Tiralis Global

Consulting

AIRLINE MERCHANT ACQUIRING

How times have changed!

Mike Smith, Head of Merchant Acquiring Services at Tiralis Global, discusses the key differences between "then" and "now" in airline merchant acquiring. Risk and exposure is now high on the agenda for both acquirers and airlines.

28 February 2019

Airline Merchant Acquiring

How Times have changed!

Mike Smith

The Beginning

The airline industry with its Universal Air Travel Plan was instrumental in the development of the credit card industry and airlines were among the founding merchants for the Card Schemes. The industry exemplified the prestigious and international dimension of credit cards and generated high volumes of high value transactions made easily accessible via already highly developed channels of distribution. This made airlines a high value sector for the developing issuer network and a key merchant account for the airline's principal banker. Risk was low on the agenda, helped of course by the fact that so many airlines "benefitted" from some element of government ownership. That much has certainly changed.

Transition

Just as transitory has been the card industry's affinity with the airline sector which over time has switched its focus to the issuing side as a source of spending incentives whilst the relative importance of the airline sector as merchants has diminished dramatically as the schemes matured. The emergence of super merchants in the retail sectors and the massive volumes that are now generated by eCommerce players now have the attention of acquirers, and noticeably all the interchange incentives. Acquiring has become a volumes game and in doing so has become very much a commodity offering. Specialist acquirers or more to the point, those with the capability to deliver specialist/niche services such as those required by the global airline sector are few and find it difficult to sustain service standards at these commodity pricing levels. This is not helped if a major airline's procurement benchmarking fails to take account of differing sector economics and the value of their own financial service requirements.

At the same time the reality of airline failures and the impact of consumer legislation on the acquirer's chargeback exposures have further undermined the financials of airline acquiring and served to place risk firmly onto the top of the agenda. For acquirers now compelled to take account of all, or the greater part, of their airline merchant's unearned revenue liabilities within their own "credit" headroom, this meant committing a dramatically increased share of the bank's concentration limit without delivering any commensurate increase in contribution. This was not good banking business.

So where are we now?

The key differences between "then" and "now" are that risk IS the issue, there is lack of appetite among the remaining acquirers to take it and this is compounded by the lack of credit availability to the airline sector generally. Cost pressures and a shift of sales activities to less secure channels of distribution have only served to further pressurise acquirer margins already suffering from the commoditisation of card processing services across other merchant sectors.

Risk IS the Issue

Consolidation

Technology has played a pivotal role in driving consolidation within the acquiring sector with those "traditional" bank acquirers, formerly at the "bleeding edge" as it were, falling behind the game with their legacy systems or taking the outsourcing path. This has driven a massive growth in the business of platform providers and a shift towards alliance structures which in themselves constitute a form of consolidation insofar as they impact credit availability. The new regulatory framework and more open licensing by the now "Incorporated" Card Schemes makes it easier for non-banks and even the platform providers themselves to enter the market as acquirers in their own right, but as processors not risk takers.

Where we have rapidly got to is a situation where the actual credit providers, the banks, are playing a lesser role in the acquiring sector and increasingly the bulk of profitable low risk volumes are being taken up by acquirer processors who are in fact technology companies, in many cases financed by venture capital. No need for rocket science to conclude that for an airline seeking an unsecured merchant account the market risks becoming less competitive, more risk adverse and less service oriented. Ultimately a more costly and less stable acquiring environment which is bad news given the critical strategic importance of the acquiring relationship.

Real Cost of Acceptance

Lower card fees, maybe, but in all probability a higher overall cost of ownership!! ....Very simply, if the acquirer effectively cancels out the forward sales float the airline probably has to increase borrowing and seek further efficiencies elsewhere. Increasing fares is seldom an easy option. It is ironic that the trend now is away from charging for the use of a credit card and its cardholder protections just when, for the airline sector, it seemed increasingly justified when set against the real cost of acceptance.

Limited Unsecured Capacity

Less competitive? .....The dynamics of the marketplace are such that what limited capacity for unsecured processing that is available is migrating to a small number of what are considered the most prestigious or best credits, i.e. those acquirers retaining an appetite for the sector are "cherry picking". In certain cases, this rebalancing/tidying of portfolios is resulting in displacement of lesser credits. There are of course acquirers looking to slash margins to "buy" volume on a fully secured basis but even those are cautious about unbalancing their portfolios with high levels of single merchant business.

Assessing Risk and Exposure

The airline has bought in, that was easy. But now I have to sell it to Risk!!"

Making an assessment of an airline from a credit and risk viewpoint is somewhat fraught because of the nature of the business model and its impact on the analysts' tried and trusted ratios. In comparison, the industry rarely looks particularly good; in general it is considered non-investment grade, few of its members are rated by any of the three rating agencies and even fewer are investment grade businesses.

Assessing Risk & Exposure a Challenge

The extra dimensions are the cash and forward sales cycles and strategic evaluations which are seldom sufficiently well understood for the risk manager to stick his neck out. The result is that it is easier to focus on "cleaner" volumes or hold out for an excess of collateral. In this way the acquirer often becomes part of the airline's business continuity problem and not part of the solution. In this respect the majority of airlines are currently badly served.

Sector Concentration Limits

Airlines have Business Continuity Risk

Because of the industry's inter relationships and its sensitivity to incident risks there is a tendency for risk managers to take a view of airlines as a sector and not solely as individual businesses. The result is that, like it or not, when one airline of significance makes a financial splash down, everybody else is likely to get their feet wet. This is again a consequence of thin acquirer margins and an often trigger-happy approach to initiating MAC clauses.

Ultimately an airline's credit line can be a factor of what the acquirer is willing/able to risk in the sector, reflected in the concentration limits. So, one airlines failure represents a business continuity risk to all others in that acquirer's portfolio. At the extreme of this was found eClear with its "innovative" but unfortunate approach to managing portfolio risk. Recent history is also littered with perfectly rational acquiring banks suddenly reversing their airline strategy and forcing the costs and risk of a change on perfectly credit worthy airline businesses.

So, what was once the high volume "must have" sector for the multi-currency capable acquirer is now a problem. Over time the low margins and high perceived risk have caused a major shrinkage in acquiring capacity tailored to the sector and a shortage of acquirers willing to entertain any unsecured airline volume in their portfolio.

The seeds of the problem were sown before the downturn, but the coincidence of the banking crisis and depth of the resulting global recession served to force the issues to the surface and present a major threat to the industry's business model. In some cases this threat could even result to some airlines, and not just "new starts", having no acquirer at all!

Where Next?

The industry needs to work with the Card Schemes and the main acquirers to explore ways to mitigate forward sales exposures without resorting to restricting critical cash flows. This solution must incorporate the broad spectrum of airline credits because whilst the risks are very real they amount to a small exposure compared with the benefit to be gained by the industry as a whole.

Individual carrier actions now revolve around developing strategies to maximise access to unsecured acquirer capacity wherever it is available by leveraging their status as global merchants. There is also the business continuity spectre raised now by "having all your eggs in one (acquirer) basket". The key is a managed portfolio approach to acquirer relationships.

The airlines have developed a critical dependence on cards. No amount of switch selling effort to alternative forms of payment will alter that fact and anyway the consolidation and regulation of these payment types will follow in time. After all, BankAmericard was an afop once upon a time!

For airlines, Tiralis Global help develop and implement customer payments strategies.

For acquires, Tiralis' Airline Insights service provides a comprehensive online risk management resource, including private credit scores. Tiralis provide additional sales tools and consultancy for new entrants and acquirers seeking to grow or re-balance their airline portfolio.

If you would like to find out more, contact us via www.tiralisglobal.com or Mike by email at msmith@tiralisglobal.com