

# Non Banks In The Payments System: Innovation, Competition and Risk

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*Thoughts/questions arising from the paper entitled:  
'Some Economics of Horizontal Integration in the  
Payment Industry'  
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## ***How would this analysis work in a European SEPA environment?***

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- Europe is not the same as the US – comparisons difficult to draw
  - multiple cultures, languages, currencies, regulators
  - national payment industry dynamics, economics and profiles, ‘legacy’ constraints
  - payments value chain traditionally controlled by banks, directly or via jointly owned organisations
    - increasing role for non-banks in processing and networks
    - increasing role for non-banks in E-money/Prepaid, e.g. PayPal
- SEPA principles, enshrined in the Payment Services Directive, are likely to lead to consolidation, rationalisation and outsourcing of key aspects of the value chain – vertical and horizontal integration
- The challenge for SEPA and other EU initiatives is to achieve harmonisation across Europe in the creation of a single domestic market
  - politically rather than economically driven changes?
  - mission impossible in terms of implementation without regulatory intervention?

## ***Do the principles of horizontal integration apply in the European payments industry?***

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Is it true that waves of mergers are triggered by deregulation or development of new technologies?

- In Europe the goal is self-regulation within a European regulatory environment to be broadly defined by the Payment Services Directive
  - is this deregulation or more a change in the regulator?
- For SEPA, cards technology will be Chip and PIN, but this is not new – it is just approved within SEPA principles

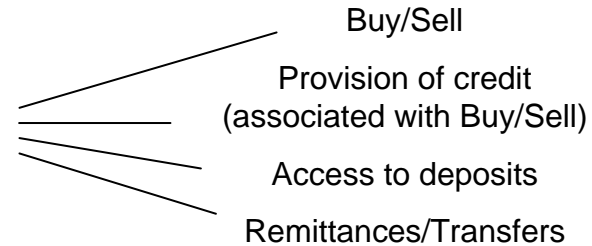
Are the reasons for mergers simply increasing economic surplus and benefitting shareholders/managers?

- Within SEPA, some mergers driven by survival strategies, the creation of entities that have scale, wider geographic coverage and merged skills

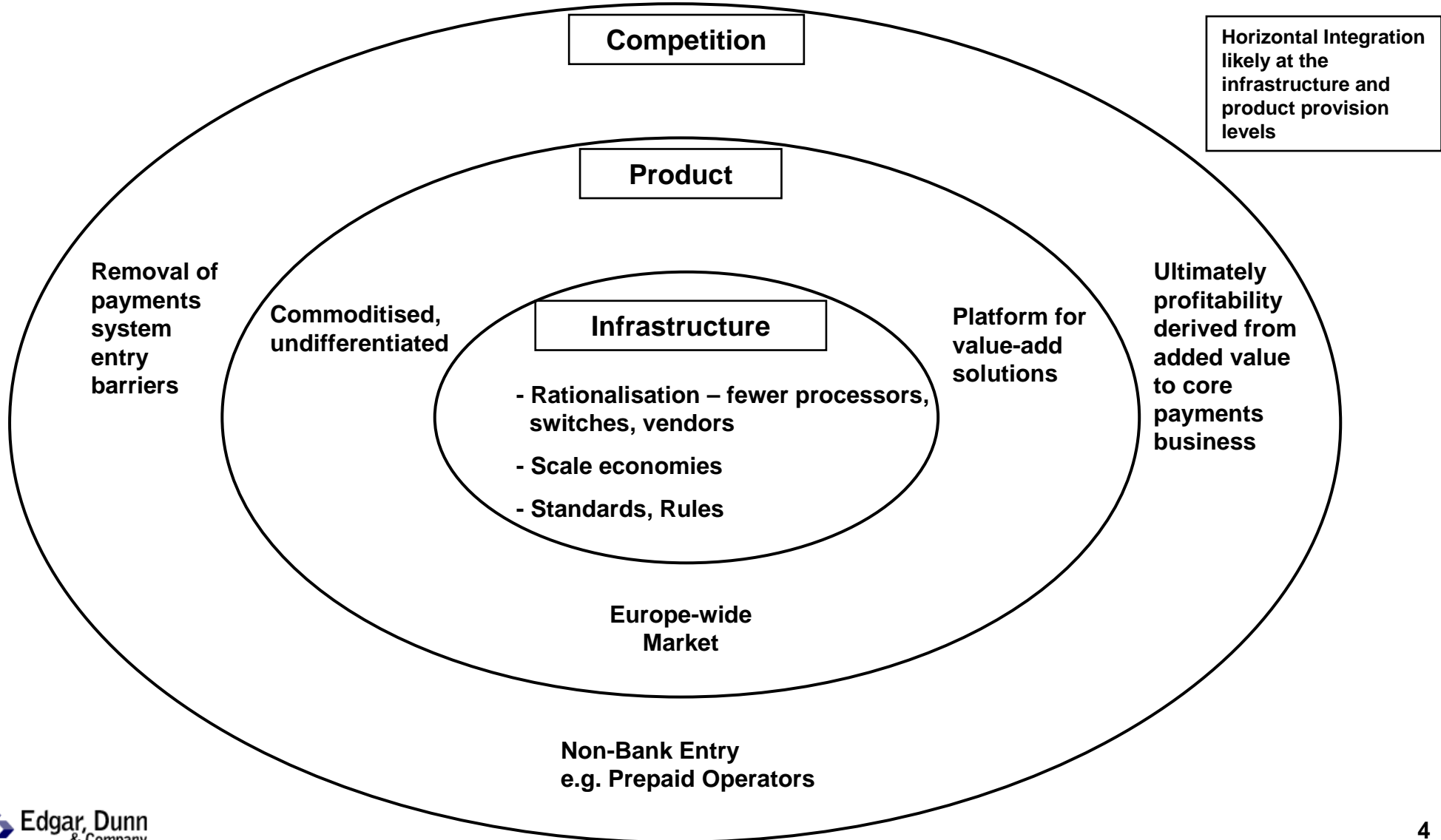
# How applicable is the two-sided network argument in European payments?

## Other factors may need consideration:-

- Payments instruments operate in several value chain
  - business models vary across those value chains
- The economics of payments product provision in Europe are completely distorted by extensive cross-subsidisation of cash
  - not transparent to consumers, merchants or corporates
  - most banks, merchants do not know extent of cross-subsidy
  - removal of cross-subsidy – a political No-Go area?
- Could horizontal integration lead to commodity pricing of payments instruments to compete with the price/convenience of cash?
- Do European regulators fully appreciate the pricing structures in the payments industry two-sided market?  
Do they have the toolset to fully analyse impact of changes?
  - European regulators continually criticise fees around payments
  - for two-sided networks to operate efficiently, is there an argument for less rather than more regulation?



# What are the potential consequences of SEPA?



## ***Horizontal integration and non-banks***

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- Barriers are being removed that prevented horizontal mergers in the past in European payments
  - breaking down of national payment schemes
  - significant merger activity also involving non-banks
    - Link/Voca, SSB/SIA
- Non-banks already exploiting opportunities to intermediate in payments industry under the European E-money regulation
  - interest in non-bank involvement in payments varies across Europe
- The difficulty in finding the balance between regulation and competition is clearly evident in Europe. Horizontal and vertical integration may generate barriers to non-banks
  - investment required to optimise scale economies?
  - less appetite for technology innovation/implementation?
  - 'Europe-wide' entry barrier replacing 'national' entry barriers
- What is really meant by the statement,
  - “As far as competition policy is concerned, the only thing that matters is the governance structure of the different networks and their access criteria and pricing rules”?

# *Horizontal integration in the payments industry in Europe?*

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**Who will be the winners/losers?**

Consumers

Merchants

Corporates

Banks

Processors/Network Providers

Payment Schemes

Technology Providers



Lawyers

Regulators (EU)

Regulators (National)

Consultants

Analysts

Investors (European)

Investors (Non-European)