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Participants in the Payments Purchasing Chain

How Key Players Facilitate Payment Transactions—and How Their Roles Are Changing

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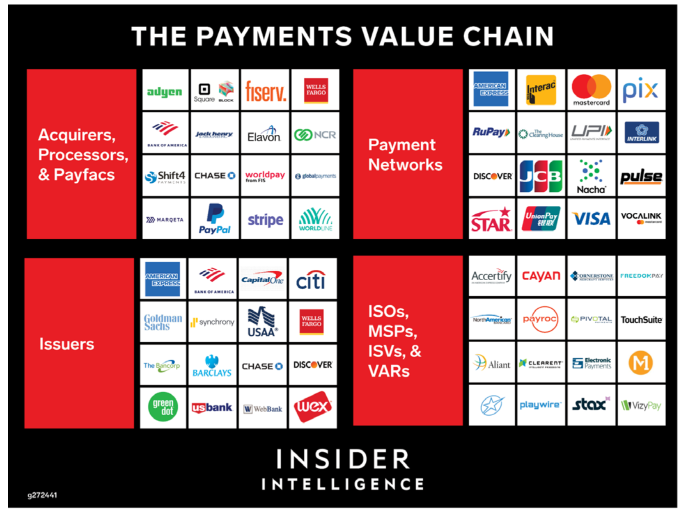
Participants in the Payments Purchasing Chain: How Key Players Facilitate Transactions—and How Their Roles Are Changing

Within a given transaction, acquirers and processors, networks, and issuers all help bring payments from the point of purchase to settlement. Diving into each of their roles reveals where the payments industry stands and how it might evolve in 2022.

3 KEY QUESTIONS THIS REPORT WILL ANSWER

1. What roles do the key players in the payments purchasing chain play in an end-to-end transaction?
2. How are market dynamics changing the payments purchasing chain and how its stakeholders interact?
3. What are the top trends impacting acquirers and processors, networks, and issuers in 2022?

WHAT'S IN THIS REPORT? We define the major categories of payment providers, discuss their volume and revenues, and evaluate key trends impacting their performance.



KEY STAT: All areas of the payments ecosystem will undergo rapid change thanks to pandemic-driven shifts but especially merchant acquiring: Revenues will rise at an 11.3% compound annual growth rate through 2025, per Boston Consulting Group.

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Key Points

- **Three classes of providers play roles in the payment process: acquirers and processors, networks, and issuers.** Each provider extracts a fee in exchange for services provided.

- **Acquirers and processors—whose responsibilities include acquiring merchants' transactions and selling processing services—are racing to build out end-to-end solutions.** These offerings make products more compelling to merchants. Building new tools also gives acquirers and processors new ways to access sellers, which can combat squeezing margins and rising competition.

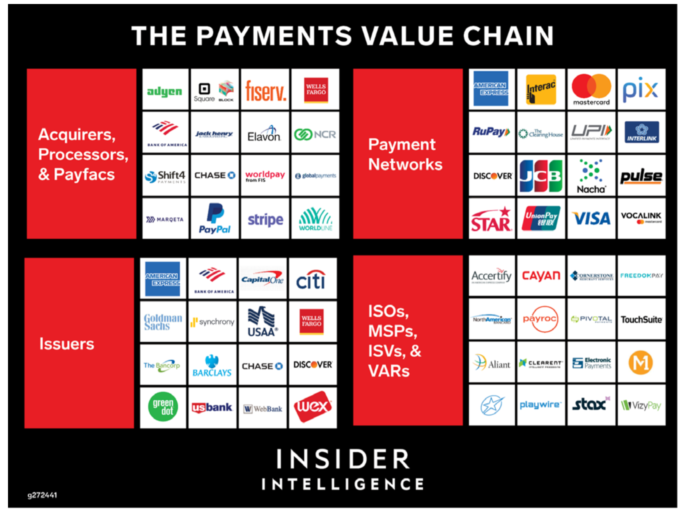
- **Tensions between card and noncard networks, which route transactions between payers and recipients, are intensifying worldwide thanks to fee pressure.**

- **Issuers hold deposits, extend credit, and in some cases, manage authorization and settlement—and they are balancing increasing opportunity with increasing costs.** They are the card and account provider for payers. Fee pressure will push issuers to innovate and seek partnerships with modern card issuers to grow their reach.

Introduction

A pandemic-driven surge in digital payments is expanding payments providers' addressable market—but it's also shaking up their roles and power dynamics. When payers initiate transactions, data is sent through several stakeholders—including acquirers and processors, networks, and issuers—to reach its destination. Each provider earns a fee for helping complete the transaction.

Industry growth has also created commoditization, making providers contend with cost and margin pressures, and an increasing need to differentiate. Understanding these changes paints a picture of where the ecosystem stands in 2022. Below, we define each stakeholder category, discuss its role in the ecosystem, and evaluate how it is shifting.



Acquirers and Processors

Providers in these discrete but overlapping categories offer merchants and payees access to systems that let them accept payments. They also manage these systems and provide services, including software and hardware sales, merchant account management, and data transmission.

Acquiring Banks

Acquiring banks provide merchants with a bank account into which settled funds are deposited. They also assume risk associated with card transactions. Acquiring banks must comply with the rules and regulations of the card networks they support, such as Visa and Mastercard.

Merchant Acquirers

Merchant acquirers solicit merchants' business, underwriting them to ensure they meet network requirements for financial stability, among others, and signing them to card acceptance agreements. These entities are responsible to other involved parties for the amount of the transaction.

Merchant acquiring is becoming one of the fastest-growing revenue generators in the industry, thanks to rising demand for digital payments. Merchant acquiring revenues grew at an 11.8% compound annual growth rate (CAGR) globally between 2015 and 2019, per Boston Consulting Group (BCG)—the fastest rate of the sectors mentioned in this report. That growth was driven by ecommerce, digital payment methods, and the addition of value-added services that help acquiring and processing players diversify their business. After a pandemic-driven slowdown, growth will return to a brisk 11.3% CAGR through 2025.

Both banks and nonbanks can be merchant acquirers. Some acquiring banks, like Chase and U.S. Bank, perform merchant acquiring in-house. Banks also sponsor nonbanks—such as FIS, Fiserv, and Global Payments—to provide acquiring services either in partnership or on their behalf. Other nonbank entities also participate in this process, including independent sales organizations (ISOs) and merchant service providers (MSPs), payment facilitators (payfacs), and independent software vendors (ISVs).

Like other participants in the payments purchasing chain, merchant acquirers earn fees for their efforts. These fees flow from a discount rate they charge merchants, which is roughly 2.5% of the purchase amount. Revenues generated by the discount rate also flow to processors and networks in the form of fees for their services. However, the largest share of discount rate revenues flows to card issuers in the form of interchange income.

ISOs and MSPs

ISOs and MSPs serve as distribution channels by signing up merchants and selling processing services to them on acquirers' behalf. There is only one difference between the two company types: MSPs are registered with Mastercard (there are more than 1,000) and ISOs with Visa (more than 3,000). Unlike acquirers, ISOs and MSPs do not have access to merchants' cardholder data or cardholder data environment.

These providers often sell, lease, and service payment terminals. Once a merchant chooses an acquirer, processor, and terminal, an ISO or MSP becomes that seller's point of contact.

Payment Facilitators

Payfacs like PayPal and Block (formerly Square) simplify the merchant onboarding process by onboarding a merchant as a subaccount under the payfac's master account. This allows the payfac to set up and manage multiple payment processing relationships and systems on the merchant's behalf. Payfacs also set up merchants' electronic payment and processing services, underwrite their accounts, and process their transactions. In return for taking on duties otherwise performed by acquirers, they earn a slice of acquiring revenues.

For a deep dive into how payfacs are changing the payments landscape, see our June 2021 report, **"Payment Facilitators: How These Providers Are Eating the Payments Value Chain."**

Merchant Processors

Merchant processors primarily route transactions from merchants to their cardholding customers' issuing banks for authorization, where they ensure customer funds are sufficient to complete a transaction. They also provide technical support and back-office services to the merchant. However, they do not acquire (that is, settle with the merchant for the transactions).

Card Issuer Processors

These processors connect networks and bank card issuers to route funds to settlement. The path ends when transactions are deposited in merchants' accounts. Card issuer processors are often responsible for fraud protection and prevention.

Modern issuer processors, such as Marqeta, are card issuer processors that leverage open API-based infrastructure. By directly connecting card networks and issuing banks, these providers help businesses rapidly issue white-labeled physical and virtual payment cards. They also manage real-time funding, authorization, settlement, and transaction security. Some incumbent acquirers and processors have adopted modern issuer-processing functionality, signaling a shift toward this business model.

Software Vendors

Software is a key differentiator in the payments space as mobile point-of-sale (POS) technology drives down hardware costs. Nonbank financial technology companies like FIS, Fiserv, and Global Payments often provide software services themselves. But at times, they also partner with two types of vendors:

1. **ISVs** create and sell software platforms to merchants or other sellers.

2. **Value-added resellers (VARs)** consolidate ready-made software and integrate it into hardware, like computers or terminals, before selling the finished product to merchants.

In these partnerships, acquirers can leverage ISVs and VARs to deliver merchants increasingly sophisticated solutions that blend POS hardware, business management software, and payment processing.

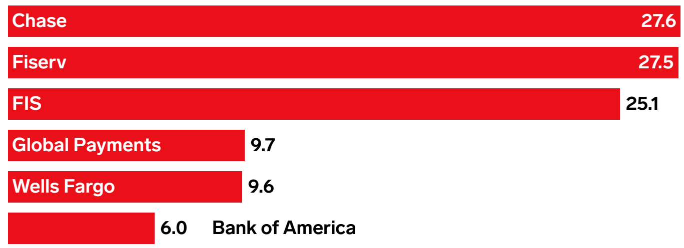
Key Trends We're Watching

The Biggest Acquiring and Processing Players Are Getting Bigger

Three nonbank megamergers in 2019 allowed providers—FIS and Fiserv in particular—to extend their offerings beyond acquiring services. This has paid off: In 2020, each of the top three US merchant acquirers saw nearly three times the volume of the fourth- and fifth-ranked providers, which themselves remain firmly ahead of the pack. And giants are continuing to use acquisitions to target specific sectors. This consolidation will increase their scale and reach—driving revenues as margins shrink—while making it harder for new entrants to break through the noise.

Top 6 US Merchant Acquirers*, Ranked by Purchase Transactions, 2020

billions



*Note: includes all purchases made with credit cards or PIN debit cards; *portfolios of merchant card acceptance contracts in the US for acquiring payments from global and domestic-only brands*
Source: Nilson Report, "Issue 1193," March 18, 2021

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To adapt to consolidation, acquirers and processors will pursue two strategic growth strategies:

Two-Sided Product Suites

Megamergers have allowed providers to more effectively build products that serve both issuers and merchants. This allows them to own entire transaction flows and manage both payer- and payee-side processes.

Serving both sides grants providers better visibility into the payments chain—in turn improving efficiency, adding transparency, and growing revenues. They can "stitch" together insights from the transaction on the issuing and acquiring side and use them to launch new products, per Adyen's 2020 Investor Day.

For example, by enabling data sharing between partner issuers and partner merchants, acquirers and processors can limit fraud, boost approval rates, and in turn grow revenues for everyone, Fiserv exec Nandan Sheth previously told Insider Intelligence. Global Payments has seen similar benefits, per results shared at its September 2021 Investor Conference.

Horizontalized Solutions

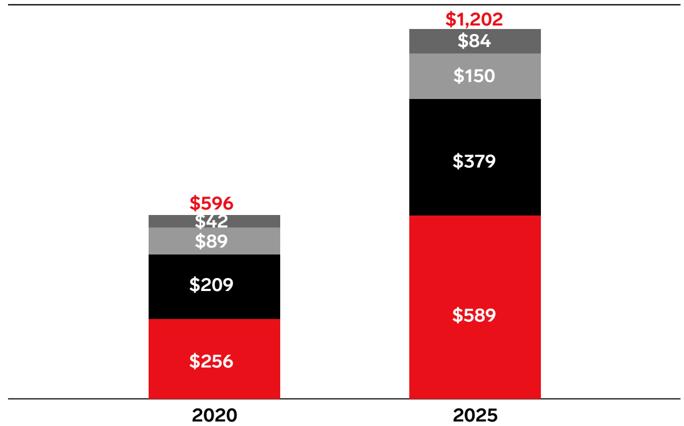
Acquiring and processing entities are increasingly looking to exert influence across the entire value chain. By selling services to merchants, serving as an acquiring bank and merchant acquirer, processing transactions, and more, they can diversify revenues while offering merchants a simple, comprehensive solution.

Offering one access point to an array of services can attract a wider variety of clients, in turn growing providers' prospective transactions and customer base. For example, Adyen customers can reach a processor and card scheme, among other services, via a single access point—a model that reduces complexity and that other providers are trying to copy.

Acquirers and Processors Accelerate Development of Value-Added Solutions

Approximately 80% of revenue growth in payments-related merchant services will stem from payments performance and commerce enablement through 2025, according to McKinsey, with commerce enablement specifically growing faster than any other sector. That's because rising digital payments have squeezed margins and made core processing table stakes for providers, leading acquirers and processors to pursue new, higher-value services that win clients and recoup lost revenues.

Revenues for US Payments-Driven Merchant Services, 2020 & 2025
billions



- Commerce enablement
- Payments software, infrastructure, and services
- Core transaction processing and transaction enablement
- Balance sheet-based offerings

Note: includes revenues from all providers of merchant services that offer payments as a core part of their proposition
Source: Mckinsey & Company, "The 2021 McKinsey Global Payments Report," Oct 13, 2021
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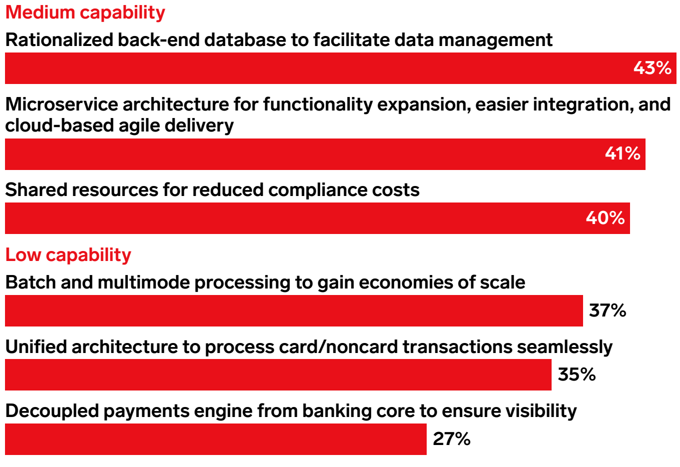
But there's considerable work to be done: Payments executives report that their core processing platforms still offer fairly low capabilities, per Capgemini's 2021 World Payments Report.

Capability of Current Core Payment Processing Platforms According to Payment Firms Worldwide, Oct 2021

% of respondents



Note: n=164
Source: Capgemini, "World Payments Report 2021," Oct 7, 2021

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To diversify and make their offerings more valuable, providers are zeroing in on three areas:

1. **New types of payment acceptance.** Customers will abandon carts if their preferred payment method isn't available. Fiserv partnered with cryptocurrency exchange Bakkt to let consumers buy, sell, and spend digital currencies—furthering crypto acceptance at Fiserv merchants. And European acquirer TrustPay will enable merchants to offer PayPal as a payment method.

2. **Verticalization.** Integrating vertical-specific tech stacks can help providers meet specific merchant needs—widening providers' seller base. Oracle's expanded partnership with payments tech and services provider EVO Payments deepens EVO's reach in hospitality. And NCR acquired Foremost Business Systems, which offers restaurant solutions.

3. **Unified commerce.** Merchants want offerings that unify in-store and online processing into a single platform. Development of these services will accelerate: Lightspeed acquired two ecommerce companies to provide an omnichannel commerce platform for sellers in early 2021, for example.

These moves set the stage for 2022, which could see acquirers and processors make deeper forays into local payment method support, chargeback mitigation, and commerce enablement, per McKinsey.

The Payfac Model Will Continue to Grow in Popularity

Payfacs are increasing their share of merchant acquisition versus competitors like ISOs, MSPs, and others. They offer a number of benefits as an acquiring partner:

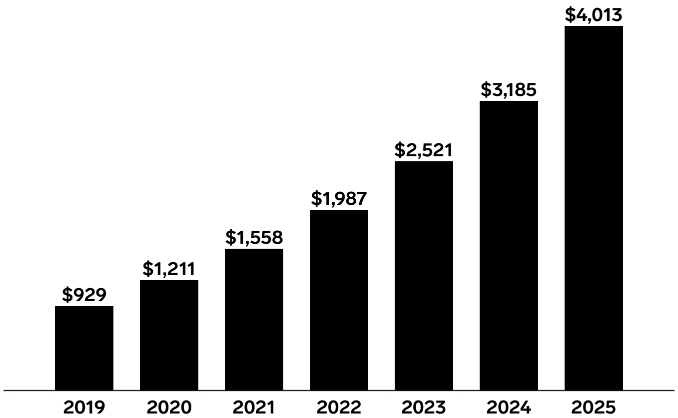
- The model **quickly diversifies the types of businesses that acquirers reach.** Payfacs can limit acquirers' exposure to risk. And rather than devoting resources to selling directly to small businesses, a single payfac partnership lets acquirers reach thousands. However, this carries long-term tradeoffs related to merchant relationships and control.

- The model can be a **boon to merchant-facing nonpayments companies**, ranging from ISVs to marketplaces. These companies can complement their own business models while also capturing a slice of payments revenues that otherwise flows to acquirers.

- The model also **taps into small business needs**: Payfacs simplify and accelerate merchant onboarding and can offer a one-stop shop for small businesses to access payments and software.

The payfac model's benefits will create a rapidly growing segment of the industry both in numbers and in business. Because payfacs garner a share of acquiring revenues, if interest in partnerships grows, so will the monetary incentive for providers like ISVs to become payfacs—assuming they are willing to take on risk. This would increase both the number of payfacs in operation and the share of transactions they're responsible for, driving their overall volume.

Gross Payment Volume of Payment Facilitators Worldwide, 2019-2025
billions



Note: CAGR=28.4%
Source: Infinicept and AZ Payments Group, "Payment Facilitator Global Opportunity Analysis and Industry Forecast, 2018-2025," April 22, 2020
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Networks

Payment networks are the rails that flow funds between payers and recipients. Their global revenue growth in recent years is expected to hold steady at an 11.4% CAGR through 2025, per BCG. This will far outpace global GDP gains (6.2% CAGR) in the same period even amid strong economic recovery, based on IMF forecast data.

Card Networks

Card networks route transactions between issuers and acquirers while establishing and enforcing rules for others involved in payment card processing. These providers help set merchant-facing interchange and other network fees, within regulatory limits, that are paid to other stakeholders. They also resolve disputes with network members.

US card network transactions can be routed through two classes of networks, which differ on speed, cost for merchants, and verification requirements:

1. **Signature networks.** Now a misnomer, since signature verification is no longer required for most transactions, the four major US networks (Visa, Mastercard, American Express, and Discover) transact via this class.
2. **PIN-exclusive networks.** Due to 2010 debit reform designed to increase industry competition, retailers can route some debit transactions over these networks. The lower-cost, speedier option is available via networks, including Interlink (owned by Visa), Pulse (Discover), and Star (Fiserv).

Automated Clearing House Networks

Automated Clearing House (ACH) networks are electronic funds transfer systems that route transactions between payers and payees through the National ACH Association in the US. They often reach sectors that card networks can't access, including B2B, bill pay, and other high-value transaction categories. Their popularity is, in part, due to lower costs: The average ACH transaction costs payees between 0.5% and 1.5% versus as high as 2.5% for card transactions.

While currently less prevalent than card networks in retail payments, since they have limited merchant acceptance, ACH networks will likely become more prominent in coming years. At the same time, innovation is improving speed, bolstering safety, and improving accessibility by making ACH networks easier to use for a wider set of transaction types.

Key Trends We're Watching

Transaction Costs Will Heighten Scrutiny, Opening the Door to Noncard Alternatives

Card networks' high transaction costs add up fast: US merchants spent $44.4 million on Visa and Mastercard fees alone in 2020, per The Nilson Report. That's sparked ongoing litigation, like a recent $14 billion UK class action suit against Mastercard. And it has drawn regulatory attention: The US Department of Justice is investigating Visa for potential anti-competitive practices.

Tensions will mount as card networks weigh tweaking fee structures to shore up their bottom lines—thereby increasing the cost of popular transaction types, like ecommerce. This could have two outcomes in the year ahead, though neither will substantially cut into networks' overall retail dominance in the short term:

Rising Merchant Pressure Could Drive Down Card Network Fees

After delaying changes for several years due to the pandemic, card networks may cave and adjust fee structures downward as an olive branch to merchants, which are continuing their years-long battle against networks: Amazon is surcharging Visa credit purchases in Australia and Singapore, ceasing acceptance in the UK, and considering switching its US co-brand partner. The pressure could also prompt regulatory inquiries that mandate lower fees.

Greater Demand for Noncard Alternatives Sparks Development and Implementation

Merchants and other providers might seek out ways to accept payments at a lower cost. Alternative networks, like account-to-account payments, which facilitate direct payments from one bank account to another, offer these options—and as demand for them increases, so will availability. Card networks will also continue pursuing noncard offerings, like Visa Direct and Mastercard Send, to avoid disintermediation and diversify their businesses.

Competition Is Intensifying Between Regional Networks and Multinational Titans

Card networks operate multinationally, so providers can enable transactions both within and between markets worldwide. This grants payees and payers easy entry into a global ecosystem. But fee tenson is dimming the glow of card networks' multinational operability, and it's becoming easier for merchants to accept digital payments, thanks to factors like rising mobile penetration. In turn, sovereign governments, bank coalitions, and other players are mounting newly competitive challenges to card networks.

New noncard payment systems could impede card networks' growth potential in emerging markets and their reach in developed ones. For example, India's Unified Payments Interface is breaking records monthly, and Brazil's Pix recently reached 110 million users (equivalent to 51.7% of the country's population). Growth might accelerate if domestic networks scale cross-border, as providers are aiming to do across Southeast Asia. And the trend isn't limited to emerging markets: A new Pan-European payments initiative threatens Visa's and Mastercard's market share in one of their largest markets.

Card Networks Will Emphasize Value-Added Services to Maintain Positioning

Though card networks are pricier for merchants, they also offer a wider array of services that strengthen their positioning and keep competitors at bay. Visa and Mastercard boast advantages beyond payment rails—including developer sandboxes, hefty analytics, and fraud prevention benefits—for their merchant clients and other payments partners. Though some services carry additional costs, they also enhance value.

Card networks will bolster compliance, risk and data management, and privacy protection offerings to maintain appeal, per BCG. They're also likely to continue diversifying via less tapped sectors, like B2B payments and crypto, as well as new verticals and global markets.

Integrated Solutions Create a New Challenge for Card Networks

Beyond the four major card networks, a growing set of providers are blending payments, software, and transaction network services that allow them to become rail providers. Their rise marks a competitive shift in the ecosystem that could challenge traditional card networks.

For example, besides its acquiring and processing business, Fiserv operates a major debit network. Integrating this solution with its other offerings differentiates its product suite, in turn improving Fiserv's value and driving retention, per the firm's 2020 Investor Day. PayPal and Block are also developing their own version of integrated solutions.

Issuers

Issuers serve as the card and account provider for payers, allowing them to initiate transactions. The sector's global revenues grew at a 9.4% CAGR over the past five years, though that will fall to 7.6% through 2025, per BCG. It will still outpace global GDP growth on an annual basis, but providers face a shifting economic environment and fee pressure that could reduce their earnings, per McKinsey.

Issuing Banks

Issuing banks hold the deposits or extend the credit associated with payment cards, which feature their logos. These banks are also responsible for customer account data and card services, like those pertaining to fraud. Additionally, merchants can hold them fully or partly liable if the customer does not pay.

The same financial institution that acts as an issuing bank can also perform other functions, like acquiring.

Key Trends We're Watching

Legacy Issuers Will Seek New Growth Paths to Offset Cost Headwinds

While legacy issuers' massive reach and market share will help them maintain a strong position in the year to come, they're under pressure. Uneven pandemic recovery could dent spending, hitting issuers' volume and revenues. Further, the expenses associated with programs designed to entice spending, like rewards, could outweigh their benefits, per BCG.

Issuers will instead direct spending toward technology that creates new revenue generators. The goal of this tech spending is to build fresh products and services and extend issuers' ecosystems—and ultimately offset the upfront investments.

One tactic that will become increasingly prominent is virtual cards—credit products issued, distributed, and managed digitally. Virtual credit cards allow issuers to ramp up security, accelerate card issuance, and cut costs. Most issuers are testing the waters through partnerships, like American Express' tie-up with Extend that lets business cardholders create white-labeled virtual cards and send them to employees, contractors, or vendors.

Virtual cards are most popular in the corporate and commercial realm: 39% of US businesses expect to expand their virtual card usage in 2022, per Amex. But this year, usage of the tech will likely become more popular for consumer-side products as legacy issuers leverage digitization to add scale.

The Rise of Modern Card Issuers Could Offer New Volume but Diminish Issuers' Visibility

As embedded finance pulls a wider set of enterprises into card issuance, the client set for issuers is broadening. Modern card issuers like Marqeta partner with issuers to offer a ready-made solution for businesses looking to enter the card space. Their speed, flexibility, and customization appeal to firms that may have avoided the card space entirely because they'd rather focus their resources on things like customer experience, according to Nasdaq.

For a deep dive into embedded finance and how it's reshaping the financial services industry, see our January 2021 report, **"The Embedded Finance Explainer."**

For example, Marqeta recently partnered with Bill.com and Coinbase to power card issuance for their customers, and it extended its Uber Freight tie-up that expedites driver payouts. Fiserv is moving into the space as well. Top US issuers might seek more partnerships with these providers to get a piece of the pie from the clients they are serving.

But modern issuer processors could dilute issuers' brands in the long run. One of their most appealing offerings is white-label technology, which makes it look like brands are issuing their own cards. This could obscure the issuer's role in the payments purchasing chain to both consumers and brand partners, who no longer clearly see the bank playing a role in the process—forcing a shift in marketing strategy.

Read Next

Top acquiring players lean on merchant solutions to jump-start growth

Worldline launches new white-label payment solution to lower merchant costs

Mastercard and Visa delay fee hikes for another year

Marqeta delivers impressive Q3, outlines four key growth pillars

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