

Global Trends in the Payment Card Industry 2013: Acquirers

Key challenges faced by card acquirers and their implications for the payment card industry



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1. Highlights

The payment card industry continued with its growth story in 2011, as non-cash transactions continued to grow and cards continued to remain the leader in terms of largest market share. With the growing penetration of online and mobile commerce, cards are now being increasingly used for low- as well as high-value transactions.

The payment acquirers industry is becoming increasingly competitive, which is impacting the margins of each individual player. As a result, acquirers are trying to preserve these margins by offering value-added services. In addition to the price competition, which is putting pressure on acquirers, the growing concern of data breaches is also creating an impact and has led to greater compliance requirements for both acquirers and merchants.

The industry is also witnessing a continual increase in mobile payments, as more and more consumers are using their mobile devices to pay for their purchases. This has led to demand creation for solutions that enable acceptance of mobile payments. Companies like Square®, Isis Mobile Wallet™, and PayPal™ are offering new and innovative solutions to cater to this demand.

This situation presents a strong opportunity for acquirers. Therefore, despite the obstacles related to rapidly evolving technologies, and new fraud threats, merchant acquirers are preparing to invest heavily in mobile payment acceptance solutions.

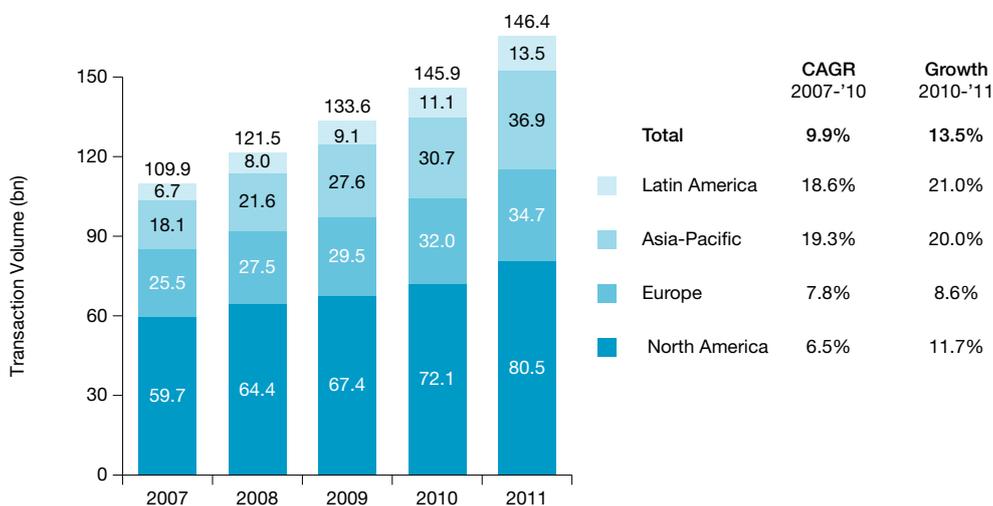
2. Introduction

2.1. Global Payment Card Industry Performance

Card usage across the globe has been growing since the financial crisis hit the world in 2008–2009. During 2011, the transaction volume for cards grew by 13.5%, which is considerably more than the growth rate of 9.2% seen during 2010 largely due to increasing debit card usage globally. The percentage share of cards in the mix of non-cash payments has been consistently growing and was 55.8% in 2010. In 2011, cards also remained the most preferred non-cash payment instrument globally, with 58.8% of the global non-cash payments originated via cards. The growing share of cards in the non-cash payment mix indicates an increasing preference for cards compared to other non-cash payment instruments, such as direct debit, credit transfers, and checks.

In developed countries, card transaction volume is very high, as consumers prefer to use cards even for low-value transactions. However, the developed countries have not been able to match up to the growth showcased by the emerging world. The growth in transaction volume of cards in Europe was in single digits at 8.6% in 2011 and in the U.S. it was 11.7%. This growth is hardly comparable to growth rates exhibited by Latin America, which saw a growth rate of 21.0% and Asia-Pacific, with a growth rate of 20% in 2011. Both Latin America and Asia Pacific have been showcasing enormous growth for the past few years.

Exhibit 1: Global Card Transaction Volume (bn) by Region, 2007–11



Source: Capgemini Analysis, 2013; ECB Statistical Data Warehouse, 2011 figures released September 2012; Bank for International Settlements Red Book, 2011 figures released January 2013, Country' Central Bank Annual Reports, 2011

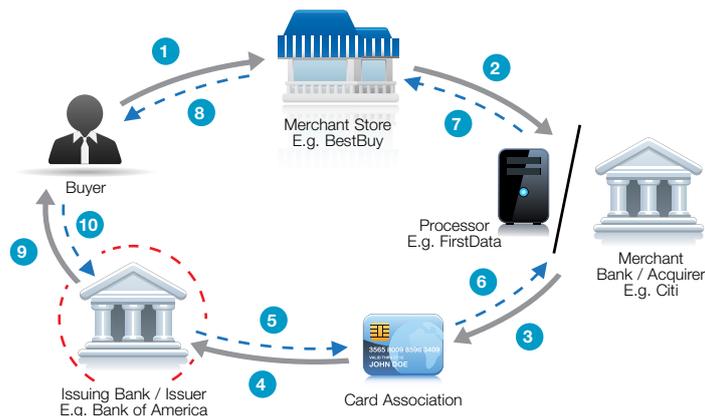
In terms of number of card transactions per inhabitant, North America emerged as the market leader with an average number of transactions per inhabitant of 232.6 in 2011. This is significantly high when compared to Latin America (22.6 transactions per inhabitant) and Asia Pacific (13.1 transactions per inhabitant) in 2011. This trend is due to the high penetration of cards in North America. However, emerging countries have a high growth potential and card usage is likely to grow in the coming years as consumer preference shifts from cash to plastic. The growing acceptance of cards at various point-of-sale (POS) units is also likely to drive increased adoption and usage of cards in most emerging countries.

2.2. Key Payment Card Industry Participants

A simple card transaction between a cardholder and a merchant involves several players:

- **Card acquirers:** the merchants' banks
- **Card processors:** third-party organizations that aid in card authorization and settlement processes
- **Card issuers:** the cardholders' banks that issue the cards and maintains customers' accounts
- **Card association network providers:** typically MasterCard® or Visa®—play an essential role in completing the card authorization and settlement cycle, as illustrated below

Exhibit 2: Typical Card Transaction Flow Structure



- 1 Cardholder uses a credit card to pay for a purchase transaction
- 2 Merchant sends transaction information to the acquirer by swiping or manually feeding card information at the POS terminal
- 3 The acquirer or third-party processor on acquirer's behalf sends the transaction information to the card association
- 4 The card association sends the transaction information to the issuer for authorization
- 5 Issuing bank pays the card association network once it validates the transaction (after deducting their charge)
- 6 Card association pays the acquirer processors on acquirer's behalf (after deducting their charge)
- 7 Merchants account is credited for the transaction amount by the processor (after deducting their charge)
- 8 Purchase transaction is completed
- 9 Issuer bills the buyer for the transaction based on the billing cycle
- 10 Buyer settles the bill

Source: Capgemini Analysis, 2013; <http://www.yahoofinance.com>, August, 2012

This paper focuses on the key trends that merchant acquirers have been experiencing and how the industry is responding.

3. An Overview of Trends in the Payment Card Industry: Acquirers

With the emergence of new payment technologies and players, growing smartphone sales, and increasing adoption of online card payments, the merchant acquiring industry has moved away from traditional business models.

With the advancements in technology, the increasing penetration of smartphones and increasing instances of online card payments, the merchant acquirer industry is witnessing a shift from the traditional models. These technological advancements have led to an increase in the intensity of competition in the merchant acquirer space, which has led the acquirers to look for additional revenue streams. Some of these additional revenue streams include providing value-added services and products to the merchants.

Acquirers are also focusing their efforts toward increasing mobile payment acceptance, both online and offline, at the point of sale. To remain competitive, merchant acquirers are adopting new technology systems. The system gaining the most traction is mobile payment acceptance, i.e., having the necessary infrastructure to accept payments through customers' mobile phones. With the growing number of mobile payments, the demand for mobile acceptance solutions is likely to increase.

The two prominent trends that can be seen in the acquirer's space are:

1. Increased focus on merchant retention through provision of value-added services
2. Growing demand for mobile acceptance solutions due to increased mobile payments

While trends covered in the 2012 *Global Trends in the Payment Card Industry* series continue to be relevant, they are not discussed in detail in this paper.



Global Trends in the Payment Card Industry: Acquirers



Global Trends in the Payment Card Industry: Processors



Global Trends in the Payment Card Industry: Issuers

4. Trend 1: Increased Focus on Merchant Retention through Provision of Value-Added Services

4.1. Background and Key Drivers

The merchant acquirer's space continues to evolve and expand at a rapid pace. Also, the battle over merchant acquisition and retention, and the pursuit of higher margins are driving acquirers to re-evaluate their traditional strategies and initiatives to capitalize on the opportunity of gaining a high market share. Some degree of attrition in a portfolio is normal in this business, especially due to the recent downturn in economy and the competitive nature of the merchant business. However, there is also a portion of attrition that appears to be preventable and is the priority for most of the acquirers.

In order to address this attrition, merchant acquirers are increasingly looking to offer a host of value-added services to their clients to have a competitive edge, such as:

- Improved fraud management through analytics models and products
- Loyalty-based solutions such as targeted offers, advertising and coupons
- Mobile point of sale (mPOS)
- New pricing strategies
- Multi-channel acquiring solutions and e-commerce

The key drivers for increased focus on value-added services by acquirers are:

- Increasing number of high-profile data breaches have exposed an increasingly large number of card customers to fraud
- Stiff competition has mandated offering of loyalty-based solutions, which will also result in increased revenues

4.2. Analysis

Merchant acquirers are looking to adopt a comprehensive approach, which will enable them to provide cost-effective differentiated solutions and services to merchants while remaining competitive in the market. The following value-added services are expected to be the focus of merchant acquirers over the next few years:

- **Loyalty Solutions Could Improve Retention and Open New Revenue Streams:** Loyalty-based solutions, such as targeted offers, advertising and coupons, represent an opportunity to create long-term relationships with merchants and to monetize new revenue streams in addition to traditional merchant acquirer fees. With respect to potential new revenue streams, 37% of respondents to the ETA-GS Merchant Acquirer and ISO Survey believed that merchants were willing to pay as much as 5% of offer value for loyalty-based solutions and another 23% believed that merchant would pay up to 10% of the offer value¹. However, though merchant acquirers are likely to only get a portion of this revenue (i.e., the provider of the loyalty platform would likely get most of the pie), the incremental margin on these transactions could be very high (i.e., little additional cost of acquisition, as merchants are existing clients). Given the potential positive impact to attrition and profitability, acquirers are increasingly looking to offer these loyalty-based solutions to merchants.



Prevention is better than a cure. The most successful strategy for retaining valuable merchant customers is to detect potential attrition and take effective action before it occurs. Keeping a profitable customer is always more beneficial to your bottom line than finding, recruiting and boarding a new customer.”

From Best Practices: Merchant Retention by the Electronic Transactions Association

¹ “Electronic Transactions Association (ETA)-GS Merchant Acquirer and ISO Survey”, Goldman Sachs, July 10, 2013

- **Merchant's Interest in New POS Technologies, such as tablets, smartphones, and dongles:** Approximately 11–25 % of the existing merchant base has expressed interest in new POS technologies². This increased merchant awareness of new payment technologies can be seen as an approach for merchant adoption. Acquirers should therefore look to offer assistance to merchants in the implementation of these technologies.
- **Multichannel Acquiring and E-commerce:** Online commerce is growing rapidly and emerging as an important channel for retailers across the world and online merchant acquirers are blurring the lines between brick-and-mortar points of sale (POS) and online sales, extending services to merchants that go far beyond payment acceptance. Most traditional merchant acquirers have not invested heavily in online acquiring capabilities and as a result, there is room for growth in this area. The annual online compound annual growth rate (CAGR) from 2012 to 2017 for Europe is forecasted to be between 9% at the low end for the Netherlands, to the high end of 18% for Spain. Also, in 2013 worldwide e-commerce sales are expected to grow at 18.3% to \$1.298 trillion³. This growing trend highlights the need for an integrated multichannel acquiring solution which can handle POS, ecommerce, and mobile- based transactions, to provide a seamless experience to merchants.
- **Fraud Management through Analytics:** Merchant acquirers participate in a very competitive market, where frequent occurrences of fraud have led to a high level of account churn. This, in turn, has led to a demand for fraud prevention mechanisms. Fraud detection models often perform calculations in real time during payment transactions to evaluate potential risks of a transaction and serves as a guide to the merchant to decide whether to accept or reject a transaction.

4.3. Implications

In order to remain in the business, it is imperative for merchant acquirers to provide more value-added services to merchants. Though it may hurt the margins, it will help the acquirers in staying competitive and gain additional revenue. To provide some of these added services, the acquirers may have to seek assistance from professional services players.

The acquirers also need to demonstrate the benefits of the services to the merchants and reach a pricing mechanism on that basis, which should be beneficial to both parties.

Also, given the high churn rates, acquirers should implement a system that can help forecast the expected attrition. For example, Discover has designed a merchant predictor model that helps the acquirers manage merchant retention efficiently.

2 "Electronic Transactions Association (ETA)-GS Merchant Acquirer and ISO Survey", Goldman Sachs, July 10, 2013

3 "Forecast growth in percentage of online retail / Ecommerce sales", <http://www.smartinsights.com>, April 29, 2013

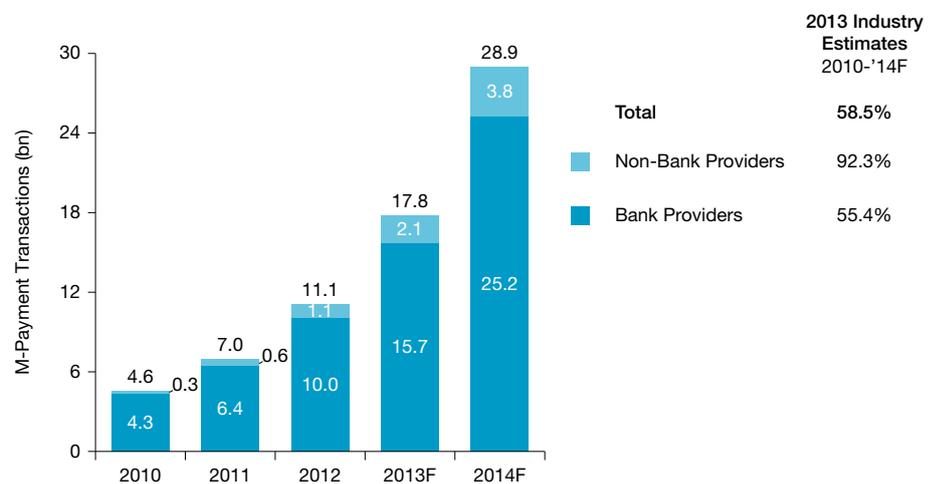
5. Trend 2: Growing Demand for Mobile Acceptance Solutions Due to Increased Mobile Payments

5.1. Background and Key Drivers

Increased usage of smartphones by consumers to make purchases, as well as payments, has led to a rise in mobile payment transactions. The global mobile payment transaction values are expected to be USD 235.4 billion in 2013⁴, a 44% increase from the 2012 value of USD 163.1 billion. This transaction value is likely to be USD 670 billion by 2015⁵.

Global mobile transactions reached 11.1 billion in 2012 and are expected to cross the 28 billion mark in 2014—driven by increasing smartphone penetration and innovative offerings.

Exhibit 3: Number of Global M-Payment Transactions (bn), 2010–2014F



Source: World Payments Report 2013, Caggemini and RBS

Ease of use and the ability to make instant purchases through apps and mobile websites are key drivers for consumers to use mobile for their purchases. Nearly one-third of U.S. mobile phone users in 2012 have reported using mobile devices to make a purchase⁶. In a similar way, merchants are also increasingly depending on mobile technology for various reasons, such as to keep employees connected to the office, provide a better shopping experience for their customers and also offer mobile as a payment device in the form of multiple payment options for their customers.

Consumer demand is the key driver for merchants to adopt various technology changes and the leader gaining traction is mobile payment acceptance, i.e., accepting payments made through mobile that will help merchants expand their payment acceptance options and better serve their customers. The market of mobile payment acceptance, especially for low-value transactions, which was once ignored by banks and traditional payment providers due to factors such as high risk and low profitability is now growing due to:

- Increased usage of smartphones by consumers (especially by unbanked segment)
- Sophistication of smartphones
- Availability of low-cost commodity software (mobile apps)
- Add-on hardware devices (dongles, cases)

⁴ Gartner, Inc: "Forecast: Mobile Payment, Worldwide", Sandy Shen, May 15, 2013

⁵ "Mobile Payment Strategies: Opportunities & Markets 2011-2015", Juniper Research, July 5, 2011

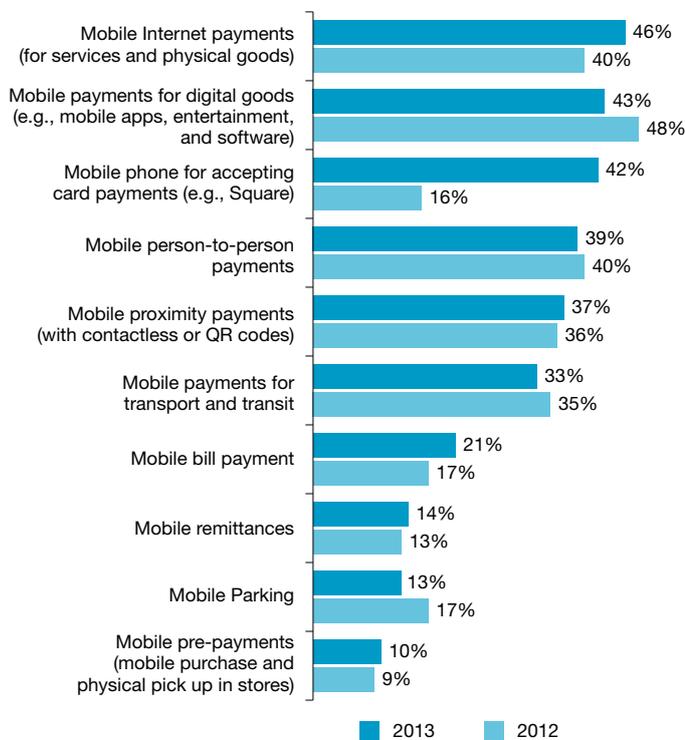
⁶ "Mobile Payments: An Evolving Landscape", Federal Deposit Insurance Corporation, December 2012

5.2. Analysis

Usage of mobile for financial transactions is expected to increase across various categories.

PayPal and card networks, among the key stakeholders, are most likely to drive the growth in mobile payments in 2013. For example, PayPal reported processing over USD 14 billion in mobile payments in 2012, a 250% increase over the prior year⁷.

Exhibit 4: Percentage of Consumers Conducting Mobile Financial Transactions for Different Categories, 2012–2013



Source: "Advanced Payments Report", Edgar, Dunn & Company, February 27, 2013

Merchants have high expectations for the emerging mobile payment channel as a way to increase revenue and also not lose customers to their competitors. The percentage of merchants using a mobile device to accept face-to-face credit card payments is increasing and the devices used to accept mobile payments correspond to current consumer usage trends. According to MasterCard, 1.2 million mPOS solutions were shipped to its merchants worldwide in 2010 and 2011 and about 75% of those went to merchants who did not previously accept credit cards.

Most of the current mPOS offerings require a separate hardware device (such as a dongle) that attaches to the smartphone and reads payment cards wherein the card credentials captured by the hardware are typically linked to a software application within the smartphone to process the payment. Square and iZettle[®] are two of the leaders in this field. In the U.S., Square's card reader processed payments for over 2 million U.S. individuals and businesses as of June 2012. According to Annapolis Group, Square has already seized 20% of the mPOS market in the U.S. While Square is dominant in North America, iZettle has emerged as one of the key players in Europe.

However, the growing mobile payment acceptance market can become a target for criminals/fraudsters. Mobile devices are attractive to fraudsters and are susceptible to attacks from both digital and physical vectors. For example, firewalls are not generally available for mobile devices and anti-virus technology is not well matured, making compliance with PCI Data Security Standard (PCI DSS) a significant challenge for

merchants and their acquirers. For these reasons many mPOS solutions make use of point-to-point encryption (P2PE) technology, which encrypts card data within the external card reader (or dongle) and decrypts card data on the mPOS provider's back-end systems.

5.3. Implications

As the market for mobile payment acceptance is expected to increase, and the merchants look for solutions for the existing security challenges, the acquirers must design and deploy robust acceptance solutions and ensure that all authorizations are processed so that the fraudulent transactions are tracked. Also, the acquirer should have the capability to identify unique fraud patterns for mobile payment acceptance, which will enable acquirers to capture a greater share of the market.

Also, more merchants are likely to use smartphones/tablets at point-of-sale terminals to provide a better experience for their customers, who also use smartphones for payments.

⁷ "PayPal Non-profit Newsletter", <http://www.paypal.com>, 2013

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What You Need to Know: Cards looks at emerging trends in the card payments industry for three key participants: merchant acquirers, card issuers, and card processors. The papers include analysis of key market trends, business and technology implications of these trends, and leading practices in the industry. The latest publications in this series are available at www.capgemini.com/cards.

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