



Surcharging, Unit Economics and Competition Analysis

Prepared for Block inc.

DECEMBER 2024



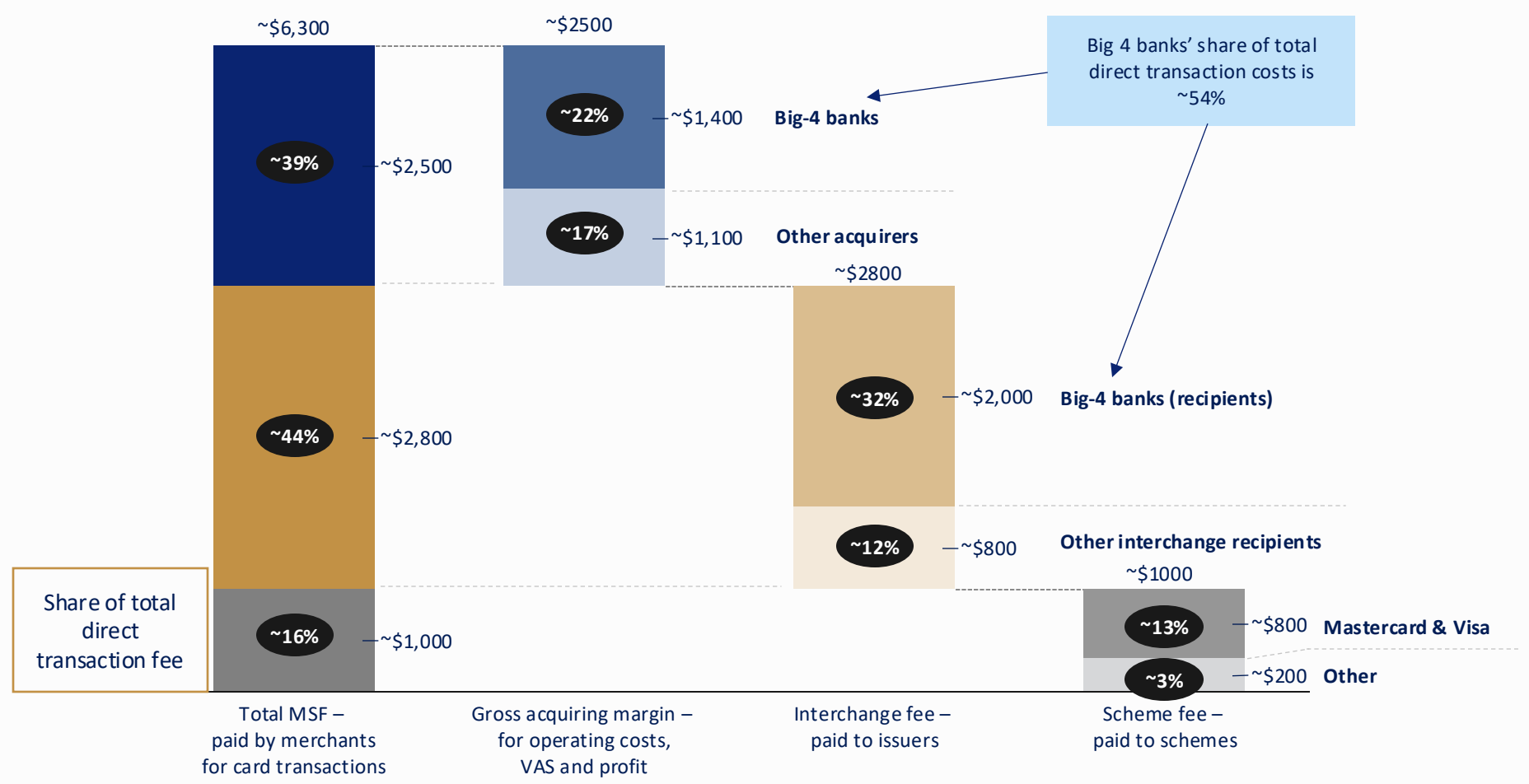
Glossary – definitions of terms used throughout this document

Term	Definition in context of this document
Blended pricing	A pricing structure for payment processing services where certain transaction types are combined into a single price. For example, one price applies to all Visa and Mastercard transactions (including debit and credit), while a different rate applies to eftpos transactions.
Unblended pricing	Pricing structure for payment processing services where merchants pay different % rates for each transaction based on which payment method was used (synonymous with differentiated pricing).
Fixed pricing	Pricing structure for payment processing services where merchants pay a flat % per transaction across all networks, transactions, and card types.
Simple pricing	Synonymous with fixed pricing.
Differentiated pricing	Synonymous with differentiated pricing.
PSP	Payment Service Provider who provides any payments processing services to any customer type (merchant or Payfac).
Fintech PSP	New Fintech entrants to the payment facilitator market, generally used to describe non-bank providers of payments processing services, synonymous with Payfacs, often not an acquirer themselves.
Large Acquirer	Acquirer that primarily serves large merchants and Fintech PSPs with acquiring services.
Issuer-Acquirer	Acquirer that also is a significant card issuer – primarily referring to the big 4 Australian banks.
Payfac	Payments Facilitator, synonymous with Fintech PSP.
LCR	Refers to least-cost routing, a functionality that routes payments through the least expensive payments rail.

Large issuer-acquirers, which dominate the acquiring and interchange market capture ~54% of total direct transaction costs

Breakdown of direct transaction costs by fee type and market participant

\$M, 2024, three- and four-party transactions



Key Findings:

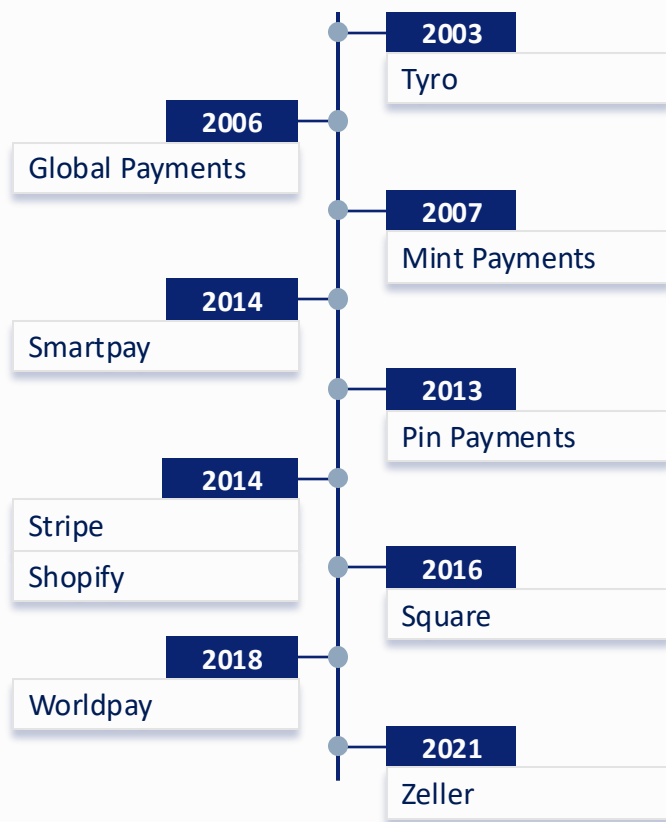
- Large issuer-acquirers capture an overwhelming share of the total direct transaction costs, accounting for 54% of the ~\$6.3 billion paid in direct transaction costs annually.
- All other acquirers in the market capture just 17% of the total direct transaction costs, approximately ~\$1.1 billion.
- The schemes fee segment is dominated by Visa and Mastercard, which capture ~81% of the market.

Source: Expert interviews; RBA (2024), The Initiatives Group; Mandala analysis

Fintech PSPs have increased competition and driven down acquiring fees

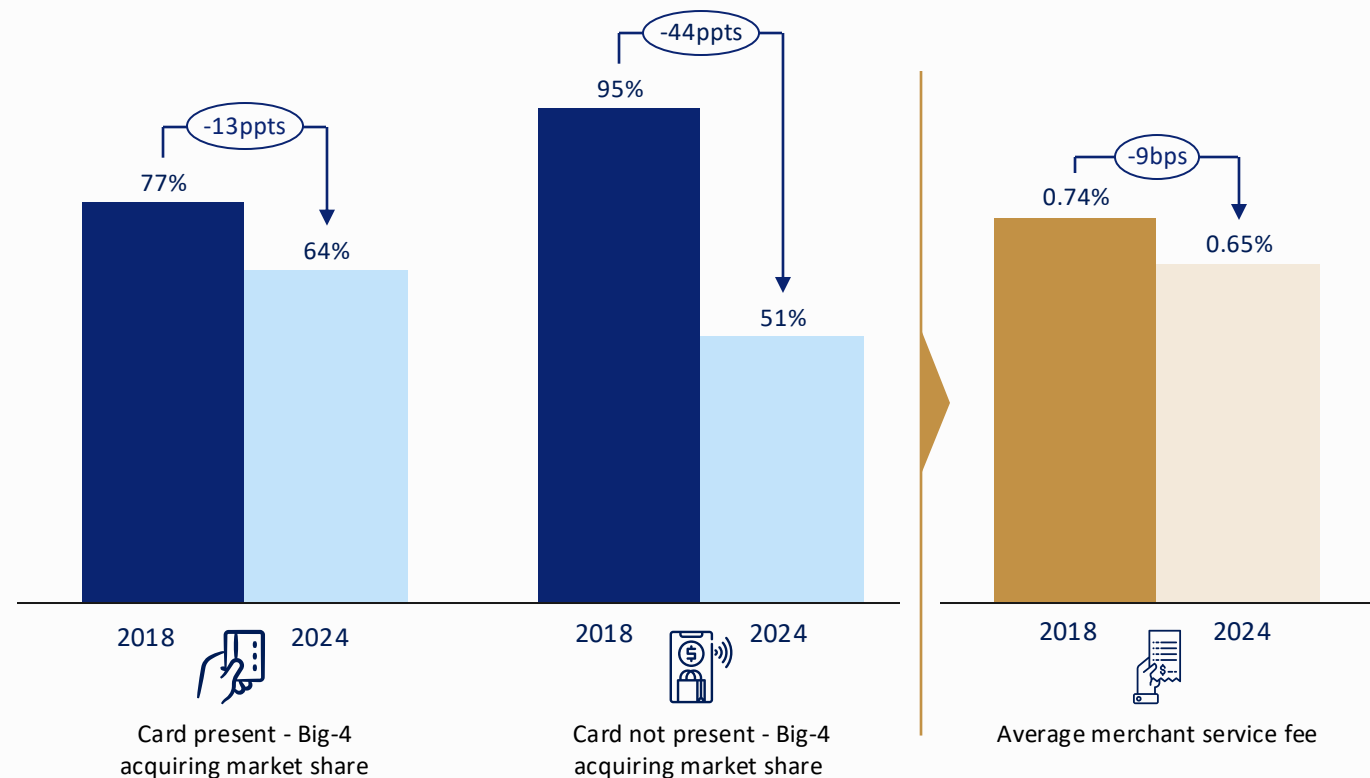
New entrants to the acquiring and PSP market

Timeline of market entry of acquirers and fintech PSPs, Australia, 2003-2023



As market concentration in PSP/acquiring has declined, so too have average merchant service fees

Market share of major banks in the acquiring market compared with average merchant service fees, 2018-2024

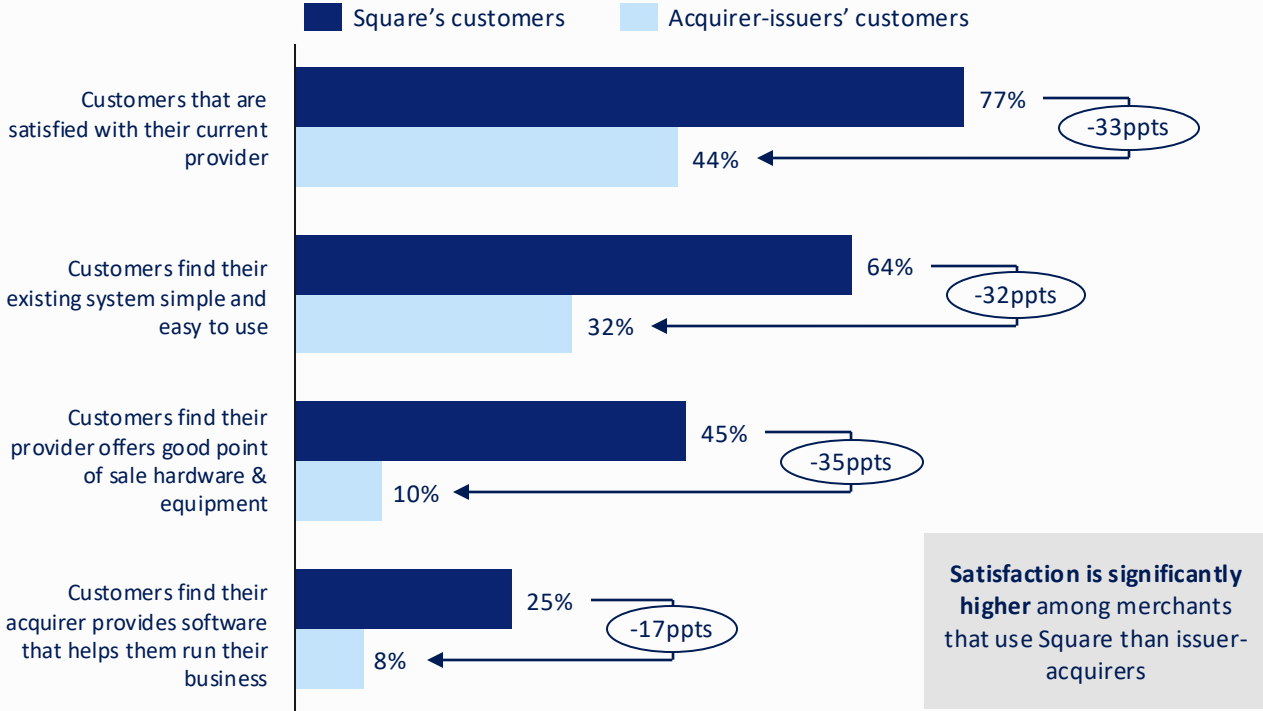


Source: Desktop research; The Initiatives Group (2024); RBA Payments data; Mandala analysis

Merchants are overwhelmingly satisfied with Square. The services Square provides are highly valued and utilised

Square's offerings are more likely to retain merchants

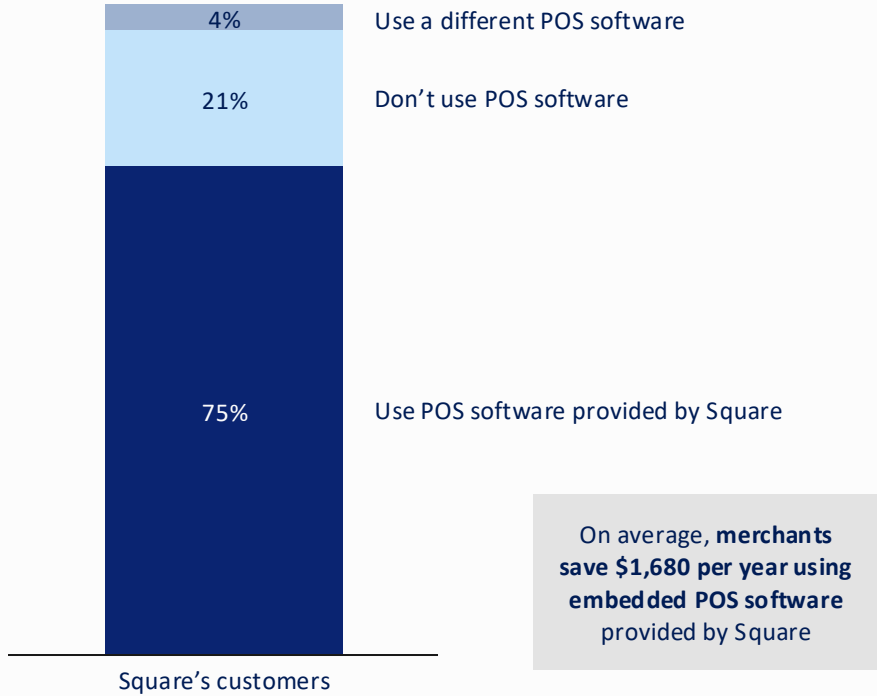
Why have you not bothered to look at other card acceptance providers?



Square customers report high satisfaction and place significantly greater value on key offerings such as simplicity, hardware, and software compared to customers of issuer-acquirers.

Square's merchants overwhelmingly use the embedded POS software

What point of sale software does your business use?



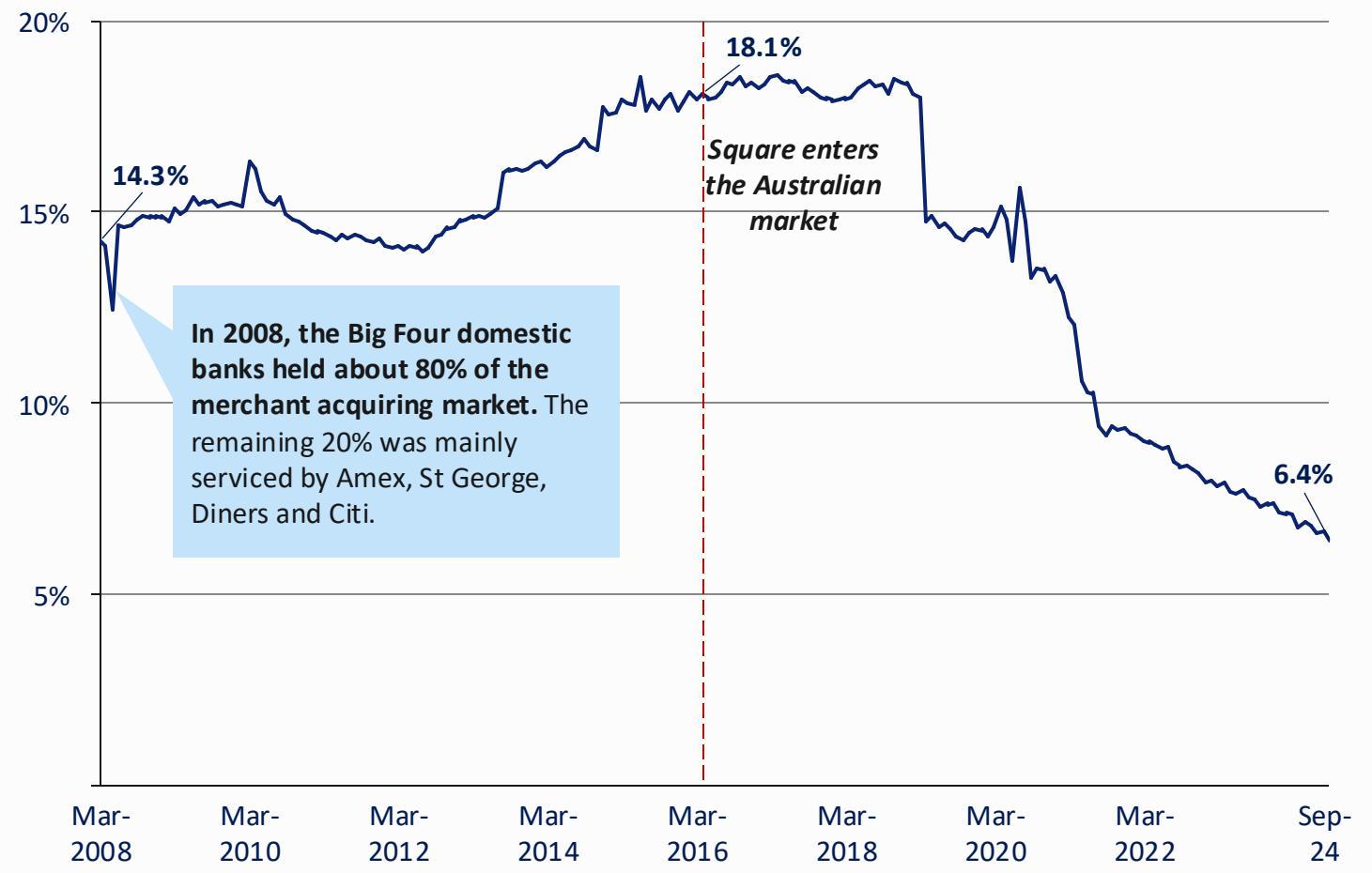
Square's customers overwhelmingly use embedded software, further indicating a high level of satisfaction with their service. This saves the average merchant \$1,680 a year.

Square has had an outsized impact on competition in the merchant acquiring sector

- The merchant acquiring market is dominated by large issuer-acquirers, but their dominance has fallen over the last decade.
- New acquirers, such as Square have injected competition into the market.
- This competition has brought not only more choice for merchants but has also invigorated innovation and improved service offerings.

Transactions where the debit card was issued and acquired by the same institution

% of total debit transactions acquired in Australia by value, March 2008 – Sept 2024



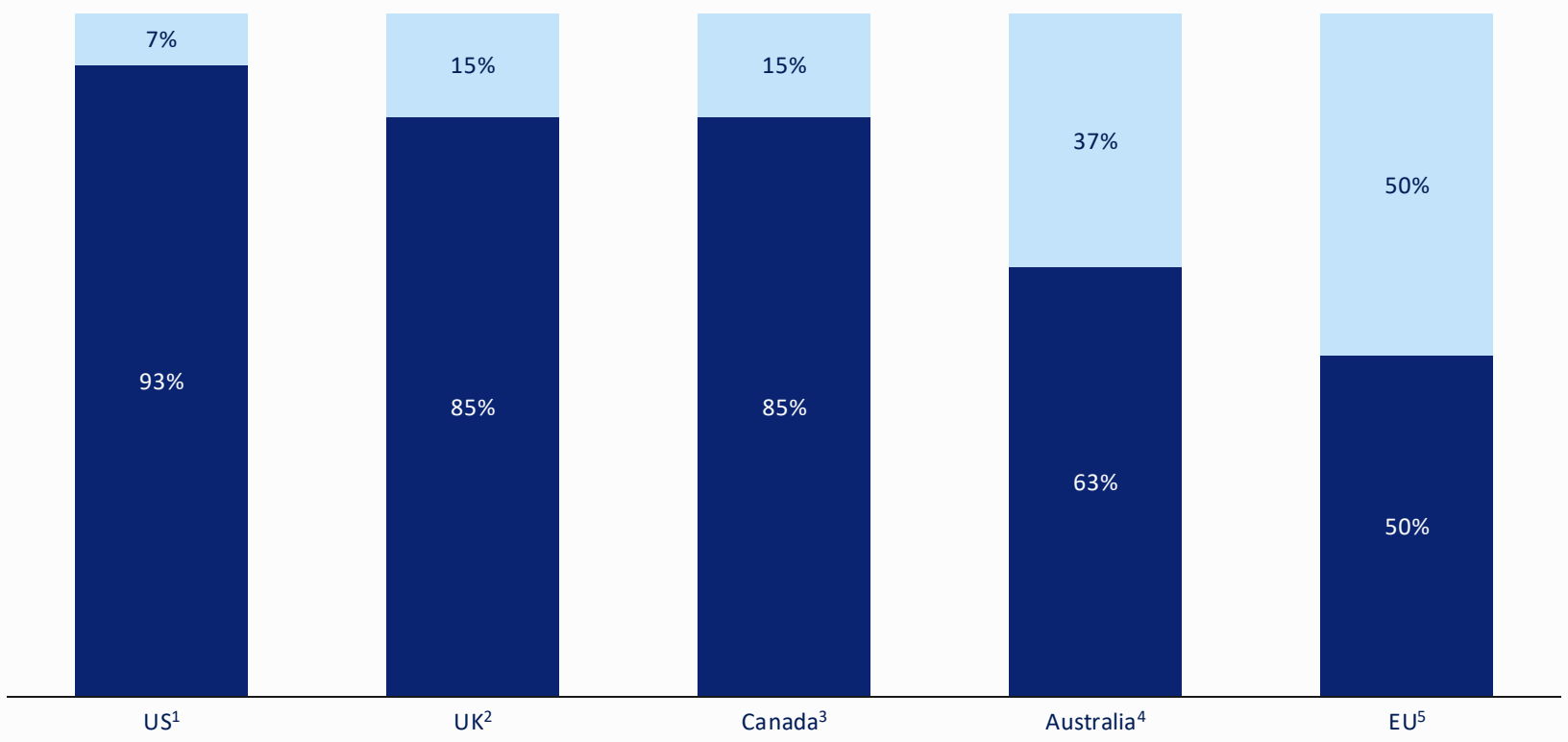
Source: RBA (2024), RBA (2022); Mandala analysis.

Australia’s merchant acquiring market is competitive compared to peer economies

Market concentration in the merchant acquiring sector

Market share captured by largest four* merchant acquirers, Australia and select peer economies, latest data

Rest of market Largest four* merchant acquirers



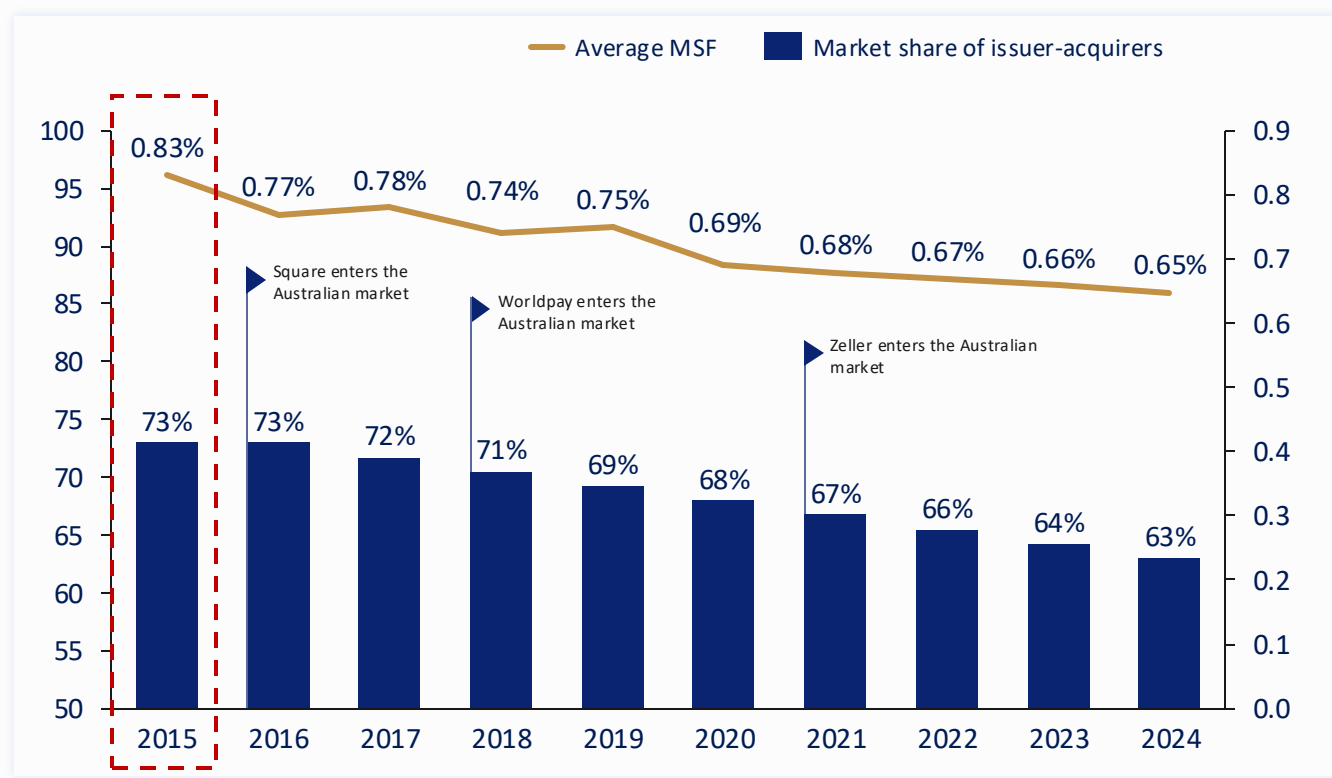
Key findings:

- Australia has a relatively low market concentration in the merchant acquiring sector, relative to peer economies.
- The four largest players in the merchant acquiring sector, which are all banks, account for just 63% of total transactions.

Notes and sources: * Data for Canada represents only largest two merchant acquirers. 1) Market share of four largest merchant acquirers by transaction value, [2023](#); 2) Market share of two largest merchant acquirers by transaction volume, [2024](#); 3) Market share of four largest merchant acquirers by transaction volume, [2020](#); 4) Market share of four largest merchant acquirers by transaction volume, [2024](#); 5) Market share of four largest merchant acquirers by transaction value, [2022](#); Mandala analysis.

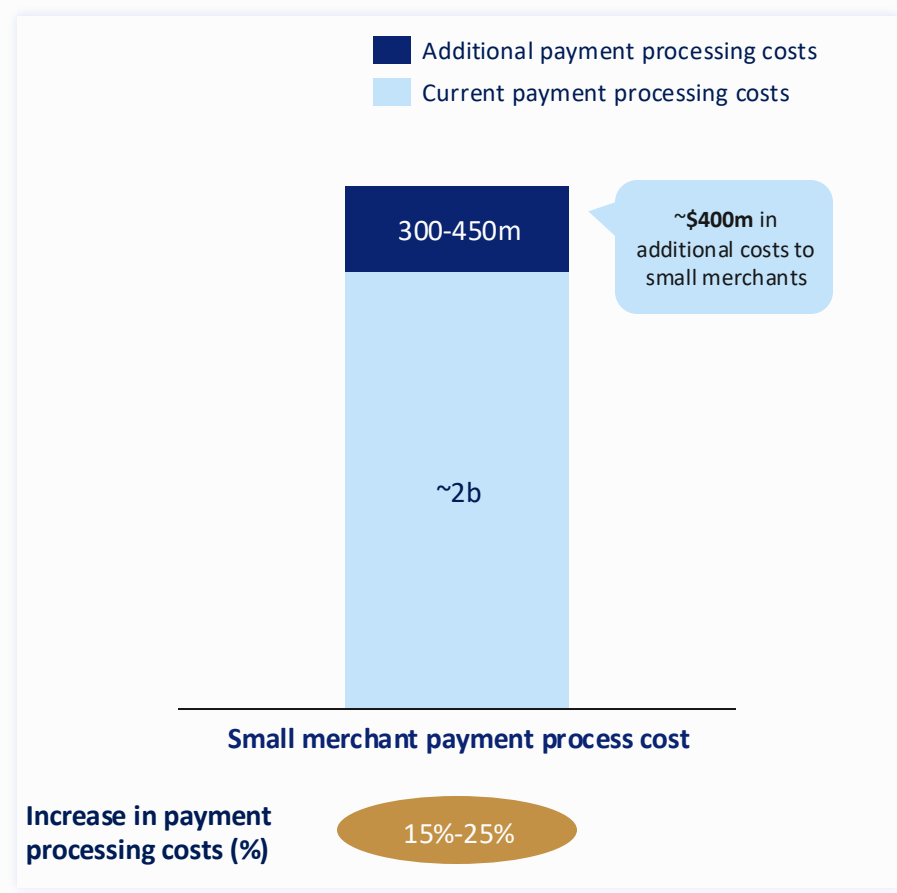
Small business payment fees would be ~\$400M higher if average fees were at historic highs when competition was lacking in the market

Changing market conditions as newer Fintech PSPs enter market



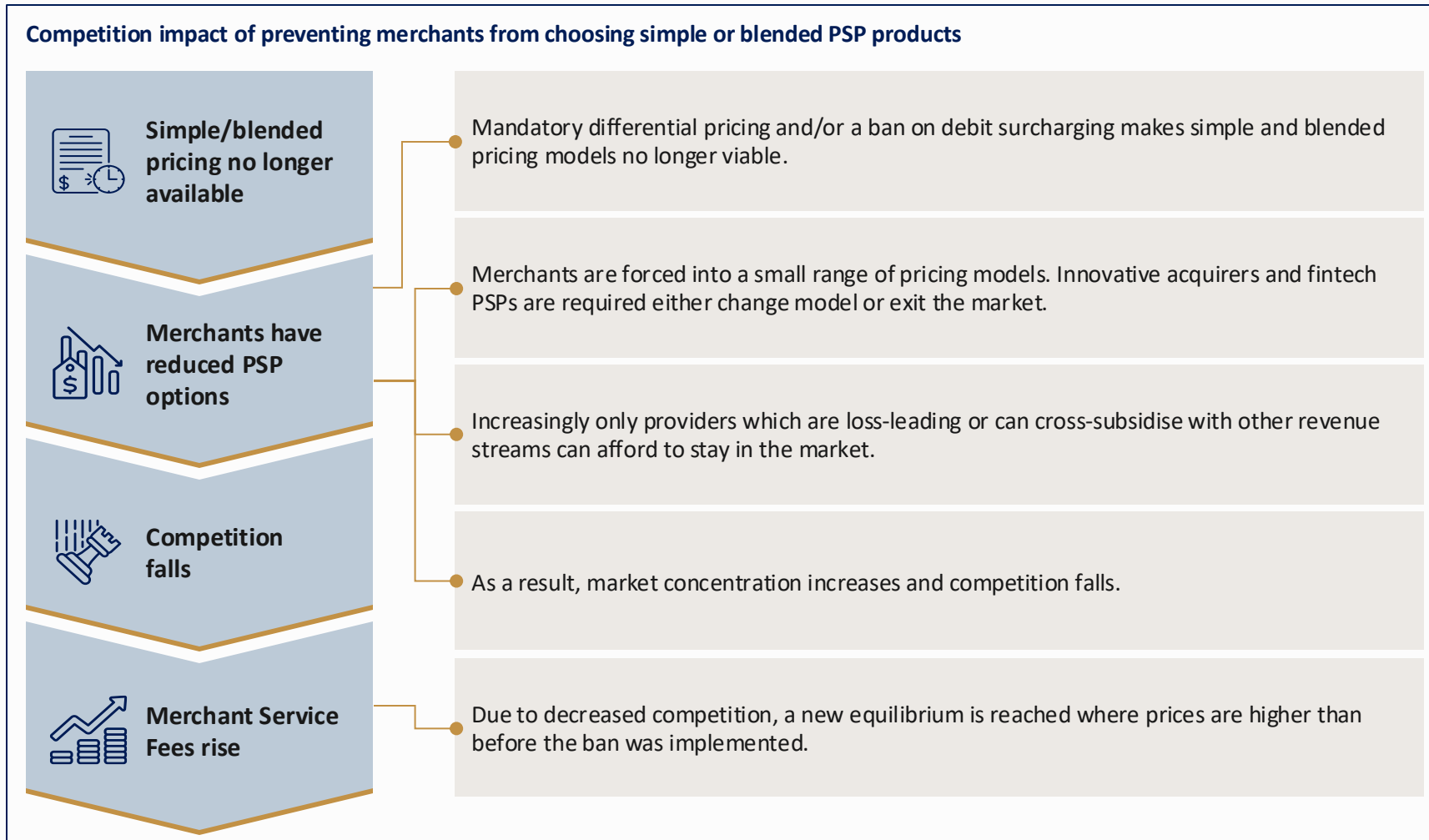
Should Fintech PSPs exit the market, and issuer-acquirer share returns to 2015 levels, it is possible that average MSF may return to 2015 levels (15-20bps higher).

Small merchant cost impact under 2015 market conditions¹



Notes: 1) Small merchants represent those <1m, payment processing costs calculated as total value of transactions for businesses under 1m multiplied by the average txn cost. Source: RBA (2017); Cuscal (2024); Mandala analysis

Banning simple or blended pricing leads to less competition and higher costs

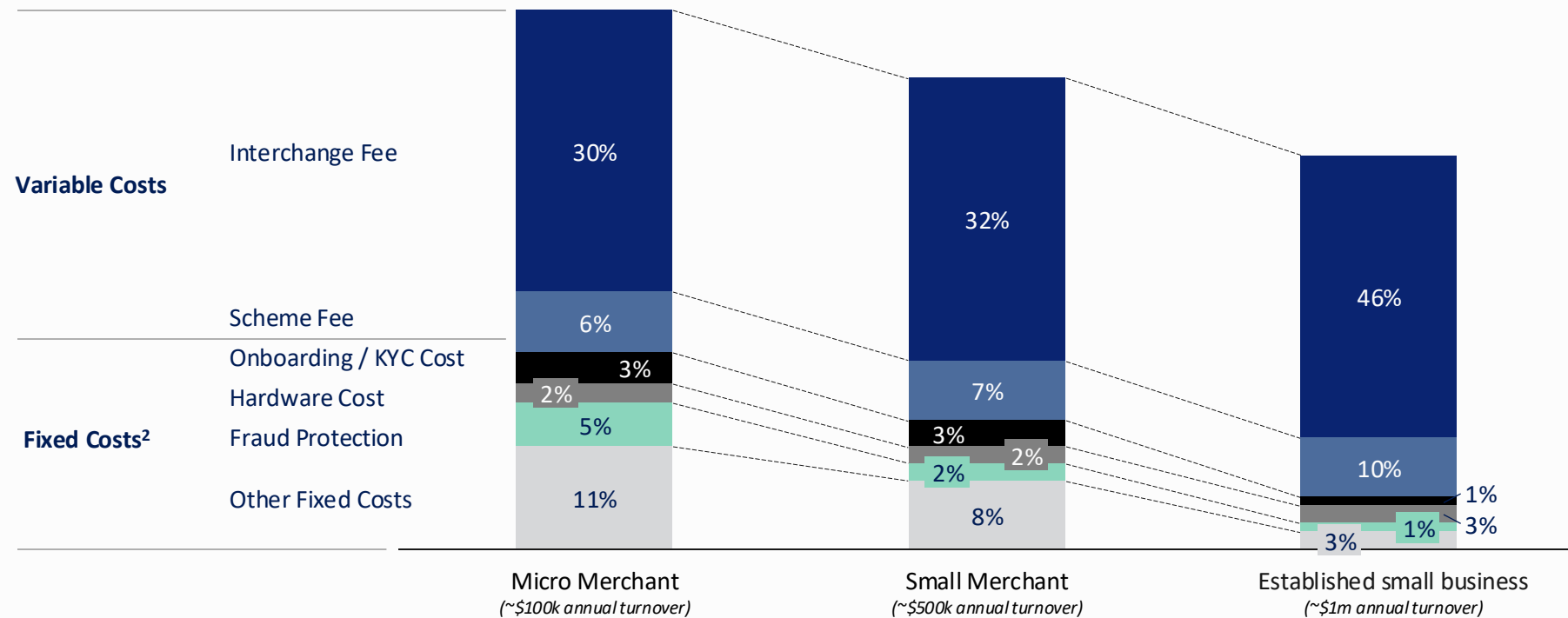


Payment Service Provider service incur both fixed and variable costs.

Indicative numbers

Indicative cost to serve merchants of differing sizes

Relative direct transaction costs¹, \$, 2024



Key findings

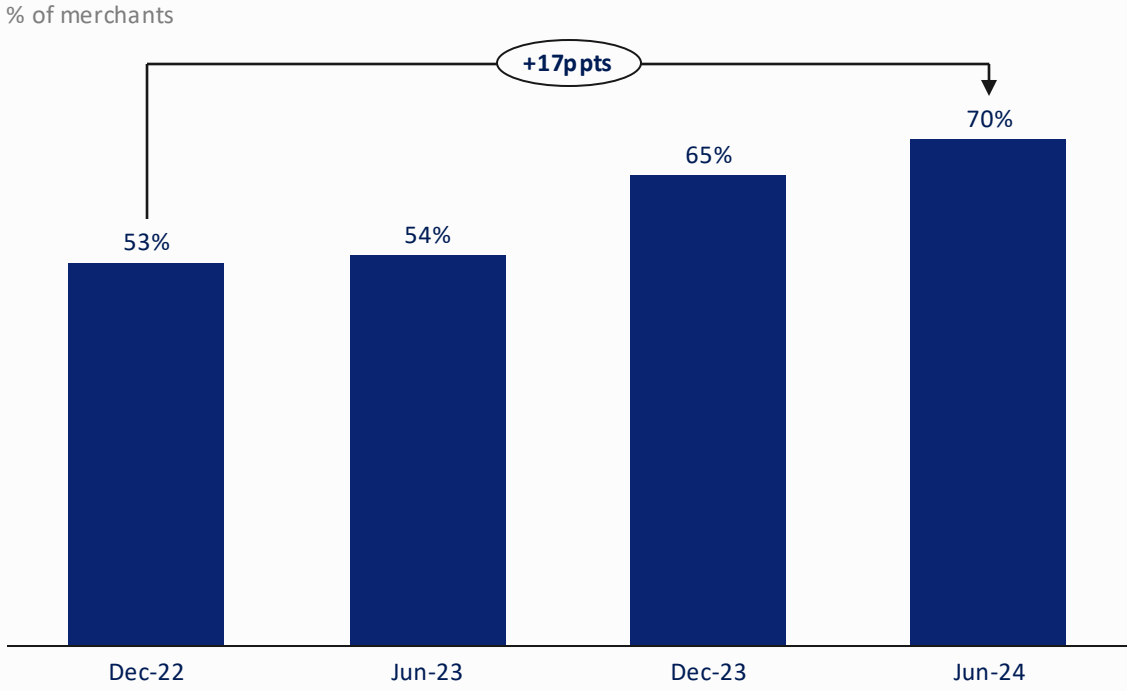
- Fixed costs represent approximately **35%** of direct transaction costs for micro merchants, compared to approximately **25%** for small merchants and **15%** for large merchants.
- These fixed costs reflect the higher cost to serve smaller merchants, including **essential components required to maintain a stable and secure payment system** (e.g. risk and fraud protection, necessary customer service).

Notes: 1) Assumes \$100 transaction, does not factor additional fees a PSP would incur including switching fees and operational costs associated with provision of broader services 2) Other Fixed Costs include other direct transaction costs including marketing, customer support related costs.

Source: Expert interviews, RBA

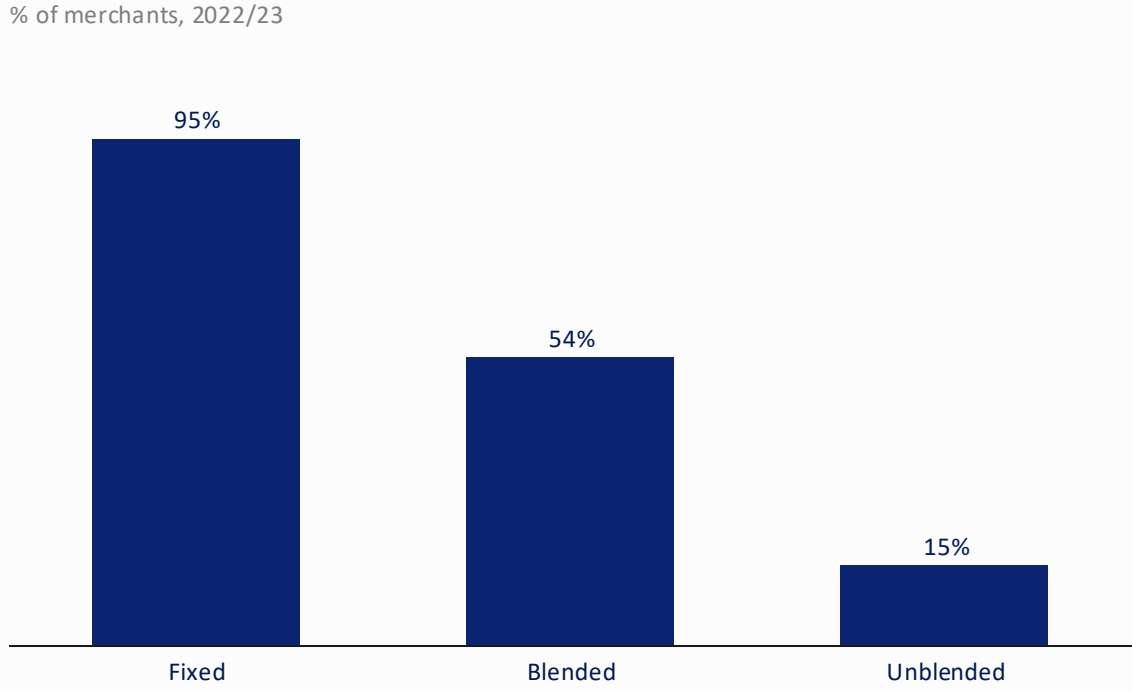
70% of merchants have LCR enabled for in-store debit card transactions, with the highest adoption rates among those on fixed plans

Enablement of LCR for card-present debit card transactions



- In 2021, in response to slow industry progress, the RBA established a clear expectation for PSPs to offer and promote LCR.
- While LCR has been made available to over 90% of merchants since Dec-22, actual enablement remains at 70%, up from 53% in Dec-22.

LCR enablement rate by pricing plans



- Merchants on fixed plans have the highest LCR enablement, driven by automatic enablement, reaching 95% in 2022/23 (latest data).
- RBA regression analysis on LCR benefits for merchants on fixed plans was limited in accuracy due to the small comparison group, consisting of only 5% of fixed-plan merchants who were not LCR-enabled.

Source: RBA (April 2024, June 2024); Mandala analysis

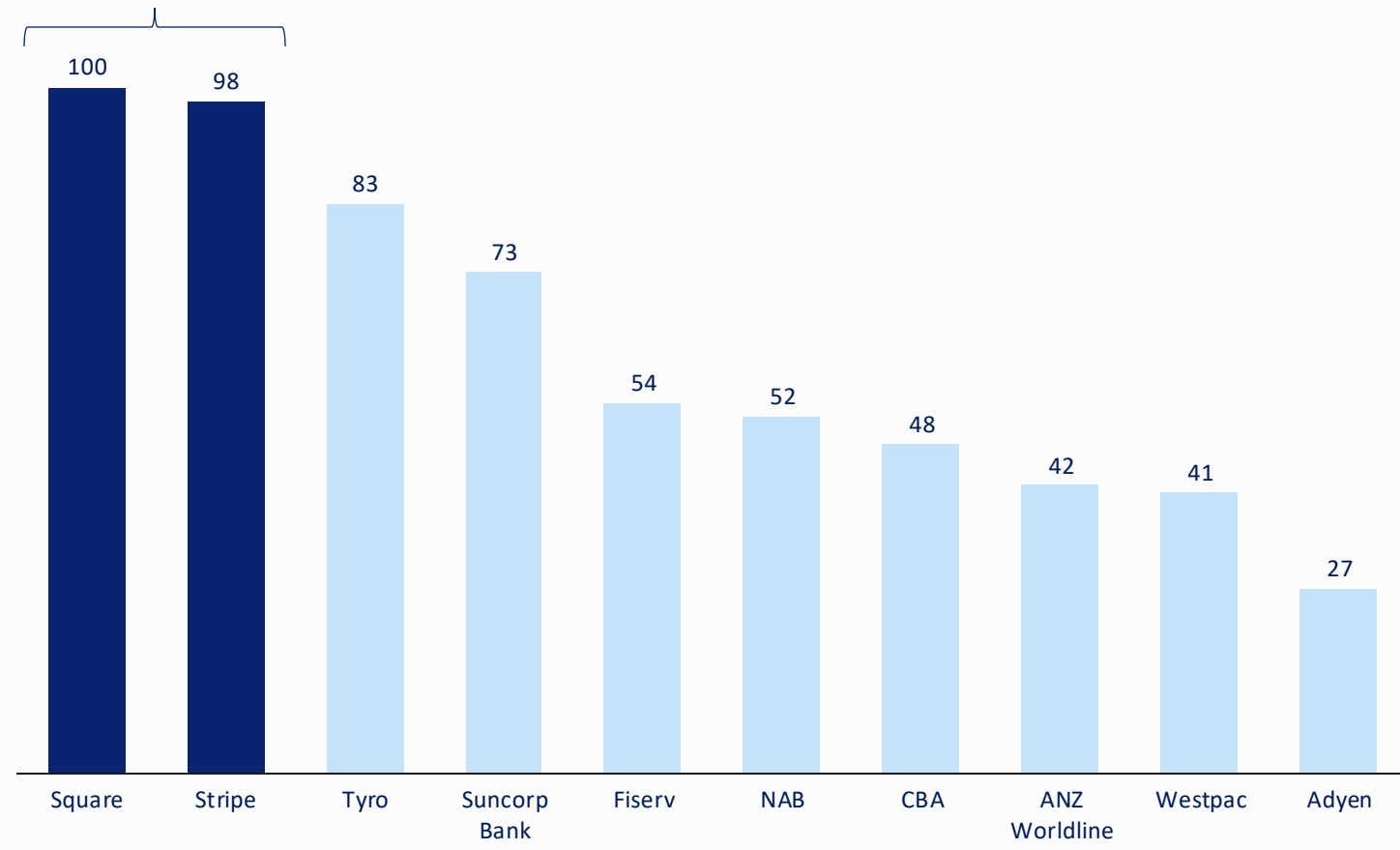
Acquirers with the highest LCR enablement have started reducing simple plan rates

- LCR allows payment service providers (PSPs) to route debit card transactions through the lowest cost rail (e.g., Mastercard/Visa or EFTPOS).
- The resulting lower wholesale costs for PSPs can be passed on to merchants on fixed plans, depending on the level of competition.
- Recent evidence highlights that PSPs with the highest LCR enablement are passing on these benefits to merchants by lowering fees:

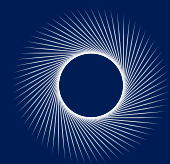
Enablement of LCR for card-present debit card transactions by acquirer

% of merchants, Jun-24

Recently reduced MSF



Source: RBA (June 2024); Mandala analysis



MANDALA