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Stress Points in Acquiring

The acquiring business has entered an age of disruptive change, but it will emerge all the stronger for it, argues Eric Grover.

In the world of payments, issuing is the more glamorous realm. It captures the lion's share of transaction economics, delivers a rich menu of additional benefits, and is highly visible to consumers and regulators. In contrast, gritty, industrial merchant acquiring and processing have been issuing's critical but less sexy, taken-for-granted, brand-neutered sibling.

But change is brewing on the acceptance side of the network.

Nassim Taleb's book, *AntiFragile*, discussing risks and opportunities in so-called fragile and "anti-fragile" systems, provides an interesting framework for thinking about the percolating innovation that's attacking the merchant-acquiring system. Fragile systems break under stress. Anti-fragile systems, stressed up to a certain point, become stronger. Chinaware and a financial system dominated by too-big-to-fail banks are fragile. Biological systems tend to be anti-fragile.

While individual acquirers and independent sales organizations are fragile, acquiring as a whole is anti-fragile. Challenged, individual firms may fail while some adapt, and the system becomes stronger. With this in mind, let's take a look at some of the current and developing stress points.

Low Barriers to Entry. In acquiring, barriers to entry are modest and decreasing. Commercial networks, rather than being the restrictive gatekeepers of yore, welcome new entrants and innovators that can quickly build on merchant

processors' foundational data capture, authorization, clearing, and settlement. Regulators are focused on networks and issuers, not acquirers. The system consequently is open to those with a dollop of capital and a putative better mousetrap.

Meanwhile, a wave of private-equity is buying and invigorating established franchises such as WorldPay, Vantiv, TransFirst, and GlobalCollect. This, combined with venture capital that's betting on plucky entrepreneurs, is putting pressure on traditional acquirers.

For example, a pack of specialists—including iZettle, Sumup, mPowa, Intuit's GoPayment, North American Bancard's PayAnywhere, and Square, along with most full-suite merchant processors—have plunged into the land rush for mobile-phone-based acceptance.

Nobody generates more buzz than Square. Out of the gate, it was what Vantiv's chief product officer Bill Weingart characterizes as a "new-age ISO," relying on mobile-phones and tablets rather than purpose-specific countertop terminals, and pushing retail distribution, abbreviated underwriting and contractual commitments, and clear fees. Square stresses and strengthens the system.

In contrast, foreign competitors haven't caused the industry to lose a wink of sleep. The U.K.'s largest acquirer, WorldPay, is on the brink of divesting its U.S. acquiring business. Canada's largest acquirer, Moneris, remains a tier-two U.S. player. Brazil's largest acquirer, Cielo, bought Merchant e-Solutions to bolster



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its e-commerce payment-processing offer, not to establish a beachhead in the world's most competitive market.

Instead, it's acquirers overseas who hear footsteps. U.S. merchant acquirers, processors, and ISOs seeking growth are spearheading a global-payment-processing land grab.

Outsiders' Vertical Integration.

Here in the U.S., suppliers vertically integrating pose a greater threat than foreign acquirers. Ingenico and VeriFone want processing revenue to increase their business models' resiliency. Ingenico has scooped up half a dozen processors. It paid a nose-bleed 8.6 times revenue for gateway Ogone, and in 2009 3.4 times 2008 revenue for German merchant processor EasyCash. In a similar vein, VeriFone's Point acquisition gave it a platform delivering processing and services to merchants.

However, the trespass on their principal customers' (acquirers') domain is fraught with risk.

Pricing.

Challengers whose principal business isn't payments can be difficult matchups for traditional acquirers. Marketing phenom Groupon charges its merchants a 1.85% discount. LevelUp provides "free" or

discounted acceptance fees but takes 35% to 40% of credits merchants give its subscribers. It's a clever but probably unsustainable business model.

Fees matter. While many ISOs seek pricing opacity, gentle net-merchant-discount-fee erosion continues. Interchange-plus pricing is the rule among large merchants. Heartland Payments' Bob Carr beats the pricing-transparency tom toms. And Square's media blitz trumpeting transparent and fixed fees may change the tenor of price competition. ISOs will adapt.

Merchant Boarding.

Origination-channel innovation can make the franchise. W-2 and contract sales reps are a major cost of boarding small merchants. Intuit leverages its proprietary channel selling acceptance to QuickBooks users. Mammoth First Data uses multiple origination channels: direct sales, ISOs including Intuit, bank referral programs, and bank joint ventures. Mercury Payments partners with restaurant and retail software providers. Gateways, acquirers, and e-commerce platforms integrate with and refer business to each other, jockeying for relationship primacy.

Brand Building.

The most potentially disruptive developments are

brewing around acquirer-cardholder relationships, and attempts to add value around payment acceptance. Historically, acquirers haven't had consumer relationships. Issuers and merchants have.

Large retailers use sophisticated retail credit card and loyalty programs to manage customer relations, delivering credit, promotions, and loyalty and reward programs generating incremental sales. Hence, ISO-sponsored digital wallets should be on issuers' radar. If payments spurred and made by LevelUp or Square Wallet are funded by a Chase Visa credit card, even though Chase's and Visa's economics particular to the transaction haven't been diminished, their value has.

Issuers and networks invest in building powerful brands. Acquirers have seen little need to. Now, however, to reach millions of small businesses and consumers and set themselves apart from the pack, acquirer contenders are attempting the daunting task of building national brands.

The merchant-acquiring industry is anti-fragile. Besieged by an unprecedented host of challengers, it will emerge stronger. **DT**

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