Payments Newsletter

Demystifying the merchant acquiring business

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pwc

Foreword

Dear Readers,

It is my pleasure to bring to you the latest edition of our Payments newsletter, where we take a closer look at the acquiring landscape in India while drawing parallels to global trends. We also bring to you key considerations for the way ahead in light of new regulations and changing market dynamics.

I hope you will find this to be a good and insightful read.

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In this issue

Introduction

When considering the participants involved in a typical card payment, four immediately come to mind – the card network, the card issuer, the consumer and the merchant. 'Acquiring' is a somewhat less glamourized part of the industry, but the role that acquirers play in enabling the digitization of payments in the economy is a vital one. Every time a consumer pays a merchant, it is the acquirer that captures, authorises, processes and settles that transaction.

Although by definition, merchant acquiring covers payment acceptance through any payment mode, in India, the term is most associated with POS machines, due to the dominance that this particular acceptance channel has on the merchant acquiring landscape. Additionally, government incentives, aimed at promoting a merchant acquiring by POS has increased the demand for these machines from banks, making them the most accepted mode for merchant payments.

Historically, acquiring function was generally conducted by a bank which had relationships with merchants for other banking requirements and hence also offered merchant acquiring facilities. Over time, the acquiring industry has evolved, with non-banking players entering the fray and providing support directly or indirectly for merchant acquiring. Technology-first players are entering the market and offering solutions to merchants with new value proposition focusing on merchant convenience and customer experience. These include players that range from those with a strong technology skillset (Google, Samsung, WhatsApp) to players whose current setup includes a wide distribution network (telcos, FMCG players, payments processing companies).

On the customer front, preferences are slowly but surely transitioning from card-present to card-not-present (CNP) modes of payment. This trend, in addition to the high initial setup cost borne by merchants, is paving the way for BHIM QR to become the next revolutionary wave in merchant acquiring. The uncomplicated merchant onboarding process that is offered by BHIM QR on the app platform is sure to propel its usage further than Bharat QR, where merchants would have to visit the bank to successfully be on boarded onto the platform. The above mentioned trends in addition to a supportive regulatory environment is paving a positive way ahead for the increase in acceptance of digital payments and subsequently, merchant acquiring.

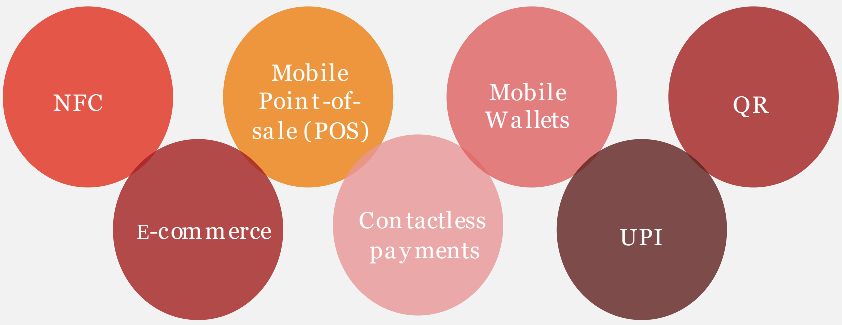
Being an attractive business that ensures merchant stickiness to the bank (for potential cross sell business and relationship strengthening), the focus on promoting merchant acquiring is understandable. However, this segment is facing many potential business challenges through disruptive technologies, new player segments, questions on financial viability and evolving business models.

Key challenges impacting the acquiring business

- Diminishing margins
- Threat of non-traditional players
- Fraud and security concerns
- Commoditized business

Entities / players that will provide innovative solutions to solve the above challenges will most likely emerge winners in the future. They will be able to ring fence the merchants to ensure higher engagement and increase merchant life cycle value thereby ensuring higher profit pools for the business.

Innovations and potential market disruptors



Regulatory impact on acquiring

India regulatory measures to boost acquiring

The Government, over the last few years, has had unprecedented focus on increasing digitization both issuing and acquiring across the county. Towards this end, it has sculpted numerous laws and regulations providing incentives to various stakeholder within the ecosystem to help in the uptake of digital payments. One such regulation was announced on the 6th of December 2017, through which the government brought about several changes to the merchant discount rates (MDR) to increase the acceptance of debit cards by a wider set of merchants.

Additionally, in an attempt to further this cause, the Ministry of Electronics and Information Technology (MeitY) announced that it would, through a reimbursement mechanism, bear the full amount of MDR applicable on transactions made through debit cards, UPI and AEPS (for transactions < INR 2000), for a period of two years. The reimbursements would be made directly to the acquiring bank on behalf of the merchant, exempting them from the totality of the cost thereby pushing them closer towards adopting digital payments. However considering various operational challenges involved in the execution of this scheme, the sustainability of such a program is still questionable. MeitY is also promoting the expansion of the acquiring businesses of both public and private sector banks, as well as within various states, by assigning hard targets on terminal deployment (PoS and QR) and merchant onboarding, thereby facilitating a spirit of healthy competition between these players.

MDR has been revised to 0.4% (small merchants) and 0.9% (merchant revenue > INR 20 lakhs) for all debit card transactions for POS and 10 bps reduction on the above figures for QR transactions subject to respective caps.

While these MDR rationalization measures are welcome steps, the interchange fee – forming the major portion of the MDR fee – has not been regulated yet in India. Merchants have often criticized that card networks and their issuing banks for exercising their oligopolistic market power to set excessively high interchange fees which in turn drive up a merchants costs of accepting card payments.

Global regulatory measures to boost acquiring

Interchange fees rationalization has long been a controversial issue worldwide as well. However, globally, policy makers have salvaged the situation by subjecting interchange fees to various regulations and government interventions in order to expand the overall card acceptance infrastructure in their respective countries, with very promising results.

- In the US, the Durbin Amendment (2011) regulated interchange fees charge bases on the regulated (assets>$10 billion) or unregulated (assets<$10 billion) status of the bank. The regulated debit fee is 0.05% + $0.21, while the unregulated fee is 1.60% + $0.05.
  Although MDR was impacted in a limited capacity, it significantly increased the acquirer's margin from 0.6 to 0.9.
- European Union Regulation 2015/751 card transactions limited the interchange fees to a maximum of 0.2% for Debit Card transactions and 0.3% for Credit Card transactions.
  This resulted in a considerable increase in the profits for acquirers, despite the decrease in MDR.

Other similar interchange specific regulatory initiatives taken up by countries worldwide, have led to notable direct and indirect impacts on the acquiring businesses in the respective countries. Some of the impacts include significant decrease in the MDR rates, rise in the number of card transactions and a considerable increase in acquirer and merchant margins

With the growth of digital payment and acceptance infrastructure across countries, regulators play an increasingly important role in molding the ecosystem through the policies they frame. Going forward, regulators and policy makers must find a way to make regulations sustainable for all participants that inhabit the ecosystem, in order to incentivize issuing as well as acquiring banks.

Future of Acquiring

Riding on the wave of digital disruption, the acquiring space is experiencing a dynamic transformation. Some key trends which are sure to impact the future of merchant acquiring as a whole, are as follows:

1 Government incentives and targets

While regulatory focus on increasing digital payments has helped boost adoption in the country, it has subsequently changed the economics of the industry. With new regulations chipping away at revenue lines an environment has been created where economies of scale have come to determine profitability. However, in an attempt to counter this decline, the government (MeitY) is offering incentives, reimbursements and providing targets to private and public sector banks and various states and ministries, in an attempt to boost distribution/ merchant onboarding of various merchant segments.

2 Collaboration and partnerships

Emergence of new technology-first players into the acquiring ecosystem has led to the creation of unique collaborative opportunities between traditional banking players and different hardware, software and distribution firms across industries. This has resulted in various players experimenting with different business models in an effort to remain competitive in an industry that is transitioning from traditional bank owned acquirers to those that are owned either in partnership or by independent more nimble companies.

3 Consolidation of instruments

BHIM-UPI, Bank specific UPI payment options, Bharat QR, UPI QR, Aadhaar based payments, viz. Aadhaar Pay, AEPS, Cards, wallets, mobile payments– the digital payments landscape in India offer a variety of payment options. However, one could argue that, in a short span of time, the introduction of multiple modes of payment has caused some level of confusion in the mind of the end consumer and merchants alike. To avoid the hassles of adding newer acquiring channels one-by-one, several players are introducing a common consolidated solution (one-stop POS) that encapsulates the functionality of a majority of upcoming payment channels.

4 Changing consumer behavior

Mobile and online technologies are revolutionizing consumer access to information and sparking demand for new services that can support multichannel commerce, big data analytics, enhanced loyalty programs and targeted advertising. Consumers are increasingly using new tools to move dynamically between computers, mobile devices and in-store experiences while shopping, blurring the distinction between online and physical channels for payments

5 New technologies

With a changing consumer dynamic and newer technologies hitting the market in a relatively short span of time, acquirers are now open to experimenting with innovative solutions aimed at heightening the consumer experience. For example, Google's payment app, Tez, features a technology called audio QR that allows users to transfer money using sounds to pair two devices. Another example of innovations across acquiring, is adaptation the legacy PoS system to accommodate newer modes of payments such as QR codes/ UPI.

The changing environment due to this digital disruption as well as regulatory changes, may inflict short-term difficulties on an acquirer's business model, but implementing the relevant changes will also lay the foundations for the digital acquirer of the future. Combined efforts are required from various stakeholders across the ecosystem to make the business a viable proposition and enhance the overall customer experience.

Payment Technology Updates

Banks eye 1 million merchants on Bharat QR network

The Times of India

The next time you walk into a kirana store in a small town without electricity or landline phones, chances are that you will spot a BharatQR code placard which can be scanned for payment using your bank's mobile application. Indian banks and payment network companies -Visa, MasterCard and RuPay -have said that one million small shops will be onboarded for accepting digital payments using BharatQR code in a year.

(Read more)

To promote cashless transactions, RBI reduces MDR charges for debit cards

Business Today

In a bid to further boost digital transactions, the Reserve Bank of India (RBI) on Wednesday brought several changes to the merchant discount rate (MDR) for debit card transactions. The revised charges will be effective from January 1, 2018. In its latest circular on MDR, RBI has categorized merchants on the basis of turnover. The central bank has also adopted a differentiated MDR for QR-code based transactions.

(Read more)

RBI's MDR rationalisation to hurt merchant acquiring banks'

The Time of India

Analysts today said the Reserve Bank move to reduce merchant discount rate (MDR) on debit cards is negative for acquiring banks like HDFC Bank and Axis Bank in the short-term as the surge in volumes is unlikely to make up for the losses.

(Read more)

Fino Payments Bank to deploy Android-based mPOS devices across 10,000 banking points

livemint

In a move to revamp its infrastructure, Fino Payments Bank plans to deploy multi-utility Android-based mPOS devices across 10,000 banking points throughout the country in a phased manner over the next 12 months, the company said on Thursday.

(Read more)

Atom launches app to empower Telangana retailers

Telangana Today

Mumbai-based digital payments service provider, Atom Technologies, is going to digitally empower the retailers in Hyderabad with the launch of mGalla, claimed to be India's first multi acquiring digital PoS payments app. Targeted particularly towards the unorganised retailers, mGalla integrates digital payments thereby doing away with the need of using cash in day-to-day transactions.

(Read more)

RBI's MDR rationalisation may discourage retailers, undermine digitisation efforts, say experts

First Post

Shortly after the Reserve Bank of India's (RBI) announcement of rationalisation of merchant discount rates aimed at boosting non-cash transactions, payment gateways are crying foul stating that with no equitable distribution of MDR, the slashing of rates will only add to their pain.

(Read more)

(With inputs from Mihir Gandhi, Yogesh Shetye, Pallvi Goyal, Vishal More and Namrata Kacholia)

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