

**SEPA CIM Reflection Group
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Brussels**

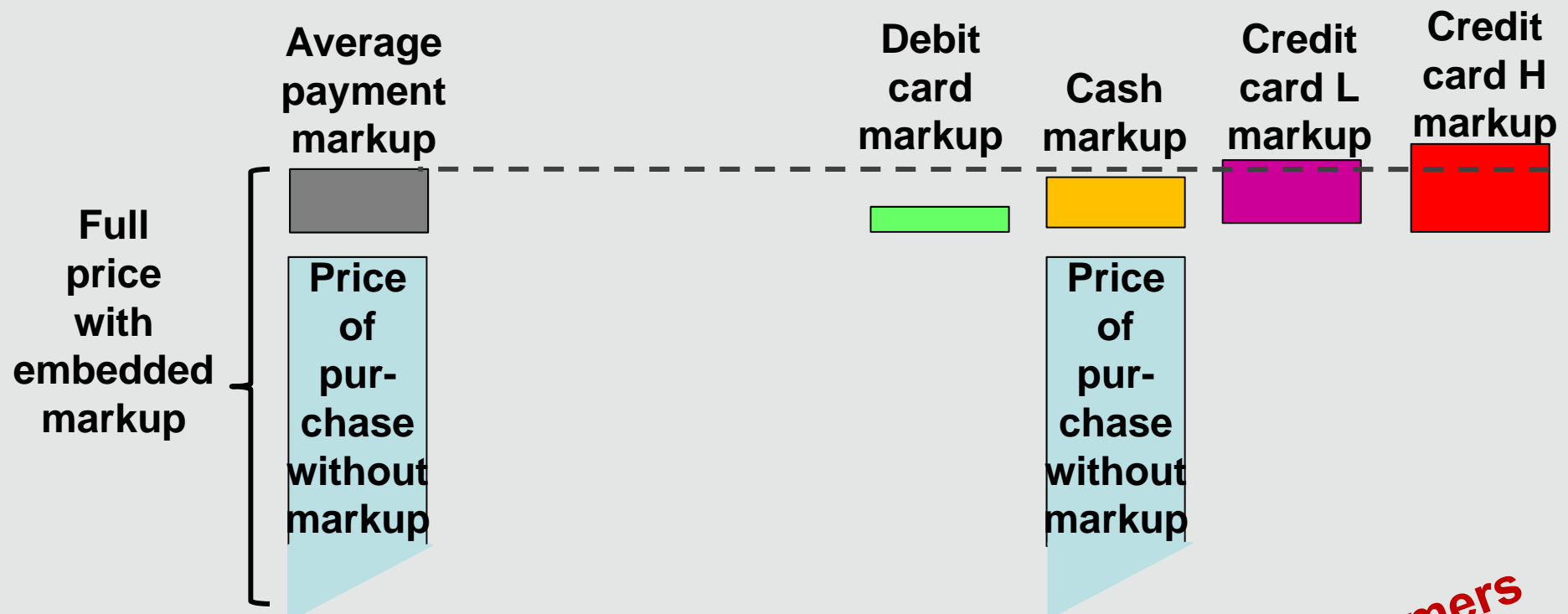


*Non-transparency
as barrier to progress
in card payments*

Harry Leinonen
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**The views expressed are those of the author
and do not necessarily reflect the views of
the Bank of Finland.**

*Merchants embed merchant fees in their prices
(like VAT markups)
consumers are the only payers*



Embedded markups result in cross-subsidisation, hidden efficiency differences and biased volumes.

Invisible prices eliminate price competition.

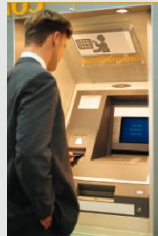
Are consumers better off with hidden charges?

Paying directly with cards saves cash costs for all (especially banks)

Cash payment process



Get card



Go to ATM



Get cash to shop



Get change

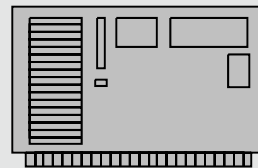


Package & transport



Update account & repackage

Update account



Update accounts

Card payment process



Get card

Pay in shop



Note: Efficient cash processes also use card technology !!!

**Generalised CB (BE, FI, NL, NO, PT, SE) research findings:
Today, only coin-sized cash payments are cost efficient.**

Customers see cash usage as free, but merchants are charged for returning cash.

Normal market mechanisms are removed by non-transparency, float, MIFs, non-surcharging, (cross-)subsidies, monopolies, oligopolies, closed networks, proprietary standards etc

Current card and cash charges far from cost-based and volumes are far from economically optimal ie cards should be used much more.

Also other means than increased transparency is needed to restore normal market mechanisms and efficiency.

Credit cards are bundled products, payments + credits with non-transparent, non-competitive credit costs passed on to non-credit users (low income households)

- ◆ Embedded credit card MIFs and merchant charges increase merchants' payment markups for all customers
- ◆ Non-negotiable invisible interest on credit card credits are high compared to other consumer credits (merchant charge card fees of 1%, 2%, 3% correspond to ca 10%, 20%, 30% pa)
- ◆ Total long-term consumption effects of consumer credits are negligible because of budget constraints (total consumer credits merely mirror business cycles)

How would consumers react to unbundled visible credit card interest rates, based on use?

Non-transparency is an entrance barrier

- ◆ Impossible for efficient entrants to compete with invisible prices
- ◆ Efficiency differences remain hidden to customers
- ◆ Entrants need synergy effects from other product lines for subsidisation possibilities (eg TELCO, advertising ...)

In addition to other barriers

- ◆ Large customer base needed to attract merchants
- ◆ Payment network participant rules
- ◆ Regulatory requirements

Payment markets are

- **difficult to enter and**
- **entrants would choose non-transparency (eg PayPal)**

**Who would want
to enter payments market
and especially alone
in transparent mode?**

Negative social consequences of hidden/embedded/non-transparent business model

- i. price competition is limited: no price, no price competition
- ii. Low awareness of cost differences among payment alternatives
- iii. payers lack incentive to economise due to invisible cost factors (compare with effects of visible pricing on disposable plastic bags)
- iv. higher overall costs due to distorted volumes when economies of scale benefits of efficient instruments are reduced
- v. new efficient entrants find it difficult to enter a market without visible price/cost factors revealing their superiority
- vi. development pace in payment services is slow owing to lack of price/cost incentives.

The current non-transparent business model promotes inefficiency

*The card payment industry is
trapped in a non-transparent
legacy business model
without incentive to change.*

*Efficiency developments will be slow
until this trap is removed
and authority actions seem to be required.*

**Benefits of
price transparency
are difficult to sell to
uninformed public.**

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