It is incumbent upon MasterCard to make an aggressive case to roll back regulation… The regulatory mandarins need to be confronted.

MasterCard's Brave New World, Post-IPO

By going public, MasterCard is throwing off the fetters of bank influence and control, opening up a previously forbidden array of business opportunities with mobile operators, merchants, insurance companies, and others looking to harness the capabilities of a worldwide electronic payments network, says Eric Grover.

What does MasterCard's initial public offering portend? MasterCard is one of two genuinely global retail payment networks. It has payment products, powerful brands, and a web of banks providing worldwide acceptance and issuance. Post-IPO, the global payments colossus will be in a position to leverage these assets, as it never could before, to broaden the range of customers it serves and create huge value potential for its new shareholders.

Foremost, post-IPO the global payments network will no longer be controlled—constrained—by banks. MasterCard will have a war chest and a public currency to fund acquisitions, forge new channel relationships, and recruit and motivate talent. It will be accountable to financial shareholders and have an imperative to grow.

The implications of the global payment network's freedom, in tandem with pressure to deliver short-term top and bottom line growth, are momentous. MasterCard will start to think of and conduct itself as a business. It will, ever so gradually, become more nimble, flexible, and aggressive in how it competes and how it expands existing businesses.

Here are just some examples of how this might play out. Payment products can be distributed through channels banks view as competitors and that were therefore, in the past, out of bounds, or at least not energetically explored. Mobile-phone operators, retailers, insurance carriers, and governments have huge reach and payments and financial-services aspirations.

A Mobile Partnership

Retail banks and mobile operators view each other with suspicion and have been loath to collaborate and share customer information and relationships. An independent payment network will not be viewed with apprehension by mobile operators. Rather, they will see it as a potentially powerful partner enabling them to deliver robust and convenient payments and financial services to their customers, reducing churn and generating profits.

There are 2 billion cellular connections on earth, a billion of which were added in just the last three years, versus 2.2 billion general-purpose payment cards. Ovum forecasts 3 billion mobile phone subscribers by 2010.

Mobile operators have longstanding ambitions to provide payment services. Their efforts to date, for the most part made on their own, have failed or been lackluster. Now, however, MasterCard can actively collaborate with them to develop payments services. Conversely, Visa will remain encumbered in working with telcos. American Express, Discover, First Data, and JCB are handicapped by weaker global acceptance.

Mobile operators could issue and acquire MasterCard payment products, just as banks do today. For consumers, mobile phones can hold or serve as keys to credit, debit, or stored-value account numbers. On the merchant side, hybrid

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mobile phone devices can serve as a new point of sale, enabling cost-effective acceptance.

Retailers on Board

Consider retailers. They contract with or own banks and finance companies to develop and deliver a range of general-purpose and proprietary retail financial services. The global payments network will be able to serve retailers more directly and is likely to become more accommodating with its rules and economics, spurring the creation of more compelling retail finance features, promotions, and rewards for consumers, generating incremental issuance and spending.

Or take insurance carriers. The global payments giant can create value participating more actively, particularly in consumer-driven health care. Carriers are natural customers to stitch together MasterCard-badged FSA, HSA, and self-pay debit and credit products with discount health-care and wellness provider networks, and third-party reimbursement backstops.

Today, where it is well established MasterCard is still not used for most payments by a majority of its cardholders. It has an array of programs, many in need of competitive-zeal booster shots, to increase utilization in sectors such as health-care, education, corporate purchasing, and government. MasterCard is rarely used for very large or micro payments. Adapting pricing and rules can extend existing products into the adjacent micropayments space. The marginal processing cost of an electronic $1 newspaper purchase is zero, if a human doesn't touch it on the backend.

Those Nasty Suits

Clearly, the path ahead is chock full of opportunities for growth. However, several challenges loom.

The global payment network has been under relentless legal and regulatory assault. In the U.S., the most menacing are retailer-inspired lawsuits. While MasterCard's calculation that it was better to settle the Wal-Mart suit than to subject the organization to potentially catastrophic risk was understandable, it also put blood in the water. Bright, rapacious plaintiffs' attorneys now know there are, potentially, billions to be had. In the U.S., there are currently 38 federal lawsuits pending related to interchange pricing and practice, and to no-surcharge rules. More are certain to come.

But post-IPO, it can no longer be persuasively argued MasterCard is a consortium of banks fixing prices and restricting competition. In contrast, Visa USA is keeping its bank association governance model. To reduce its and its board-member banks' potential legal liability Visa USA plans to add independent directors to oversee interchange and transaction processing pricing, firewalling decision-making at the heart of the most dangerous suits.

While a good attempt, which will weaken merchant plaintiffs' argument, Visa will nonetheless remain bank-owned and controlled. So, while Visa with its deep pockets and even deeper member pockets will remain in plaintiffs' cross hairs, MasterCard will be a less inviting target.

Similarly, competition authorities' and central banks' rationale for regulating the global payment network will become weaker post-IPO. That said, in no jurisdiction will regulators of their own volition rescind existing regulations. Moreover, it seems certain, now that the regulatory mandarins have their hands on card-based payment systems, they will persist and, indeed, seek to expand their regulatory scope.

In the U.S., government interventions in card-based payment networks have principally been in the form of a few anti-trust actions. American regulators do not view and treat the payment networks as public utilities. No Fed regulation seems imminent.

Getting Confrontational

Elsewhere however, regulators been heavy-handed and remain keen. In the U.K., Australia, the Netherlands, Spain, Poland, New Zealand, the E.U., and Russia, regulators have implemented or are exploring implementing restrictions on how the nonproprietary card-based payment networks conduct their business. The interchange system is the focus of their ministrations.

A dangerous regulatory theme recurring in many jurisdictions is the notion interchange fees should be cost-based and that regulators should determine permissible costs. Interchange fosters card issuance, which builds payment-network value. It also fuels cardholder rewards, spurring card use and creating additional payment-network value. Hence, continued interchange regulation will suppress the global payment network's ability to create additional value for its shareholders.

It is incumbent upon MasterCard management to make an aggressive affirmative case to roll back regulation. The regulatory mandarins need to be confronted in the political and public arenas, where they are susceptible to pressure.

Last and perhaps paramount, post-IPO MasterCard will still suffer its association-culture legacy. It lacks competitive and innovative verve. On the day of the IPO, MasterCard will not undergo a Cinderella-like transformation into a plucky and muscular competitor. MasterCard chief executive Bob Selander must relentlessly engage the organization on culture and attitude.

If it can meet these challenges, MasterCard can after its IPO dramatically accelerate its growth by broadening the range of customers through which its products are delivered to consumers and merchants alike. DT

MasterCard Worldwide QuickStats

Purchases and cash volume: $790.5 billion*
Branded cards: 716.3 million*
Acceptance locations: 23 million (includes 1 million ATMs)
Member banks: 25,000

**Through June 30, 2005*
Source: Company report