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The Best Is Yet To Come

The recession presents Visa and MasterCard with a wide range of opportunities that their relatively new status as publicly held companies frees them up to seize, says Eric Grover.

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A year ago, notwithstanding considerable angst over the subprime mortgage implosion, the market was giddy over the initial public offering of the world's largest electronic payment network: Visa Inc. Its bank card cousin MasterCard Inc. had paved the way, trading up 425%. Visa priced at $44, traded up 28% opening day, and crested several months later, up a whopping 104%.

Now the world is mired in a recession, one likely to be long and deep. Heretofore seemingly inexorable card-payments growth is stalled. Visa Inc.'s stock is down 46% from its May high last year and MasterCard's is down 56%.

In the U.S. and Western Europe credit card use and transaction size are declining. Emerging-market growth is slackening. And by putting a damper on international recreational and business travel, the recession is tamping down the card-payment networks' most profitable volume: cross border. Compounding economic downturn worries, protectionist sentiment now reigns in Washington and is rippling across the EU, Russia, and India.

But, MasterCard and Visa will weather the economic storms. Absent benighted government policies, the long-term leverage, power, and value of the open worldwide card-payment networks will remain undampened.

There is growth yet even in the world's largest payments market, the U.S. Sectors such as health care, government, business-to-business, and vending machines, parking meters and a range of other micropayments remain substantially undeveloped, and tens of millions of Americans still pay with cash. Abroad, in most national markets, retail commerce continues to be conducted almost entirely in cash. And there are enormous payment-network opportunities MasterCard and Visa are pre-eminently qualified to develop.

More Enterprising

In the slowdown, management must be tempted to simply batten down the hatches. Managers are pressured to trim costs—especially huge brand spends which, while strategically vital, are difficult to measure in terms of effectiveness; they think of slipping through discrete price increases—particularly on the acceptance side of the network; and, above all, they hold on, hoping to ride out the recession. This would, however, be missing a signal opportunity. Now is the time to extend the network and establish beachheads in markets difficult to develop in balmier economic climes.

Visa and MasterCard long sat at the center of a global commercial web, but had passive, gatekeepers' mindsets. Their owner banks kept the bulk of card-payment products' value. However, since their IPOs they have, baby step by baby step, become more enterprising and consciously commercial, and moved to capture a greater share of payments value in the network.

Opportunities that leverage, extend, enrich, or support MasterCard's and Visa's existing open network and processing franchises are logical places to expand.

Money transfer fits the bill. The market implications of billions of people worldwide being able to send—from phones, voice-response units, ATMs, and browsers—electronic funds to each other are enormous. Visa enables money transfer through 48 banks in 14 countries. MasterCard's money transfer, for now, focuses on India, Singapore, and a mobile person-to-person service in the U.S. enabled by processor Obopay Inc. While competing in a handful of corridors may be adequate for getting the kinks out, it doesn't exploit the full power of the open global network. A compelling electronic money-transfer service would blanket the planet, including all or most MasterCard and Visa licensees, and should invite traditional branch-based networks such as Western Union and MoneyGram to participate.

The mobile-phone channel ought also to be compelling for MasterCard and Visa. Behind the mobile-payments hype lies real opportunity. Mobile operators have more than 3 billion subscribers, many of whom don't use card-payment products. It is in the networks' interest to bring carriers directly into the payments value chain, enhancing offers to their bank licensees' existing cardholders and, more important, reaching new consumers and businesses and diminishing their dependence on Goliath retail banks such as Bank of America, Chase, and Citi.

Carriers must, however, adjust their pricing expectations from the 50%-plus take they expect on digital-content payments. While carriers will own consumer relationships they originate, it is critical the card networks maintain consumer and merchant brand visibility.

Decoupled debit fosters issuer competition and enables greater payments participation by mobile-phone operators and retailers, which is good for consumers and the networks. MasterCard supports several decoupled debit card programs, albeit with less than gusto. Before the IPO, controlled by banks, it wouldn't have. Visa has more banks with large demand-deposit-account bases, and has therefore stayed its hand so far.

Another opportunity lies in the automated clearing house, which is a payments network, albeit lower value, simpler, and not retail. There are more than 50 billion ACH transactions in the U.S. and EU annually. A variety of ventures harnessing ACH are attempting to challenge MasterCard and Visa with lower merchant-acceptance fees. While they evince little interest in doing this, the dominant retail payment networks could more easily subsume ACH. MasterCard and Visa have relationships with virtually all financial institutions generating ACH and access to their current accounts.

The networks have started to act on some opportunities. They provide processing to support and enhance their payment products. Visa launched a joint venture with Yalamanchili Software to serve emerging-market debit and prepaid card issuers. To better match up against Visa in the U.S. and overseas, MasterCard partnered with ACI Worldwide and Computer Sciences Corp. to support issuer processing. Its Orbiscom acquisition enables differentiation in issuer card management. Both global networks also increasingly seek to add value from the treasure trove of data processed, offering a range of fraud prophylactics and marketing services.

Looming Threats

With retail banks reeling, now is an opportune time for the networks to be more assertive, to fortify their payment brands in consumers' and merchants' minds, and to stress the features and value associated with their brands, gingerly, over that of their licensees. Star, NYCE, and Accel/Exchange offer a stark example of what happens to payment networks with no retail brand awareness.

Overseas, shell-shocked banks battered by credit losses may be more willing to divest interbank processing co-ops, enabling MasterCard and the Visa federation to capture more value associated with their branded cards and transactions, and eroding legacy national payment schemes' value. Why, for example, should Spanish banks want to continue to tie up interbank processing resources with CECA or a merged Sistema 4B/Servired?

While, post recession, the electronic-payments world ought to be MasterCard's and Visa's oyster, there are threats to their business models.

Closed-loop general-purpose card systems are adopting a more open model. Discover Financial Services has struck relationships with 88 acquirers and is on the path to achieving U.S. acceptance parity with MasterCard and Visa. American Express vies for the world's largest issuers' business.

Credit and debit issuer consolidation advanced with Chase scooping up Washington Mutual, Wells Fargo Wachovia, and PNC National City. There has always been tension between the networks' and their largest licensees over brand prominence, over who is perceived by merchants and consumers to convey what value, and over the networks' enabling smaller and nontraditional competitors. When fewer financial institutions control greater market share, payment-network value and power are diminished.

However, the paramount danger to the global card payment networks remains government. In 2008 MasterCard and Visa dodged a price-control regulatory bullet: the Orwellian-named "Credit Card Fair Fee Act." Nonetheless neither MasterCard nor Visa has yet found an effective strategy to curb the planetwide regulatory assault on its business.

If they continue their transformation, increasingly leaning into their opportunities, and if they can stave off government regulation, their best days lie ahead. DT