



PIN-Based Debit Processing Market Could Benefit From Consolidation, Industry Experts Say

Mergermarket

April 30, 2019

Mergers of domestic US PIN-based debit processing networks would help them better compete with market leaders Visa [NYSE:V] and Mastercard [NYSE:MA], four industry experts told this news service.

Debit processing networks provide the underlying technology for consumers to withdraw cash at ATMs, get cash back in stores, and make payments using PIN-authenticated debit cards. Such payments are processed on a different payment rail from signature-authenticated transactions.

Both Fiserv's [NASDAQ:FISV] proposed acquisition of First Data [NYSE:FDC] and FIS's [NYSE:FIS] USD 35bn acquisition of Worldpay would see companies operating smaller PIN-based debit networks combine. These deals provide the opportunity for the payment technology companies to improve their positions in the PIN-based debit market against Visa and Mastercard, a sector banker said.

Callum Godwin, chief economist at merchant service and advocacy group CMS Payments Intelligence, said that, given the broad market penetration of Visa and Mastercard, the space needs more sizable players who are strong enough to draw more card-issuing banks to include these debit processing networks on their bank cards.

"In order to enable PIN-authenticated payments with debit cards, merchants must pay interchange fees and network fees as transactions route among merchant acquirers, processors, card networks and card issuers. Merchants would have more power to negotiate a more reasonable rate, if the market is more competitive", Godwin said.

Visa's Interlink network had a 35% share of the US market in 2016, while Mastercard's Maestro had about 20%. First Data's Star Network is the only comparably large operator, with around 20% market share. Other large networks include Discover's Pulse, FIS's NYCE, Fiserv's Accel, FIS's Culliance, member-owned SHAZAM and Worldpay's Jeanie, according to data from CMS Payments Intelligence.

While Visa and Mastercard run global operations, their competitors' PIN debit networks in the US are largely just domestic. These domestic networks have seen challenges in finding organic growth, given that they benefit from less marketing and brand exposure than Visa and Mastercard, said Anand Goel, CEO of Optimized Payments Consulting. He added that Visa and Mastercard benefit from a more comprehensive technology infrastructure, such as in credit card processing, and a stronger presence in ecommerce, which makes them move faster in addressing new markets.

Mergers among the domestic debit networks could increase their growth potential by leveraging more resources together, Goel said.

The Worldpay/FIS deal was granted early termination of its waiting period under the HSR Act on 29 April. The First Data/Fiserv deal received a second request from the Department of Justice on 4 April.

The falling market shares of domestic debit networks

The current competitive landscape is shaped by decades of consolidation since the mid-1980s, according to a report by the Federal Reserve Bank of Kansas City published in 2003. In 2002, the Star Network handled about four times the number of PIN-authenticated transactions as Visa's Interlink, while Mastercard was poised to just begin aggressively promoting its international debit network Maestro within the US, the report says.

However, the government's appetite for allowing further consolidation reached a limit in 2004, with First Data's USD 7bn acquisition of Concord EFS. In order to secure antitrust approval from the Department of Justice, First Data had to divest its NYCE processing network to Fiserv, as Concord owned competitor Star. Concord acquired Star in 2001 for USD 850m.

Now, though, further consolidation among domestic PIN-based debit processing market would take place in a very different context, as Visa and Mastercard have grown to dominate the market since then, said David Robertson, publisher of payments newsletter, *The Nilson Report*. The two companies' networks accounted for over half the market in 2016, according to CMS Payments Intelligence.

There are now also more nationwide and super-regional merchants who need to use broader range of debit networks, he added.

A hard battle against Visa and Mastercard

"A challenge for any competitor to Visa and Mastercard are those companies' ubiquitous networks and strong relationships with banks and merchants", Robertson said. "The comprehensiveness of their capabilities makes it hard for the domestic companies that largely only operate PIN-based debit networks to compete", Goel said.

The domestic PIN-based networks broadly use a single-message system, by which transactions are routed with a single message that contains both authorization and settlement requests. In comparison, while Visa's Interlink and Mastercard's Maestro are single-message networks, the companies also operate signature-authenticated dual-message systems for debit processing that ride on their technology for processing credit card transactions, Goel said.

In 2017, only 35% of all debit transactions in the US were routed via single-message systems, according to a report from the Federal Reserve Board.

In addition, the ecommerce boom gave Visa and Mastercard another boost, because the PIN-debit networks are typically not used for ecommerce transactions, Goel said.

Domestic debit networks trying to catch up

Neither Fiserv and First Data nor FIS and Worldpay have publicly disclosed their post-deal plans for their PIN-based debit processing network strategies.

"As Fiserv and First Data continue to operate as separate companies, we are unable to comment on any future plans," a spokesperson for Fiserv said.

Godwin said that the deals would benefit merchants if the parties could set up more competitive card networks.

For example, if the Fiserv and First Data merger completes, the combined company could hypothetically look to leverage Fiserv's customer base of banks to secure the issuance of Star-branded debit cards, and then use First Data's merchant relationship to route transactions directly on the Star Network and avoid Visa and Mastercard's rails, he explained.

In the example of Worldpay/FIS, Worldpay's regional Jeanie network could benefit from partnering with a firm that has a national presence, said Craig Falls, a partner in Dechert's antitrust practice. "So you increase the scale efficiencies of the benefits to consumers of having one national network in a way that would not have happened organically, at least not as quickly," Falls said.

There are, however, some organic initiatives being undertaken by the network owners in order to improve competitiveness. For instance, several domestic PIN-based debit network operators have recently launched dual-message solutions. Star introduced a signature-based service in 2016, both in single-message and dual-message formats, according to *Digital Transactions*. **Walmart** [NYSE:WMT] is among the merchants using Star's signature-based debit processing service.

Catering to the ecommerce trend, the domestic debit networks have also developed PIN-less debit processing capabilities, where transactions are routed via domestic networks but doesn't require a PIN.

By Yizhu Wang in New York and Christopher Kane in Washington, DC

© Copyright 2020 Nilson Report

Share

Share

Tweet