Visa and Mastercard Would Benefit from More Paranoia

By Eric Grover

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Visa's founding CEO Dee Hock, whose vision and dogged perseverance did more than any other man to create the open global general-purpose bankcard payment networks, died July 16th. Hock's Visa and cousin Mastercard became the world's leading payment networks, thus improving the lives of billions of people. Both continue to scale, extend, and enrich their platforms.

Yet arguably, the global payment-network duopoly has never faced a greater and more diverse array of threats. The late Intel CEO Andy Grove warned "Only the paranoid survive." A modicum of paranoia at Mastercard and Visa and less pro forma corporate wokery, would augur better for shareholders, client financial institutions, and end customers.

Merchant lobbyists, regulators, politicians, and competitors, hope picador challengers will weaken if not fatally disrupt the global payment networks. Much to their frustration, however, every year Mastercard's and Visa's network effects increase and their moats become deeper.

The global-network duo compete with each other, a handful of tier-two multinational payment networks such as American Express, Discover, PayPal, JCB, China UnionPay, Alipay, and WeChat Pay, hundreds of national card networks and alternative payment systems, and cash. The bases of competition are well-understood, and, on a level playing field the global networks will continue to win more than their fair payments share.

New classes of competitors are emerging.

To have value, challengers must find a path to critical mass of spend and acceptance. That’s enormously difficult. Hock pioneered an open model to build network critical mass, relying on a contractual web of thousands of banks worldwide to deliver Visa cards and acceptance to consumers and merchants, respectively. It proved far more successful than proprietary and closed-loop models maximizing network reach. More partners innovating and generating new cardholders, merchants, and payments, begets more partners, cardholders, merchants, and payments. In payment networks bigger is better.

Eighty-plus buy-now-pay-later systems on a tear taking retail-payments share from credit and debit cards have captured headlines. There’s nothing new, however, about consumer installment credit. Still, low-friction, often-fee-free credit is effectively acquiring borrowers. The promise of incremental sales attracts merchants, notwithstanding BNPL acceptance costs them more than credit cards.

BNPL transactions typically generate multiple card payments to pay back the loan and to pay the merchant, and often leverage Mastercard's or Visa's acceptance network. The market has come to understand that BNPL systems are neither disruptive nor a serious threat to the global payment networks. High-flying BNPL phenom Klarna's valuation is down 85%. Onetime BNPL darling Affirm's stock price is off 79% from its high.

Some challenger payment networks use fee-free peer-to-peer payments to acquire and engage consumers before pushing for retail acceptance and use.

Square's Cash App has 70 million users. It's building a closed-loop payment system letting users pay with Cash App at Square merchants. Peer Venmo also has roughly 70 million users. PayPal encourages them to pay with Venmo in addition to using it to split restaurant bills with friends. Cash App and Venmo are primarily funded by debit cards, and have companion debit cards earning market interchange fees. (Interchange fees are paid by merchants to issuers of credit and debit cards.) While Venmo and Cash App take share from, they also generate transactions for the global card networks. Neither is going to displace Mastercard and Visa in the US, much less worldwide.

The largest US P2P payment system is bank-owned Zelle. Zelle retail payments would cannibalize highly-profitable credit and debit card transactions, a loser for banks.

In Europe there are a host of P2P payment networks pushing retail use.

Launched in 2012, Swedish banks’ mobile-payment system Swish has 8 million users. The merger of P2P mobile payment systems Vipps, MobilePay, and Pivo will have 11 million consumers and 330 thousand businesses across Norway, Denmark, and Finland.

While many of these systems are winning payments share in particular markets, they are and will remain weaker networks than Mastercard and Visa.

Network interoperability is an intriguing but yet-to-be-realized-at-scale path to enable smaller payment systems to punch above their weight.

The Brussels-headquartered Euro Alliance of Payment Schemes attempted to build a pan-European network by connecting national systems. It failed because members were unwilling to invest at the EAPS level and it wasn’t compellingly better than Mastercard and Visa.

In a similar vein, the Zurich-based European Mobile Payments Association is making member systems interoperable. Seamless mobile-payment system interoperability has more promise than EAPS and may establish a viable multinational European payment scheme.

Discover has reciprocal-acceptance partnerships with card networks such as China UnionPay, JCB, and the National Payment Corporation of India's Rupay. However, because there's no co-branding and point-of-sale-acceptance signage, they've had limited success.

Touted as disruptive, open banking through application programming interfaces lets permissioned third parties access bank data and generate transactions. However, it lacks merchant acceptance, consumer protections, and rewards. And for banks, payments without interchange fees are hardly a winner.

More than sixty countries have implemented real-time interbank-payment systems. While they don't compete directly with Mastercard's and Visa's retail networks, their infrastructure can support would-be competitors.

One of the first attempts to harness real-time payments at retail was Pay by Bank (originally branded Zapp) in the UK, where Mastercard and Visa enjoy 99% card-payment share. It didn't solve a problem, failed, and, ironically, is now owned by Mastercard.

In India, however, instant-payment systems are having an impact. E-wallets like Google Pay and Walmart's PhonePE have made good use of the NPCI's real-time UPI payment system to fund retail payments.

Digital wallets for managing payment credentials can lower transaction friction. They can also be competing payment systems. Notwithstanding often being funded by Mastercard and Visa cards, PayPal is a competing albeit weaker network.

Tech giants Amazon, Apple, Facebook, and Google use and have further aspirations in payments. Apple Pay and Google Pay are open e-wallets enabling consumers to manage and pay with existing credit and debit cards. But any platform that concentrates and can influence payments share should worry the global networks.

Digital currencies have fired the imaginations of those bent on disrupting the reigning payment systems. Being able to instantly send an electronic bearer instrument of value from anyone, anywhere, anytime to anyone, anywhere, anytime, is potentially a powerful payment network. But cryptocurrencies are not fit for purpose as payment systems. They lack compelling licit use cases and network critical mass, have performance and governance deficiencies, and volatile values, and are subject to regulatory hostility, if not outright bans.

Stablecoins – electronic tokens backed by fiat currencies, are less volatile and worrisome to regulators. If – and it’s a big if, they can find compelling mainstream payments use cases, they could be a plausible threat.

Central bank digital currencies are coming. Like cash they will compete with electronic payment systems. But CBDCs will have to build network critical mass to become relevant and have a chance at displacing well-entrenched electronic payment systems.

New competitors are not the only menace to Mastercard and Visa. Regulation and politics are a threat planetwide.

Payment protectionism is worsening. Many countries view payments as strategic infrastructure, and, therefore, advantage national champions. China flagrantly flouted its 2001 WTO commitment to open up its domestic payments market. Today card monopoly CUP, and mobile-payment dragons Alipay, and WeChat Pay own it. Russia has its national card-network champion Mir. India and Turkey mandated foreign networks process in-country and have national champions Rupay and Troy, respectively.

In many jurisdictions regulators have imposed price controls, primarily on interchange fees used to balance participation on both sides of the network. While the networks, banks, and processors have adapted, interchange price controls reduce issuer innovation, funding for neobanks, and cardholder value.

Picking up where he left off with his eponymous Durbin Amendment, which capped debit-interchange fees for politically-unsympathetic large banks and require that merchants have debit-network routing choice, Senator Durbin is proposing the “Credit Card Competition Act of 2022.” It would mandate that merchants be able to choose between at least two networks for credit-card transactions. Without naming them, his bill targets Mastercard and Visa, which enjoy pricing power on the acceptance (merchant) side of the network. Routing choice would cause their variable credit-card processing and licensing fees to plummet. They might even go negative.

Durbin’s latest salvo underscores that Mastercard and Visa need to invest more, making an affirmative case in the public and political arenas for the enormous value they deliver and for the freedom to compete and price.

Management complacence and politicizing payments are also risks to the global networks’ to-die-for franchises.

Before 2012 they enjoyed a payments duopoly in India. If they'd invested more aggressively there, they might today own the huge emerging payments market.

Both global networks have taken their near-indestructible businesses and assured growth as license to indulge in virtue-signaling that has nothing to do with their businesses. Mastercard has chief sustainability and inclusion officers and Visa has chief sustainability and diversity officers. They destroy value. Mastercard and Visa can best serve their shareholders and customers and do the most good by focusing on delivering ever-better payments to more people worldwide.

Mastercard and Visa are valued at $445 billion and $342 billion with 16.25 and 16.64 revenue-valuation multiples, respectively. One can quibble with their valuations, but if they continue to lean into their opportunities, they will still be the world's leading payment networks a decade hence.

Eric Grover is Principal at Intrepid Ventures, providing corporate development and strategy consulting to financial services, payment network, and processing businesses, and to firms serving and investing in the payments space.