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Payments companies: Will mobile end the party?

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Having spent the better part of the last seven years working in the retail ecosystem, it is extremely interesting to consider the different business models of the various players.

In particular, there are two primary categories that create the most enterprise value or market capitalization: merchants and payments companies.

Processing types
The merchants are of two varieties: pure-play online merchants or multichannel retailers with a broad channel mix.

Most multichannel players do a majority of their business offline in their stores but find that online is growing faster than in-store. The payment businesses are categorized into several areas such as issuers, acquirers, processors and others.

What is fascinating is the huge difference in the respective mechanics of how each of these segments creates enterprise value. And, specifically, how mobility disrupts the payments business.

Is mobile technology the silver bullet that has finally arrived which will change the rules and be a catalyst for redistribution of value creation from the payments players to the merchant segment?

For merchants, we all know how complicated this business can be. You must have inventory and bear the associated financial and obsolescence risk. There are people – for example, a typical large retail chain with 1,000 stores could have as many as 50,000 store associates.

Many of these associates can be part-time and not terribly committed to the mission of the company. And, of course there are physical locations. Do you buy the buildings? How long a lease do you sign? Is this the right location? Who are your neighbors? Who opens in the morning, and close shop at night?

The list of operational and associated financial complexities for a retailer with bricks and mortar are endless.

A typical retailer has an enterprise value that roughly equates to one times the company's trailing twelve months of revenue.

Guns and prose
Take Cabela's as an example of a retailer with a solid trading multiple. Its last twelve months of revenue is approximately $3.4 billion and the market capitalization is $4.6 billion as of today, giving an enterprise value to revenue multiple of 1.35 times revenue. It also has $700 million of inventory and about 50 stores comprising more than 5 million square feet of retail space. It employs more than 15,000 extremely dedicated and "Cabela's passionate" people.

Cabela's is executing really well, and has a tremendously loyal customer base. In short, it is at the top of its game. It should also be noted that Cabela's owns a bank, called The World's Foremost Bank, which makes a positive contribution to its market capitalization.

There is also an example of a firm at the other end of the spectrum from a metrics perspective.

Barnes & Noble is a company that is having an especially difficult time due to the emergence of ecommerce. Its numbers are as follows: The last twelve months of revenue is approximately $6.7 billion and its market capitalization is $823 million as of today, giving an enterprise value to revenue multiple of 0.12 times revenue. It has $1.75 billion of inventory and about 1,361 stores comprising more than 17 million square feet of retail space. It also employs more than 34,000 full- and part-time folks.

The overwhelming conclusion you must reach is that it sure takes a lot of effort to create a dollar of enterprise value in this business with employees, facilities, capital, inventory and technology.

Add to this that the entire industry is under assault from the likes of Amazon and other pure-play online retailers. Showrooming tops online and traditional business media. Pundits are predicting the end of shopping as we know it. It can be a tough business segment to make a buck.

Now let us look at the payments companies.

All charged up
For the purposes of this analysis I have chosen Visa, MasterCard and American Express.

Arguably we could go much deeper and consider First Data, Citi, CapitalOne, Discover and others, but these three companies form an oligopoly that controls a significant portion of retail industry transactional throughput.

Here is the data, and the numbers are breathtaking.

For Visa, its last 12 months of revenue is approximately $11.5 billion and the market capitalization is almost $136 billion, giving an enterprise value to revenue multiple of an almost shocking eleven times revenue. It also employs only 8,500 people, has no inventory and no retail facilities to look after.

MasterCard's numbers are similarly striking. Its last twelve months of revenue are approximately $7.8 billion and the market capitalization is almost $87 billion, giving an enterprise value to revenue multiple almost the same as Visa: 11.15. It also employs only 7,500 people, has no inventory and no retail facilities to look after.

Finally, there is American Express. Its last twelve months of revenue is approximately $34.3 billion and the market capitalization is almost $89 billion, giving an enterprise value to revenue multiple of a relatively paltry –compared to Visa and MasterCard – 2.5, but well north of its retail partner range of one. It also employs 63,500 people, which is only twice the number of Barnes & Noble employees, but it has more 100 times the market value.

Compared to the retailers, in whose stores most of their earnings are generated, it appears effortless for these firms to create enterprise value. They live in the same ecosystem as retailers, but have much less operational complexity for every dollar of enterprise value created.

It makes you wonder how sustainable this is. With numbers such as these, is it any wonder that merchants want to try different things?

One initiative that the retail industry has aligned to form is MCX, which is a mobile payments platform under development that participating retailers will use. The express purpose of MCX is to reduce Interchange fees (read: revenues to the payments providers) and gain back full control over their customers.

Other mobile payments initiatives are emerging, although nothing has yet formed which truly threatens the stranglehold that the existing payments ecosystem has over the retail industry.

Is mobile the catalyst that will transform the payments ecosystem, blow up the oligopoly and re-align the players while shifting power back to the merchants who sell products? Will the spoils flow to consumers in the form of reduced prices?

IT IS LIKELY that mobile technologies will finally enable the merchant class to claim more of the value creation that occurs in this ecosystem.

Mobile wallets, branded loyalty applications and emerging payment systems are all early disrupters of the status quo, with lots of innovation announced every day.

Certainly this is not a zero sum game, but mobile will be the catalyst that drives big changes on the horizon. Not only is this fun to watch, but it is fun to be a part of.

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