Comment: The rise of the payment service provider

Payment service providers are having a growing impact on the overall payments ecosystem, but why is this happening and what is their role? Payments consultant Mark McMurtrie has his say.

A payment service provider (PSP) plays a critical role in payment card processing today. They provide a range of services for retailers allowing consumers to pay securely for goods and services in-store, online, by phone or via their smartphone. These services are largely technical and operational in nature. The PSP has established itself as a specialist in the field of electronic transaction processing and it provides retailers with a valued outsourced or managed service.

Historically retailers used to connect and send their payment card transactions directly to an acquiring bank. However the norm now is to work with a PSP who acts as an intermediary. We will discuss some of the key reasons behind this change in a minute.

In most cases the acquirer negotiates the financial terms for accepting each card type and they provide retailers with a merchant services contract and funds settlement services. The acquirer also generally holds the financial transaction risk and provides the connectivity to the various international payment networks or brands such as Visa, MasterCard, American Express, Union Pay and JCB and ultimately to the card issuers. The PSP will accept the payment authorisation request and switch the payment transaction to the appropriate acquirer. Therefore retailers will need to hold contracts with both an acquirer and a PSP.

Why are PSPs becoming more important?

Thanks to the increased regulatory environment that now exists, it is no longer cost effective or sensible for the majority of retailers to operate their own payment switch or gateway in-house. PCI data security compliance is such a complex and costly task these days and this has been a big driver towards outsourcing payments processing to a PSP. You have to be an extremely large merchant to continue to run your own payment processing systems internally.

A decade ago acquirers failed to make the necessary investments to upgrade their payment processing platforms to cope with the introduction of IP communications and eCommerce transactions. Acquirers failed to see how significant the transaction volumes would be from these channels and emerging technologies. It is worth noting that all UK acquiring was at this time handled by the high street banks (something that is no longer the case). PSPs being smaller and more nimble organisations were able to support these emerging payment requirements faster. Since then PSPs have never looked back and now have established significant market share.

PSPs were also faster to recognise the need to switch a wider variety of electronic transaction types over and above traditional credit and debit card payments. Retailers were increasingly introducing value added transaction services and new card types and technologies. These include mobile phone top-up, gift cards, dynamic currency conversion, purchasing cards, payment of utility bills, licences and government payments. This is a further reason why PSPs have become such key stakeholders in the payments eco-system today.

Do PSPs only process eCommerce transactions?
Although eCommerce was the initial driver for retailers to contract with a PSP this is no longer all they offer. PSPs now provide transaction-processing services to address multiple sales channels and transaction types. Each PSP has a slightly different focus; this can be geographically, sector or channel in nature. The processing platform used by each PSP has to cater for the diverse functionality required by each of these. PSPs have a positive track record of expanding their capabilities both through acquisitions and by organic investment.

There are many alternative names for a PSP: some of these are Third Party Processor, Payment Gateway, Transaction Processor or Managed Services Provider.

So 'no', the term PSP is not restricted solely to eCommerce payments processing. It includes multiple channels and transactional service types.

Are there many PSPs to choose from?
Yes, a surprising number of PSPs are now operating in the UK. There are at least 40 that I would include within this category. This breaks down into two main groups: those who primarily address face-to-face transactions (F2F) from stores and physical business premises, and customer not present (CNP). Around 60% of PSPs focus on CNP. This is probably due to the reduced complexity involved in processing card payments from internet stores and via call centres. The potential for consolidation in the PSP sector exists over the coming years.

How about omnichannel PSPs?
In the same way that omnichannel is a key driver for most retailers, the same applies for PSPs. A single view of all customer payment activity is desired particularly as customers are now transacting across multiple channels. If a customer buys online, but then needs to initiate a refund in-store, then having a single payment service simplifies this process.

So eCommerce PSPs are now looking to add F2F payments capabilities. Whilst simultaneously, F2F PSPs are introducing CNP processing. There is a race on between the PSPs to be able to deliver true omnichannel payment processing capabilities. Each PSP is currently at a different stage towards being able to offer omnichannel processing. Retailers are encouraged to probe, as some PSPs have been known to exaggerate!

Having contracts with multiple PSPs is expensive for a retailer. It produces duplications, higher costs and more suppliers to manage. The customer experience is also not consistent. That is why so many retailers are reviewing their current PSP relationships.

New technologies like point-to-point encryption and tokenisation are also helping accelerate the move by retailers to shift to an omnichannel PSP.

International considerations?
Thanks to eCommerce most UK retailers are already selling internationally. As such they need to accept multiple currencies, payment types, languages and support the appropriate security technologies. Many are also either already present with stores in continental Europe or considering doing so. This has often resulted in multiple PSP and acquiring relationships. Significant cost savings can be achieved by consolidating all payment processing to a single pan-European omnichannel PSP. Retailers may wish to consider global and regional PSPs. UK-based PSPs are not the only option to choose from.

Are independent sales organisations and mobile payment companies PSPs?
Independent sales organisations (ISO) and mobile point of sale companies are increasingly active in the UK. There are at least ten of each category now present in the UK. They have some similarities at first glance to a PSP but are in reality completely different organisational types. This topic – as well as advice on how retailers can pick the right PSP – will be covered in detail in my next Essential Retail comment piece, so watch out for this upcoming article.

*Mark McMurtrie is an independent consultant focussed on consumer payments and technologies. He provides a range of advisory services for retailers through his company Payments Consultancy Ltd****www.payments-consultancy.com*** *He helps with strategy development, market assessment, technology reviews and supplier selection. Mark acts as the official payments consultant for RBTE.*