Visa Consulting & Analytics

Opinion Paper

Merchant Acquiring

Commoditized and consolidated?
Or differentiated and diversified?

What's the direction of the merchant acquiring market, and how can forward-thinking banks benefit?

With all of the shifts we are seeing in the global payment market, it could be argued that merchant acquirers are subject to some of the biggest and most far-reaching changes of all.

On the surface, with large international players summoning-up ever-greater scale, it may look like a classic case of commoditization and consolidation. But, at Visa Consulting & Analytics, we believe that some subtler and more nuanced changes are at play.

In this paper, we consider the main trends, the responses from both traditional and new players, and the type of opportunities open to today's acquirers.

Few global markets are quite as dynamic as merchant acquiring.

As the world embraces electronic payments, what was once a steady, predictable sector is being subject to some significant shifts. There is broad consensus that cashless payments will continue to grow apace. As an example, in its most recent World Payments Report, Cap Gemini forecast a compound annual growth rate (CAGR) of 22.3% for non-cash transaction volumes through to 2022[1]. In rapidly developing markets, the rate should be even faster. And, if anything, the legacy of the COVID-19 crisis is further accelerating this shift away from cash.

While most of the public attention and much of the industry focus may go to the consumer side of the payment business, merchants and their vendors play an equally important role.

Alongside the clear opportunity to enable the growth in online payments, there is considerable scope to displace more cash payments in the face-to-face environment, to benefit from new point of sale technologies, to better integrate the virtual and the physical worlds with seamless omnichannel payment propositions, to respond positively to the sweeping regulatory changes, and to create new value for merchants by delivering a suite of payment and payment-related value-added services (VASs).

In this paper, we investigate six major forces that are shaping the market – before going on to consider the responses from the incumbent players, and the imperatives for forward-thinking acquirers.

1. *World Payment Report, Cap Gemini, September 2019.*

Force #1

The commoditization effect

Leading to a price war in the medium-to-large merchant segments

The traditional acquirer processing model is destined to become more commoditized and less profitable. On the one hand, merchants are looking for a more holistic set of services that goes beyond standard processing functions. On the other, the biggest players in the merchant acquiring market are looking to progressively expand geographically, add more scale, and capture more of the value chain.

Force #2

The e-commerce effect

Enabling specialist online acquirers to outperform the wider market

We continue to witness the dizzying rise in the scale and influence of e-commerce – a trend which, if anything, has been further accelerated in the wake of the COVID-19 pandemic.

As a consequence, the payment facilitators have become major players in the payment value chain. And this, in turn, has had five big implications:

1. An increase in the range of payment methods accepted
2. Seamless merchant onboarding processes
3. A determination among merchants to deliver a frictionless consumer experience
4. Extreme ease of integration across e-commerce platforms
5. Differentiated merchant pricing strategies with an emphasis on simplicity and transparency

Force #3

The disruptive technologies effect

Leading to an expansion of the acquiring value chain and a new range of services

The POS environment was once the domain of closed, proprietary technologies and bespoke, standalone devices. With the adoption of open technologies and low-cost devices, there has been far more scope for acquirers to offer a fuller range of richer services and solutions.

For example, savvy acquirers have looked at how to offer a mix of fixed and portable POS devices, and/or offer omni-channel payment propositions, and/or provide access a marketplace of value added services (VAS) (like inventory management, marketing and loyalty, and working capital solutions etc).

Force #4

The VAS effect

Bringing potential to significantly grow the revenue pools

With the ability for acquirers to offer much more than processing comes the potential for deeper, broader profit pools.

This is particularly the case for micro-merchants and small merchants who are most likely to welcome one-stop access to a range of business-relevant VAS (e.g. CRM, HR services, inventory management). But, in our experience at Visa Consulting & Analytics (VCA), we also see significant potential among the medium and large business segments.

Force #5

The new entrants effect

Forcing traditional acquirers to compete in non-traditional ways

The sharp decrease in technology costs, combined with the shifts in consumer behaviour, have unlocked significant new market opportunities.

Incumbent players were generally slow to spot and grasp the potential. Initially, it was left to a new breed of tech-savvy players to fill the vacuum. And this, in turn, prompted more established players to re-think and re-formulate their offers to both defend and extend their position in the value chain.

Force #6

The regulatory effect

Putting yet more pressure on margins – and yet more rationale for VASs

Across the world, regulatory pressures are putting downward pressure on prices and margins.

In the European Union, for example, interchange regulation paved the way for an attack strategy from new entrants who were suddenly able to compete aggressively on price. And, as the industry's pricing strategies were reformulated, a new level of emphasis was put on VASs – which have played a pivotal role in margin protection.

4. VVCA Co-Brand Engagement, 2019

The reaction from the incumbent players

One of the most interesting consequences of the shift is the different ways that traditional banking acquirers have reacted. Indeed, responses have varied significantly and have been largely determined by the willingness and/or ability of each player to invest in their acquiring operations.

In general, we have seen four broad approaches.

The first two have most relevance to clients who support the medium-to-large merchant segments (where the emphasis is on scale and global coverage). The second two are more relevant for the micro-to-small merchant segments (where there is more of an emphasis on cost efficiency and VAS availability.

Response #1

Rethink the business model

Depending on their willingness to invest, many banks have made fundamental choices about the future of their acquiring business – ranging from the strengthening of the function, right through to full outsourcing to specialized players.

Four broad options are available:

Compete

A few best-in-class traditional players are investing heavily and enhancing their value proposition. They are able to maintain direct customer contact and control, and have a 360° customer view. However, they also need to commit to continuous efficiency improvements. The option is only viable for large-scale operators in markets that compete mainly on price.

Make alliances

Some players have entered formal joint-ventures with a large payment processor with proven technological and innovation capabilities. Direct customer contact and control can be maintained, with the innovation burden shifted to a specialist, scale player, though fortunes are locked-in to a single partner. This option is most relevant in markets where innovation and price both play an important role in competitive dynamics.

Outsource processing

Some players have opted to outsource their processing infrastructure to a third party, enabling them to offset overheads. They still benefit from direct customer contact and control, and they retain a 360° customer view. However, they have to accept an irrevocable lock-in to a single partner. This scenario is most common among players who see acquiring as a core business, but struggle with an uncompetitive cost position.

Re-sell a third-party service

For banks that don't consider acquiring to be core to their business, by re-selling services, they benefit from a risk-free margin, without any innovation or compliance overheads. However, they sacrifice direct customer contact and control, and lose access to customer and transaction data (and the scope for creating VASs that comes with it).

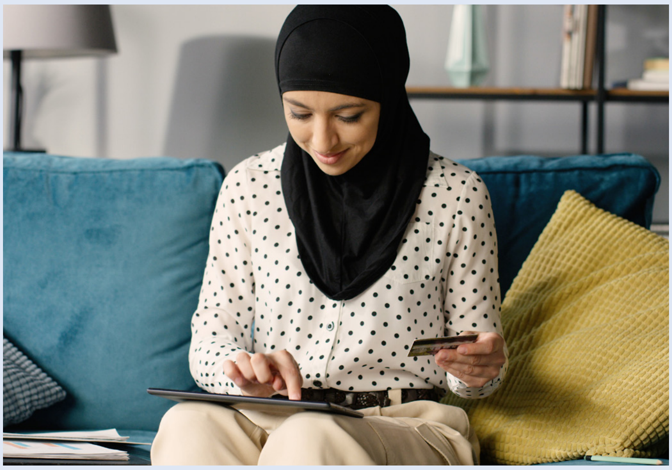
Response #2

Specialize in the most innovative channels

Again, the growth in online payments has been outpacing the growth of the market as a whole. Meanwhile, increased digitalization brings a demand for seamless cross-channel experiences like online-to-offline or vice versa. And, for the largest and most demanding merchants, advanced online and omnichannel payment capabilities are increasingly regarded as a 'must have'.

This is not easy territory for many traditional players to excel in. To do so effectively, they need to:

- Enable the acceptance of multiple payment methods across multiple channels
- Enable easy integration via APIs
- Enable a seamless and friction-free payment experience, irrespective of channel
- Provide merchants with reporting and analytics



Response #3

Excel in innovative face-to-face payments

While the highest growth may be seen in online payments, there is still plenty of potential for innovation in the face-to-face arena, particularly through the delivery of simplified, low-cost solutions to SMEs and micro-businesses. This territory has been revolutionised by the emergence of new hardware solutions combined with innovative software applications which, in turn, can act as readymade platforms to deliver VASs.

For example:

SmartPOS

All-in-one POS and payment systems, integrated with a dedicated app store enables acquirers to offer – and smaller businesses to benefit from – new VASs and business-focussed applications.

Pricing innovation

Instead of one-size-fits-all more flexible and appealing pricing models are appearing, such as zero hardware rental fees balanced by per-transaction processing fees. This model moves revenues from payment fees to payment services.

SoftPOS

Mobile and smartphone technologies have had a transformational impact on the way in which payments can be accepted and the choices available to merchants. Indeed, we have reached the point where almost any type of payment method (including contactless cards, wearables, mobile wallets and so on) can be accepted with almost any type of smartphone (if it is equipped with the right peripherals and runs the right apps).

Thanks to this innovation, it has become possible for banks to provide an acceptance proposition and a pricing proposition that is specifically tailored to particular types of merchant – especially small and micro-merchants.

Response #4

Maximize the VAS opportunity

Especially in the small and micro-merchant segments, the provision of VASs is becoming a key selling point among the new players entering the acquiring market. But, again, this is a relatively straightforward area for banks to pursue – given their existing customer relationships, their customer knowledge, their ability to broker deals with third-party developers, and their broader product and service set.

Also, it should be remembered that this is not entirely new territory for most incumbent acquirers, as they have traditionally offered a range of VAS – such as dynamic currency conversion, tax refunds on international transactions, basic fraud prevention tools and so on.

The challenge – and the opportunity – is to extend this approach and start to add ancillary services that are business-centric and are only indirectly linked to payment acceptance. Examples include:

- Customer relationship management (CRM)
- Inventory management
- Employee management
- Loyalty program management
- Accounting
- E-commerce management
- Reporting and analytics
- Lending at POS
- Working capital financing

Of these, the final two are perhaps the most strategically significant, in that they are likely to be closely aligned with the bank's core business, and represent a direct competitive threat if offered by third-parties. However it is important to bear in mind that many SME's needs are extremely complex and likely to vary significantly from segment to segment, so as well as offering VAS it is imperative that you have effective segmentation in place which will enable the correct intersection of your VAS offerings with the needs of the specific SME segments you are targeting.

Five imperatives for forward-thinking acquirers

In this paper, we have set out our analysis of the changes in the acquiring market.

Simply put, the large merchant segment is a complex, at-scale business that is more and more controlled by sophisticated at-scale providers. However, we still see significant and profitable opportunities for banks to offer differentiated and diversified acquiring services to the micro-merchant and small-to-medium merchant segments.

The specifics of the response will be determined by the bank's circumstances, the size and characteristics of its commercial and business banking portfolio, and the nature of the retail environment in its home markets. However, VAS will play an increasing relevant role in terms of differentiating factor and revenues driver. To this extent we have compiled five imperatives that, we believe, are relevant to any acquiring bank operating anywhere.

Five imperatives for acquirers targeting the Micro- and SME-merchant segments

Construct the right technological and digital capabilities

An excellent SmartPOS ecosystem (including the physical device technology and an app marketplace) is a pivotal requirement. Also, strong digital capabilities are needed to deliver mobile-based VASs (including a laser-like focus on the elegance and simplicity of the UX).

Assemble a relevant VAS portfolio

A complete set of advanced VASs are a 'must have'. Our experience at VCA is that, day-by-day, price competition is becoming less relevant when compared to the range and quality of VASs offered to merchants.

Resolve the 'make or buy' strategic dilemma

'Make' and 'Buy' strategies are both viable. But, if you pursue a 'Make' strategy, it must be backed-up by the right level of investment, and you need to be in a position to move at real pace through your planning and deployment cycles.

Assemble a strong pool of VAS developers

Even when pursuing a largely "Buy" strategy, it is still necessary to assemble a strong pool of VAS developers. It is necessary to stay 100% focused on VAS updates and innovations. And, again, time-to-market is crucial in the new environment, requiring the capability of an autonomous reaction.

Monetize the new data flows

One of the main benefits of a 'Make' strategy is the ability to harvest and retain all of the data that is generated by the VAS usage. This data can be monetized in many different ways – one of the most notable opportunities may be the enhancement of credit scoring and monitoring.

About Visa Consulting & Analytics

We are a global team of hundreds of payments consultants, data scientists and economists across six continents.

- Our consultants are experts in strategy, product, portfolio management, risk, digital and more with decades of experience in the payments industry.
- Our data scientists are experts in statistics, advanced analytics and machine learning with exclusive access to insights from VisaNet, one of the largest payment networks in the world.
- Our economists understand economic conditions impacting consumer spending and provide unique and timely insights into global spending trends.

The combination of our deep payments consulting expertise, our economic intelligence and our breadth of data allows us to identify actionable insights and recommendations that drive better business decisions.

For more information, please contact your Visa Account Executive or email Visa Consulting & Analytics at **VCA@Visa.com**.

You can visit us at **Visa.com** or on **YouTube**. You also might want to take a look at:

- VCA Opinion Paper: Accelerating the shift to ecommerce

Visa Consulting & Analytics is a global team of industry experts in strategy, marketing, operations, risk and economics consulting, with decades of experience in the payments industry. Using analytics from the payment network with the most purchase transactions worldwide, our team of subject matter experts can provide you with proven strategies and data-driven insights that support your business objectives.

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