Why MC's Revamp Will Work (and Visa's Won't)

BY ERIC GROVER

MasterCard International and Visa U.S.A. are beset by franchise-threatening lawsuits, some of which reach beyond the associations to attack their largest member banks. In response, the payments Goliaths each plan to take measures in 2006 to reduce their and member banks' U.S. legal liability exposure.

Their approaches are starkly different.

MasterCard International's defense is a bold move: to go public. Independence from banks will insulate it from the most damaging plaintiffs' suits. It will also provide huge collateral benefits: invigorating the global payment network; enabling new channel development, more aggressive pursuit of processing business, and acquisitions to fuel growth and enrich the offer; and altering MasterCard's character.

Visa U.S.A.'s response is more cautious. It will add eight independent board directors to oversee pricing. While the measure is a good attempt to reduce the payment network's and member banks' legal liability exposure, it is no silver bullet. Moreover, it will not stoke Visa's competitive and innovative coals.

The Wal-Mart suit vividly brought home the menace posed by U.S. plaintiffs. While MasterCard's and Visa's decisions to settle rather than risk catastrophe were understandable, they whetted the appetite of plaintiffs' attorneys.

Merchant plaintiffs contend in their interchange and no-surcharge-rule suits that MasterCard and Visa are bank consortiums fixing prices and restraining trade. It is not an unreasonable argument. Both payment networks are banker clubs having market power, establishing prices and rules for members' benefit, as they see it.

However, post-IPO, outside Europe, MasterCard will genuinely no longer be controlled by banks. It will be a commercial supplier with which banks and, for now indirectly, merchants choose to do business. U.S. plaintiffs will lose their anchor argument against MasterCard.

Independent, MasterCard will be free to cultivate nonbank channels to issue and acquire its payment products. Retailers, insurance carriers, and mobile-phone operators, with their enormous reach and financial-services ambitions, would make attractive partners.

The bank card payment associations struggled for decades to increase their share in the $1 trillion health-care sector. Able to work more directly with insurance carriers, MasterCard can move to the forefront, scaling consumer-driven credit, debit, and prepaid health-care payment services.

In the mobile space, NTT DoCoMo, Vodafone, T-Mobile, Orange, and Telefonica Moviles, among others, want to develop payment services. Portentously, a wave of ventures such as C-Sam, Inside Contactless, Just in Mobile, TextPayMe, and ViVOtech aim to enable mobile payments from handsets and cards with radio transceivers. MasterCard collaboration with mobile-phone operators and the constellation of enabling technology and service providers should enhance the likelihood and speed of mass mobile payments adoption.

MasterCard will also be highly motivated to more aggressively compete for processing business. It makes 6.45 cents per interbank transaction processed. But outside a bare handful of Anglo-American markets, it does not process the lion's share of its own transactions. Worldwide, MasterCard's processing presence is skin deep, handling cross-border MasterCard-branded transactions only. It has an enormous opportunity to more deeply penetrate developed and emerging national markets for its own and competitors' transaction processing.

Many of these markets are served by bank processing cooperatives. With its public currency and IPO war chest, MasterCard could buy national processors, enabling banks to monetize the value of their stakes and providing them access to state-of-the-art systems.

MasterCard will experience cultural teething pains over the next several years, transitioning from an association to a for-profit enterprise. Henceforth management will think of MasterCard as a business.

While MasterCard is finding its footing as a for-profit public company, at Visa it will be business as usual.

Visa U.S.A.'s independent directors, rather than the entire board, will have authority over interchange and processing pricing and other economic decisions. Plaintiffs will therefore have more difficulty reaching beyond Visa to establish liability with board-member banks for the consequences of decisions they have not directly participated in. Member banks such as B of A and Chase will consequently be more comfortable retaining their board seats.

Nevertheless, plaintiffs will still have an argument against Visa, albeit a somewhat weaker one. Visa's governance compartmentalization is at best an imperfect prophylactic against trial lawyers. Visa U.S.A. will continue to be owned and controlled by its banks. Banks will appoint and compensate the independent directors. Their decisions will be made with a view to Visa members' best interests.

Visa U.S.A. is trying to have it both ways: to remain a bank association and, by having only independent directors ratify pricing, inoculate itself against merchant suits. It is likely to have cause to revisit the approach, whether because legal threats persist, it finds itself disadvantaged versus more agile and aggressive for-profit competitors, or both. Having opted to cross the governance Rubicon, MasterCard faces a different set of challenges: managing cultural transition and accelerating growth.

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