadened, other times these arrangements are inexistent and need to be established.

- In particular, it is essential to count with a good cooperative framework between the overseer and the anti-trust agencies that rule against uncompetitive behavior.

- The public authorities should use Payment Councils, industry associations groups and similar bodies as important cooperative tools.
Thank you

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