



MIF Application to Commercial Cards: How Does it Impact Italian Firms?

Summary of Research Results

September 29, 2014

Agenda

The Commercial Cards Market in Italy

Future Challenges of MIF Regulation

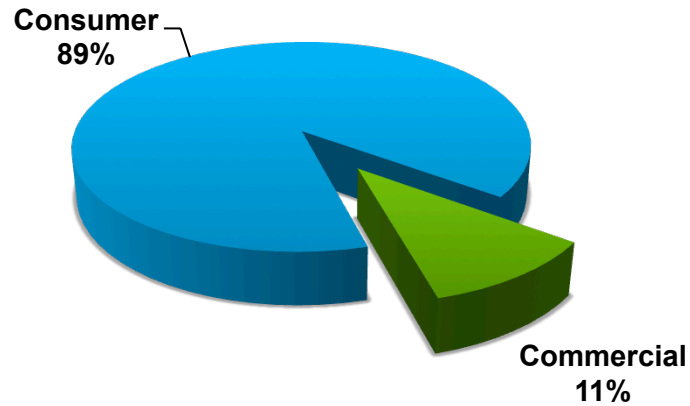
Research Background, Goals, and Applied Methodology

Summary of Main Results

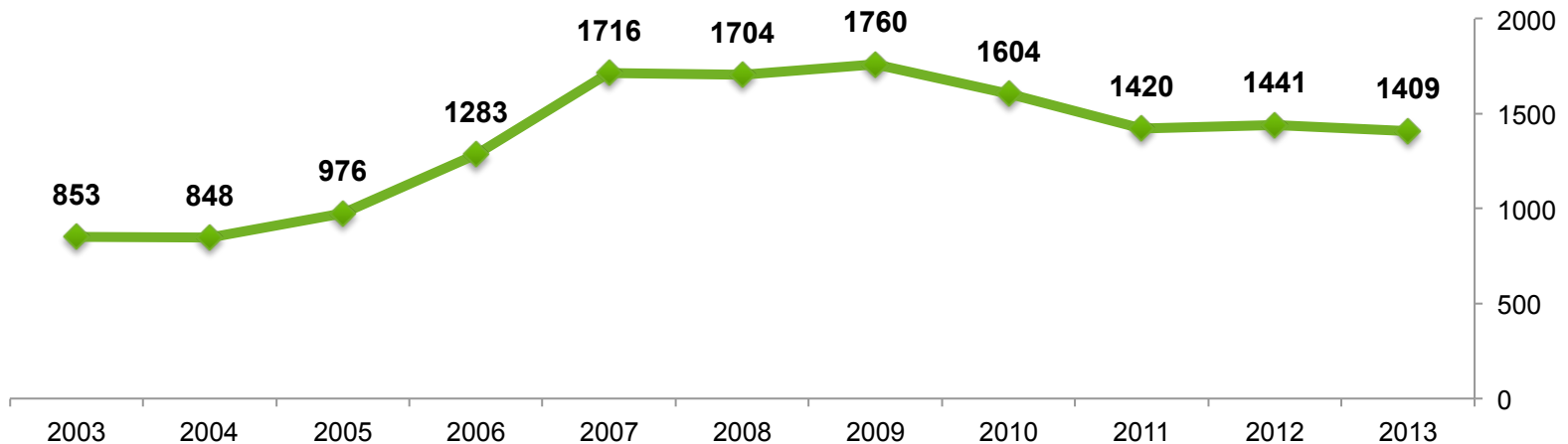
Further Implications of Policy

Commercial Cards Market in Italy – Cards in Use

**Card Types in Italy
(by total number of active cards - 2013)**



**Commercial Cards in Italy:
Number of Active Cards (thousands of units – 2003/2013)**



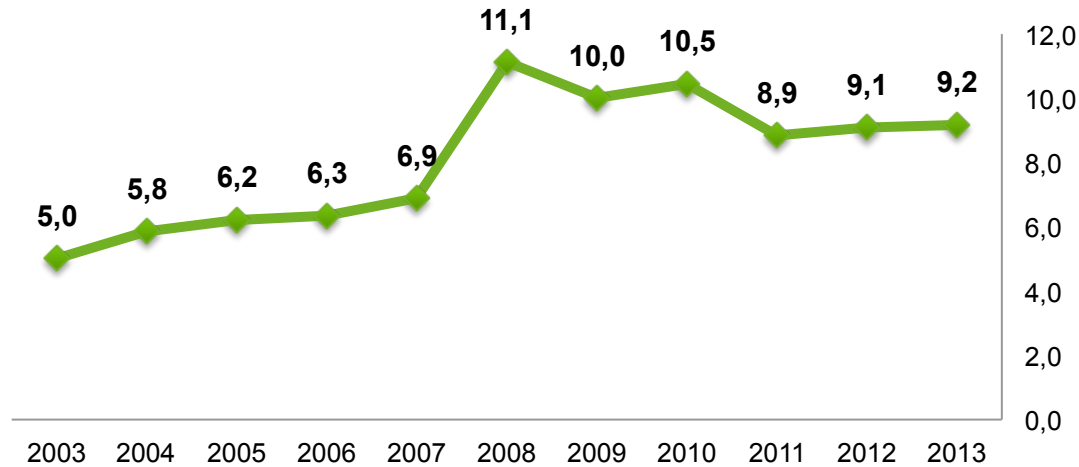
Source: Bank of Italy, 2014

Commercial Cards Market in Italy – Volume and Transactions

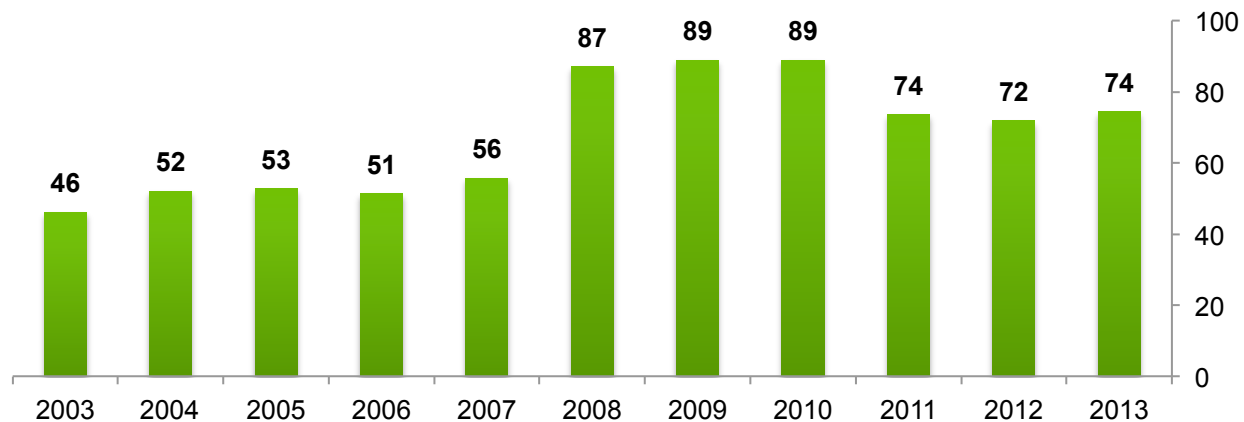
Percentage by Card Types in Italy
(by overall transaction volume - 2013)



Commercial Cards in Italy: Overall Volume
(€ bln – 2003/2013)



Number of Annual Transactions involving Commercial Cards in Italy (mln. transactions – 2003/2013)



Source: Bank of Italy, 2014

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Framing Features of Prospective MIF Regulation

In July 2013, the European Commission published a "Proposal for Regulation by the European Parliament and the Council of interchange fees for card-based payment transactions"
(MIF Regulation)

The main points of the Commission's Proposal concerning credit cards transactions are:

- A regulatory **MIF cap** identified by **0.3% of transaction volumes** originating in credit cards
- The **exemption of commercial credit cards** from the regulatory cap

However, relevant issues are still being considered currently

- The **MIF cap exemption is restricted only for cards whose balance is debited on firm's bank account**, even for SMEs
- The **negative impact on issuers' revenues in diversified manner** due to the regulatory cap
- Potential issuers' reactions, such as **pass-through strategies**, both in terms of **higher pricing and/or service rationing**
- The manner in which firms with less than 50 employees, and larger corporations might react in terms of a **lower demand of commercial cards or internalization of card management processes**, currently outsourced to issuers

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Research Background

On 7/25/2013 the Commission proposed to introduce a regulatory cap for MIFs. This cap has been identified at 0.3% of the transaction value for credit card payments.

According to the proposal of the European Commission, the average MIFs in Italy amounts to 0.7%. Therefore, the regulatory cap of 0.3% in Italy, will decrease by 57% the amount of fees collected from credit card payments.

This decrease in the amount of fees might be detrimental to the revenues collected by issuers. Subsequently, issuers might try to recover lost revenues by implementing one of the strategies below:

Strategy #1: Increase the commercial cards costs

Strategy #2: Decrease the availability of ancillary services offered with commercial cards

We queried commercial cards users with regard to an increase in the costs of cards, or a decrease in the availability of ancillary services offered with commercial cards.

IDENTIFY PRICE ELASTICITY OF DEMAND
AND ELASTICITY OF SUBSTITUTION
PERTINENT TO COMMERCIAL CARDS

EVALUATE ECONOMIC IMPACT
ON ITALIAN FIRMS FOLLOWING
A REGULATORY MIF LOWERING

- Estimate the reaction of firms by measuring **two kinds of demand elasticity**
 - **Price elasticity** based on sampling average costs of commercial cards
 - The strategy of **elasticity of substitution against service rationing** implemented by issuers within a lower MIF revenue context
- Estimate the **elasticity effects** (price and substitution) on **transaction volumes** of commercial cards
- Evaluate **the impact on operative costs and investments** following a service rationing operated by issuers

Research Methodology – The Economic Impact on Italian Firms

A survey of 23 questions has been distributed to CFOs/CEOs, Travel Managers, Commercial Cards Managers of **26 Italian firms** that use at least one commercial card for their business activities

To evaluate the effects of a regulatory MIF lowering **we have simulated an economy composed by issuers and firms (following Monte Carlo simulation with 500 iterations)**

Step 1

- We simulated 100 cards issuers. For every issuer, we randomly assigned one of the following two strategies:
 - Increasing the costs of cards
 - Cancelling ancillary services currently offered with commercial cards

Step 2

- We then simulated the behaviour of 1,000 firms. Every firm has been randomly assigned to an issuer, which follows one of the strategies described in step 1
- Every firm adapts its usage of commercial cards on the basis of its own elasticity as it results from the survey outcome

Step 3

- We iterated the simulation 500 times. For each iteration, we evaluated the impact on commercial cards volumes.
- Furthermore, on the basis of the survey results, we also calculated the effects of a potential internalization costs following an ancillary service rationing

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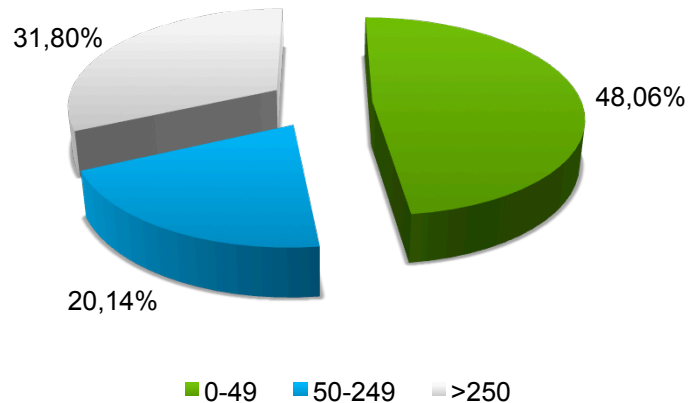
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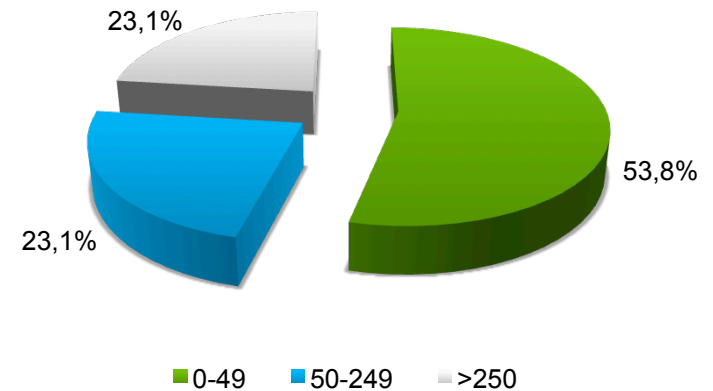
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Description of Sample – Firms Involved in our Research

Breakdown of Italian firms by Number of Employees (2013)



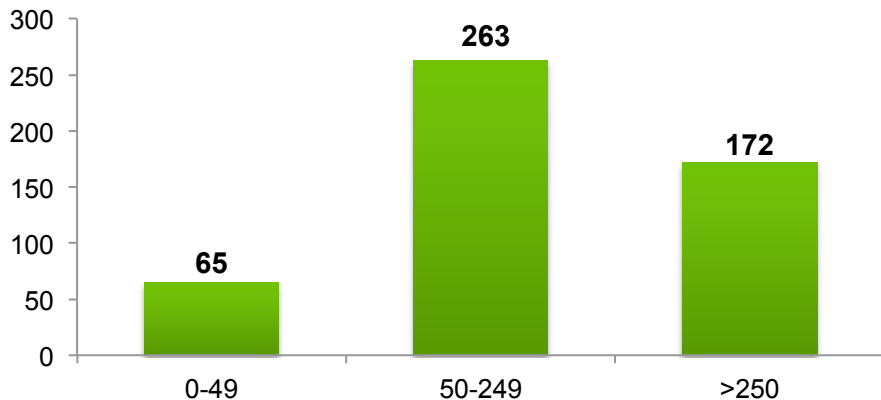
Firms Involved in our Survey by Number of Employees



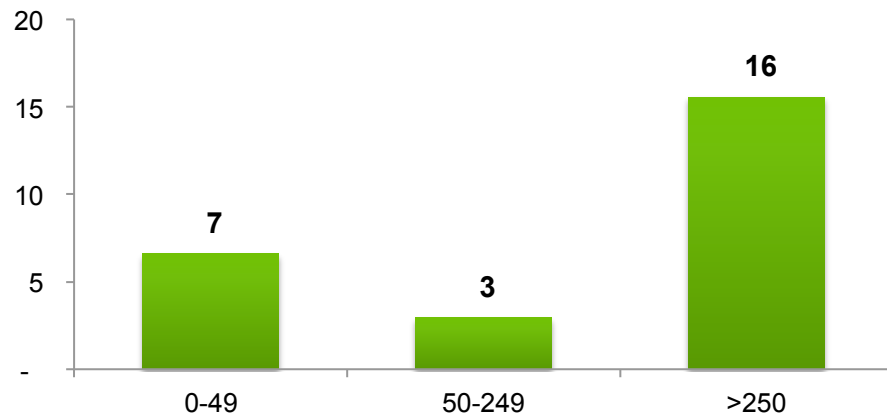
Our sample reflects rather accurately the breakdown of Italian firms in terms of number of employees

Description of Sample – Use of Commercial Cards

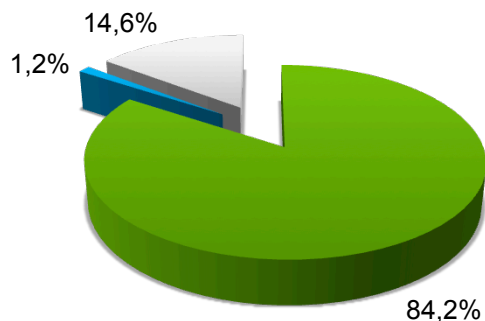
**Number of Cards Considered in the Survey
(by number of employee clusters)**



**Transaction Volumes of Cards Considered in the Survey
(by number of employee clusters)**

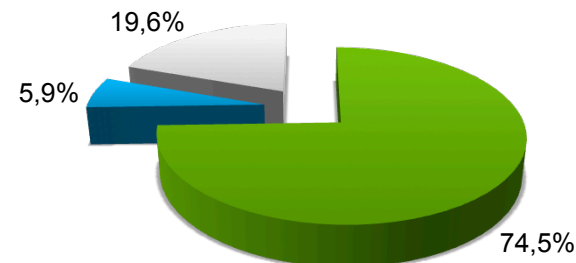


**Main use of Surveyed Cards
(by number of cards)**



■ Walking Cards ■ Recurring Bills ■ Travel and Entertainment

**Main Use of Surveyed Cards
(by transaction volume)**

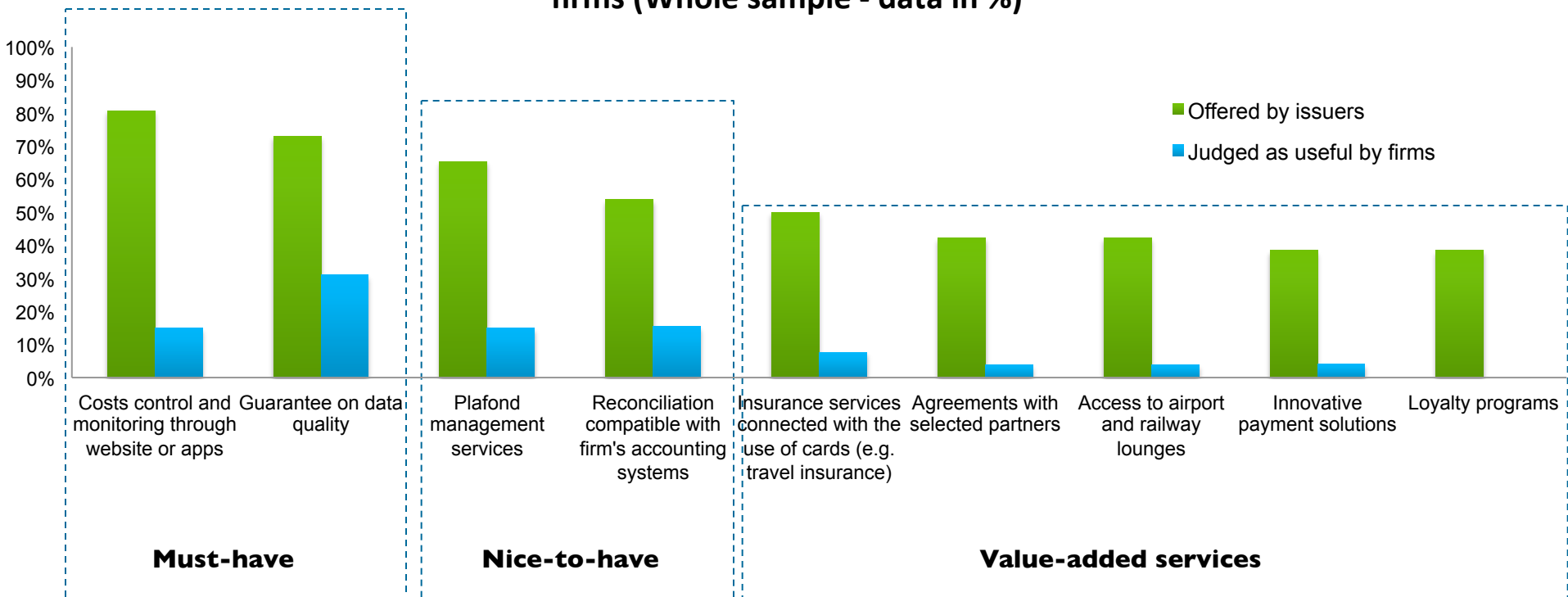


■ Walking Cards ■ Recurring Bills ■ Travel and Entertainment

Source: I-Com Survey

Needs Met by Commercial Cards – Needs Expressed and Services Offered

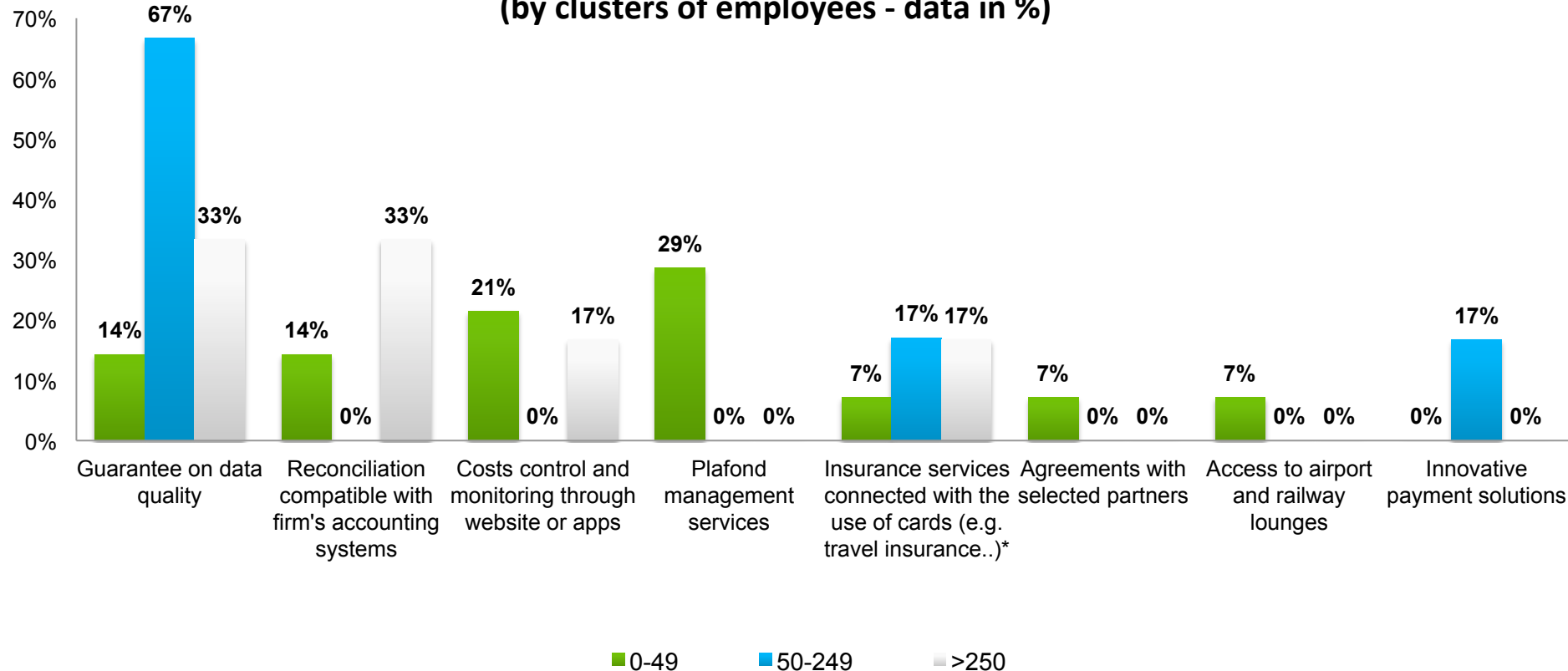
A comparison between ancillary services offered by issuers and utility declared by firms (Whole sample - data in %)



The ancillary services address specific needs of firms, differentiating market offers against consumer cards

Needs Met by Commercial Cards – Differences Emerged within Clusters

Which services are the most useful for firms?
(by clusters of employees - data in %)



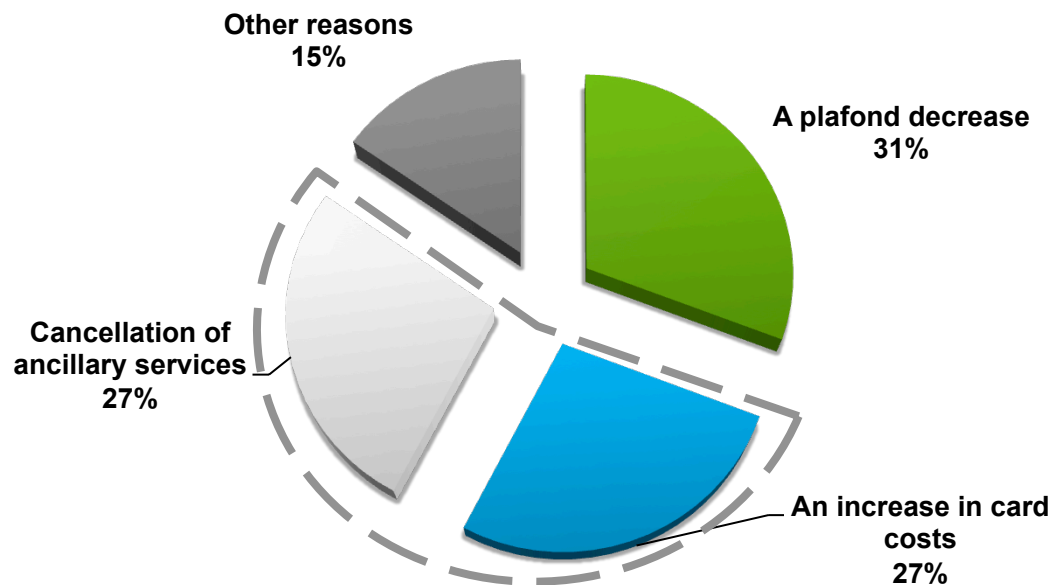
This evidence suggests a **substantial heterogeneity across ancillary services preferences within different clusters**

Source: I-Com Survey

* Includes services on fraud prevention (i.e. early warning etc.)

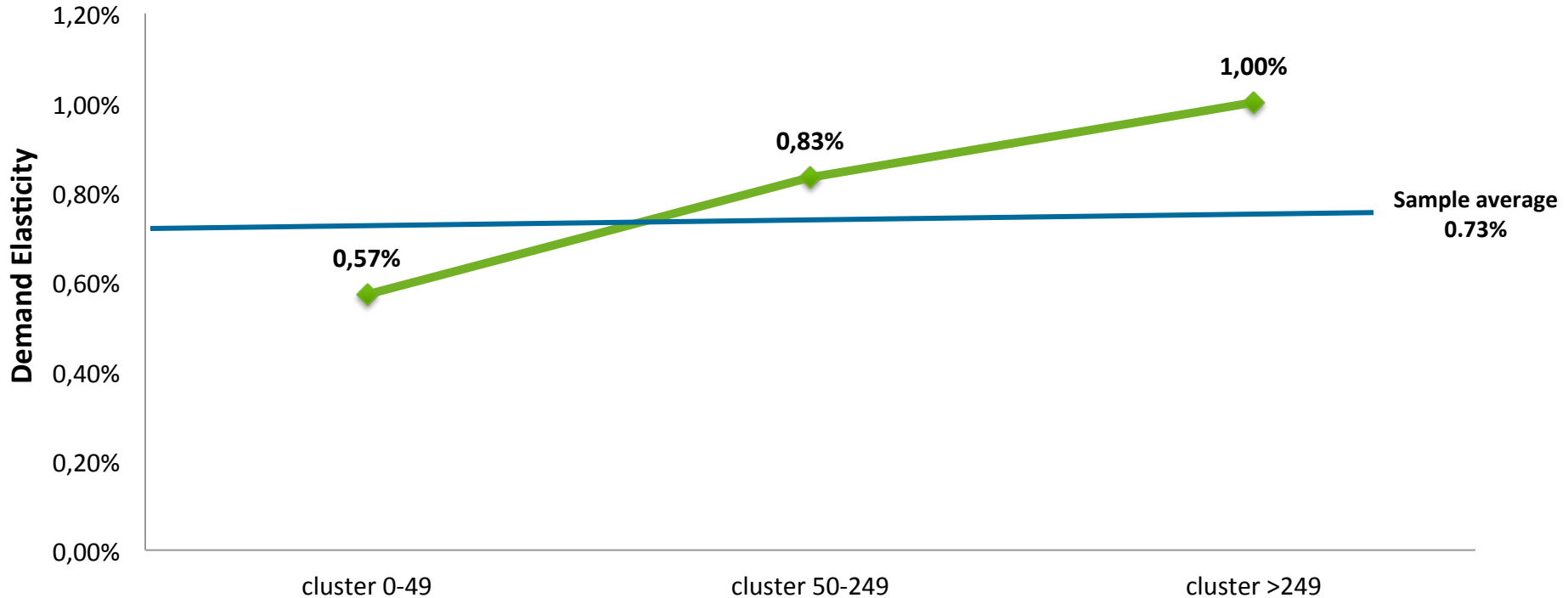
Determinants in the Use of Commercial Cards

Which one of the following events would decrease the amount of cards currently used by your firm?



More than 54% of firms would experience a decrease in the demand for cards in case of an increase in costs or a rationing of ancillary services

Firms' Reaction: the Decrease in Cards Demand in Response to an Increase of 1% in the Costs of Cards

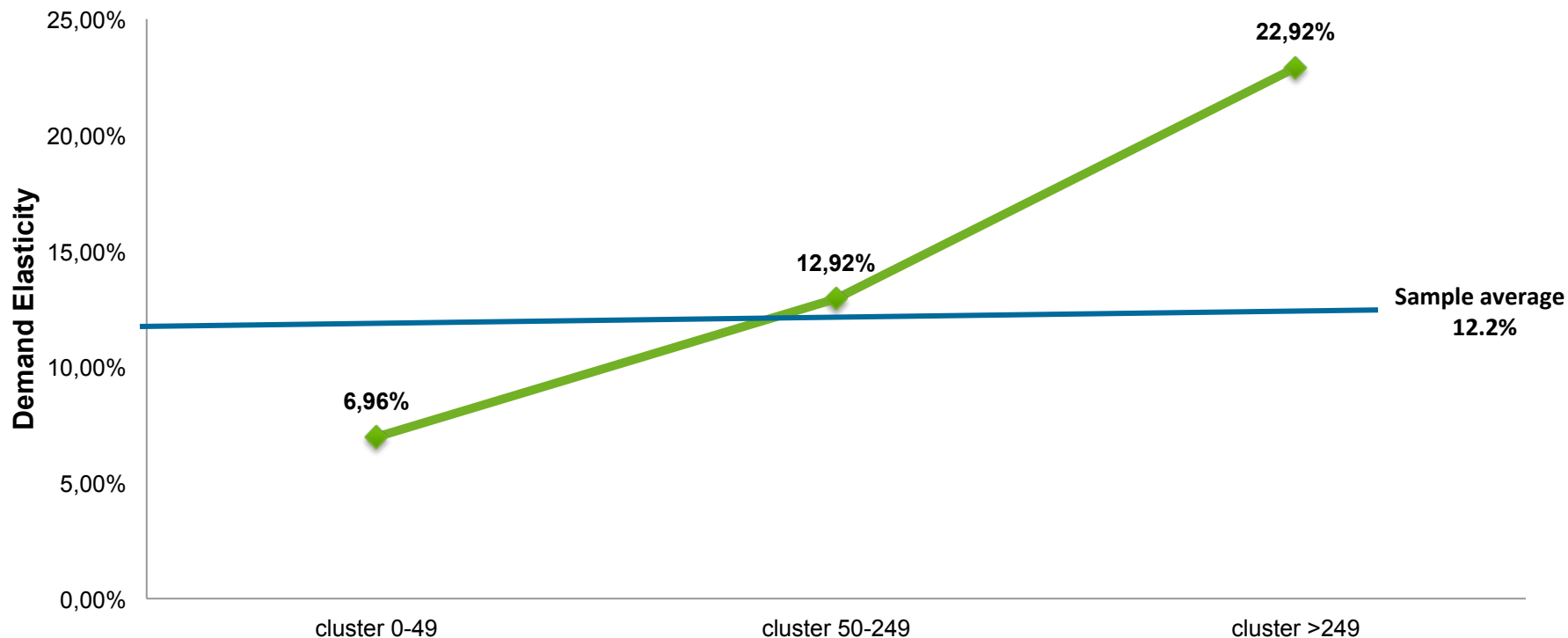


The results indicate that larger firms' demand for commercial cards is more elastic to price changes

It follows that, **on average**, a 1% increase in the costs of commercial cards would result in a decrease of **0.73%** of the number of cards used by the firm

Source: Elaboration on I-Com Survey

Firms' Reaction – The Decrease in Card Demand in Response to a Decrease in the Availability of Ancillary Services



The demand for commercial cards of larger firms is more elastic to the availability of ancillary services

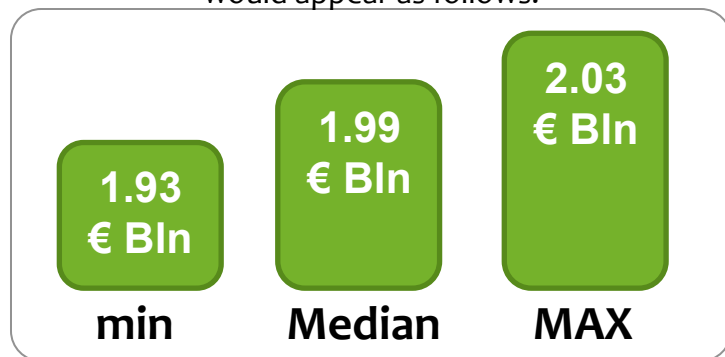
On average, if Issuers no longer offer additional services, the number of commercial cards would decrease by 12%

Source: Elaboration on I-Com Survey

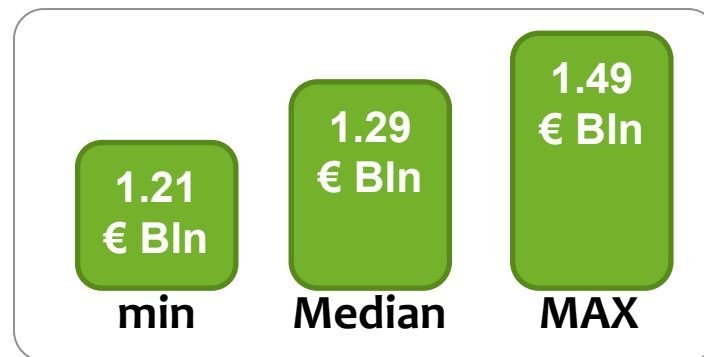
Simulation results – Demand Elasticity

This case scenario is based on the commission projections hypothesizing a decrease of 57% in the amount of fees. We have also assumed a pass-through of 50%.

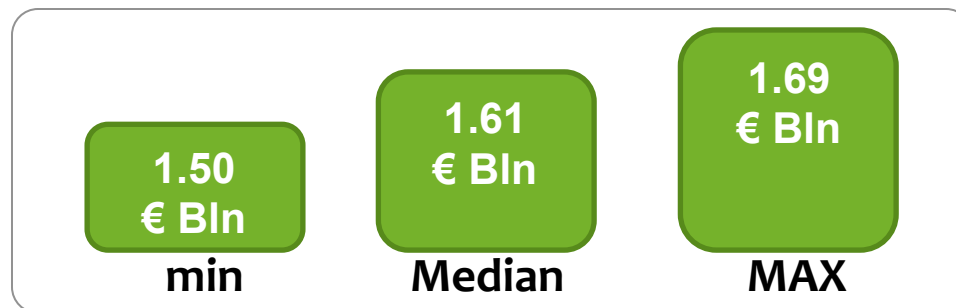
Our simulation indicates that, with a probability of 99%, the decrease in the volume of credit cards transaction would appear as follows:



Our simulation indicates that, with a probability of 99%, the decrease in the volume of credit cards transaction following a rationing of ancillary services would appear as follows:



When we assign randomly to each issuer one of the two strategies, **with a probability of 99%**, the decrease in transaction volume appears as follows:



If the decrease in the amount of fees is passed on to credit card users, the decrease in the volume of credit cards payments might be significant.

What will the internalization costs for firms with less than 50 employees be?

The rigidity in the usage of commercial cards might require firms with less than 50 employees to internalize monitoring and data management if Issuers do not supply these services after the introduction of the MIFs changes

The internalization costs might arise following investments in fixed capital and additional working hours

In our estimation, with a probability of 99%, the **Internalization costs for firms with less than 50 employees** emerges as follows:



699
€ Mln
min

805
€ Mln
Median

913
€ Mln
MAX

The regulatory cap to IF might generate severe costs for firms with less than 50 employees

Source: Elaboration on I-Com Survey

Note: The costs for firms with less than 50 employees have been calculated considering only card users. We estimate the number of card users starting from the number of cards owned by firms in the cluster 0-49 in Italy. We then acknowledged only the share of active cards (Source: Bank of Italy) and considered that, conditioned upon the usage of cards, the firm in the cluster 0-49, on average, possess more than one card. (Source: I-Com Survey)

Why larger firms are more sensible to the rationing of services?

The organizational complexity of enterprises with more than 50 employees might require the internalization of monitoring and data management of card transactions

The internalization costs may arise from investments in fixed capital and from additional working hours

In our estimation, with a probability of 99%, the **internalization costs for Italian companies** with more than 50 employees emerges as follows:



204
€ Mln

min

236
€ Mln

Median

266
€ Mln

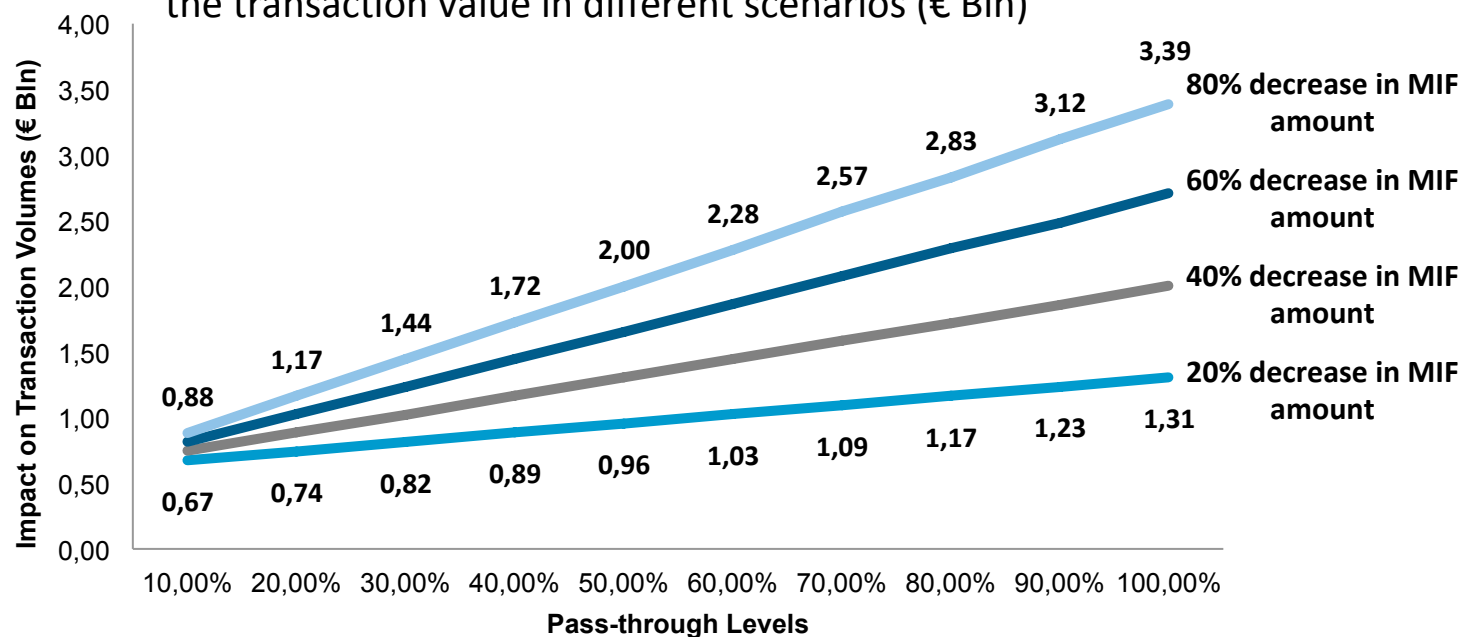
MAX

The regulatory cap to IF might generate a negative impact even on companies with more than 50 employees

Source: Elaboration on I-Com Survey

Simulation Results – Scenario Outcomes

In our case scenario, we considered a decrease in revenues from MIF of 57% and a pass-through of 50%. As a robustness we repeat the analysis for different pass-through levels and different levels of the decrease in revenues. The picture below reports the a decrease in the transaction value in different scenarios (€ Bln)



The chart above depicts our results for different decrease values in the MIF amount (20, 40, 60 or 80%) and for various level of pass-through (10-100%)

In all scenarios simulated, the decrease in the transaction volume following a lower MIFs on active commercial cards exceeded 500 € Mln

Simulation Results – Summary of Economic Impact in Terms of Additional Costs and Investment for Italian Firms

Cluster	Number of Firms in the Italian Economy (units)	Internalization costs in the first year following introduction of the regulatory MIF cap	Long-term Internalization costs beyond the initial first year
Firms with 0-49 employees	4.282.023	€ 805.464.468	€ 172.082.425
Firms with more than 50 employees	24.955	€ 235.819.607	€ 117.816.151
OVERALL TOTAL	4.306.978	€ 1.041.284.075	€ 289.898.576

During the first year, the introduction of the MIF cap in the commercial cards market might prescribe an average internalization costs for every Italian firm amounting to €188 for firms with 0-49 employees, and €9.450 for larger corporations.

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Implications of Policy

- **Commercial cards usually address different needs** compared to exigencies typically considered in regards to consumer cards
- If the MIF cap is applied across the entire commercial cards market, it could **impact issuers' revenues negatively for €42 Mln per year** (Commission estimates)
- The effect of internalization in terms of **higher costs and investments** for Italian firms in the first year following introduction of the MIF cap, **could exceed the amount of €1BLN**
 - **Firms with less than 50 employees** will incur additional costs and investments of **€805 Mln during the first year**
 - **Larger corporations** will experience a negative impact on their business of **€236 Mln during the first year**
- Furthermore, **approximately €290 mln in additional costs per year** will recur over time
- The possible review of commercial cards definition could have a **severe impact on enterprise costs and a negative effect on the entire economy**



Piazza dei Santi Apostoli, 66
00187 Roma
tel. +39 06 4740746
fax +39 06 4746549
info@i-com.it
www.i-com.it