

# MERCHANT SERVICE FEES AND MARKET SHARES FOR CREDIT AND CHARGE CARDS

This month the Reserve Bank begins publishing, on a quarterly basis, average merchant service fees for American Express, Diners Club, and the Bankcard, MasterCard and Visa credit card schemes. The Bank is also publishing data on the collective market share of American Express and Diners Club and the collective market share of the Bankcard, MasterCard and Visa schemes on a monthly basis.

This article discusses the main features of the newly released data.

## Merchant Service Fees

It has been nearly two years since the Reserve Bank's reforms to card schemes came into effect. One of the main features of the reforms was the introduction of a standard that effectively lowered the fee paid by a merchant's bank to a cardholder's bank whenever a cardholder used a Bankcard, MasterCard or Visa card – the so-called 'interchange fee'. Prior to the reforms, this fee averaged around 0.95 per cent of the amount spent; it now averages around 0.54 per cent.

At the time the reforms were implemented there was a strong expectation that competition between banks would lead to the lower interchange fees being reflected in lower bank fees to merchants for accepting credit card payments (so-called 'merchant service fees'). To monitor the extent to which the lower interchange fees were passed through, the Bank began collecting quarterly data on merchant service fees and other related costs in March 2003. Data have been, and continue to be, collected from the nine financial institutions (including American Express and Diners Club) that are the largest providers of credit/charge card acceptance facilities to merchants.

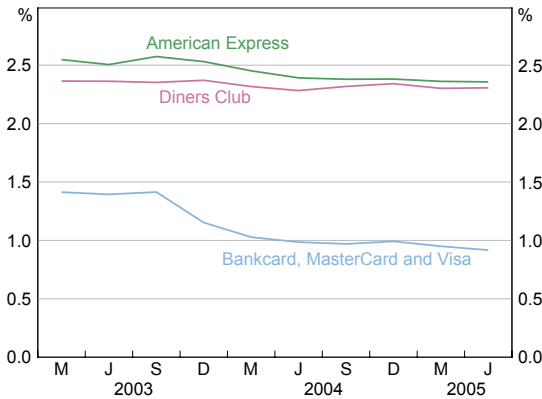
The results of the Bank's survey will, from this *Bulletin*, be published in a new table (Table C.3). This table shows the average merchant service fee levied on transactions in the Bankcard, MasterCard and Visa schemes,<sup>1</sup> as well as the average merchant service fee for each of the American Express and Diners Club schemes. It also shows other fees associated with merchant acceptance of credit cards, which include fees for terminal rental, stationery costs and chargebacks; these other fees are relatively small compared with merchant service fees and have remained fairly constant over time.

When the Bank first reported the results of its survey in July last year, the decline in interchange fees had been almost fully passed through to merchants. The Bank noted, however, that it expected that competition between banks would cause the average merchant service fee to fall a little further. This has indeed happened. The average fee in the June quarter this year was

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<sup>1</sup> The average merchant service fee for these three schemes is published as one number because the merchant service fee paid by a merchant is the same regardless of which scheme the card was issued under.

**Graph 1**  
**Average Merchant Service Fee**  
 Per cent of transaction value



0.92 per cent, down from 0.99 per cent a year ago, and from 1.4 per cent immediately prior to the reforms (Graph 1). The average merchant service fee has now fallen by more than the 0.4 percentage point decline in the average interchange fee.

When the reforms were implemented it was also expected that the decline in merchant service fees in the Bankcard, MasterCard and Visa schemes would put downward pressure on the fees that American Express and Diners Club charged merchants. This has happened to

some extent, although the declines have been relatively modest. Since the reforms came into effect, the average merchant service fee charged by American Express has fallen by around 0.15 to 0.20 percentage points to 2.36 per cent, while the average fee charged by Diners Club has fallen by around 0.05 percentage points to 2.31 per cent. These declines are smaller than those experienced in the Bankcard, MasterCard and Visa schemes, and as a result, the premium that merchants pay to accept American Express and Diners Club cards has increased.

The Bank's liaison with merchants suggests that while some merchants have been able to negotiate reductions in the fees charged by American Express and Diners Club, many others have not been able to do so. In some cases, merchants have indicated that they have little choice but to accept these cards, and find it difficult to surcharge. Some have also indicated that they would like to be able to steer customers to cheaper forms of payment but were prevented from doing so by clauses in their contracts with American Express. Over the past year, the Bank discussed this issue with American Express and, as a result, American Express has recently written to all its merchants informing them of the removal of the 'anti-steering' clauses from its contracts.

The removal of these restrictive clauses, together with the earlier removal of the clauses preventing surcharging, has given merchants a greater range of options than was the case a few years ago. To the extent that merchants are prepared to use these options, the Bank expects that the average merchant service fees of American Express and Diners Club will continue to fall. In addition, the publication of average merchant service fees in the *Bulletin* should help to encourage competition in the card-acquiring market, as merchants will be better able to compare average merchant service fees both across schemes and with their own negotiated rate.

In total, as a result of the Bank's reforms, merchants' cost of accepting credit and charge card payments were around \$580 million lower over the past year than they would otherwise have been. Given the competitive nature of Australian business, these cost savings are finding their way into lower prices for goods and services, or smaller price increases than would otherwise have taken place.

## Market Shares

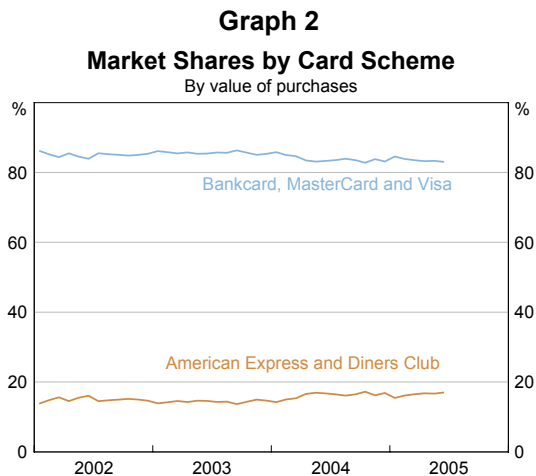
The Bank has been collecting data on the value and number of credit card transactions in Australia since 1984 and broadened the collection to include charge cards in 2002. The data are published in aggregate form in the *Bulletin*. For some time, the Bank has viewed it to be in the public interest for these data to be augmented with information on the market shares of the various schemes. However, the secrecy provisions of the *Reserve Bank Act 1959* prevent the Bank publishing such information without the agreement of the schemes.

In an effort to promote better understanding of the credit and charge card market in Australia, the Bank wrote to all schemes earlier this year seeking their agreement to the publication of market share data. Both Visa and American Express indicated that they would agree, provided that the other schemes did likewise. In contrast, Bankcard, MasterCard and Diners Club would not agree to the Bank publishing these data. Diners Club did, however, consent to the Bank publishing the combined market share of American Express and Diners Club. American Express has also consented to this information being published.

These market share data will be published in a new table in the *Bulletin* (Table C.2). The table shows the combined market share of Diners Club and American Express, in terms of both the number and value of transactions. It is available on a monthly basis since January 2002 (due to space limitations only the most recent observations are published in the *Bulletin*; the full series are available for download from the Bank's website). The table also shows the combined market share of Bankcard, MasterCard and Visa.

The data show that around 83 per cent of the value of purchases on credit and charge cards are currently undertaken with a Bankcard, MasterCard or Visa card (Graph 2). These schemes account for a slightly higher share of the number of purchases, reflecting the fact that the average purchase made through these schemes is lower than the average purchase made through the American Express and Diners Club schemes.

Over the past couple of years there has been a small increase in the combined market share of American Express and Diners Club. In the financial year prior to lower interchange fees coming into effect (2002/03) these schemes accounted for 14.6 per cent of the total transaction value. Over the past financial year, the comparable figure is 16.5 per cent. This increase was largely concentrated in the second quarter of 2004 and was coincident with the issuance of American Express credit cards by two of the major Australian banks. Since that time their market share has shown relatively little change.



Some commentators have suggested that the effects of the Bank's reforms to the Bankcard, MasterCard and Visa schemes are being undermined by a shift away from the regulated schemes towards American Express and Diners Club, both of which have relatively high merchant service fees. The above data allow these claims to be put into perspective. As an illustration, a shift of 2 percentage points in market share towards American Express/Diners Club would, all else constant, increase merchants' costs by around \$44 million at current levels of spending and merchant service fees. The cost saving of around \$580 million discussed above incorporates this effect. ↗