Merchant Acquiring

In danger of becoming a "zero-sum game"

It could be argued that the Reserve Bank of Australia's (RBA) reform of interchange in the credit card market has inadvertently initiated higher levels of merchant churn than have previously been seen in Australia. Acquiring banks, mandated by the RBA to explain the fee changes to their merchant customers, appear to have awoken them to the fact that there could be more compelling offers available from other providers.

This is borne out in East & Partners' latest six monthly Merchant Acquiring & Cards Markets Report, which shows that roughly 25 percent of Corporate, Commercial and SME merchants are "definitely" or "likely" to consider a change in supplier relationship over the next six months. Of these, some 29 percent of Corporates, 48 percent of Commercial merchants, and 20 percent of SMEs are looking to shift acquirer in isolation from their Transaction Bankers. The extremely high proportion of middle market merchants (companies turning over between A$20 and 340 million per annum) indicating they will strip away their acquiring from the rest of their transaction banking services is revealing. It provides further evidence of the increasing disaggregation of products and services taking place among Commercial customers – something which has been "the norm" in the Top 500 segment for many years. With the heightened level of competitive activity taking place in the banking markets, this can be expected to become even more the case over coming years. Added to which, early signs of disaggregation are starting to occur among larger SMEs, with acquiring being one of the first service areas to be separated from the customer's overall transaction banking relationships.

Acquiring needs to be "stickier"

The dilemma for service providers aiming to retain and deepen existing customer relationships is that acquiring does not appear to be particularly "sticky" – yet it should be. Despite the emphasis on enhanced relationship management and closer understanding of customers' business, banks do not appear to be wrapping merchant services into the overall customer package in a compelling enough fashion. In most cases, businesses are happy to pay for products that are delivered with a service, "value-add" component. But essentially, the key inducement for merchants changing provider is "substantially reduced pricing". This is massively the case among smaller businesses, with some 68 percent of SMEs and 72.5 percent of Micro Businesses stating pricing as a reason to switch. More unexpected, however, is the 45 percent of Corporates and the more than 56 percent of Commercials which are also saying price is the key reason for looking at other providers. Customer expectations are obviously climbing with respect to acquirer abilities to continue reducing fees. Acquiring requires scale to cover the huge technology infrastructure required to provide service and achieve profitability, suggesting a "law of diminishing returns" may be taking hold, especially as for most merchants outside the Top 500 acquiring is their single largest transaction banking cost.

So what can banks do to make merchant services a stickier product space and/or cause an attitudinal shift on the part of merchants towards their acquirers? Some acquirers are supporting loyalty and reward programs for merchants to offer onto their customers in a bid to introduce a more businesslike, partnership element to the relationship. But there could also be significant benefit in adopting a more advisory role in merchant/acquirer relationships. For example, East's latest report reveals that a rapidly growing number of businesses are planning or considering applying a surcharge on credit card payments in the wake of the RBA reforms, led by the example of Telstra and Qantas. How much do businesses – particularly smaller ones – know about successfully implementing surcharging? Are their surcharge differentials based on a terminal being present or not? Providers could play a more proactive role in helping their merchants make the transition from viewing card payments facilities purely as a cost centre, to being a payments channel covering itself by way of surcharges, to potentially becoming a net revenue generator. This would constitute true business partnering in the eyes of most merchants.

Figure 1

Receivables Transaction Behaviour — Commercial Customers Only

	Average % of Total Annual Receivables	
	December 2005 (N: 312)	**June 2005** (estimated)
Debit Cards (terminal based)	12.0	13.2
Credit Cards		
Terminal Payments	12.4	13.3
Website Based	4.6	4.8
IVR	3.0	2.7
Mail	12.5	12.1
Other	1.0	1.0
Cash / OTC	19.0	18.5
Cheque	28.2	27.0
Direct Credits and Standing Orders	7.3	7.4
TOTAL	100.0	100.0