

Merchant's View

A call for transparency

By Rene Pelegero



“Are smaller merchants subsidising larger merchants? Are acquirers benefiting from MSF that ‘bundle’ additional costs such as corporate/ purchasing cards, non-domestic cards? Is MSF a true and fair representation of interchange plus acquirers’ operational cost plus a fair profit? No one really knows – and that is the crux of the matter.”

One of the thorniest issues in the ongoing debate between the bankcard industry and merchants is interchange. In the US, most merchants know (or should know) the interchange they pay for their credit card transactions. However, in other Visa and MasterCard regions, interchange is closely guarded and it is the subject of a lot of rumour and speculation.

The Discount or Merchant Service Fee (MSF) structure that exists globally helps conceal, and possibly contributes to, inefficiencies in the system. Are smaller merchants subsidising larger merchants? Are acquirers benefiting from MSF that ‘bundle’ additional costs (ie corporate / purchasing cards, non-domestic cards) even if the merchant does not accept them? Is MSF a true and fair representation of interchange plus acquirers’ operational cost plus a fair profit? Do acquirers have any pricing flexibility when, as reported, 80 percent or more of their pricing consists of interchange?

No one really knows – and that is the crux of the matter.

As an analogy, imagine that for many years, you have been taking all-inclusive holidays to your favourite tropical island. Everything is bundled: lodging, meals, alcoholic drinks, local tours, etc. As long as the price seemed reasonable, you did not care how the amount was arrived at. However, the price is beginning to feel expensive. The problem is – for the purposes of this analogy – you have no choice. You must go on your holiday. Now, wouldn’t you like to find out what is included in the price? Turns out you do not drink and you have been to this island so many times that the local tours are of no interest to you. Wouldn’t you be interested in giving up some of these features in lieu of a price reduction?

Merchants feel it is a reasonable thing to ask for disclosure of what is included in their MSF. They want to know what is ‘bundled’ in this cost and they want to choose whether they want all of the features for which they currently pay. Despite what some industry folks think, merchants are willing to pay for services provided to them and also understand the need for the financial services industry to make a profit. What they react negatively to is the ‘bundling’ associated with MSF and their lack of choices.

‘Wait a minute,’ acquirers may say, ‘merchants do not disclose to their customers their cost of goods. So, why should acquirers disclose their cost components to merchants?’

For two reasons. First of all, in an open, competitive market, pricing levels are set so that if a consumer finds the price at a merchant too high, he’ll go to a competitor. Merchants do not have the luxury of an alternative choice. Asking for alternative forms of payment is not a realistic option as the card schemes have done a brilliant job making their cards ubiquitous forms of payment. In some markets they are almost like utilities, something that consumers expect and take for granted.

The second reason is that, in general, merchants have a good understanding of the costs incurred by vendors in their supply chain. This awareness allows them to select better suppliers and negotiate fairly with them. In other words, if they truly know how the ‘scheme’ works, they do not ask for stupid, unreasonable terms. This is truly a case where knowledge brings about trust whereas ignorance generates suspicion and discontent.

In this age of globalisation, non-US merchants see their US counterparts as having an advantage because US merchants know what they pay their acquirers and what is passed to the associations and issuers as assessments and interchange. If Visa and MasterCard’s US Region can disclose interchange, why not the other regions?

One major reason may be that, in the rest of the world, the acquiring business is just an extension of the issuing business. This arrangement provides little incentive to issuers and acquirers to become more efficient, to find ways to take costs out of the system, or to introduce alternative forms of payment. This linkage, I believe, will be the subject of closer inspection by regulatory authorities in the future.

Therefore, I believe that one of the steps that the bankcard industry should take globally is to move towards interchange transparency as it is done in the US. Interchange transparency will expose systematic inefficiencies and pricing unfairness. Transparency allows acquirers to compete on price and make all parties in the payments chain accountable for the services each provides. Finally, I believe that transparency would be a very good and valuable first step in the opening of a meaningful dialogue amongst all parties in the cards industry.

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