

# Competition and Innovation in Card Payments Markets

27 October 2008

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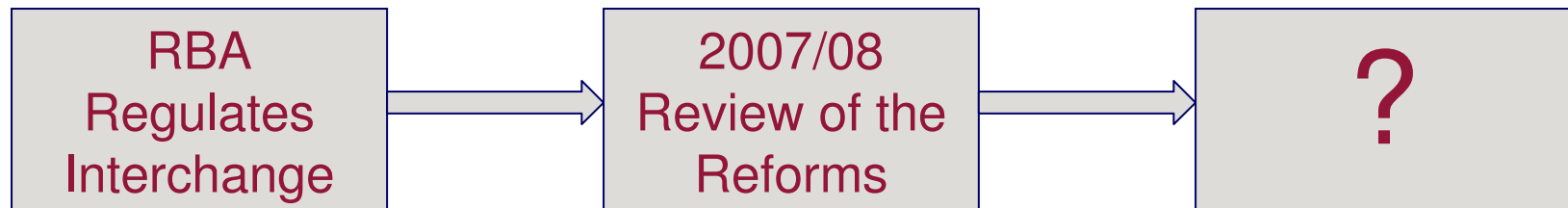
# Presentation will cover

1. Where the Industry is up to
2. Economics of Card Payment Markets
3. Indicators of Competition in these Markets
4. Ways Forward for the Industry



# Background

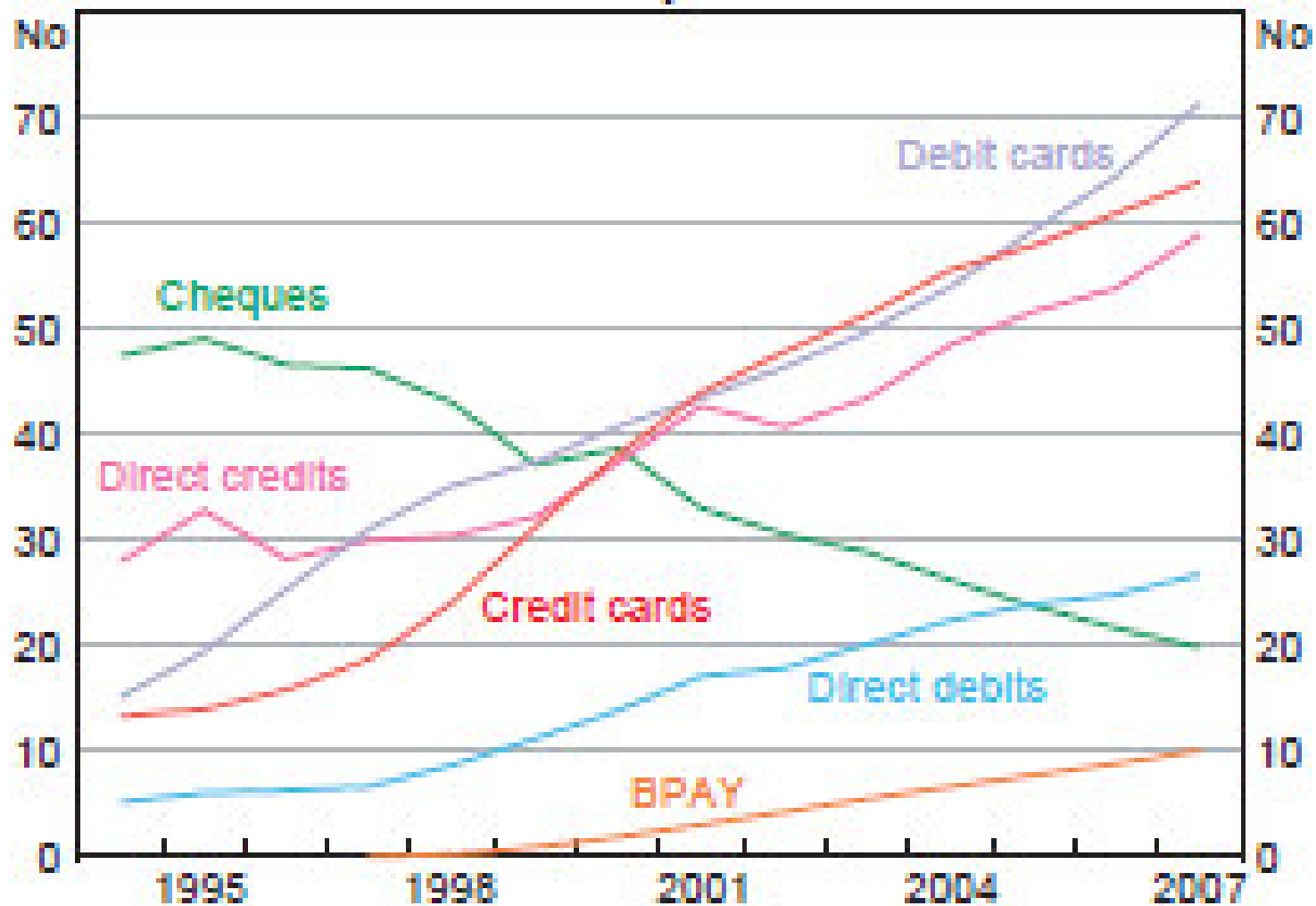
- The RBA has recently indicated that it would prefer to relax its regulation of interchange.
- But to do this it needs to see progress from the industry.
  - Need to ensure competitive forces remain
  - Desires increased transparency
  - Further changes to the EFTPOS system and honour-all-cards rule
- Up to the industry to show that progress has been made.



# The RBA's regulation

- The RBA has intervened in a number of ways:
  - Interchange fees
  - Access
  - Transparency requirements
  - HAC
  - Surcharging
- It would like to pull back, but in a way that ensures sufficient competitive forces remain in place.

# Changes in payment patterns



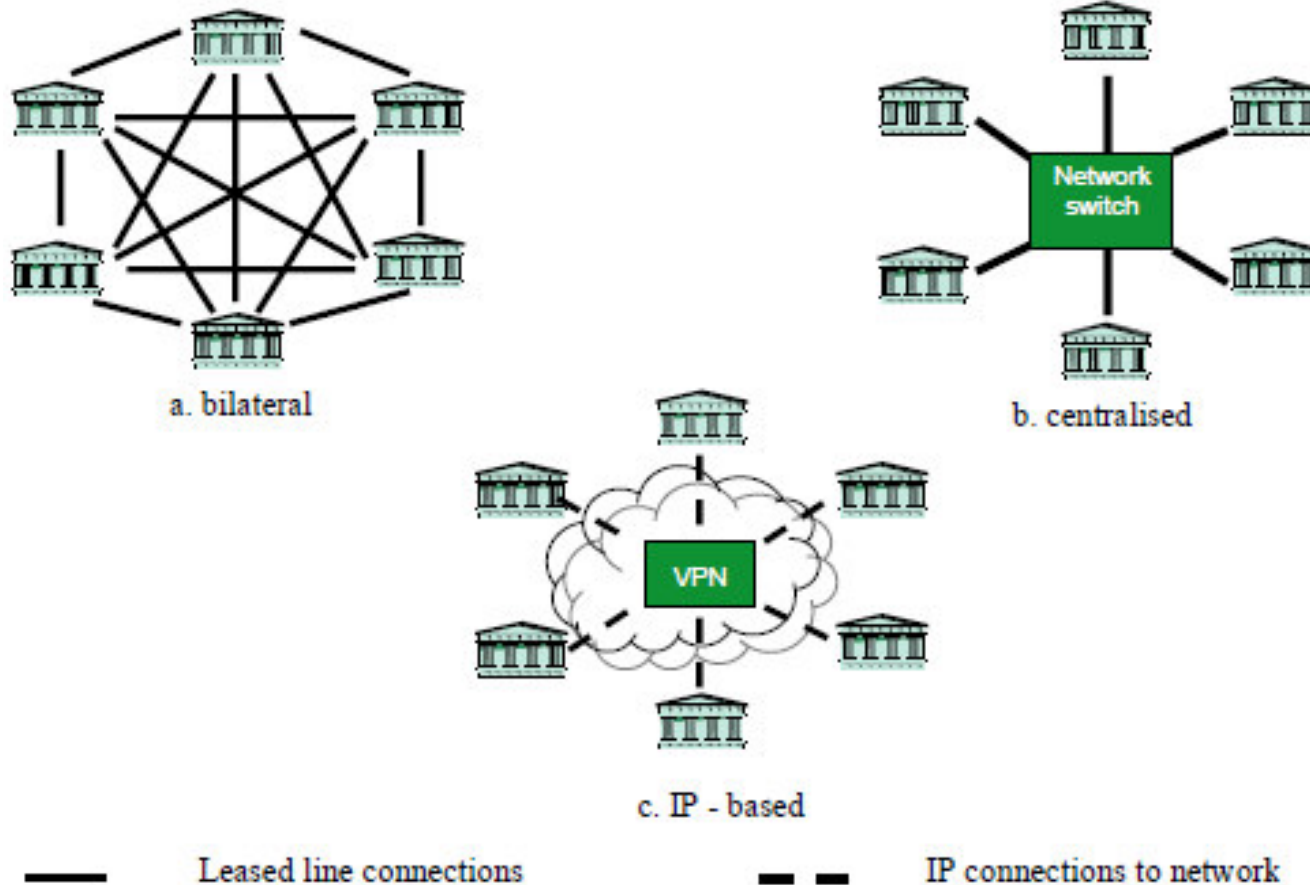
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# Evolution of payments market

- Interchange fees have traditionally been needed in payment markets to encourage take-up of new products
  - Flowed to consumers when conditions were such that they needed to be encouraged to use the new product (e.g. credit cards)
  - Flowed to merchants when it was they who needed to invest
- This logic is particularly useful for explaining the difference in direction between IFs on scheme cards versus EFTPOS.
- In the US, fees have been increasing in recent years. What does this tell us?

# Network structure

- Different network structure can influence ability to change.



# Lessons from the literature

- Card markets are different from other markets. Their two-sidedness means standard economic analysis doesn't apply.
- Generally accepted that it cannot be decided what level of interchange fees would be socially optimal.
- Fees play a balancing role, hence should not necessarily be reflective of costs.

“it is necessary to ask what, if any, policy relating to interchange fees can be justified by the state of economic understanding of payments systems”

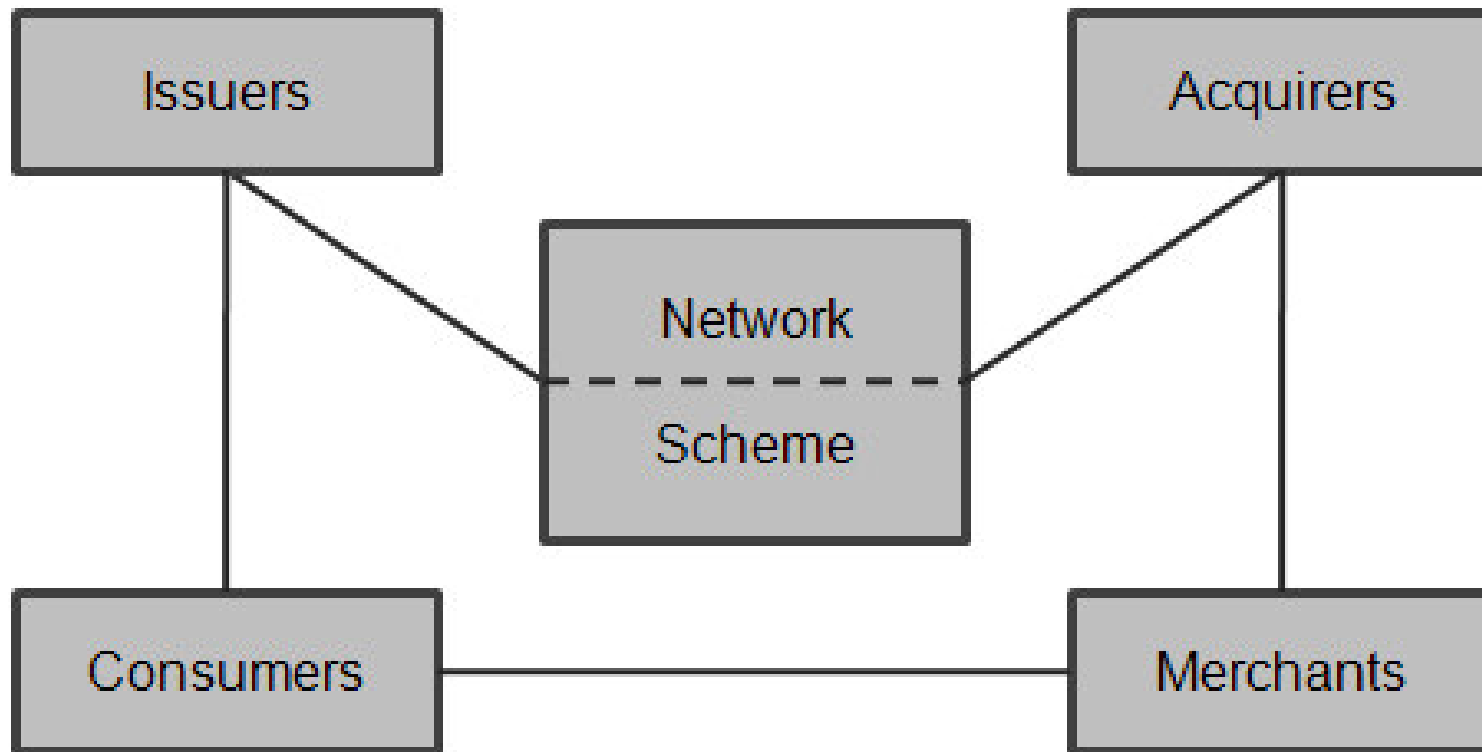
King (2008)

# Indicators of competition

- We need to know what competition in the payments system ‘looks like’.
- Need indicators which can be used to assess level of competition in a particular payment markets.
- Typical indicators used in regulatory debates include:
  - Concentration ratios
  - Pricing
  - Access
  - Transparency
  - Innovation



# Card network structure



# Summary of indicators

Category	Indicator	Comment
Concentration	Concentration ratio	High concentration ratio in a market is a necessary but not sufficient indicator of competition concerns
Access	Natural barriers Artificial barriers	High start up costs may mean duplication not optimal Barriers imposed by the industry of more concern
Transparency	Pricing System Design	Provides information for analysis of market performance as well as informing decisions of market participants
Pricing	Price differentials Degree of surcharging Price flexibility	Can be an important influence over consumer decisions Provides merchants with the ability to undo IFs Changes in rewards, IFs and MSFs as market change
Innovation	Product innovation Network innovation	International benchmarking can provide useful information on how Australia is performing in this area.

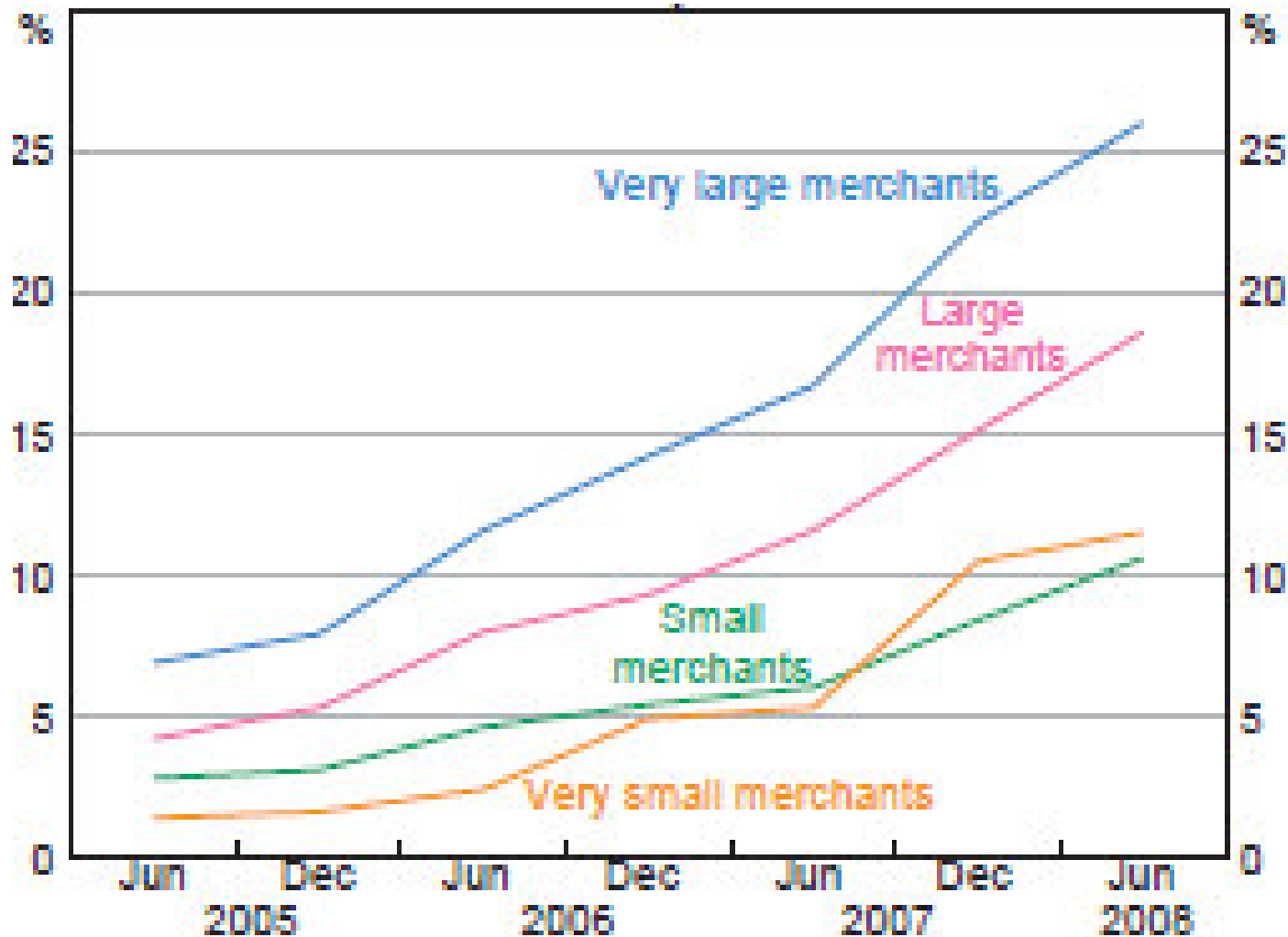
# Concentration

- Used in competition cases as a proxy for whether sufficient disciplinary forces are placed on incumbents.
- Defining the market.
- Easy to measure, but is it useful?

# Pricing

- Key question is whether current pricing leads to consumers choosing the socially efficient payment option.
- Key interactions of several measurable factors:
  - Size of interchange fees
  - Extent of surcharging (i.e. is MSF being passed on to consumers)
  - Competition between merchants and acquirers (size of MSF)
  - Competition between issuers and consumers (size of rewards)
- Can reveal useful information about market.

# Pricing – surcharging increasing



# Transparency

- Transparency aids in two ways:
  - Allows regulator or industry to monitor market performance
  - Allows participants to make more informed decisions
- Likely to be a key feature of any ongoing monitoring, whether this is through RBA regulation or an industry solution.

# Innovation

- Innovation ensures product offerings and quality continue to ensure a smoothly functioning and efficient market.
- Useful exercise to benchmark these against international payment markets:
  - Product level: how are existing products being developed and are new products finding market share
  - Network level: are existing networks operating effectively and are best practice network/governance structures being adopted.

# Cooperation vs competition

- Focus has been on the role of competition in promoting efficiency.
- But in some areas cooperation, not competition, should be the focus.

Competition → Access, pricing, transparency

Cooperation → Innovation: standards, governance

# Conclusion

- Competition issues are not clear.
- However, it is possible to establish a framework in which to consider competitive forces.
- Of more importance is how it is used – up to the industry to take matters from here.

