



# The transformation of global acquiring

The merchant acquiring business has been a key driver for a fast-growing and very attractive payments market over the past several years, triggering a wave of aggressive M&A activity. Important underlying trends will likely continue: ongoing consolidation—both regionally and globally; increasing investment requirements, (e.g., driven by the shift from physical to digital sales channels); and, most critically, the need for acquirers to transform from payments processors into software and technology-based companies.

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To illustrate the pace of the change, the top ten global acquirers accounted for nearly 60 percent of transactions in 2017, up from 48 percent just five years earlier. Two-thirds of acquiring growth is projected to come from digital channels (versus physical point of sale) through 2022.

The traditional acquirer processing model is destined to become commoditized and less profitable, as merchants gravitate toward solutions addressing a holistic set of business issues beyond standard processing functions. In this environment, we believe there are four strategies an established merchant acquirer can pursue: attain regional/global reach and acceptance, become a digital/omnichannel champion, build a best-of-breed offering in a chosen merchant segment/vertical niche, and/or integrate with a future-banking merchant ecosystem. If none of these options seem feasible or desirable, given recent all-time-high valuations, the time might be right to monetize one's assets by exiting the acquiring business.

## Decelerating growth overall, with pockets of strength

Beneath the surface of a rosy growth picture in payments and merchant acquiring, overall secular growth has begun to decelerate, especially within the latter. Since 2011, total returns to

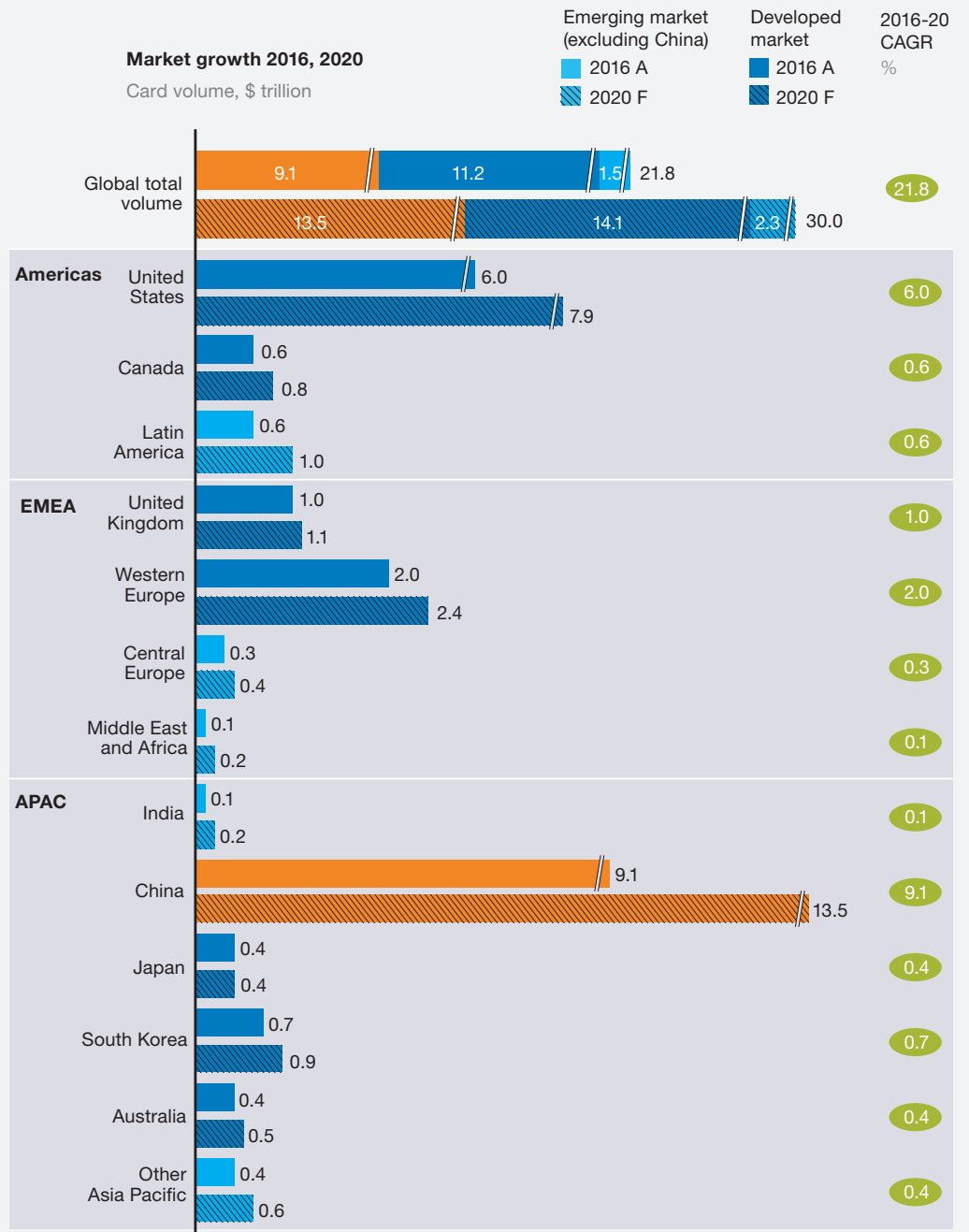
shareholders for acquiring businesses have surpassed even the broader payments space, and well outpaced sectors such as asset management and corporate and retail banking. While still growing at double-digit rates in the past three years, acquiring returns in particular have moderated to more nominal levels. There remain sizeable pockets with strong outlooks, leaving acquirers to take a more granular approach to pursuing growth. Emerging markets—including China—are still expanding at double-digit rates (Exhibit 1), while in mature markets like the United States, attractive growth profiles exist in nontraditional verticals. For instance, healthcare, business services, and recurring utility and housing payments continue to offer double-digit growth opportunities.

Digital payments and ecommerce, particularly cross-border, will continue to spearhead growth (Exhibit 2, page 14) and give rise to new models such as subscription-based payments. To address slowing growth rates in other areas, many acquirers will likely revert to M&A as a growth lever (see “As value creation reshapes payments, can banks catch up with specialists?” *McKinsey on Payments*).

Regional and global giants will increasingly dominate the industry, putting pressure on subscale players. The primary objective is not

Exhibit 1

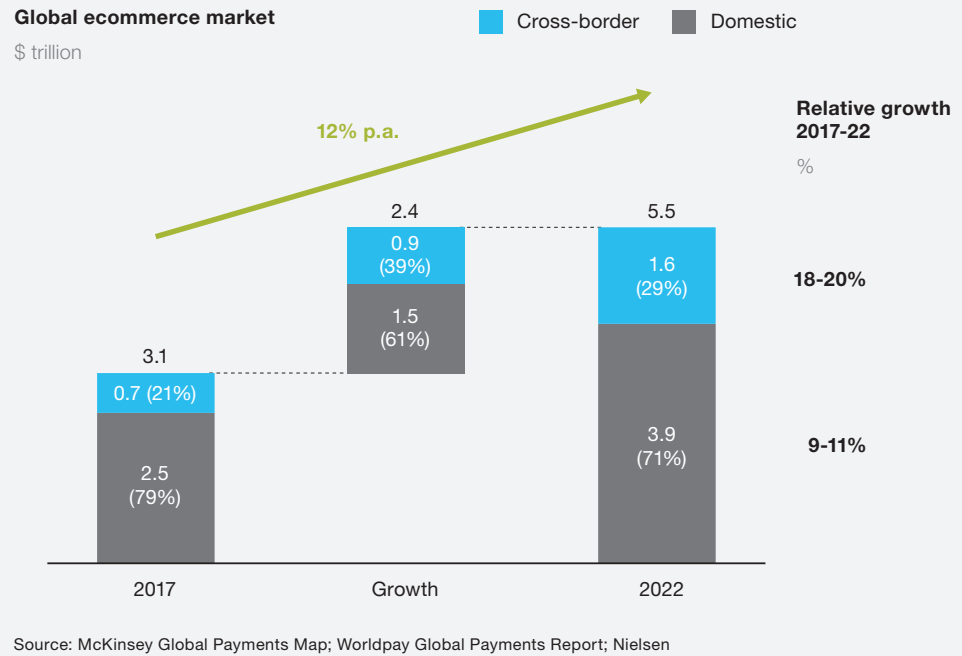
**Emerging market volume growth will continue at double digits through 2020, while mature market growth slows.**



Source: 2016 McKinsey Payments Map

Exhibit 2

Cross-border ecommerce growth will increase its share of a fast-growing global market.



back-office efficiency, however, but rather meeting the increasingly critical demand for global reach and acceptance, across both geographies and payments types. For example, Adyen is capable of supporting over 200 alternative payments methods, removing a multitude of barriers that may surface across disparate merchants. The company is using these capabilities as an early-mover advantage to gain market share.

**Changing customer needs raise demands on acquirers**

At the same time, all varieties of commerce are undergoing a reformation of business models, accelerating the demand for omnichannel solutions (Exhibit 3). This shift is driven by the blurring of consumer purchas-

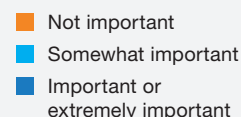
ing patterns; for example, consumers increasingly browse for options on mobile devices, pay for goods online, and collect them offline.

Although online and offline channels are converging, merchant segment needs remain distinct, predominantly by size and vertical—differences that are likely to persist in the future. It is also instructive for acquirers to consider the perspectives of other parties to the relationship. According to McKinsey’s Retail Practice, most merchants incur card-processing costs equal to 0.5 to 0.75 percent of revenue. Although acquirer fees comprise only a fraction of this cost, retailers tend to focus negotiating efforts on acquirers, viewing them as both the most approachable player in the mix and the one

Exhibit 3

## Consumers prefer omnichannel experiences.

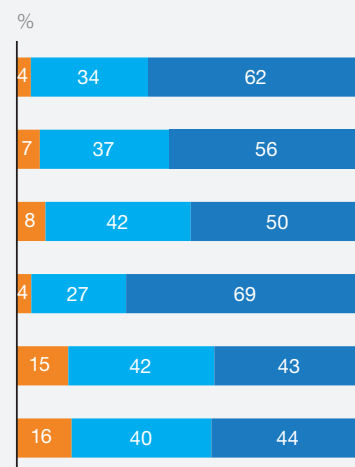
### Importance of multichannel functions among survey participants



#### Percent of respondents using service



#### Importance to those using service



Source: McKinsey survey of 4,877 consumers

most likely to have some flexibility in pricing. In the process, however, retailers often overlook larger opportunities, many of which impact the top line rather than expenses and can be powered by value-added acquirer services, such as intelligent routing, security, and optimized card-decline rates.

Although the merchant onboarding experience has historically had limited impact on provider choice, digital-first merchants are starting to influence onboarding timeline expectations, putting pressure on established traditionalists to follow suit (Exhibit 4, page 16). A large global acquirer recently digitized its onboarding journey, reducing time to market from two and a half weeks to less than four hours. While this is impressive, it is still

well short of the capabilities of leading tech-savvy acquirers—PayPal, Stripe, and Square, for example, can accomplish the same in as little as five minutes.

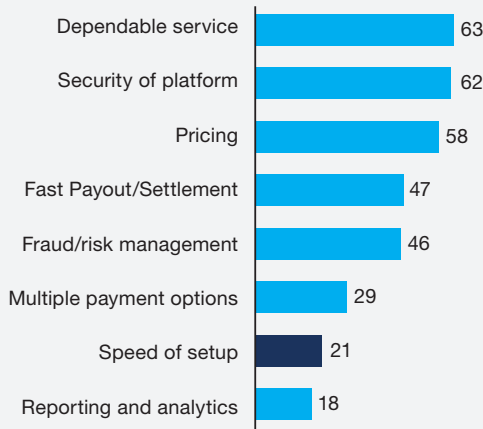
To stay relevant to customers, merchant acquirers must invest to create omnichannel capabilities, including the digitization of legacy processes and, moreover, move to an agile operating model in order to lower the cost base while meeting changing merchant expectations rapidly and seamlessly. For instance, value-added features could include add-on services like point-of-sale lending, inventory/order management solutions, and customer analytics. The potential for share shift among small and medium sized businesses (SMEs) is particularly stark—such

Exhibit 4

**Onboarding experience has had limited impact on merchants' acquirer choice but digital-first merchants are starting to influence expectations.**

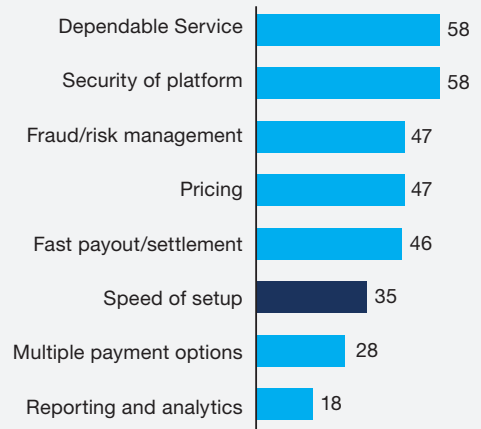
**Most important factors when choosing an acquirer**

Percentage ranking extremely/very important



**Top 5 factors when choosing an acquirer – digital merchants**

Percentage ranking extremely/very important



Source: McKinsey Payments Practice

firms are constrained in administrative resources and hungry for integrated solutions that solve multiple pain points.

There are multiple approaches to expand into omnichannel capabilities. Companies like Braintree and Stripe position themselves as commerce platforms rather than gateways, focusing (for now) on “app first” merchants where their strengths resonate. Cybersource is acquiring omnichannel capabilities through partnerships with firms such as Verifone. Meanwhile, acquirer-owned and smaller gateways currently compete as providers of less complex gateway solutions, many with plans to gradually roll out more specialized offerings. On the M&A front, legacy hardware provider Ingenico

has made at least a dozen acquisitions over the past decade, transitioning itself into an acquirer and processor in both the online and physical worlds.

Regulatory intervention and ecosystem consolidation is opening the global acquiring playing field at the same time it imposes new constraints. Such governmental intervention in payments is proceeding at an accelerating pace, as evidenced by numerous open banking initiatives across the globe (notably via PSD2 in Europe). Mandates regarding security and customer privacy combined with new EU interchange limits drive investment needs while simultaneously reducing return on investment. China has begun to enact similar regulations; while the outlook for US mandates are

less clear, such interventions regarding privacy and access could become a global factor.

The ongoing development of new payments-related technologies combined with pressures to reduce costs has created an environment in which significant capital expenditures have become table stakes. Investment in new payments-related technology is increasing—the payments industry has seen the largest share of fintech investment, as tracked by the McKinsey FinTech Panorama database—forcing existing firms to keep pace. In parallel, we observe continued cost pressure on acquirers, fueling innovation in both alternate service offerings and digitization to lower overall costs to serve.

Meanwhile, newer commerce ecosystems like Alibaba, Mercado Libre, and Amazon have continually expanded their payments functionality beyond digital wallets, consolidating large pools of payments volume that until recently would have been unthinkable.

### Strategic options

With continued consolidation both regionally and globally, and increasing investment requirements, there is a fundamental need to transform from payments into technology companies. In our experience, firms who have made this transformation are growing at double-digit rates, whereas those persisting with legacy business models remain in the low single-digit range. In embarking on this transformative journey, there are four strategies established merchant acquiring firms can pursue:

- Double down and invest to compete on a global level. This will require global reach and scale, or at minimum regional strength augmented with a solid ecommerce gateway to address needs in other geographies.

Such players must also transform from traditional processors to digital champions and offer omnichannel solutions supporting a full range of alternative payments methods and enabling selection of the path offering the desired risk/reward profile (e.g., providing functionality along the lines of Adyen and Stripe) as well as cross-border capabilities.

- Existing firms unwilling to invest the resources for an all-in bet can pursue niche plays. One is to become a recognized center of excellence for a subset of high-growth product verticals. These include in-app payments and—depending on geography—prepaid card, fuel cards, and meal tickets.
- Alternatively, differentiating solutions can be built around customer segments or use cases. For instance, integrated reward/payments platforms with at-table restaurant solutions, service industry solutions with prepayment capabilities integrated with scheduling, and easy-to-implement one-click solutions for micro-businesses all address known merchant needs. Innovations that improve the customer shopping experience—such as improving card approval rates and enabling real-time installment lending offers—are likely to find a ready market (e.g., Klarna and PayPal prioritizing development of SME-friendly solutions).
- Still others may elect to integrate their acquiring offerings into a broader future banking ecosystem offering to merchants, driving cross sales of “classic” corporate banking services such as cash management (e.g., ING acquiring Payvision, JPMorgan Chase acquiring WePay).

If none of the above are strategically compelling or feasible, the time could be right to

monetize the sector's all-time-high valuations by exiting the acquiring business, as many players have done. We anticipate more moves like the Swiss banks' consolidation of Six Payment Services into Worldline.

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We foresee an eventual endgame featuring a handful of large merchant acquiring firms,

each with strong regional market shares and significant global overlap. These will be flanked by a large number of nimble, niche-based attackers. It is imperative for today's leaders to chart a course of action to avoid finding their firms in the middle ground between these poles, a group destined for far less certain returns.

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