Brave New World in Payments

Tapping the power of Big Data in merchant portfolio management

By Mike Strawhecker

In the novel *Brave New World*, Aldous Huxley wrote, "One believes things because one has been conditioned to believe them."

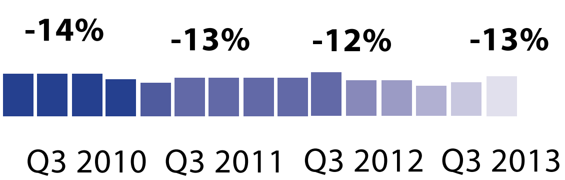
The same might be said of portfolio owners and managers who previously were limited by what they knew—what they *believed* to be true. But in today's competitive landscape, we now have the power to act upon what *is* true. Big Data gives information to merchant acquirers that wasn't available in the past.

Several firms that serve the payments industry, including The Strawhecker Group (TSG), have been developing tools that give merchant portfolio owners and managers insight into the performance not only of their own portfolios, but of the portfolios of others in the market as well. These tools are Big Data breakthroughs, and they are reflective of the future of the business for a multitude of reasons, including the following:

1. Context. In an industry that has historically been close to the vest in regard to financial performance, the ability to see market rates has provided context to decision makers not seen before. For example, portfolio owners often claim their attrition is very low. The question is, relative to what? If you think you have market data to compare your portfolio against, how do you know that attrition was measured the same way? When calculating the metrics, it's important to apply a consistent calculation using the data for each of the 18 data-contributing portfolios so all the performance measures are apples to apples. For example, Figure 1 shows that the average volume gross attrition in the U.S. market in Q3 2013 was -13 percent.

FIGURE 1

Volume Gross Attrition



Source: The Strawhecker Group database

2. Sample Size. The increasingly large sample sizes now available provide numerous portfolios the kind of market perspective that has previously been exclusive to the largest of acquiring players due to their sheer size. Regardless of a participating portfolio's number of merchants within a certain merchant type or geography, the participants have insight into all segments of the U.S. market. In the past, portfolios would often rely on their salespeople to tell them how they were priced in the market, and typically it would be "too high." Because of Big Data, the portfolios can see for themselves how they are priced versus the market. For example, Figure 2 shows the current rate that restaurants are paying for card processing (discount rate), the percentage of the transaction that makes up the ISOs' net revenue, and the gross profit the ISO makes (net revenue minus residuals). In the restaurant segment, an ISO typically sees gross profit of 0.503 percent.

3. Microsegmenting. Microsegmenting describes what merchant acquiring companies are doing to make strategic decisions, taking a very granular and specific look at a

FIGURE 2

Restaurants in the U.S. Market (Q3 2013)	
Discount Rate	1.632%
ISO Net Revenue	0.711%
ISO Gross Profit	0.503%

Source: The Strawhecker Group database merchant type. Using the aforementioned example of restaurant pricing—while it is good information, it is not specific enough for a portfolio owner/manager to use to make decisions. Through Big Data, merchant acquirers can use inputs on various dimensions to make data-driven decisions. Let's take a look at a specific example:

- **SIC code or merchant type:** 5812 (eating places)
- **Tier or size of merchant:** Tier 4 (card dollar volume between $1 million and $2 million a year)
- **Geography or location of merchant:** New England
- **Sales model or what type of channel the account was sold through:** Agent bank
- **Vintage or when the account was sold:** 2013

Completing a database query on the following metrics produces output that is much more specific than the previous example given. As compared to the previous general restaurant example, this microsegment of merchants is priced much higher (2.337 percent) and is less profitable (0.196 percent) than the general U.S. restaurant marketplace (see Figure 3). Each segment and microsegment is different. Big Data provides acquirers the ability to compare their merchant profitability and attrition performance to those of merchants in the database with similar demographics—size, geography, SIC, vintage, and more (see Portfolio X in Figure 3). Analyzing merchant performance metrics using Big Data often is a first step for ISOs constructing sales and re-pricing strategies. Merchant acquirers may have more success selling into various markets—or deciding if they want to target them in the first place—if they are armed with the most apropos information possible.

FIGURE 3

Eating Places / Tier 4 / New England/ Agent Bank / Sold in 2013 (Q3 '13)

	Port. X	Avg.
Discount Rate	2.119%	2.337%
ISO Net Revenue	0.562%	0.467%
ISO Gross Profit	0.203%	0.196%

Source: The Strawhecker Group database

4. Drivers of Value. Big Data offers merchant acquiring companies' management, board of directors, and investors better insights into the value drivers of these companies than ever before. The Gross Profit Value Index Growth Bridge is an example of this type of analysis.

The data in Figure 4 indicates that the collective merchant portfolio's gross profit value has increased a total of 39 percent (1.00-1.39) from Q4 2010 to Q1 2013—a CAGR of +16 percent. An increase in residual payouts (-0.05) and slowing same store sales growth (-0.07) are the only factors creating incremental headwinds for the merchant portfolio's value, according to the chart. These types of outputs show decision makers the value of a portfolio's revenue stream and, therefore, help them better understand what areas of the business need to be prioritized and focused on with forward-looking strategies.

5. Access. Building on the theme from the previous point, timely access to relevant metrics from Big Data is key for portfolio owners and managers. Because of these developments in Big Data, many merchant acquiring companies have built in-house "data cubes" to better monitor and manage their portfolios' performance in real time. This capability is paramount to understanding and acting on changes in the market—an agile company can be proactive in its tactics instead of reactive.

Why has Big Data started to see big success in the merchant acquiring space? The answer is simple: data-driven decision making. Let's say for the sake of argument that the average merchant produces $1,032 of gross profit annually. If a merchant acquirer can sell or retain 100 merchants in one year because of its Big Data efforts—either internally or outsourced—the Big Data created or saved more than $100,000 of new revenue. This is often enough ROI for even the smallest of ISOs to consider a Big Data solution. ***TT***

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FIGURE 4

TSG GPVI Growth Bridge (Movement in index from key metrics)

Source: The Strawhecker Group database