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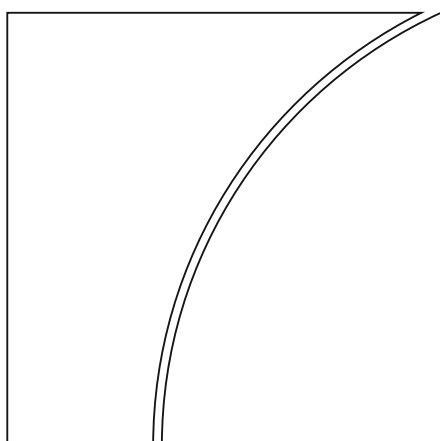
No 1163

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Monetary and Economic Department

January 2024



JEL classification: G21, L11, L4, L5.

Keywords: Access pricing, interchange fees, payment cards, payment facilitators, two-sided markets

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ISSN 1020-0959 (print)
ISSN 1682-7678 (online)

Interchange fees, access pricing and sub-acquirers in payment markets*

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January 2024

Abstract

Sub-acquirers, also known as payment facilitators, have played a vital role in fostering merchant digital payments acceptance, particularly in developing countries. To provide access to digital payments (ie card acceptance) to merchants, sub-acquirers do not have a direct connection with the card network but through the acquirer. This paper aims to study the optimal pricing in the payments industry when: i) the sub-acquirers and acquirers compete in the same downstream market, and ii) the sub-acquirers enter niche markets that are not covered yet (eg micro and small-sized merchants). In the first scenario, a conflict arises as the acquirer might have incentives to deter entry by charging prohibitive access fees. In the second scenario, the acquirer obtains an extra profit from granting access to the card network for the sub-acquirers, and welfare increases. That said, the regulator can play a relevant role in the first scenario by setting an access fee to allow socially but not privately desirable entry.

Keywords: Access pricing, Interchange fees, Payment cards, Payment facilitators, Two-sided markets

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*I acknowledge financial support from the FIT IN Initiative led by the Toulouse School of Economics in partnership with the Bill & Melinda Gates Foundation. Most parts of this paper were done during my master's studies at TSE (2021-2022). I am grateful to Carola Müller, Raul Morales, and Anahi Rodriguez for our very insightful discussions as research team. I thank Matthieu Bouvard, Carola Müller, Jon Frost, Yang Ji (discussant) and the participants at the FIT IN Initiative: Workshop on Mobile Money Interoperability (Toulouse, 2022) and II Regional Conference on Payments and FMIs (Bogota, 2023) for constructive comments. The opinions shared in this paper are solely my own and do not necessarily reflect those of the Bank for International Settlements or the Central Reserve Bank of Peru. All errors and omissions are my own.

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1 Introduction

Over the last decades, credit, debit and prepaid cards have become more important in retail payments as a substitute for cash. Moreover, the coronavirus pandemic highlighted the relevance of digital payments; in particular, card payments as an alternative when fearing viral transmission through cash (banknotes and coins) (Alfonso et al., 2020; Auer et al., 2020). Despite these positive facts, low-income and unbanked people still use cash as their only payment instrument (Aurazo and Vega, 2021b; Shy, 2020) and many micro and small-sized businesses do not accept means of payment other than cash in developing countries. A few reasons behind the low merchant card acceptance are related to demand-side factors such as tax evasion (Aurazo, 2020; Aurazo and Vasquez, 2020; Aurazo and Vega, 2021a) or supply-side factors such as cost inefficiencies and operational risk management (Müller, 2023).

In this context, new players so-called payment facilitators/aggregators or more generally sub-acquirers¹, are playing a relevant role in fostering card acceptance, specially for micro and small-sized businesses and in developing countries. They offer a new value-added product by providing an easier and cheaper way of accepting cards for merchants. Indeed, sub-acquirers could bring an efficient remedy to the higher costs that merchants usually face (due to vertical and horizontal integration and exclusivity arrangements between acquirers and card networks) or the null perception of a real benefit from accepting payment cards². Unlike acquirers, sub-acquirers do not have a direct connection with the card network but through the acquirer to provide merchant card acceptance, and thus an anti-competitive behaviour could arise.

The paper aims to analyse the optimal pricing (interchange fees, access charges, cardholder price and merchant discount rates) when the sub-acquirer competes with the acquirer in the same downstream market and in niche markets (which are not covered yet). In the first scenario, the acquirer might have incentives to deter entry by setting prohibitive access fees to sub-acquirers, while in the second scenario the acquirer is less likely to deter entry as it obtains an extra profit from granting access in this new market.

The model is built upon Rochet and Tirole (2011) but includes a sixth player (sub-acquirer) that can compete with the acquirer in the downstream market, and splits the acquiring market into upstream and downstream activities. On the one side, there is an upstream market in which the acquirer grants connection with the card network and allows transactions from sub-acquirers to be validated and processed; on the other side, there is a downstream market in which acquirers provide card acceptance to merchants and they can compete with sub-

¹In the card industry, there is a large discussion about payment aggregators and payment facilitators. For simplicity, this paper treats both terms as sub-acquirers (third-party providers) that have a contractual relationship with acquirers to provide merchant card acceptance instead of a direct connection with the card network. For instance, Square, Stripe, and PayPal are all examples of sub-acquirers.

²For instance, in Peru both sub-acquirers Izipay and Vendemas allowed merchants to accept all the card networks at the point of sale when the main acquirers were exclusive with only one card network (Visa or Mastercard); ie instead of contracting with Niubiz and PMP separately and incurring double costs, small merchants opted to affiliate with the sub-acquirer to accept both card networks. Another example is MercadoPago which is an e-commerce platform that allows merchants to accept all cards in Latin America and the Caribbean.

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