

SHOULD TRADITIONAL MERCHANT ACQUIRERS 'BEWARE OF SQUARE'?



2010
Square Enters the Market

Among the first to widely market a dongle and offer one flat rate



Smart Phones and Tablets became available as terminals



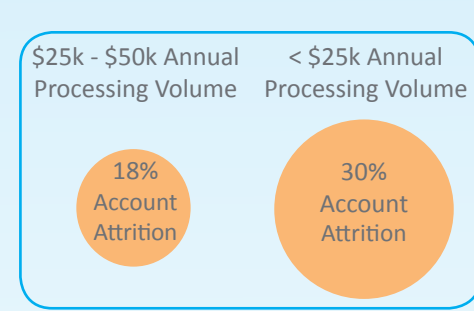
These micromerchants have generally not been pursued by traditional Merchant Acquirers due to:

- High attrition rates
- Lack of viable technology
- Low demand
- Low margin rates

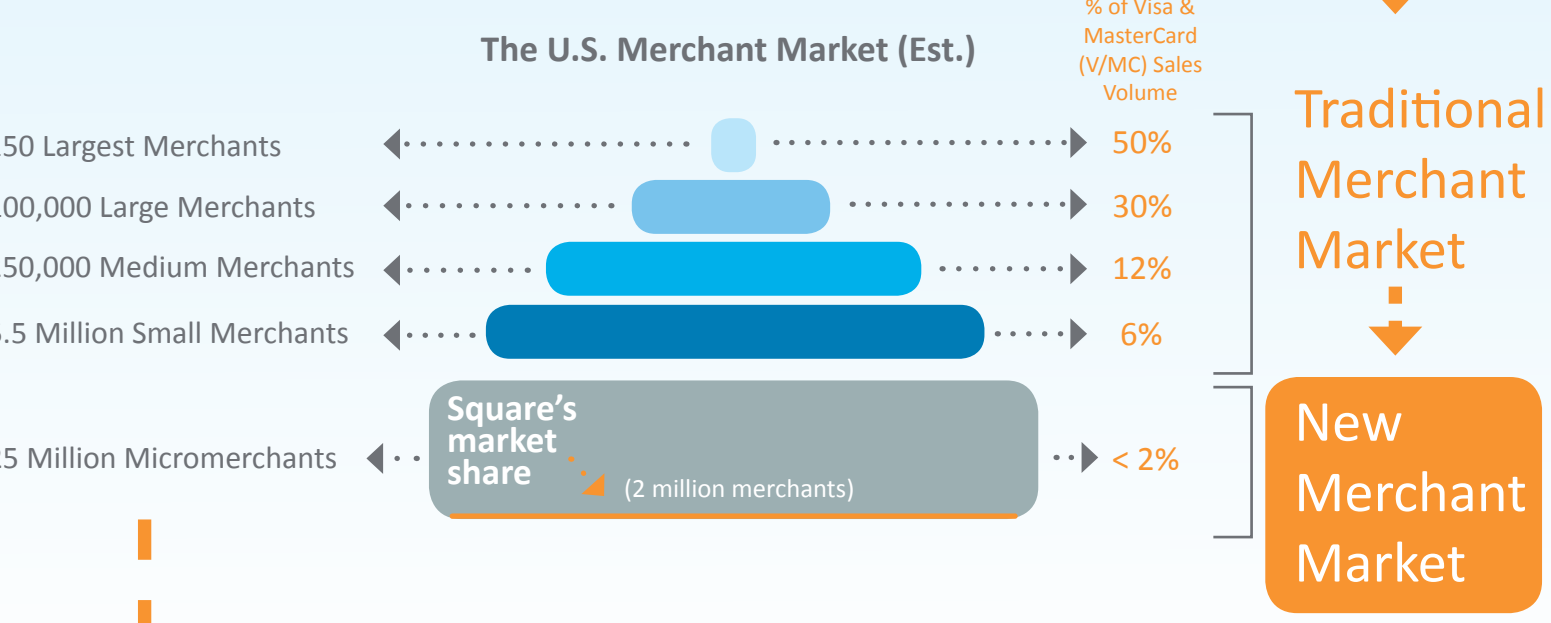
The Result?



Card acceptance became available to a whole new category of merchants such as Landscapers, Plumbers, and School Fund-Raising Organizations who previously found it difficult or uneconomical to accept cards



Consumer trends and technological advances in electronic payments have opened a new market of card accepting merchants. This is where Square fits right in.



Square merchants are different



\$470,000
Traditional Merchant's Approximate Average Annual V/MC Processing Volume

\$4,000
Square Merchant's Approximate Average Annual V/MC Processing Volume

Square isn't appropriate for all merchant sizes



Some have been confused regarding this due to Starbucks' investment in and partnership with Square

Some clarification:

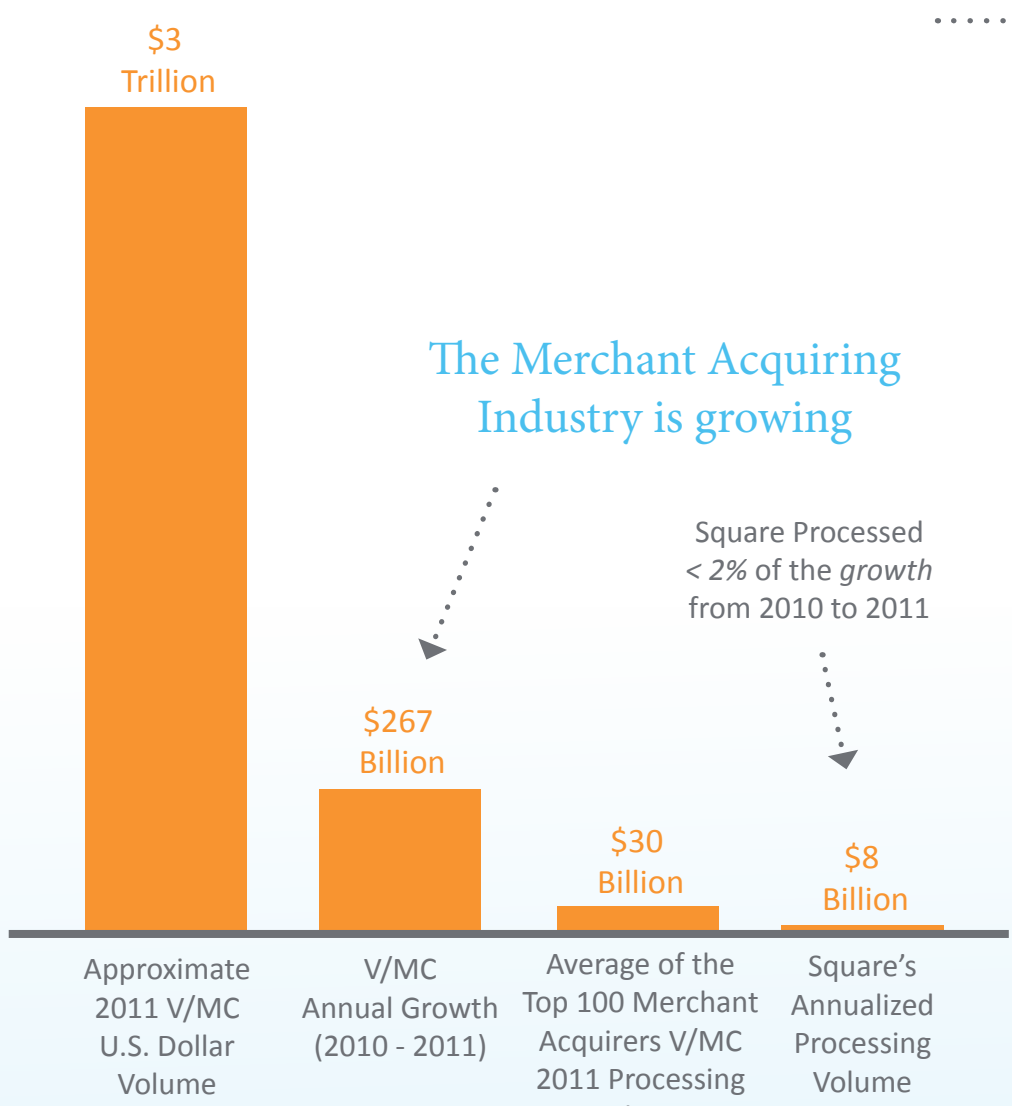
- Square's dongle isn't used at Starbucks
- Starbucks offers its customers the option for Square's mobile wallet
- Square terminals don't offer the feature functionality many traditional merchants rely on

Other Merchant Acquirers play in this space as well

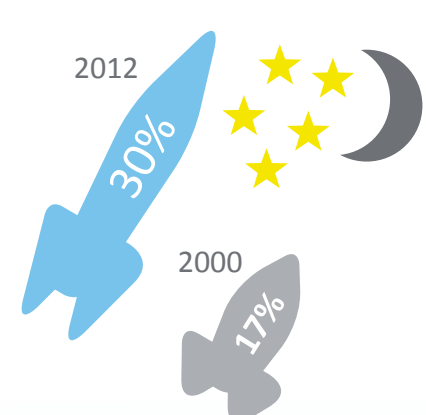


Generally, successful Merchant Acquirers have diversified merchant portfolios. Though Square's merchant types are diverse, their size and behaviors tend to be more similar.

The U.S. Merchant Acquiring Industry is not a zero sum market



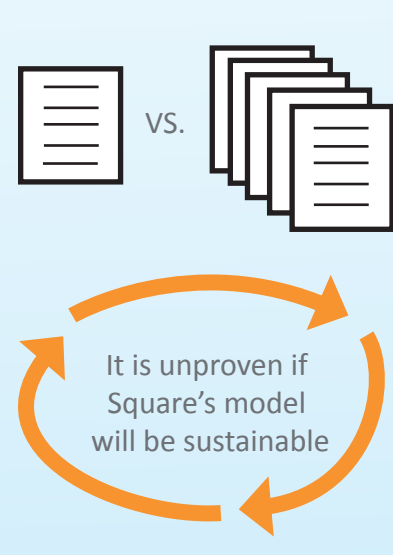
Card Usage as a percent of Non-Durable Consumer Spending has nearly doubled since the year 2000



Over 2/3 of U.S. small businesses don't accept cards

Is Square's Model Sustainable?

- Risk & Underwriting**
Square's approval process is lenient compared to the market
- Micromerchant Portfolio**
Micromerchants have higher attrition and longer payback periods
- Security & Compliance**
Most of the Square readers in the marketplace are not encrypted



The Verdict?

Traditional merchant acquirers should be cautious of Square as a competitive threat due to its disruptive growth rates. However, it can be argued that much of Square's status is driven by its founder's PR prowess rather than a proven sustainable business model.



Square's emergence has come from offering the underserved micromerchant market a dongle solution for card acceptance with a flat processing rate and its impact in the payments industry has been felt simply due to its existence. Merchant acquiring companies must be able to succinctly communicate to their stakeholders and the merchant community that they provide comparable or better offerings than Square's offerings.

Square's model started with simplified payments acceptance but longer-term, it's business model end-game may center on marketing analytics. Additionally, Square may try to move upmarket and compete with legacy ISOs and processors in the future, as micromerchants have long been considered unprofitable.

At this point in time, Square does have a substantial marketing advantage in the consumer marketplace (including many of the sole-proprietorships in the micromerchant arena), but this alone will not likely put Square 'over the top' in the traditional merchant marketplace.

Is Square a disruptor? Yes. Does Square have the ability to win long-term in the merchant acquiring marketplace? That remains to be seen.

© Copyright 2012. The Strawhecker Group. All Rights Reserved.

Sources
TSG Merchant Database
Square (1) (2)
Visa
MasterCard
Bureau of Economic Analysis
Morgan Stanley
J.P. Morgan



The Trusted Advisor To The Payments Industry