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Merchant Acquiring: Special Edition Navigator

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vantiv and People's United Bank®

formed a merchant services joint venture to create

People's United Merchant Services

A subsidiary of People's United Bank®

2014

The undersigned served as exclusive advisor to People's United Bank

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BANK OF THE WEST

renewed its merchant services alliance with

Elavon

August 2014

The undersigned served as exclusive financial advisor to Bank of the West

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Consolidation and the Un-Banking of EU Acquiring

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Acquiring Opportunities in the Mid-Size Agent Bank Market

Over the past 12 years, only four of the twenty largest (by assets) U.S. agent banks have changed their acquiring partners. This trend may be attributed to the complex and bespoke specifications the largest banks and their customers require. Changing... More

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Acquirers Differentiating through Early Stage Investments

By Patrick Carroll

The acquiring industry has long been familiar with M&A activity and has experienced continued consolidation over the years. Historically, most of the M&A activity involves acquirers purchasing other acquirers or ISOs. It has been less common for acquirers to make investments in early stage technology companies. However, we observed a number of large investments in technology start-ups from leading acquirers in 2013, particularly from First Data Corporation and Heartland Payment Systems. The investments hint at the future of the point-of-sale and acquirers' commitment to differentiating their respective suites of products and services.

One of the notable themes is that acquirers are seeking to invest in market leading tablet-based POS solutions. First Data acquired Clover, a young technology company that developed a sleek, cloud-based, open architecture POS solution. Clover offers a full-service platform that enables merchants to accept payments, manage payroll, track inventory, and perform other tasks. Merchants can utilize apps to customize and manage day-to-day business needs. In a similar case, Heartland recently invested in Leaf, another tablet-based POS developer. Leaf similarly offers multiple apps that empower retailers to tailor their POS solution to their unique needs. Leaf is an integrated cloud-based platform that accepts payments, handles day-to-day business tasks, and provides managers with a dashboard to analyze performance. While the cost of First Data's acquisition of Clover wasn't disclosed, Heartland's investment in Leaf was reportedly $20 million.[1]

On the software side of payment acceptance, First Data acquired Perka, a mobile loyalty solution. Perka is an application that integrates with existing POS platforms and enables merchants to interact with their best customers. Heartland recently invested in TabbedOut, a mobile commerce application that also works alongside a merchant's existing POS. TabbedOut targets the restaurant and hospitality industry, and it enables consumers to pay their tabs via their smartphone. Merchants can integrate TabbedOut's software to expedite customer checkout, improve table turnover, and distribute relevant offers. Heartland contributed to TabbedOut's $7.75M Series B funding round.[2] Moving forward, TabbedOut will leverage Heartland's national sales network to support distribution.

The acquiring landscape is fairly concentrated, with the top 10 acquirers making up 80% of the acquiring market. To avoid making payment acceptance a commoditized product, acquirers are looking to advanced technology and value-added services to differentiate their merchant services offering.

[1] Bostinno - Sept, 2013.

[2] FinExtra - Oct, 2013.

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A Look at the Partnership Landscape in the ISV Market

By Alicia Francois

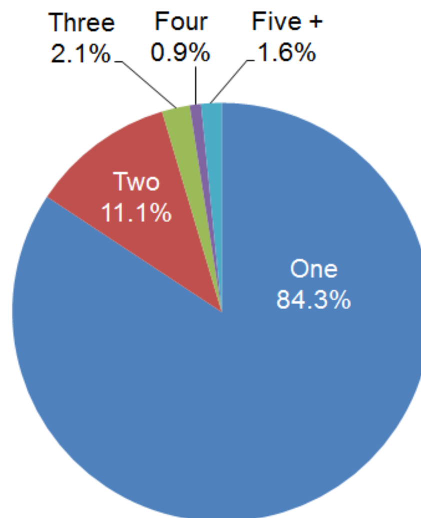
Over the last several years, acquirers have increasingly pursued partnerships with Independent Software Vendors (ISVs) as a method to gain new merchants as more merchants turn to iPOS solutions. First Annapolis maintains a database of over 5,000 ISVs that are active today, and we believe this represents only 40-50% of the market. Despite first movers like Mercury having successful and long-standing ISV strategies, the ISV market remains large and fragmented, and there is plenty of room for acquirers to enter the space.

Even with the growing number of referral partnerships between acquirers and ISVs, there is a large amount of exclusivity, or at least defacto exclusivity, in the market. Of the 5,000 ISVs in our database today, very few are certified to multiple acquirers, and those that are tend to be the major players (e.g., Micros, NCR, Squirrel). Of those ISVs that we have certification information on, 84% are certified to only one acquirer, while only 1.6% are certified to more than five acquirers, as Figure 1 illustrates.

Looking at partnerships from the acquirer's perspective, the share of an acquirer's ISV partners that can be considered unique certifications (i.e., not shared by any other acquirer) varies. The lowest we have seen is around 50% (that is, 50% of that acquirer's ISV partnerships are exclusive), while some acquirers have unique partnerships with upwards of 95% of their ISVs. For the most part, there does not seem to be a contractual obligation of exclusivity but rather a de facto exclusivity. The small size of many ISVs, the potentially time- and labor-intensive certification process, and many other factors likely contribute to this trend. We speculate EMV will exacerbate this phenomenon.

For acquirers, the large and fragmented ISV market with potentially thousands of untapped partnerships represents a valuable, albeit daunting, opportunity.

Figure 1: Share of ISVs by Number of Acquirer Certifications



Source: First Annapolis Consulting proprietary research.

Capitalizing on this requires a thoughtful ISV strategy. An acquirer can choose to focus based on an ISV's industry focus, lifecycle stage, technological capabilities, or size, which allows the acquirer to pare down the market of 10,000+ ISVs into an actionable list of targets for potential partnerships.

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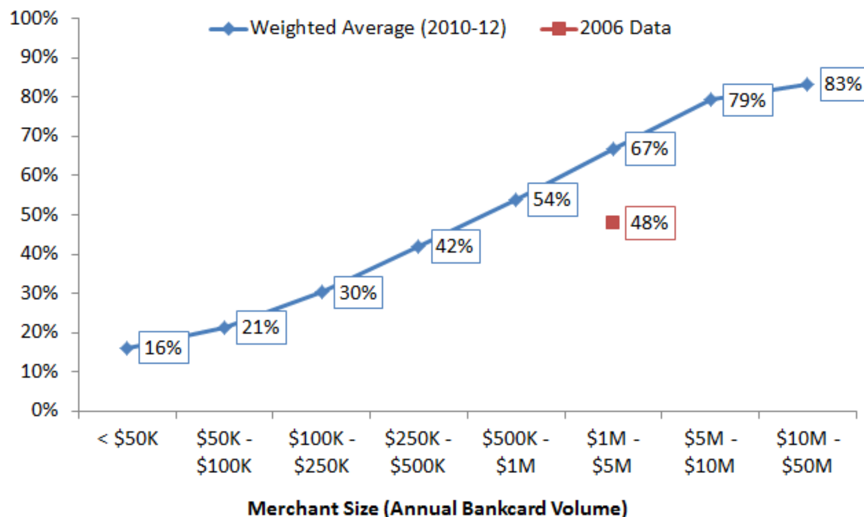
Interchange Plus Pricing for Small and Mid-Sized Merchants

By Nick Kaw

Interchange plus pricing has long been a staple of large merchant relationships due to the pricing structure's comparative transparency and competition for these large, stable accounts. In recent years, we have heard anecdotal evidence regarding changes in merchant pricing that suggests interchange plus pricing is becoming more common, even in the small and mid-sized merchant market. With this in mind, we wanted to see if our data would confirm this hypothesis. In 2006, survey data indicated that 48% of merchants with bankcard volume between $1M and $5M were priced on an interchange plus basis (October 2006, "Discount Rate Structures in the Small Merchant Market" by Marc Abbey). Hoping to see whether interchange plus pricing has become more prevalent over the past half-decade or so, we examined recent merchant data from five acquirers. This analysis supports our hypothesis, and Figure 1 shows that the share of merchants priced with interchange plus pricing in that $1M – $5M size segment is almost 20 percentage points higher than 2006, up to 67%.

Figure 1: Percentage of Merchants Priced on Interchange Plus by Volume



Source: First Annapolis Consulting proprietary research and merchant database.

The increased use of interchange plus pricing among small and mid-sized merchants suggests a combination of increasing merchant sophistication and intensifying competition. Many emerging payment service providers, for example, sell transparent pricing as one of their primary value drivers, which may be pushing traditional acquirers to offer interchange plus pricing on a more widespread basis. In any case, the continued rise of interchange plus pricing reduces acquirers' opportunities for interchange management revenue and the higher margins that other pricing structures can offer.

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Sales Compensation Among Large U.S. Acquirers

By Brooke Ybarra

In 2013, First Annapolis surveyed top U.S. acquirers regarding their sales compensation rates and practices. All of the survey respondents are among the 25 largest U.S. acquirers, and three are in the top 10. We asked about base salaries and incentive compensation for field-based and telesales-based sales representatives. We further asked survey respondents to distinguish between sales representatives covering regional and local merchants and those responsible for selling to large, national merchants.

On average, base salaries were almost twice as high for national field sales staff ($87,000) compared to regional/local field sales reps ($45,000). Telesales reps had an average base salary of about $32,000. Incentive compensation (combination of ongoing and/or upfront commissions and bonus payments) followed the same pattern, but the difference based on the type of rep was much less – national field sales reps earned, on average, an additional $49,000, regional/local field sales reps an additional $36,000, and telesales reps an additional $35,000. These results are in Figure 1. It is important to bear in mind that incentive compensation results from the combination of the acquirer's plan and the rep's productivity, so we cannot draw firm conclusions about compensation plans (e.g., sales staff compensation at full quota) based on the average payment amounts alone.

Figure 1: Average Compensation Amounts (000's)

Source: First Annapolis Consulting survey and analysis.

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To calculate incentive compensation for field-based sales reps, most acquirers we surveyed used a combination of upfront and ongoing commission, only occasionally supplemented by quarterly or annual bonus payments. Incentive compensation for telesales reps was more often derived from an upfront commission only. The specific drivers of incentive compensation varied by acquirer, and many acquirers used multiple drivers (e.g., number of merchant approvals and a percent of expected or actual net revenue) to calculate commissions and bonuses.

Most acquirers we surveyed had a very large range between the lowest and highest compensated sales reps in each channel. In some cases, the rep with the highest total compensation earned more than three times the average and almost seven times more than the lowest value. This result demonstrates an acquirer's ability to reward the highest performing reps.

An acquirer should develop a sales compensation plan that incentivizes the behaviors required to meet its goals. The components of a compensation plan, such as the drivers of incentive compensation, the ratio of base salary to incentive pay, and the residual rate and duration, can be thought of as a series of sliding scales that must work together to create a comprehensive plan that motivates sales staff toward the acquirer's goals.

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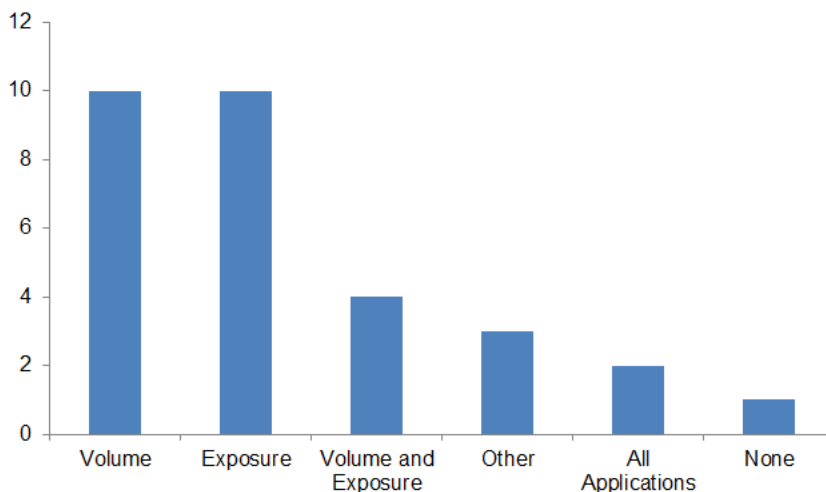
Sponsor Banks Vary in Permitting ISOs Underwriting Authority

By Raymond Carter

For banks that sponsor ISOs, one key to success is establishing a new account approval process that strikes a delicate balance between meeting the fiduciary responsibility of mitigating risk and permitting the ISO to independently approve certain lower risk accounts in a timely fashion without bank interference. Underwriting oversight can be time consuming and costly for a sponsor bank, and the bank must be sure to optimize the risk/reward balance. First Annapolis looked at a sample of twenty sponsorship agreements to gain an understanding of the typical thresholds under which ISOs can independently underwrite new merchants without requiring specific bank approval for each account, and the results vary significantly. Often, sponsor banks set a threshold, which may be based on annual volume, credit risk exposure, or other factors, under which ISOs are permitted to approve new merchant accounts that otherwise adhere to credit policy guidelines. New merchant applications that exceed the thresholds require the approval of the sponsor bank before the merchant can begin processing.

Figure 1: Frequency of Threshold Type



Source: First Annapolis Consulting survey and analysis.

Two of the agreements in the sample require that the bank approve all new merchant accounts, and one agreement has no stated threshold. The research indicates that those sponsor banks that do have thresholds in place (17 of 20 in the sample) range from under \$1 million to \$100 million in annual volume, or from \$200 thousand to \$25 million in credit risk exposure. Of note, there is a fairly strong correlation between the threshold level and the size of the ISO. Large ISOs have higher thresholds and small ISOs have lower thresholds. However, the thresholds for mid-sized ISOs varied from high to low and were more correlated to the size of the bank than the size of the ISO.

Volume and exposure are the two most frequently used thresholds, as depicted in Figure 1, and four sponsor relationships utilize both types in a manner such that any application package that exceeds either the volume threshold or credit exposure risk threshold required bank approval. First Annapolis views this dual threshold as a best practice. Other threshold triggers include certain high risk and prohibited merchant category codes, a high chargeback rate, and a high average ticket.

While the sample size is relatively small, the volume thresholds used by sponsor banks strongly correlate to the size of the bank with large banks averaging \$32.5 million annual volume as a threshold, medium banks in the sample averaging \$15.1 million, and smaller banks just under \$1 million. Note that these thresholds are for retail card present merchant applications and are materially lower at most sponsor banks in the sample for mail order/telephone order ("MOTO") and Internet merchants. Exposure thresholds revealed a similar correlation with large banks averaging thresholds of \$17.5 million, mid-sized banks under \$5 million, and smaller banks at \$2 million.

Of the ten agreements with volume thresholds, six had tiered thresholds, meaning the highest dollar threshold was reserved for low risk merchants and at least one other reduced tier for merchants with higher risk business models. On average, the higher threshold was 13.5 times the lower threshold, meaning if an ISO could independently sign a merchant with up to \$1 million in annual higher risk card-not-present volume, they could independently sign a low risk card present merchant up to \$13.5 million annual volume. The multiples ranged from four to twenty.

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The Death of Terminals? Will phone- and tablet-based points of sale replace the traditional terminal?

By Marc Abbey and Scott DeHaven

The use of mobile-phone-based POS ("mPOS") and tablet POS payment solutions to accept card payments has become a prevalent trend in the payments industry. At the same time, OEM shipments of terminals have fallen steadily in the U.S. for years and for multiple reasons, but the degree to which mobile solutions are terminal replacements and whether they will come to supplant traditional terminals is unclear.

Acquirer Expectations

Acquirers have a range of opinions and outlooks relating to mobile solutions. However, a common denominator is the opinion that mobile POS solutions have not yet had a significant impact on the traditional terminal market but will likely have a greater impact in the future.

- "Mobile isn't really displacing terminals. I do think tablets or tablet-like solutions will rule once the distribution model is figured out." —Top 20 bank acquirer
- "We are not seeing a tangible change in the number of terminals. We are seeing mobile as incremental so far. We do expect terminals may change over the next few years as tablets take off." —Top 10 acquirer
- "We have not seen a tangible change in the number of deployed terminals during the past year. I do believe tablets will have a greater impact in future years." —Bank Alliance Partner
- "Surprisingly, we are not seeing a tangible change in the number of terminals we're putting into the field. I do expect that the days of leasing and selling equipment will come to a halt. The timing is hard to predict." —Top 10, non-bank acquirer
- "Terminals are still the preferred method of processing for small businesses. Tablets are being adopted by new businesses more than existing businesses, but I do think merchants will begin to shift how they sell in-store and use [tablets] more." —Small bank acquirer
- "We still think terminals are going to be the heavy hitter because merchants will not want to switch to tablets." —Top 30 bank acquirer
- "Yes, tablets and the market for them is increasing dramatically. With that said, EMV could slow the change to tablets. In the interim, I think there is still a market for terminals at the lower end of the market." —Top 20, non-bank acquirer

Acquirers' mPOS and Tablet Positioning

All of the top ten acquirers offer mPOS solutions and most support multiple types of solutions, some proprietary and some from third-party providers. However, the acquirers tend to position the products differently. In many cases, in acquirer marketing, phone-based solutions are positioned for small or very small merchants new to card acceptance.

- "Vantiv Mobile Accept is perfect for small- and medium-sized businesses that do cash and check transactions today but would benefit from the ability to accept card payments at the time of service." —Vantiv product descriptions

In other cases, phone-based solutions are positioned as an adjunct product to accompany traditional POS solutions.

- "…you'll benefit by having a single processing provider—with just one account, one statement, one phone call—for both in-store processing and mobile payments." —Heartland Payment Systems product descriptions

Some acquirers positioned the tablet as a replacement for a low-end integrated solution rather than a terminal replacement.

- "Isn't it time your cash register did more than just ring up a sale?" —Vantiv
- "The easy-to-use and flexible solution offers small- and medium-sized merchants a highly-functional, cost-effective cloud-based POS system to facilitate transactions as well as manage sales, inventory, staff, and customers, all from an iPad." —Global Payments

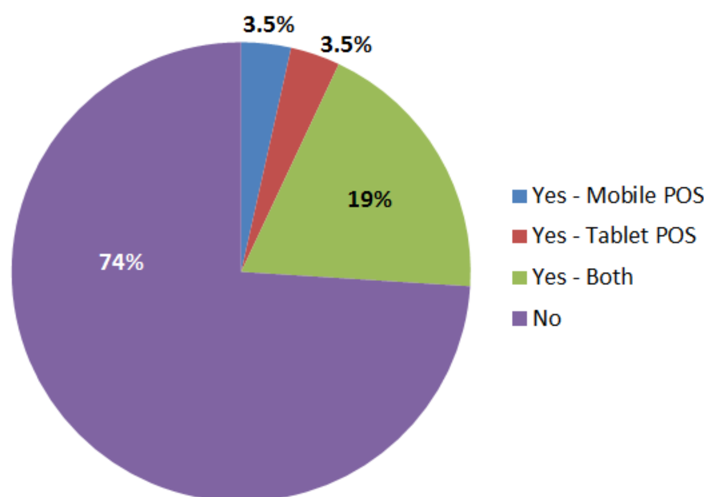
In other cases, the positioning is more mixed and the tablet could both be a terminal replacement and an iPOS replacement.

- "Clover Station is the first solution to meet the complete spectrum of small- to medium-sized business owners' needs." —Bank of America

Merchant Adoption of mPOS and Tablet POS Devices

To understand the level and nature of mPOS and tablet adoption, First Annapolis recently completed a survey of 200 card accepting merchants, well diversified over geography, merchant size, and type. Of this population, over 25% of respondents are using an mPOS and/or tablet solution. However, only ~35% of respondents who have an mPOS exclusively use it as their only acceptance device; the remaining nearly two thirds of the respondents use an mPOS and/or tablet solution in addition to a traditional POS environment.

Figure 1: Do you accept credit cards using a smartphone (mPOS) or tablet (tablet POS) credit card acceptance solution?



Source: First Annapolis Consulting Merchant Survey (April, 2014).

Of the 35% who use a mobile solution exclusively rather than a traditional acceptance device, nearly half are accepting cards for the first time while the other half replaced a traditional POS solution with a mobile solution.

Based on these statistics, it seems clear that a significant percentage of merchants is currently using mobile solutions as complimentary card acceptance tools in conjunction with a credit card terminal or iPOS, which has lessened the impact that the adoption of mPOS and tablet POS devices has had on traditional terminals, as of yet.

Of the merchants using mPOS or tablets, the single biggest business reason for doing so was mobility, with more than 40% of the merchants indicating mobility as their principal reason for buying the solution. Of course, it makes

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perfect sense for the early adopters of this technology to be motivated by mobility, though not all merchants in the broader market will have such a need. Over 40% of the merchants not using mobile solutions indicated a preference for traditional POS environments. The number one specific reason for preferring a traditional POS was integration with other business functions like inventory management, time and attendance, menu management, etc.—integration that exists with traditional iPOS solutions but often not with tablets and mPOS.

In summary, though the importance of mobile acceptance devices is undeniable, the evidence is decidedly mixed on the degree and rate of displacement of traditional terminals by mobile solutions. Our expectation, based on these dynamics, is for change, albeit change that takes several years to play through.

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Formation of People's United Merchant Services

By Brooke Ybarra

On July 17th, People's United Bank and Vantiv announced the formation of a joint venture, People's United Merchant Services, which closed in the 2nd quarter. First Annapolis served as the exclusive advisor to People's United Bank.

Both companies contributed merchant accounts to the partnership, including the total People's United Bank portfolio, which had over 5,300 merchants and processed over $1 billion in bankcard volume in 2013. Vantiv and People's United Bank have an eight-year history working together on debit processing and ATM services. As part of this alliance, People's United Bank will retain a 49% ownership share in the joint venture and recognized a $20 million gain on the formation of the alliance.

The formation of this joint venture supports a two-decade trend of banks pursing joint venture and revenue sharing alliance partnerships. We have identified several common forces that are driving this trend:

1. Specialization: Many acquiring operations, such as merchant underwriting, are specialized and sub optimized when a bank leverages its generalized/shared services operations. Non-banks have a razor focus on acquiring and bring a level of specialization and experience that can drive growth in the business.
2. Complexity: Merchants' needs are becoming increasingly complicated due to POS change, multi-channel needs, and data security requirements. Acquirers are investing heavily to meet these needs, and some banks have found it difficult to stay competitive and current given their other business lines and initiatives.
3. Scale: Scale, though not a decisive characteristic, is nevertheless central to competition, and large acquirers have a cost advantage of 2x – 3x the average acquirer (say, <10¢ compared to 25¢ – 30¢ per transaction).

Banks represent an attractive sales channel for acquirers. With long sales cycles, strong incumbency advantages, and a decreasing number of new banks to partner with, banks are well positioned to negotiate attractive partnership terms. To that end, we have seen some changes in the structure and key terms of bank – non-bank partnership agreements that generally favor banks, as shown in Figure 1.

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Figure 1: Changes in Bank – Non-bank Partnerships

	Then	*Now*
Structure	• Partnerships fit neatly into defined joint venture or revenue sharing alliance buckets	• Acquirers are offering hybrid proposals in response to banks' desire to have more input
Compensation	• Partnerships use traditional compensation structures such as a revenue or profit share	• Acquirers are conveying value in different ways, including payment in kind via contributed portfolios and the use of earnings guarantees • Some acquirers are creative on the expense side, even offering free processing and servicing as part of the overall value transfer
Governance	• Partnerships are run by a general manager, appointed by the acquirer • Acquirers hold final authority for all strategic decisions	• Acquirers are proposing defined board structures with representatives from both parties • Banks have veto rights on key issues such as pricing, marketing, or credit policy
Portfolio Management	• Only sales and customer service are fully dedicated to the bank partnership, while other servicing aspects operate under a shared service model	• Acquirers are offering more dedicated services (e.g., pricing, HR, underwriting) for banks large enough to support them
Competition	• First Data and Elavon dominated the bank partnership space	• A number of acquirers are competing for bank partnerships including Global Payments, Merchant e-Solutions, TransFirst, TSYS, and Vantiv

Source: First Annapolis Consulting research and analysis.

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More News from the Brazilian Market

By Janinne Dall'Orto

The Brazilian market continues to make the news. In the January 2014 Navigator, we reported on recent regulatory actions taken by the Brazilian government with the aim of opening up the market to increased competition. Today, we report on the progress of several new players in the market and a new acquiring alliance formed in Brazil.

Last year, the Central Bank of Brazil ended the Brazilian card industry's self-regulation system and appointed itself as regulator. In November, the Central Bank issued the regulatory framework for the industry. The regulatory framework's main objectives are to promote financial inclusion, competition, innovation, reliability of the system, and the interoperability of payment networks.

In July 2013, Santander Brasil, the Brazilian unit of Spain's Santander Bank, reached an agreement to acquire Brazilian card payment processor GetNet. Santander previously owned 50% of GetNet. The final deal was announced on April 7, 2014 through security filings. The announcement listed the value of the transaction at 1.1 billion Reais (approximately $493 million USD). As a result of the transaction, GetNet will now be owned by Santander Brasil's local card processing unit, giving Santander Brasil an indirect stake of 88.5% in GetNet.

Founded in 2003, GetNet specializes in the development, implementation, and management of solutions for capturing and processing electronic transactions. GetNet's services currently include, among others: POS and mobile card processing services, sales of prepaid mobile telephone credit services, merchant loyalty programs, billing services, funds transfers, and corresponding banking services. The Santander/GetNet partnership is making steady progress in capturing market share at the expense of the largest players, Redecard and Cielo, who still hold a combined market share over 90%. At the end of October 2013, Santander/GetNet's market share was estimated at 6%. This is slightly lower than Banco Santander's banking market share in Brazil, which stood at 7.5% (when measured by total assets) as of December 2013.

Early this year we saw more signs of an increasing competitive environment in Brazil. In January, First Data announced that it has formed an alliance with Bancoob (Banco Cooperativo do Brasil S.A.) to enter the Brazilian merchant acquiring market. Bancoob, a privately owned bank, supports Brazil's largest credit union – Sicoob. The alliance provides First Data with access to Sicoob's client base, which includes approximately 300,000 merchants in 23 Brazilian states through a network of more than 2,200 branches. On August 15th, First Data announced the launching of "Bin," First Data's acquiring solution specifically developed for the Brazilian market. According to the press release, First Data invested more than $150 million to build and launch the Bin solution, including investments in the development of logistics and support operations, the hiring of over 200 employees, and the opening of a new office in Sao Paulo.

Also in January, Global Payments announced during its fourth quarter earnings call (second quarter of Global's 2014 fiscal year) that it had launched its previously-disclosed Brazilian joint venture with Spanish financial institution CaixaBank. Global Payments' CEO Jeff Sloan stated that the JV currently has 2,000 merchants live on its platform in Brazil.

These developments are occurring in a market where the market leaders, Cielo and Redecard, continue to perform exceptionally well when compared to U.S. and European acquirers. For example, Cielo, which processed 449 billion Reais (approximately $201 billion USD) in 2013, grew volume and revenue 22.5% and 19.3% respectively in the first quarter of 2014 over the same quarter in 2013.

We expect 2014 will be an interesting year in the Brazilian acquiring market. International acquirers will continue to be attracted to Brazil because of the positive characteristics in the market. New players will continue to capture market share at the expense of the incumbent Brazilian acquirers, while there is no doubt that Redecard and Cielo will implement strategies designed to protect their dominant positions in an increasingly competitive landscape. Stay tuned.

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Consolidation and the Un-Banking of EU Acquiring

By Joel Van Arsdale

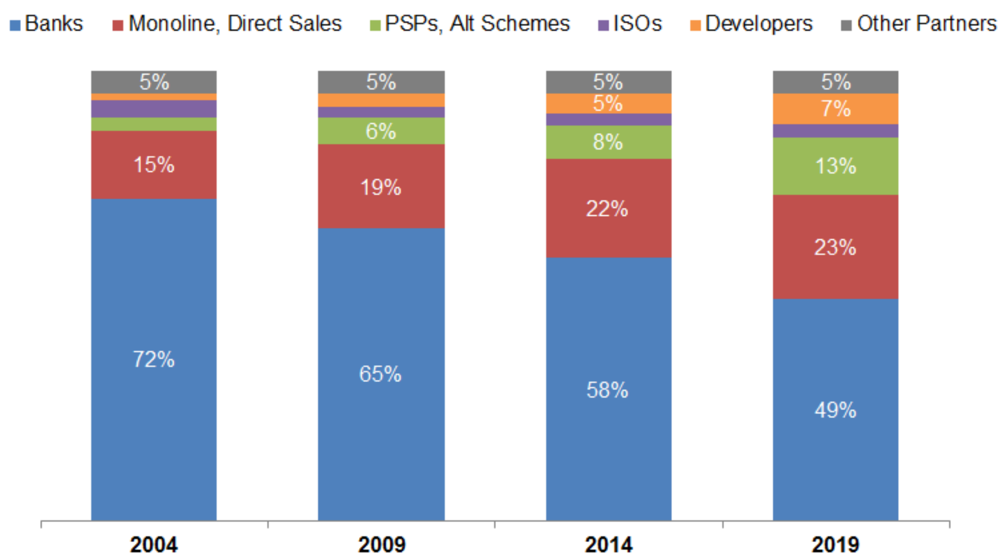
The pace of consolidation in European acquiring is quickening in the face of the second version of the Payment Services Directive (PSD2) and other impending regulations and mandates. Small acquirers are finding it more difficult than ever to operate an acquiring business, driving more to sell out, often into an alliance.

The pace of European acquiring divestments is being driven by a number of forces:

1. Regulatory mandates
2. Breakdown of interbank shareholdings (e.g., Nets, Paylife, Luottokunta)
3. Rich valuations and capital raising
4. Preparation for the future of the product

Regulatory mandates, particularly PSD2 (inclusive of interchange regulation), are driving an investment mandate onto EU acquirers,

Figure 1: Estimated European Acquiring Distribution Share* by Channel



Note: *Including e-comm platforms, ePOS platforms, other.

Source: First Annapolis Consulting market observations and estimates.

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which, in turn, are often choosing to explore strategic options to avoid this investment. The interchange regulation requires interchange plus scheme fees plus merchant service charge pricing (referred to as interchange plus-plus pricing) while many European acquirers lack this capability and face an investment mandate of approximately €1-2 million or more in order to make their platforms compliant.

Valuations in European payment acceptance are rich. Both Nets and Euroline are pending sale at valuations north of 12x EBITDA. And leading Payment Service Providers (PSPs) still regularly fetch valuations of 15-20x EBITDA or more. Capital-raising is a less prevalent theme today in Europe, but it is not hard to see the motivation for banks to cash out at such valuation levels (which represent highly accretive outcomes for banks).

European banks are more conscious of their own limitations in a marketplace that is technically complex, driven by a shift to e-comm and m-comm environments. In this environment, banks are seeking operating partners capable of delivering tomorrow's product and customer experience so that they can, at a minimum, maintain the customer relationship.

While bank exits are fueling European acquiring consolidation, the "MSP Channel" is driving a fragmentation, of sorts, into the marketplace. As with the evolution of the value-added reseller (VAR) channel in the U.S., the new forefront of competition among European acquirers is for Merchant Services Provider (MSP) distribution. MSPs come in a number of forms: PSPs, ePOS, facilitators, alternative schemes, and commerce platforms, among others. These MSPs white-label and imbed acquiring into their own products and services, often making it easier for merchants to obtain and enable payment acceptance.

The net effect of these forces is an un-banking and a digitization of payment market shares in acquiring, as shown in Figure 1. Banks are playing a diminishing (though still significant) role in the market while digital service providers play an increasingly important role.

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Acquiring Opportunities in the Mid-Size Agent Bank Market

By Elizabeth Hooper

Over the past 12 years, only four of the twenty largest (by assets) U.S. agent banks have changed their acquiring partners. This trend may be attributed to the complex and bespoke specifications the largest banks and their customers require. Changing acquirers can be both labor-intensive and expensive for top-tier banks; as such, these banks tend to maintain a relationship with their incumbent acquiring partner who has become familiar with their requirements. Incumbent acquiring partners are, therefore, well-positioned to maintain a stronghold within this segment.

The acquiring market for banks outside of the top 20, however, has become increasingly competitive in recent years. Acquiring providers such as TransFirst, TSYS, and Vantiv are gaining share in agent banking by targeting mid-sized banks. Agent bank partnerships with mid-sized banks tend to be shorter in term, ranging between three and five years. With shorter-term contracts, mid-sized banks have the opportunity to come to market more often for acquiring partnerships. Mid-sized banks also typically have a lower cost of conversion, which makes them more likely to consider switching partners compared to the top 20 banks, who are often committed to longer and more complex contracts that would be time consuming and expensive to switch.

First Annapolis maintains a database of the top 200 agent bank partnerships. This research reveals that the agent bank market has increased in competitiveness over the past three to four years among acquirers focused on mid-sized financial institutions. Vantiv and TSYS have experienced the largest market share gains, though First Data, Elavon, and TransFirst continue to enjoy the leading market shares.

The mid-size agent bank market represents an increasingly significant opportunity for acquirers with agent bank strategies given the higher frequency of contract renewal and lower cost of conversion. Successful acquirers will develop strategies to identify potential bank targets coming to market and will establish competitive acquiring offerings to maintain current relationships and secure future opportunities.

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Founded in 1991, First Annapolis is a specialized advisory firm focused on electronic payments. Our market coverage is international in scope with a primary focus on North America, Latin America, and Europe. In total, we have over 70 professionals across our practice areas giving us one of the largest and strongest advisory teams focused exclusively on electronic payments.

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