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Shifting tides for Brazil's credit card waters

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The initial public offering of **Cia. Brasileira de Meios de Pagamento**, known as VisaNet Brasil, was this year's largest IPOs to date. For now it has a monopoly providing **Visa Inc.** payment card acceptance to Brazilian merchants. Its **MasterCard Inc.** acquirer cousin **Redecard SA**, which also holds a monopoly in Brazil, had one of the most successful offerings in 2008.

Brazil is a large, high-growth retail card market on many multinational payment processors' radar. General purpose payment card transactions and volume rose 19.4% and 25.8%, respectively, in 2008.

Robust growth plus steep pricing -- net of interchange and network fees 6 to 8 times the U.S. -- enable Brazil's acquirers to command rich valuation multiples. Redecard and VisaNet are valued at 7.8 times and 7.2 times revenue, respectively, much greater than comparable businesses in competitive markets. **Global Payments Inc.**, a multinational acquirer and processor deriving a majority of its revenue from fiercely competitive North American markets, trades at 2.2 times revenue. **Total System Services Inc.**, a Columbus, Ga., provider of electronic payment processing, is valued at 1.6 times revenue.

However, Redecard's and VisaNet's valuation multiples have slid as the market cottons to the fact their monopolies are not sustainable.

On Aug. 6 the antitrust department of Brazil's Secretariat of Economic Law of the Ministry of Justice demanded Visa publish within 30 days its criteria to grant additional acquiring licenses and to end VisaNet's exclusivity. At the end of the month, it stayed the order pending a Sept. 16 hearing. Even if the order is delayed by several months, the death knell for network-exclusive acquirer monopolies in Brazil has sounded.

The provision of MasterCard and Visa acceptance is almost indistinguishable, and in most markets merchants buy both from a single acquirer. Antitrust authorities rightly note merchants' redundant point-of-sale systems and networks with Redecard and VisaNet are a deadweight loss.

Now that Visa is being forced to grant additional acquiring licenses, dual acquiring will become the norm. Visa may voice a pro forma objection, but it will happily comply. While Redecard is the only active MasterCard acquirer in Brazil, **Banco Santander SA** and **Banco IBI SA** have unused MasterCard acquiring licenses. MasterCard will issue a license to a rebranded VisaNet and others.

MasterCard and Visa are commercial networks. It is in their interest the provision of card acceptance become competitive. That will lower fees, end delayed merchant payment for credit cards, increase acceptance and reduce retailer resistance to taking cards in lieu of cash, all of which will increase card use, boosting the global payment networks' revenue.

Additionally, more licensees operating on each side of the network increase its value and processing opportunities. More acquirers providing acceptance will boost MasterCard's and Visa's processing revenue.

Many national markets have had monopoly acquirers. The British, German and Dutch markets had network-exclusive monopoly acquirers. They broke down because of regulatory intervention or pressure, as well as new entrants.

Up until 1989 in the U.K., the world's second-largest card payment market, **Barclays plc** enjoyed a Visa-acquiring monopoly, and JCCC -- a joint venture of **Royal Bank of Scotland Group plc**, **National Westminster Bank plc**, Lloyds TSB Group plc and Midland Bank plc -- enjoyed a MasterCard-acquiring monopoly. The Monopoly and Mergers Commission was critical. Lloyds broke rank and became a Visa acquirer too. The other major retail banks quickly followed suit. With dual acquiring and competition, credit card merchant service charges came down 60 to 80 basis points and plateaued.

In the '90s, Germany's largest acquirer, **Euro Kartensysteme GmbH** had a monopoly providing MasterCard acceptance. In 1999, provoked by RBS dual acquiring for a few travel and entertainment merchants, it decided duality was inevitable. With its scale, it chose to lead the charge and continue to dominate the market. In response Visa acquirers **B&S Card Service GmbH** and **Citigroup Inc.** started providing MasterCard acceptance. In the following year, pricing collapsed, and acceptance increased 15%. Euro Kartensysteme's acquiring business was spun off as **ConCardis GmbH**. Today among a dozen acquirers active in Germany, it is still one of the big three, though no longer dominant.

Bank-owned **Interpay Nederland BV** enjoyed an acquiring monopoly for the Netherlands' national debit card system PINS until 2004 when the Nederlandse Mededingingsautoriteit, the country's competition authority, forced its eight shareholder banks to acquire directly. Regulatory pressure, a public spotlight on merchant fees and the introduction of competition caused average debit card merchant service charges for small merchants to decline 18% and for large merchants 21% from 2003 to 2006.

While it is very much in the interest of Redecard's and VisaNet's management and shareholders to stall competing with each other, the moment a new acquirer enters the market both will go dual, if not sooner due to regulatory pressure.

Brazil is one of if not the most attractive large emerging payments market. New merchant acquirers and processors will come.

Potential entrants include Banco Santander, Global Payments, **First Data Corp.** and **U.S. Bancorp**'s Elavon Inc. The challenge for those without a Brazilian branch network is to establish relationships through which they can cost-effectively reach merchants.

For Global Payments, which is an accomplished multinational operator, the logical local partner would be **HSBC Holdings plc** with whom it has an acquiring JV operating in 11 Asian markets, and from whom earlier this year it acquired the U.K.'s third-largest acquirer, HSBC Merchant Services LLP.

Payment processing behemoth First Data's enormous debt load may hamper serious effort to penetrate a market the size of Brazil. In 2007 it acquired a Brazilian beachhead: Check Forte Processamento de Dados Ltda. If it launches an acquiring business, it will almost certainly seek a local bank partner or partners.

Elavon has acquired and built a pan-European acquiring business. Subject to management bandwidth and finding a path in, Brazil ought to be an irresistible expansion market.

With a Brazilian retail bank network and an acquiring business in Spain, Banco Santander has the wherewithal to be a formidable competitor. Moreover, with payment volume falling in Spain because of the recession and net acquirer fees having fallen 75% over the last several years, Brazil has to look appealing relative to its home market.

However, no challenger will achieve scale and therefore unit costs comparable to the two incumbents anytime soon.

Redecard and VisaNet will each offer every one of their million plus merchants MasterCard and Visa acceptance. Redecard has more to gain as Visa has a greater share of Brazil's payment volume than MasterCard. For giant retailers such as **Grupo Pão de Açúcar**, **Carrefour SA** and **Wal-Mart Stores Inc.**, fees will collapse. In 2005 Brazil's top 15 retailers had 14% of total formal retail sales. Assuming Brazil's acquirers don't succumb to an orgy of price cutting, fees for smaller merchants will also erode, but slowly.

Today acquiring and processing are bundled. In the future Redecard and VisaNet may well sell processing to competing bank acquirers. Total System, Global Payments, First Data and **Fidelity Investments** are also likely to sell processing-supporting acquiring businesses.

What does the future hold for Brazil's card payments industry? Growth. Competition will boost acceptance and use as well as network and issuer revenue. It will also reduce prevailing merchant service charges, Redecard's and VisaNet's share of growth, and, consequently, their valuation multiples.

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