

Market review into the supply of card- acquiring services

Consultation on the
approach to the merchant
survey

May 2019

We welcome your views on this working paper. If you would like to provide comments, please send these to us by **5pm on 13 June 2019**.

You can email your comments to **cards@psr.org.uk** or write to us at:

Card-acquiring market review team
Payment Systems Regulator
12 Endeavour Square
London E20 1JN

We will consider your comments when finalising the approach set out in this working paper.

We will generally seek to make all non-confidential responses to this consultation available for public inspection in full or in part.

We will not accept blanket claims of confidentiality, such as a standard confidentiality statement in an email message. If you wish to claim confidentiality over specific items in your response to the consultation, you must identify those specific items which you claim to be confidential, and explain the basis on which confidentiality is sought. If you include extensive tracts of confidential information in your response, we will ask you to submit a non-confidential version.

We may nonetheless be required to disclose information marked as confidential in order to meet our legal obligations. This would be the case, for example, if we are asked to disclose confidential information under the Freedom of Information Act 2000. We will endeavour to consult you if we receive such a request under the Freedom of Information Act 2000. Any decision we make not to disclose information can be reviewed by the Information Commissioner and the Information Rights Tribunal.

You can download this consultation paper from our website:

www.psr.org.uk/psr-publications/market-reviews/mr181.4/consultation-merchant-survey

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Contents

1	Introduction	4
2	Research objectives	6
3	Survey methodology	9
4	Next steps	15

1 Introduction

- 1.1** The Payment Systems Regulator (PSR) is conducting a market review into the supply of card-acquiring services. The final Terms of Reference (ToR) for this market review were published on 24 January 2019. The ToR state that we will undertake a survey of small and medium-sized merchants in the UK (the ‘merchant survey’).^{1, 2}
- 1.2** The purpose of this working paper is to explain, and seek views on, our proposed approach to the merchant survey. We would, in particular, welcome comments on the questions set out in Chapter 4 (*Next steps*). In that chapter, we also explain how to respond to this consultation, and what the timeframe for responding is.
- 1.3** We propose to run a merchant survey to collect evidence, from a broad range of merchants, on the factors that might impact demand for card-acquiring services. We are seeking to understand how small and medium-sized UK merchants who accept Mastercard-branded and/or Visa-branded cards (the ‘target population’) buy and use card-acquiring services. Specifically, we propose that the merchant survey examines the following:
- a. Do merchants have credible alternatives to card-acquiring services for Mastercard and Visa?
 - b. How do merchants access information about card-acquiring services, how do they assess that information, and do they act on it?
 - c. How satisfied or dissatisfied are merchants with the quality of service they receive from their provider of card-acquiring services?
 - d. How does the supply of card acceptance products affect merchants’ choice of card-acquiring services provider?
- 1.4** We propose to collect around 1,200 survey responses from merchants using structured telephone interviews. We believe this sample size is large enough to give us sufficiently precise answers to the questions set out in paragraph 1.3. This includes capturing differences between groups of merchants in the population. This is discussed further in Chapter 3 (*Survey methodology*).
- 1.5** We are working with an external market research agency to run the merchant survey. Merchants will be selected for interview by the appointed market research agency using random sampling methods.
- 1.6** In addition to consulting on the proposed approach to the merchant survey, we also plan to invite stakeholder views on the questionnaire that will be used to survey merchants. We intend to publish the draft questionnaire in June/July 2019.

1 Payment Systems Regulator MR18/1.2, *Market review into the supply of card-acquiring services – Final terms of reference* (January 2019), paragraph 4.2.

2 We also plan to engage directly with larger merchants in the course of the market review on the same range of research objectives as set out in Chapter 2 (*Research Objectives*).

- 1.7** This working paper sets out our current thinking on our approach to the merchant survey. It does not make any judgement on the outcome of the merchant survey. We expect that our approach to the merchant survey will be refined and updated as our work progresses, including to take account of responses to this working paper. As a consequence, the final approach to the merchant survey may depart from what we set out here.
- 1.8** As we progress the merchant survey, we will consider whether it is appropriate to provide further information on how our work has developed. In any event, we will set out how the approach to the merchant survey has evolved in the interim report of our market review, including how we have taken into account comments on this working paper. The interim report will also set out preliminary findings from the merchant survey.
- 1.9** The results of the merchant survey will be one piece of evidence we will consider when taking a view on whether the supply of card-acquiring services is working well for merchants, and ultimately consumers.
- 1.10** The remainder of this working paper is structured as follows:
- Chapter 2 sets out the research objectives we propose to explore in the merchant survey
 - Chapter 3 sets out our proposed methodology for the merchant survey
 - Chapter 4 sets out how to provide comments on our proposed approach to the merchant survey

2 Research objectives

Introduction

- 2.1** We propose to base the questionnaire for the merchant survey on the research objectives set out in this chapter.
- 2.2** We propose to use a questionnaire that is relatively short in length to survey merchants. This should maintain engagement with merchants and help produce a suitable response rate. This means that some of the research objectives set out in this chapter may be covered in more detail than others.
- 2.3** We propose that the merchant survey examines any differences between merchants with different characteristics in relation to the research objectives set out in this chapter.
- 2.4** The next sections in this chapter provide more detail on the research objectives outlined in paragraph 1.3. For the avoidance of doubt, the research objectives set out below are not the questions we propose to include in the questionnaire that will be used to survey merchants. Rather, these are the research objectives we are proposing to explore through the merchant survey.

Do merchants have credible alternatives to card-acquiring services for Mastercard and Visa?

- 2.5** This research objective seeks to examine whether merchants consider that there are credible alternatives to card-acquiring services for Mastercard and Visa.
- 2.6** We propose that the merchant survey considers if merchants have the incentive and ability to steer their customers' choice of payment method. If they have such incentives and ability, they could consume services that allow them to accept other forms of payment instead of card-acquiring services for Mastercard and Visa (for example, card-acquiring services for other card payment systems or acquiring services for non-card digital payments).
- 2.7** If merchants have both the incentive and the ability to steer their customers' choice of payment method, we want to understand how they steer their customers' choice of payment method. We also propose that the merchant survey considers the scope merchants have for not offering some payment methods to their customers.

How do merchants access information about card-acquiring services, how do they assess that information, and do they act on it?

- 2.8** Our market review was prompted by stakeholders' concerns that indicate the supply of card-acquiring services may not be working well for merchants, and ultimately consumers.³

³ Payment Systems Regulator MR18/1.2, *Market review into the supply of card-acquiring services – Final terms of reference* (January 2019), paragraph 1.12.

- 2.9** This includes concerns that there are barriers that make it hard for merchants to compare and switch acquirers. We also heard concerns that merchants tend not to shop around for card-acquiring services and that there is a lack of transparency around the fees merchants pay to accept card payments.
- 2.10** We propose to adopt the ‘access, assess and act’ (three-As) framework to examine the factors that affect merchants’ searching and switching behaviour.⁴ This framework is commonly used to analyse demand-side behaviour and identify barriers to switching.
- 2.11** We propose that the merchant survey examines the concerns described in paragraph 2.8 by looking at:
- a. How merchants access information on the price and quality of card-acquiring services available. If there are barriers to accessing information, we propose that the merchant survey identifies what such barriers are.
 - b. How easy or difficult it is for merchants to assess their own needs for card-acquiring services and to compare different offers from providers of these services. If merchants face barriers in assessing and comparing information on the offers available to them, we propose that the merchant survey identifies such barriers.
 - c. If a merchant decides to switch, how easy or difficult it is to switch between providers of card-acquiring services. We propose that the merchant survey considers whether merchants face actual or perceived contractual, technical or other barriers to switching.

How satisfied or dissatisfied are merchants with the quality of service they receive from their provider of card-acquiring services?

- 2.12** In the final ToR, we stated that we would examine how competition in the supply of card-acquiring services operates.⁵ This includes examining non-price competition between providers of card-acquiring services. We propose that the merchant survey examines:
- a. the support merchants receive from their provider of card-acquiring services to comply with the rules set by the card scheme operators
 - b. the quality of service that merchants receive from their provider of card-acquiring services, and whether they consider this to be good value for money
 - c. the non-price features of card-acquiring services that matter to merchants

⁴ For more information on this framework see: Competition and Markets Authority and Financial Conduct Authority, *helping people get a better deal: Learning lessons about consumer facing remedies* (October 2018), page 9.

⁵ Payment Systems Regulator MR18/1.2, *Market review into the supply of card-acquiring services – Final terms of reference* (January 2019), paragraph 3.3.

How does the supply of card acceptance products affect merchants' choice of card-acquiring services provider?

- 2.13** To accept card payments, merchants also buy goods or services in addition to card-acquiring services. We refer to these as 'card acceptance products'. These include, for example, point-of-sale (POS) terminals and gateways. Merchants can buy such card acceptance products from certain providers of card-acquiring services or from third-party providers.
- 2.14** In the final ToR, we explained that we will consider any effects of the supply and acquisition of card acceptance products on the supply of card-acquiring services.⁶ We propose that the merchant survey examines whether providers of card acceptance products influence merchants' choice of card-acquiring services provider. This includes examining how the relationship between a provider of card-acquiring services and a merchant was first established – for example, if it was through a referral by a third party provider of card acceptance products, or another route.

⁶ Payment Systems Regulator MR18/1.2, *Market review into the supply of card-acquiring services – Final terms of reference* (January 2019), paragraph 2.21.

3 Survey methodology

Introduction

- 3.1** This chapter sets out our proposed methodology for the merchant survey. The proposed methodology is based on the best information we currently have available to us. We may change the proposed methodology set out in this chapter in light of comments we receive on this working paper, and when we examine the data received from relevant card-acquiring services providers on their merchant customers.
- 3.2** The remainder of this chapter sets out:
- the proposed method for collecting survey responses
 - the proposed approach to the quality assurance of the questionnaire
 - the proposed approach to the design of the sampling frame – i.e. the list of merchants from which we will draw the sample of merchants we interview
 - the proposed approach to sampling

Method for collecting survey responses

- 3.3** We propose to use structured telephone interviews to administer the survey. If this approach is adopted, the interviews will be carried out by a team of trained specialist interviewers employed in-house by the appointed market research agency.

Approach to quality assurance of the questionnaire

- 3.4** For the findings of the merchant survey to be robust, the questionnaire must be of sufficient quality to elicit relevant responses from merchants. Below we set out the steps we consider will ensure the quality of the questionnaire.
- 3.5** The appointed market research agency recently undertook in-depth telephone interviews with around 30 merchants from different industries. The purpose of this research is to inform the design of the questionnaire, including the language and terminology that should be used.

- 3.6** In line with good practice⁷, we also propose to do the following:
- a. Publish a draft of the questionnaire for consultation. We plan to publish this in June or July 2019.
 - b. Carry out cognitive testing of the questionnaire. This involves conducting interviews with a small number of eligible survey participants followed by a discussion with them on their interpretation and understanding of the questions, including possible improvements.
 - c. Run a pilot of the merchant survey. A pilot is a complete run through of the survey process designed to ensure that the survey works as intended.

Approach to the design of the sampling frame

- 3.7** The target population for the merchant survey is small and medium-sized UK merchants⁸ that accept Mastercard-branded or Visa-branded cards. Small and medium-sized merchants are those that meets at least two of the following characteristics:
- a. an annual turnover of less than £36 million
 - b. balance sheet of less than £18 million
 - c. not more than 250 employees⁹
- 3.8** The sample must be of sufficient quality to allow us to draw inferences about the target population. In this section, we set out how we propose to construct the sampling frame from which the sample of merchants will be drawn. The next section sets out how we propose to draw the sample from the sampling frame.
- 3.9** We propose to construct a sampling frame that covers the majority of the target population and contains a wide variety of merchants. This will allow us to draw a sample that is representative of the target population. We are not planning to obtain a complete list of all the members in the target population. This approach would require requesting customer information from every provider of card-acquiring services serving UK merchants. We do not consider that this would be proportionate.

⁷ See for example CMA's guidance: Competition and Markets Authority, *Good practice in the design and presentation of customer survey evidence in merger cases* (2018), paragraphs 2.55 and 2.56.

⁸ We define a UK merchant as a merchant with at least one UK outlet, where an outlet is the location at which a card transaction is completed.

⁹ This definition is based on the definition of a medium-sized company in the Companies Act 2006 (as amended from time to time).

- 3.10** We propose to construct a sampling frame comprising:
- a. All active UK merchants with a card turnover¹⁰ below £28 million in 2018 that were customers of the five largest acquirers for card-acquiring services in April 2019.^{11,12,13} These acquirers accounted for approximately 90% of card transactions acquired in 2018 at UK outlets.¹⁴
 - b. All active UK merchants with a card turnover below £28 million in 2018 that were customers of a subset of payment facilitators for card-acquiring services in April 2019. We are currently evaluating which payment facilitators' customers should be included in the sampling frame.
- 3.11** We define an active merchant as one that accepted one or more card payments since 1 January 2018.
- 3.12** We propose to use annual card turnover in 2018 to determine which merchants should be included in the sampling frame, as set out in paragraph 3.10. The customer data we are gathering from a subset of acquirers and payment facilitators will not include a merchant's total annual turnover, balance sheet or number of employees. This means we cannot identify small and medium-sized merchants on the basis of those criteria. Instead, we propose to use card turnover as a proxy for merchant size. In any event, we consider that a merchant's card turnover is likely to be a more important feature of the merchant-provider relationship than a merchant's total turnover.

Approach to sampling

- 3.13** We propose to draw a random sample of merchants from the sampling frame. The sample may be stratified. Following this technique, the population is divided into segments known as strata, based on one or more merchant characteristics. Then a random sample of merchants is drawn from each stratum.

10 Card turnover is the revenue a merchant receives from sales paid for by card.

11 As we progress the market review we may ask for information on customers of other acquirers that serve UK merchants.

12 To compute the £28 million upper card turnover threshold, we multiply the upper annual turnover threshold of £36 million (see paragraph 3.7) by 78% (the incidence of card turnover in the retail sector in 2017) and round to the nearest million. The figure for the incidence of card turnover in the retail sector is sourced from UK Finance, *UK Card Payments* (2018), page 42.

13 The retail sector had the highest incidence of card turnover in 2017 and accounted for the highest total number of transactions (UK Finance, *UK Card Payments* (2018), pages 42 to 43). We consider that a higher (rather than lower) card turnover threshold is more likely to produce an appropriate sampling frame. This is because, compared to a lower threshold, a higher turnover threshold gives a higher probability that merchants that are genuinely small or medium-sized will be included in the sampling frame. We note that using a higher card turnover threshold could mean some large merchants are incorrectly included in the sampling frame. Merchants that have, on this basis, been incorrectly included in the sampling frame are unlikely to be included in the sample we draw, given there are relatively few merchants at the higher end of the turnover distribution.

14 We currently do not have reliable information on the proportion of customers that these acquirers serve, so we have based our coverage figures on transaction volumes. As we collect more information during the market review we intend to evaluate the coverage of the survey in terms of merchant numbers.

- 3.14** For the purposes of our merchant survey, stratified sampling may be useful if all of the conditions below are satisfied:
- a. There are systematic differences between specific merchant groups, in any of the respects set out in paragraph 1.3.
 - b. The number of merchants in some groups is so small that there would, without stratification, be too few of them drawn in a random sample to say with sufficient precision what their choices, views or outcomes are, or how these differ from other groups. As a result, we would be unable to meet the minimum acceptable level of precision set out in paragraph 3.21 for that merchant group.
 - c. We have available the information on merchant characteristics that is necessary to allocate all merchants in the sampling frame into strata.
- 3.15** We consider that there may be systematic differences between certain merchant groups in respect of the research objectives set out in paragraph 1.3 (see the condition in paragraph 3.14a). This is based on recent merger assessments carried out by the European Commission and stakeholder responses to our draft ToR. The merchant groups that we consider may meet the conditions in bullet 3.14a are:
- a. merchants that only operate online (e-commerce only merchants), merchants that only operate in face-to-face environments (face-to-face only merchants) and other merchants (for example, merchants that operate in both e-commerce and face-to-face environments or that only take payments via telephone)¹⁵
 - b. merchants operating in high-risk industries versus merchants in all other industries¹⁶
- 3.16** The condition in paragraph 3.14b will be satisfied if we find that some of the merchant groups set out in paragraph 3.15 account for only a small proportion of the merchants in the sampling frame. In this case, a random sample is likely to include only a small number of merchants in those specific groups, making it difficult to draw conclusions about those groups. This would make stratification a useful technique for the merchant survey.
- 3.17** Ultimately, our ability to stratify based on the merchant groups outlined in paragraph 3.15 depends on whether we can obtain suitable data on merchant characteristics from the relevant acquirers and payment facilitators (condition in bullet 3.14c).

¹⁵ The European Commission found that there may be separate market segments in acquiring services for POS terminals and acquiring services required for e-commerce. This finding is based on the differences between the features of acquiring services required for payments made through physical POS terminals and for payments in e-commerce. See for example: Case M.7873 – Worldline / Equens / Paysquare Commission Decision (2016), paragraph 30, and Case M.7241 – Advent International / Bain Capital Investors/ Nets Holding Commission Decision (2014), paragraph 21.

¹⁶ Several respondents to the consultation on the draft ToR said our work should consider how a merchant's risk categorisation might impact their choice of provider of card-acquiring services or the price they pay. See Payment Systems Regulator MR18/1.2, *Market review into the supply of card-acquiring services – Final terms of reference* (January 2019), Annex 2, paragraph 2.4.

- 3.18** We propose to use data on volume and value of card-not-present transactions to identify e-commerce only merchants and face-to-face only merchants.¹⁷ We are aware that there may be some merchants who only accept card-not-present transactions but are not e-commerce only merchants. We are considering additional steps to identify e-commerce-only merchants correctly before the interview stage.
- 3.19** We propose to use merchant category codes (MCCs) to allocate merchants to the high-risk industries group.¹⁸ This approach is subject to MCCs being sufficiently informative about the risk profile of an industry in which the merchant operates.
- 3.20** If the conditions set out in paragraph 3.14 are met, we propose to allocate merchants into strata based on the following characteristics:
- a. merchants operating in e-commerce environments only (where card-not-present transactions represent the only source of card turnover for the merchant)
 - b. merchants operating in face-to-face environments only (where card-present transactions represent the only source of card turnover for the merchant)
 - c. merchants operating in both e-commerce and face-to-face environments, or any other types of environment
 - d. merchants in high-risk industries
 - e. merchants in all other industries not captured by bullet 3.20d
- 3.21** We propose that the size of the collected sample for the merchant groups listed in paragraph 3.20 should be sufficiently large to ensure an acceptable level of precision. We consider that an acceptable level of precision means that, for each group, the true proportion (p) that would answer 'yes' to a yes/no question lies, with a 95% probability, in the interval $\hat{p} \pm 5\%$, where \hat{p} is the sample estimate of the proportion. This is widely regarded as an acceptable precision level when making statistical inferences.
- 3.22** Assuming the precision level set out in paragraph 3.20 and five merchant groups, the sample size we want to achieve for the merchant survey is around 1,200 completed interviews. This is shown in Table 1.

17 Any card transaction that is not a card-present transaction. A card-present transaction is a card transaction in which the cardholder is present at the outlet and presents the payment card.

18 The MCC is a four-digit code used to classify the merchant by the type of goods or services it provides.

Table 1: Sample size requirement assuming 3 x 2 merchant groups

Merchant group	e-commerce only	face-to-face only	both e-commerce and face-to-face, and all others	<i>Sample size requirement</i>
Merchants in high-risk industries	n_1	n_2	n_3	400
Merchants in other industries	n_4	n_5	n_6	800
<i>Sample size requirement</i>	400	400	400	$n^* = 1,200$

3.23 Before drawing the sample, the merchant groups listed in paragraph 3.20 would be allocated into strata as follows (note that this list is exhaustive – i.e. it covers all the merchants in the sampling frame):

- merchants in high-risk industries that operate in e-commerce environments only
- merchants in high-risk industries that operate in face-to-face environments only
- merchants in high-risk industries that operate in both e-commerce and face-to-face, or other environments
- merchants in other industries that operate in e-commerce environments only
- merchants in other industries that operate in face-to-face environments only
- merchants in other industries that operate in both e-commerce and face-to-face, or other environments

3.24 The precision level requirement set out in paragraph 3.21 applies to the merchant groups set out in paragraph 3.20. These groups correspond to the columns and rows of Table 1. The columns correspond to paragraph 3.20a to 3.20c, and the rows correspond to paragraph 3.20d and 3.20e. The sample sizes shown in the table for each merchant group are sufficient to achieve the level of precision set out in paragraph 3.21.

3.25 We have not set a minimum sample size n_i requirement for the individual stratum. In practice, we will aim to achieve a balanced number of merchants in each stratum. However, our ability to do this will be driven by the overall number of merchants in each stratum within the sampling frame.

3.26 At the analysis stage, we propose to apply population weights, if necessary, to adjust for discrepancies in the composition of the sample compared with the target population.

4 Next steps

4.1 We welcome any comments on the proposed approach to the merchant survey set out in this working paper. Below are some questions we believe may be particularly important to receive comments on.

4.2 The questions are the following:

- Do you agree with the proposed research objectives set out in Chapter 2 (*Research objectives*)? If not, why not?
- Do you agree with the methodology proposed in Chapter 3 (*Survey methodology*)? If not, why not?

4.3 Please send us your comments by 5 pm on 13 June 2019. You can email them to cards@psr.org.uk or write to us at the following address:

Card-acquiring market review team
Payment Systems Regulator
12 Endeavour Square
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Disclosure of information

4.4 Generally, we will seek to publish views or submissions in full or in part. This reflects our duty to have regard to our regulatory principles, which include those in relation to:

- publication in appropriate cases
- exercising our functions as transparently as possible

4.5 We will not accept blanket claims of confidentiality. If you wish to claim confidentiality over specific items in your submission, you must identify those specific items which you claim to be confidential, and explain the basis on which confidentiality is sought. If you include extensive tracts of confidential information in your submissions, we will ask you to submit non-confidential versions.

4.6 We may nonetheless be required to disclose information marked as confidential in order to meet legal obligations.

4.7 This would be the case, for example, if we are asked to disclose confidential information under the Freedom of Information Act 2000. We will endeavour to consult you if we receive such a request under the Freedom of Information Act 2000. Any decision we make not to disclose information can be reviewed by the Information Commissioner and the Information Rights Tribunal.

- 4.8** In accordance with the legal framework in the Financial Services (Banking Reform) Act 2013 (FSBRA), we will not disclose confidential information that relates to the business or affairs of any person, that we receive for the purposes of our functions under FSBRA, unless:
- we have the consent of the person who provided the information and, if different, the person to whom it relates, or
 - there is a 'gateway' permitting such disclosure. One of the gateways is the 'self-help' gateway whereby the PSR will be able to disclose confidential information to third parties to enable or help the PSR to perform its public functions. Where we disclose confidential information to a third party, we may impose restrictions on the further disclosure or use of the information by such parties.
- 4.9** You should note that information that is already lawfully publicly available or in such a form that it is not possible to ascertain from it information relating to a particular person (for example, if it is summarised, anonymised or aggregated) is not confidential information for the purposes of FSBRA.
- 4.10** We take our data protection responsibilities seriously and will process any personal data that you provide to us in accordance with the Data Protection Act 2018, the General Data Protection Regulation and our PSR Data Privacy Policy. For more information on how and why we process your personal data, and your rights in respect of the personal data that you provide to us, please see our privacy policy on our website, available here: <https://www.psr.org.uk/privacy-notice>.

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