

Can Consumer Behaviour Change Drive Down Smaller Country MSC's?

The level of Merchant Service Charges or Commissions (MSC's) within Europe has been the cause of much friction between acquiring banks and merchants for more than a decade. Over the past two years regulators have had some success in reducing rates. In addition, in several countries banks have taken voluntary action as a result of merchant pressure.

Table 1 below provides a summary of the key rulings which have impacted interchange and which should in turn result in lower MSC's in the future.

Date	Event
1999/2000	Spanish banks agree maximum MSC with merchant banks. Rates declined steadily since.
2001	EC allows intra regional MIF but Visa agrees to reduce deferred debit and credit card rates to 0.7% by 2007 and debit card rates by 20% over the same period.
2001	Danish regulator rules debit acquiring to be devolved to banks. Longer term reduction in fees expected.
2001/2/3	Netherlands Central Bank mandates debit acquiring devolved. Competition Authority investigation underway into level of MSC's.
2003	UK OFT rules MCE credit card interchange illegal. There is speculation that rates may fall to Australian level of 0.6%.

Table 1 Key Events That Will Impact EU MSC's

However, are regulators correct in concluding that the only key to lower MSC's is reduced interchange (the cost card issuers levy on acquirers for the funds guarantee)? Some would argue that regulators need to place MSC's in a wider context. The cause of high MSC's in some countries appears to be the consumer's reluctance to use plastic at the POS. As a result, the costs of acquisition can be much higher than those in the larger countries where plastic cards have been fully adopted.

Over the past eight years Payment Systems Europe Limited (PSEL) has conducted an EU wide MSC survey based on data collected from a sample of smaller countries. Surveys were conducted in 1995, 2000 and more recently in 2002. The survey input is drawn from a sample of acquirers in each country, as well as sister consulting companies and members of the European Payments Consulting Association (EPCA). Previous surveys focussed on credit cards only, but for 2002 we have also included debit. Respondees were also asked to indicate the acquiring product features included within the MSC's as an aid to comparison and analysis.

Table 2 shows the results of the 2002 survey for credit cards broken down by market sector for eight smaller countries.

	Austria ¹	Belgium ³	Denmark (domestic)	Iceland	Ireland	N'lands	Portugal	Switzerland
	Ave %	Ave %	Ave %	Ave %	Ave %	Ave %	Ave %	Ave %
MSCs all %								
Hotels	2.13	1.65	0.75	1.85	1.60	3.25	3.30	2.70
Restaurants	2.13	1.78	0.75	1.98	1.75	3.25	3.90	2.70
Small Merchants	2.60	1.66	0.75	1.58	2.75	3.50	3.60	3.00
Supermarkets	2.45	1.19	0.75	0.90	1.70	2.85	2.00	2.80
Petrol Stations	2.30	1.32	0.75	0.89	1.50	1.50	€0.15 ²	n/a
Car Rental	2.57	1.88	0.75	2.10	1.50	3.25	4.00	3.35
e-commerce	2.38	1.75	0.75	2.05	2.50	3.00	3.00	3.15
Average MSC	2.38	1.64	0.75	1.62	1.90	2.94	3.30	2.95

¹ Plus €0.10 per txn

² Customer pays a €0.5 surcharge

³ 2000 data

Table 2 Smaller Country 2002 Credit Card MSC's by Market Sector

The sector breakdown is relatively consistent with the lowest rates applicable in the petrol and supermarket sectors where volumes are highest. Higher rates apply for hotels and car rental where specialised services are provided, chargebacks are typically high and volumes low. Restaurants and small merchants generally pay higher rates that reflect low volumes and the high risk of default in the sector. Lastly, e-commerce rates remain high because of the risks of fraud and the high incidence of chargebacks.

Where data is available, we have compared small country trends since 1995. Austrian rates have fallen most (by almost 20%), whereas those for other countries have fallen by between 5% - 10%. (Note also that Danish domestic credit card MSC's are regulated and capped at 0.75%, however non domestic cards are charged on average between 2.5% - 3.5%.)

There are some significant variations in the components that make up MSC's in several countries. A proportion of terminal and telecommunication costs are included in the rates for Portugal and Switzerland (the higher rates reflect recovery of these costs). Minimum monthly fees are levied in Denmark, Ireland and Switzerland if transaction volumes fall below a threshold. In Belgium, Iceland, Ireland, Portugal and Switzerland consumables are free but charged in all others. As a generalisation merchant settlement is T+1 but with T+2/3 in the Netherlands and Belgium.

Table 3 provides the headline average credit card rates for 1995, 2000 and 2002 for the larger countries.

Country	1995	2000	2002	% Average 7 Year Change (approx.)
UK	1.5 – 1.6%	1.5 – 1.6%	1.5 - 1.6%	0%
France	0.8 – 1.0%	0.8 – 1.0%	0.8 – 1.0%	0%
Germany	2.4 – 2.7%	1.8 – 2.1%	1.72 – 1.95%	-30%
Spain	2.4 – 2.7%	1.8 – 2.2%	1.65 – 1.85%	-30%
Italy	2.7 – 2.8%	2.4 – 2.6%	n/a	n/a

Table 3 Larger Country Credit Card MSC's and Changes in Rates 1995-2002

As with all previous surveys, UK and French MSC's are significantly lower than those in most other countries, reflecting the higher volumes processed in these two markets. Interestingly, UK and French rates have remained almost unchanged over the period whereas rates in Germany and Spain have fallen. Spanish rates also include terminals and telecoms costs which if excluded would bring rates closer to European norms.

Is there a link between credit card MSC rates and the interchange in each country? It is difficult to assess because individual country MSC's reflect different levels of acquirer costs. However, a correlation appears to exist in some countries (Switzerland excluded), as Table 4 below indicates.

Country	Credit Card txn per POS per annum	Credit Card txns per annum per capita	Comment (credit card only)	Debit Card txns per annum per capita
Austria	665	4	High MSC's	15
Belgium	541	6		50
Denmark	208	3	Regulated	91
Ireland	2850	25		15
Netherlands	504	5	High MSC's	57
Portugal	832	9	High MSC's	26
Switzerland	1568	23	High MSC's	19
UK	2945	40		56
France	n/a	n/a		69
Germany ¹	735	6		9
Spain	407	9	High MSC's	10
Italy	1082	9		6

¹ Debit includes e-Cash + POZ

Table 4 Link Between Low Usage and High Credit Card MSC's

The costs of merchant acquisition are highly sensitive to volumes. Low POS usage means high costs of acquisition, which when added to the underlying interchange result in high MSC's.

Table 5 provides an MSC breakdown by sector for debit card MSC's.

	AUS ¹	BEL ²	DEN	ICE	IRE	NEDER	PORT ³	SWISS
	Ave %	Ave	Ave %	Ave %	Ave	Ave	Ave %	Ave
Hotels	0.95	€0.11	0.0	0.65	€0.20	€0.20	2.50	€0.20
Restaurants	0.95	€0.11	0.0	0.75	€0.20	€0.20	2.50	€0.20
Small Merchants	1.0	€0.11	0.0	0.70	€0.20	€0.25	2.20	€0.20
Supermarkets	0.5	€0.06	0.0	0.30	€0.12	€0.20	1.30	€0.20
Petrol Stations	0.5	€0.13	0.0	0.25	€0.15	€0.20	€0.15	€0.20
Car Rental	0.95	€0.11	0.0	0.79	€0.20	€0.20	2.60	€0.20
e-commerce	1.0	n/a	0.0	n/a	n/a	€0.20	n/a	€0.20
Average MSC	0.83%	€0.11	0.0%	0.57%	€0.18	€0.20	2.22%	€0.20

¹ Plus €0.14 per txn charge, except petrol where €0.07

² 2000 Data

³ Visa/MasterCard branded cards only

Table 5 Smaller Country 2002 Debit Card MSC's by Market Sector

Europe is undecided about its charging structure for debit. Almost half charge an ad valorem fee, with the remainder adopting transaction charges. Generally debit MSC's include the same acquiring components as credit card MSC's. However, unlike credit several countries operate debit without merchant accounting and chargeback processing to credit card standards. This almost certainly results in higher underlying processing costs for both acquirers and merchants.

Specific points relating to individual countries are as follows. Austrian rates have a flat fee of €0.14 added to the ad valorem fee. The current rates for Denmark are zero but a new fee of €0.07 (first 5000 txns free) is expected to apply from 2004 onwards. Portugal has two rates. One for Visa and MasterCard branded cards and a second for domestic Multibanco, tariffed at 1%. The Netherlands rates have increased to €0.18 - €0.20 following the devolution of debit acquisition from Interpay to individual banks.

Table 6 shows average debit card rates for the larger countries.

Country	1995	2000	2002
UK	€0.17 - €0.22	€0.17 - €0.22	€0.17 - €0.22
France	0.8 - 1.0%	0.8 - 1.0%	0.8 - 1.0%
Germany ²			
- online e-Cash ¹	0.3%	0.3%	0.3%
- offline POZ	€0.05	€0.05	€0.05
Spain	2.4 - 2.7%	1.8 - 2.2%	1.65 - 1.85%
Italy	n/a	0.83%	n/a

¹ Minimum €0.075 lower rates for petrol (0.2% minimum €0.04)

² Excludes direct debit fee of approx. €0.30 per txn for e-Cash and POZ

Table 6 Larger Country Average Debit Card MSC's

French, German and UK rates have not varied significantly since 1995. France and Spain have a common rate that applies to both debit and credit. Again, Spain includes terminal costs. Spanish debit card usage at ten transactions per capita per annum is one of the lowest in Europe, thus rates reflect the need to recover high base costs. Germany, unlike any other EU country, has an unusual structure for debit and operates a three not four party debit acquisition system.

Are debit card rates interchange driven? Some domestic schemes operate without any interchange (Belgium, Denmark, Netherlands, Germany, Switzerland and other countries not included in the survey). Others are set at relatively low rates (UK, Ireland, France, Portugal). Broadly rates reflect low underlying interchange. Unlike the USA (WalMart case), the majority of European debit transactions are online PIN (France, UK and Ireland are the exceptions). For these reasons it appears unlikely that EU merchants will take similar action to challenge fee differentials.

The conclusions of this analysis are that generally since 1995 credit card MSC's in smaller countries have declined slowly. Significant reductions, to bring some of these countries in line with UK and France are unlikely to occur until transaction volumes increase greatly. Debit card rates have remained relatively constant and in most countries are set at modest levels, if France and Iberia are excluded.

EftPos has been with us for almost 15 years, but in many countries (particularly Austria, Germany, Italy and Iberia) consumers are still more comfortable using cash. Banks and merchants still do not understand why consumers have been slow to change. There is a real shortage of market research into consumer attitudes to plastic in many of these countries. Banks and interbank schemes need to develop well thought through campaigns to "change consumer behaviour" with disincentives for cash and cheque use and greater rewards for use of plastic. For many countries only when transaction volumes increase significantly (in some countries they need to double) will there be sufficient volume to radically reduce the core costs of acquisition and thus drive down MSC's.

Peter Jones
Director
Payment Systems Europe Limited
+44 (0)20 8891 6244
e-mail: pjones@psel.co.uk