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Merchants call the cards

The merchants have a big say in the future of credit cards

If the business adage "keep nothing in the way of a paying customer" held true in the absolute sense, every merchant would accept every payment method. This of course is not the case and some payment methods are ubiquitous whilst others remain on the fringe. Beyond the need to accommodate paying customers, a merchant's acceptance decision will be driven by the cost of accepting a payment method and the alternative payment methods available. It is these two influences that are currently shaping the future of credit card usage in the Australian market.

Since their introduction in the 1950s credit cards have steadily gained critical mass as a payment method and virtually all Australian merchants now accept credit card payments. Credit cards also gained further momentum with the growth in the online marketplace, becoming one of the most common ways of making payments with internet retailers.

According to official Reserve Bank statistics the number of credit card accounts on issue in Australia is now in excess of 14 million, with further growth continuing. East's research also suggests credit cards currently occupy about a quarter of merchant receivables making them one of the most important sources of payment.

But in the last few years, credit cards have started to occupy a shrinking proportion of merchant receivables.

East's data, collected as a part of its ongoing Merchant Acquiring and Cards Markets research program, shows a persistent and accelerating attrition in the share of merchant receivables coming through as credit card payments. Larger merchants – those responsible for processing the largest volume of transactions – typically report the greatest decline in the share of receivables made up by credit cards.

To understand this decline, it helps to start with the regulatory landscape in the Australian payments industry. The Reserve Bank has been actively reforming the market since 2001. The reforms, aimed at promoting transparency and competition, have impacted on the fee flows between major industry players and have brought an end to a range of restrictions on merchant behaviour such as the removal of the 'no surcharge' rule.

Credit card surcharging has become increasingly common since the 'no surcharge' rule was removed. Starting initially at the top end of town, among merchants with considerable market power (e.g. Telstra and Qantas), surcharging has caught on elsewhere as smaller merchants realised they could now use surcharges to offset the net cost of accepting the growing number of credit card transactions.

While smaller merchants seem to be surcharging credit cards mainly to cover their costs, there are indications larger merchants are using surcharges as an additional source of margin. The average per transaction surcharge among the largest merchants is consistently higher than the surcharge among smaller merchants, even though bigger merchants are able to negotiate lower per transaction charges from their banks.

Of course, consumers don't appreciate paying surcharges on credit card payments and are usually offered the flexibility to choose another payment method such as a debit card. There is indeed evidence to suggest that consumers are now being encouraged to use debit cards.

Debit cards don't normally attract a surcharge, are widely accepted and represent a logical substitute for credit cards. This substitution effect is reinforced by the launch of Visa and MasterCard debit cards (known as 'scheme debit') which can be used for online payments, the traditional mainstay of the credit card.

East's research points to a growth in the share of merchant receivables streaming in via scheme debit card payments, however bank-issued debit/EFTPOS cards are also assuming an increasing share of payments collected by merchants. Debt card payments already account for the largest slice of receivables for the very smallest merchants. But even at the top end of town, where credit card payments dominate merchant receivables, current growth dynamics suggest that debit card payments will become the largest source of receivables in about three years.

Merchant as the 'Traffic Controller'

Traditional business logic suggests that credit cards are not going to fade into the sunset because no merchant will want to stand in the way of a paying customer who has an appetite for credit card debt. Credit cards have become one of the mainstream payment methods and have a dedicated space in most consumers' wallets. However, having been freed up to influence the customer, merchants will increasingly try to steer consumers towards cheaper payment methods. The future of credit cards in the Australian market is therefore largely in the hands of merchants.

Credit Cards and Debit Cards as a Share of Merchant Receivables