

PAYPAL / iZETTLE

RESPONSE TO ISSUES STATEMENT

This is PayPal's response to the CMA's Issues Statement of 15 January 2019 in respect of the completed acquisition of iZettle by PayPal (the **Merger**).¹ It builds on PayPal's response to the CMA's Phase 1 Decision of 26 November 2018 (the **Decision**) (the **P1D Response**).

1 Executive summary

- 1.1 The payments industry is changing rapidly. Contactless card payments are more popular than ever and are swiftly replacing cash (63% of the UK population currently use contactless payments, with 3.4 million almost never using cash).² Technology continues to deliver new solutions to make and accept payments utilising the revolution in mobile software. Meanwhile, consumers and merchants increasingly demand the ability to buy and sell across channels. Against this background, payments providers have to innovate and evolve rapidly just to keep up with the market, let alone to be at the forefront of new developments.
- 1.2 This is the context for this transaction. PayPal has been known for leading innovation in online payments since its launch in the early 2000s but has never been an offline payments specialist. In fact, [redacted].
- 1.3 It now finds itself needing to [redacted] catch up with the providers who are already offering a seamless omni-channel service to merchants – in particular large acquirers such as Barclaycard and WorldPay, payments platforms such as Adyen and Square, and ecommerce platforms such as Shopify.
- 1.4 [redacted]. [redacted].
- 1.5 The acquisition of iZettle by PayPal paves the way for a combined offering that integrates largely complementary online and offline payment offerings into a cohesive omni-channel service. It will still require [redacted], but the Parties will be much better placed to compete more quickly as a combination after the transaction than either could individually.
- 1.6 In the meantime, the CMA should have no concerns about the effect of this transaction on competition in offline payments solutions: this market is fiercely competitive, with innovation from incumbents, new entrants and new technologies offering scope for better and cheaper services for merchants. We have seen aggressive price-cutting by providers even in the short period since the Decision.
- 1.7 Indeed, PayPal Here is a [redacted] in offline payments for smaller merchants, and not the closest to iZettle's offering. Following the transaction, merchants of all sizes will continue to be well served by a range of providers – existing mPOS-only players, providers of a portfolio of POS solutions (such as the acquirers) and new entrants (including those offering new, innovative and cost-effective solutions such as tap on glass).
- 1.8 In the sections below, we set out our arguments on these points in more detail:
 - (a) why the frame of reference adopted by the CMA should not be unduly narrow (**section 2**);
 - (b) why the appropriate counterfactual against which to assess this Merger does not involve significant expansion or entry by either party alone (**section 3**);
 - (c) why no competition concerns arise in offline payments (theory of harm one) (**section 4**); and

¹ As many issues were covered by the Phase 1 Decision Response, this response does not seek to address each and every point raised in the Issues Statement but instead focusses on key themes.

² <https://www.theguardian.com/business/2018/jun/18/uk-debit-cards-transactions-overtake-cash-for-the-first-time>.

- (d) why no competition concerns arise in omni-channel payments (theory of harm two) (**section 5**).

2 Frame of reference

Offline payment services

- 2.1 As set out in the P1D Response, because the supply of non-mPOS devices imposes a significant competitive constraint on mPOS devices, the Parties consider that the CMA's frame of reference should include all point-of-sale devices. This is for four main reasons:
- (a) there has been a convergence between mPOS and non-mPOS solutions in recent times, both in terms of design (as was demonstrated at the PayPal site visit with the vast array of new devices, many of which are a hybrid of mPOS and non-mPOS, such as the new MyPOS device, which can connect via Bluetooth and has a SIM card³) and commercial propositions. Acquirers have adopted online marketing campaigns and reduced average onboarding times, as well as adopted pricing models to compete directly with those offered by mPOS-only providers (for example, WorldPay offering a "pay as you go" pricing model for non-mPOS devices);⁴
 - (b) non-mPOS devices are a valid alternative for most, if not all, merchants that might consider choosing an mPOS device. The type of payment solution a merchant chooses is driven by a host of different factors, many of which are influenced by the industry in which the merchant operates, rather than its size. This is demonstrated by the fact that non-mPOS devices are by far the most popular solution amongst smaller merchants today (the Decision considered such merchants most likely to take an mPOS solution) – accounting for in excess of 90% of transaction value accepted in-store by that group;⁵
 - (c) there are no material barriers or disadvantages faced by suppliers of non-mPOS devices in choosing whether to supply mPOS devices. Indeed, the acquirers have some material advantages. There is therefore a high degree of supply-side substitutability between these types of device (see further paragraphs 2.5-2.7 below); and
 - (d) the market for POS payment systems is especially dynamic and fast-moving, and new solutions are becoming available to merchants when seeking to take consumer offline payments, including PIN on mobile. Other card-based payment acceptance solutions, such as tap on glass⁶, as well as non-card-based payment acceptance solutions, such as bank-to-bank payments⁷, are likely to be used for consumer-to-merchant transactions in-store on a regular basis in the near future, given the advantages these options have, particularly in terms of low (or zero) hardware cost.
- 2.2 Even without a small but significant non-transitory increase in price (**SSNIP**) in the price of mPOS devices, the constraint imposed by non-mPOS devices on mPOS devices is demonstrated in the churn surveys that the Parties routinely carry out in their business. These surveys consistently show significant levels of switching from the Parties to suppliers of non-mPOS devices.

³ <https://shop.mypos.eu/en/19-card-payment-machine/87-mini-ice-credit-card-pos-terminal-printer>.

⁴ See P1D Response, paragraphs 4.13-4.18 and <https://www.worldpay.com/uk/sme/face-face/card-machines/mobile-card-machines>.

⁵ See P1D Response, paragraphs 4.2 - 4.6. As the panel observed at the PayPal site visit, London taxis, a classic small merchant mobile use case for POS devices (around £1-2,000 average TPV monthly), have over 16 Transport for London approved suppliers. Half provide mPOS solutions and half non-mPOS. The merging Parties serve less than [X] of the 21,000 London taxis (all of whom have card acceptance devices). PayPal also referred to the small, short season, stallholders at Winter Wonderland in Hyde Park (selling drinks, snacks, gifts and confectionary) who chose between a range of mPOS (32%) and non-mPOS terminals (61%), with the remainder only accepting cash (as further set out in Annex 1 to the P1D Response). At the iZettle site visit, the panel will have observed the range of devices (mPOS and non-mPOS) being used by stallholders in Borough Market.

⁶ See P1D Response, paragraphs 3.20-3.22.

⁷ See P1D Response, paragraphs 3.11-3.14

- (a) [REDACTED]⁸ [REDACTED].⁹ [REDACTED]¹⁰ [REDACTED].¹¹
 - (b) Even if one focusses attention on just the Parties' smallest customers (something which the Parties do not think is warranted given the driving factors of demand and, inter alia, the Parties' inability to price discriminate), non-mPOS providers collectively accounted for [REDACTED].¹²
 - (c) This finding is not in dispute. [REDACTED].¹³
- 2.3 In light of the above, the Parties consider that constraints from non-mPOS solutions should play an important role in the frame of reference for this Merger.
- 2.4 In addition to the evidence already submitted in our P1D Response, we set out below further comments on two main aspects of the constraints imposed on the supply of mPOS devices: first, some further evidence on the degree of supply-side substitutability between POS offerings, and second, further information on technological developments that will have a significant disruptive effect on the types of device offered to merchants in the next two years.

There is a high degree of supply-side substitutability between non-mPOS and mPOS devices

- 2.5 For the vast majority of consumers and merchants, mPOS and non-mPOS services are interchangeable. Furthermore, and contrary to the view put forward in the Decision, there are no material barriers to non-mPOS players (such as the major acquirers Worldpay and Barclaycard) expanding their mPOS offerings within their portfolio of products. In summary:
- (a) The Decision acknowledges that market feedback on its narrow frame of reference was mixed, with around half of respondents believing that non-mPOS players could enter and compete effectively in providing mPOS services.¹⁴
 - (b) An examination of the Parties' cost structures shows that major acquirers are unlikely to be at a material cost disadvantage and have cost *advantages* in several key respects:
 - (i) the on-boarding costs highlighted in the Decision as a significant differentiator between mPOS-only providers and those offering a broader portfolio are a comparatively small share of customer acquisition costs for the Parties and, moreover, the CMA has received "*evidence that [for traditional acquirers] onboarding times have reduced, at least to some extent, over the past few years*".¹⁵ This is consistent with what the Parties have observed;¹⁶
 - (ii) there is no reason to think that major acquirers will be disadvantaged in respect of more significant cost items such as marketing and purchasing of card readers. Use of online marketing is no longer a point of distinction between acquirers and mPOS only operators - acquirers make extensive use of online marketing methods¹⁷ and the Parties are reducing the share of marketing spend online.¹⁸ Furthermore, the structure of Google ad auctions is such that firms with more recognised brands, such

⁸ [REDACTED]. Even so, similar patterns can be seen in the PayPal Here data. Conducting an equivalent exercise to that discussed for iZettle in the text, the PayPal churn surveys of customer demographic data shows that [REDACTED].

⁹ [REDACTED].

¹⁰ [REDACTED].

¹¹ [REDACTED].

¹² This analysis categorised merchants based on their largest monthly TPV in the 14 months prior to churning. The figures in the text are for merchants with annualised TPV of below €24k (the "nano" definition relied upon in the Phase 1 Issues paper).

¹³ Phase 1 Issues Letter, paragraph 110(e).

¹⁴ Decision, paragraph 131.

¹⁵ Phase 1 Decision, paragraph 66.

¹⁶ P1D Response, paragraph 4.15.

¹⁷ Response to the Phase 1 Issues Paper, paragraph 80.

¹⁸ Both PayPal and iZettle are [REDACTED]. In the first 11 months of 2018, [REDACTED] of iZettle's variable marketing spend was online, [REDACTED] [REDACTED] in 2017, the comparable figures for PayPal Here are [REDACTED] and [REDACTED].

as Barclaycard and Worldpay will generally have lower online marketing costs.¹⁹ With regards to reader costs, Barclaycard, Worldpay and PayPal all use the same card reader, the Miura M10, and so one would not expect significant differences in reader costs between them;

- (iii) the nature of the Pay As You Go (**PAYG**) business model is that the key driver of profitability is not costs per se but the ability to acquire and retain an appropriate mix of customers.²⁰ The major acquirers' stronger branding and existing distribution channels are likely to help in this regard as is the fact that they offer a broader portfolio of solutions, helping them to "grow with the customer" and reduce churn; and
 - (iv) major acquirers have important cost advantages over mPOS-only providers. They do not pay a third party acquirer to process their transactions and hence have lower transaction-level costs;²¹ their huge experience in face-to-face (and omni-channel) payments, mean they are likely to incur lower fraud and risk costs; and they have already incurred the main fixed cost of entry – building a payments network.
- (c) As well as having the cost-basis to compete effectively, major acquirers will be able to provide a superior customer experience, particularly [§<], with their established networks allowing them to provide faster transaction times and a more reliable service. This high quality experience will lead to high customer satisfaction, reducing churn and increasing revenues per acquired customer.
- (d) The fact that Barclaycard has in just the last few weeks slashed its prices on its mPOS product to be among the lowest in the industry (a 1.6% transaction fee with a £29 reader cost) illustrates that such players can and do compete cost effectively.²²
- 2.6 The degree of supply-side substitution between types of device demonstrates that, from the supply-side perspective, competition primarily takes place between offline payment platforms, with the types of device that start the payment process only a small part of this (and likely to become an even less important part of the offering as new technological developments make hardware less relevant in the future).
- 2.7 As explained during the PayPal site visit, PayPal's decision to acquire iZettle was driven by [§<]. PayPal wished to acquire a business that had [§<] namely:
- (a) an in-store presence in [§<] territories and pathway to [§<] more within [§<] years;
 - (b) a proven marketing operation that successfully and cost effectively on-boarded new merchants via digital marketing ([§<] of iZettle merchants); and
 - (c) a [§<] strong business and engineering team ([§<] than PayPal Here) with highly successful in-store/offline card payment experience delivering "best in class" offline payments capability.

¹⁹ Google ad "slots" are awarded based on quality adjusted bids: bidding more will increase your probability of winning but a site with a higher "quality score" will be able to win auctions at lower cost. For an overview see: <https://www.youtube.com/watch?v=a8qQXLby4PY>.

²⁰ This is shown in PayPal's response to Q7 of the Financial Questionnaire.

²¹ PayPal's transaction costs for newly acquired customers in 2017 were [§<]. Approximately [§<] of PayPal's transaction costs in 2017 were [§<] indicating approximately the remaining [§<] of costs are interchange fees and the acquirer margin. Even allowing for additional fees on American Express, interchange fees are likely to be less than 30bp in the UK (https://www.visaeurope.com/media/images/united%20kingdom%20@%202017_01_26-73-17806.pdf), suggesting acquirer fees of around [§<]. The European Commission estimated acquirers' costs for large merchants (inclusive of fees paid to card schemes such as Visa and MasterCard) to be 6bp (http://ec.europa.eu/competition/sectors/financial_services/dgcomp_final_report_en.pdf). Assuming that acquirers do not serve large merchants at a loss this suggests that acquirers would face transaction costs around [§<] lower than the Parties. Note that this excludes any additional cost advantage due to likely lower fraud costs.

²² <https://www.barclaycard.co.uk/business/accepting-payments/card-readers/barclaycard-anywhere> .

[REDACTED].²³

Further technological developments

- 2.8 In site visit follow-up paper 2, the Parties have outlined how near to market various new technological solutions are already, and this is supported by PayPal's internal documents.²⁴ As explained in that submission, standards for the use of PIN on mobile are already available and the Parties believe that products are already being tested for compliance by the certified laboratories. This includes Square, which, once certified (expected in the very near future), is likely to see significant growth (as it did in Australia).²⁵ This technology is therefore imminent and its impact on competition in the market will be significant. The Hyperion report, provided by way of background to the site visit follow up paper, confirms this, referring in particular to new solutions coming to market from players such as BBPOS, Datecs and First Data with Clover Go.
- 2.9 Furthermore, standard development is already well underway for the next major development, tap on glass. Pilots are already underway in the UK market (and more are expected in 2019). The Parties expect that certified solutions will be available in the UK in 2020.
- 2.10 The Hyperion report also refers to the new opportunities being created by PSD2 leading to the potential for greater use of non-card payments. We referred to this in our P1D Response, and it is confirmed by PayPal's own internal documents which emphasise the extent to which non-card payment methods are increasing in importance – see for example, [REDACTED].²⁶ As a result, these new technologies can be expected to offer additional competitive constraints on the supply of offline payment services (mPOS and non-mPOS) in the near future.

Omni-channel payment services

- 2.11 Whilst the Parties agree that an appropriate frame of reference for this Merger should include omni-channel payments services, the strength and relevance of payments capabilities must be considered in the context of the broader commerce enablement solution demanded by the merchant.²⁷ This is important because:
- (a) fast-growing demand from small merchants to have a “one-stop-shop” for all their commerce needs has driven non-payments players (e.g., Shopify, Amazon and Sage) to develop or expand their own payments solutions (e.g., Shopify Payments, AmazonPay and Sage Pay). Although these began as online-only offers, they have now moved to multi-channel capabilities, and as shown at the PayPal site visit sometimes leverage the same point-of-sale device as PayPal Here; and
 - (b) omni-channel payments solutions are considered by smaller merchants in the context of the broader omni-channel commerce offering in which they are packaged. Many players (such as Square / Weebly or Shopify) already offer a broader range of omni-channel services than PayPal will gain through the Merger.
- 2.12 UK consumers increasingly desire and expect to engage with their favourite merchants from wherever they are: online, in a store, or on the go. Consumers expect that their experiences across these channels will be seamlessly connected. Therefore merchants of all sizes increasingly seek commerce solutions which allow them to sell their products through multiple channels, while centrally managing inventory, sales, and customer data. Fast-growing demand for such services has led to commerce enablement players of all types adapting their capabilities to enable these multi-channel experiences through a seamlessly integrated back-end.
- 2.13 When it comes to payments, this means enabling the merchant to accept payments in a variety of ways across multiple sales channels, coupled with the ability to view and manage those payments in a single place. The initial purpose of the Merger is to create a robust omni-channel

²³ [REDACTED].

²⁴ [REDACTED].

²⁵ See P1D Response, paragraphs 5.13 and 5.14.

²⁶ PayPal response to Phase 1 S109 Annex S039, slide 30.

²⁷ See P1D Response, paragraphs 8.1-8.4.

payments solution, by bringing together the largely complementary offerings of the Parties, to address needs of merchants selling (or seeking to sell) across multiple channels and to partner with commerce platforms. However, with the convergence of different omni-channel services (through organic product development, partnerships, acquisitions or combinations of the three), PayPal will be competing with a far broader range of suppliers than pure omni-channel payments players.

Segmentation by customer size for offline or omni-channel payment services

- 2.14 At a high level, the Parties agree that larger merchants tend to have different, more customised requirements compared to smaller/medium-sized merchants, based on the level of complexity of their business and the resources they have available to dedicate to managing their payment systems. This is reflected, for example, in the different approach that PayPal Here has taken to serving larger retailers such as [X], working with "software developer kit" or SDK partners to develop an individually tailored solution for that retailer that integrates with the retailer's ERP system,²⁸ as compared to the PayPal Here app that is used as an "off-the-shelf" offering to support the payment device being used by small/medium businesses.
- 2.15 However, within the small/medium merchant category, further segmentation is not meaningful from a payments perspective. As explained in the P1D Response, [X] are not industry-recognised terms and are used (in differing ways and contexts) by the Parties for specific internal purposes rather than as standard customer definitions.²⁹ Indeed, these terms are only consistently referred to by iZettle internally [X].³⁰ The Parties recognise that larger merchants in the small/medium category do have different, often industry-specific POS software requirements. This is why iZettle has its "Pro" software offering and why both PayPal has partnerships with specialised POS software providers such as Vend.
- 2.16 In reality, for both offline and omni-channel services, demand is influenced by a variety of factors, most of which are more influenced by the industry in which the merchant operates rather than its size (these factors are explained further below).³¹

3 Counterfactual

- 3.1 The Issues Statement invites views on whether the Parties would have entered into the market of the other, or expanded if already present, absent the Merger.³² For all the reasons that follow, the "most likely counterfactual"³³ does not involve either party to the merger significantly expanding or strengthening its existing offering.

PPH would not have significantly developed its offline offering but for the transaction

- 3.2 [X].
- 3.3 [X].
- 3.4 [X].
- 3.5 [X].
- 3.6 [X].
- 3.7 [X].

²⁸ Enterprise resource planning (ERP) systems involve business process management software that allow an organisation to use a system of integrated applications to manage the business and automate many back office functions related to technology, services and human resources.

²⁹ See P1D Response, paragraph 4.12.

³⁰ The Decision did not find any competition concerns in respect of ancillary services (paragraph 54).

³¹ See P1D Response, paragraph 4.8 for a list of other factors and paragraphs 8.12-8.13.

³² Issues Statement, paragraph 36.

³³ Merger Assessment Guidelines (OFT1254/CC2), paragraph 4.3.6.

3.8 [REDACTED].

3.9 [REDACTED].

iZettle would not have significantly expanded its online presence in the counterfactual

3.10 [REDACTED].

3.11 [REDACTED].

3.12 [REDACTED]. [REDACTED], [REDACTED]. [REDACTED][REDACTED].

3.13 [REDACTED].

Acquisition price

3.14 The Issues Statement invites views on the acquisition price paid by PayPal and whether this is relevant to the counterfactual or the competitive effects of the Merger.³⁴

3.15 The Parties commented on the valuation of iZettle by PayPal in the P1D Response, as follows:

(a) [REDACTED].

(b) [REDACTED].³⁵ [REDACTED].³⁶ [REDACTED].

(c) [REDACTED]. The price ultimately paid was consistent with these components.

3.16 PayPal's valuation did not, therefore, have any element of premium paid to remove a rival. These issues are explained further in analysis from Charles River Associates attached as Annex 2. [REDACTED].

4 TOH 1: Horizontal unilateral effects in the supply of offline payment services via mPOS devices in the UK

4.1 The Issues Statement invites views on whether the Merger could reduce the competitive constraints on the Parties and other suppliers in providing offline payment services via mPOS devices. The Parties do not consider this to be the case but, in any event, this is too narrow a frame of reference to give an accurate picture of customer behaviour in the market – in practice, small merchants consider non-mPOS options (as explained in section 2 above). Indeed, non-mPOS devices are used by the vast majority of small merchants.³⁷

4.2 As explained during the site visit, the experience of the Parties is that different merchants choose different POS devices and/or providers for a multitude of reasons. Price is important but other factors will also play a part in deciding which type of device and which provider to choose. Some of these factors are set out in the P1D Response, but they are also illustrated below:³⁸

³⁴ Issues Statement, paragraph 37.

³⁵ See P1D Response, section 11.

³⁶ Merger Notice Annex 9.05, page 32.

³⁷ See P1D Response, paragraphs 4.2-4.6.

³⁸ Slide 26 of the presentation presented at PayPal's site visit.

I want to take cards, what do I need to consider?



Merchants needs greatly differ by vertical



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- 4.3 Depending on the merchant's individual circumstances, some of these factors (such as the need for a printer or the need to integrate with other systems) may be more important than price alone.
- 4.4 This is further supported by PayPal's own customer feedback, which shows that [39]
- 4.5 The above is not to say that price is irrelevant: for a given service level and set of functionality merchants can be highly price sensitive and this is a key reason why SumUp in particular has grown strongly. Rather it is wrong to treat price as the only factor. Merchants pay for the value they receive and will pay more if they believe they are getting more in return. For example, a user might be willing to pay more up front for a non-mPOS device if they value set up support or the ability to print receipts.
- 4.6 However, even if the CMA looks at what the Parties consider to be an unduly narrow frame of reference, the CMA should have no concerns:
- historic shares of supply are not a reliable measure of the strength of parties in a dynamic and growing market such as this one (and the shares of supply relied on at Phase 1 were not complete and, in any event, already outdated);
 - competition is already strong and only increasing further, with new entry and expansion facilitated by technological development;
 - it is easy for merchants to switch provider, given the low costs of doing so;
 - the Parties are not the closest of competitors – their offerings are materially different and they have different customer bases; and
 - there is no risk of customer detriment arising from this Merger, as the Parties have no incentive to increase price after the transaction.

(a) Shares of supply

- 4.7 The Decision focussed on historic shares of supply of mPOS providers. As explained above, we believe this is too narrow an approach given the competitive constraint provided by non-mPOS devices. Indeed, the Parties themselves consider they have low market shares in their internal

³⁹ PayPal response to Phase 1 S109, Annex S039 (PP merchant and consumer focus group May 2017), slides 60 and 74.

documents, which is consistent with a broader view of the relevant market.⁴⁰ The shares of supply referred to in the Decision were also incomplete, failing to include material segments of the mPOS market.⁴¹

- 4.8 In any event, in a market where the supply of a product is characterised by significant technological development, emerging new suppliers, methods and devices for accepting payment, and a rapidly growing and complex merchant base with high levels of churn, historic shares of supply are not a good measure of a supplier's market power.⁴² Analysis of recent trends in supplier strength is more instructive.⁴³
- 4.9 In the case of mPOS devices only, app download data is a proxy for new customer acquisitions and is therefore a strong indicator of *trends* in supplier strength, although it does not take any account of the significant constraint posed by non-mPOS device suppliers.
- 4.10 Nevertheless, even just considering the 2018 app download data,⁴⁴ it can be seen that PayPal Here's share of new customer acquisitions is declining; it has been caught up by Square and overtaken by SumUp:

[§<]
[§<]

- 4.11 As such, on a forward-looking basis the Parties' combined position is considerably less strong than appears in the Decision.
- 4.12 These trends are also reflected in the results of iZettle's ordinary course of business churn survey for Q4 2018: [§<].⁴⁵

(b) Strength of competition

- 4.13 Competition in this sector is strong and only increasing. That competition comes from:
- (a) Established providers of mPOS devices, such as SumUp, Square, BarclayCard Anywhere and WorldPay POS, who are competing fiercely on price and features, in particular the software accompanying the card reader.⁴⁶
- (b) Providers of a portfolio of POS devices (such as WorldPay, Barclaycard, Elavon, Global Payments⁴⁷). As explained in Section 2 above, the large acquirers have innovated in response to newer mPOS-only entrants (including by offering their own mPOS solutions) and are already a constraint to be taken seriously.⁴⁸ They have advantages in terms of scale, a trusted payments brand, existing customer base and payments expertise, and are exceptionally well placed to take advantage of any opportunities to compete in this rapidly growing and evolving industry due to the ease of supply-side substitutability between device types and the complex demand from merchants.⁴⁹

⁴⁰ See in particular PayPal's response to Phase 1 S109 Annex S031, slide 51, which refers to [§<]; iZettle response to Phase 1 S109 Annex 024, slide 36, [§<].

⁴¹ See P1D Response, paragraphs 5.2-5.3.

⁴² See P1D Response, paragraph 5.5.

⁴³ See P1D Response, paragraphs 5.7-5.9.

⁴⁴ See the table at paragraph 5.7 of the P1D Response. The source of this data is CRA analysis of AppAnnie and the Parties' data and Decision. The app download for PayPal has been adjusted to account for accidental downloads as explained in previous submissions.

⁴⁵ See the table at paragraph 5.11 of the P1D Response.

⁴⁶ [§<]. [§<].

⁴⁷ See P1D Response, paragraph 5.38.

⁴⁸ This is evidenced by the fact that these providers have already launched mPOS offerings. However, the supply of non-mPOS devices is also a constraint on the Parties: non-mPOS devices remain the most popular device amongst all merchants, accounting for in excess of 90% of transaction value accepted in-store by smaller merchants [P1D Response, paragraph 4.5].

⁴⁹ See paragraph 2.5 onwards.

- (c) New entrants providing mPOS and hybrid POS devices, including MyPOS, First Data with Clover Flex⁵⁰ (a hybrid solution, and with an expected launch of Clover Go, a PIN on mobile solution, in 2019⁵¹), SumUp launching its SumUp 3G product⁵², Shopify launching an mPOS offering⁵³ and Stripe, which is trialling an mPOS solution in the US⁵⁴ (and which has already created an area on its UK website through which to sell such a solution to UK merchants⁵⁵). There are also rumours that another hybrid device provider (similar to MyPOS) will be entering the UK in Q2 2019 (following a launch in Germany last year).⁵⁶
- (d) Intermediaries such as PaymentSense, who package existing solutions to offer to smaller merchants or “white label providers” such as NMI and PayWorks, who provide integrated payment services, including point of sale solutions, to merchants and to ISOs and any other party who is interested in selling a POS solution with their own branding (such as some of the taxi payment device providers like Cab:app or Farepay).

4.14 In addition, as described in section 2 above, the next wave of technological development will lend itself to further entry and re-positioning in the sector, as new solutions are adopted such as PIN on mobile, tap on glass, bank-to-bank payments and in-app payments. At the site visit, we summarised the landscape as follows:

[X]

- 4.15 Most of these solutions are already in market today and tap on glass is expected to be launched within the next two years (with a number of new pilots this year, building on those already undertaken by WorldPay and Mobeewave). It is anticipated that many providers are working on delivering tap on glass solutions (First Data recently announced it intends to, for example).⁵⁷
- 4.16 Finally, we explained during the site visit how large non-payment providers are entering this market. These providers have the resources and existing customer bases to make a huge impact once they decide to move forwards in the payments space. This could be through bank-to-bank payments using apps or through utilising other technological developments. For example, Apple currently restricts access to the NFC capability of iPhones. If it maintained its policy, it could exploit the NFC capability exclusively, turning all its iPhones into card acceptance devices that can only be used through Apple – a huge potential customer base.⁵⁸ Similarly, Amazon has announced an intention to roll out its Amazon Pay technology to brick and mortar retailers.⁵⁹
- 4.17 Barriers to entry in the offline payments sector are material in terms of software and hardware development and the associated costs, but as can be seen from the above they have already been overcome by a number of new entrants that made the decision to commence that investment several years ago. The possibility of using a white label solution can also help a new entrant to launch a limited solution. Further, as explained in section 2 above, for existing acquirers, the barriers to entering/expanding in mPOS are low, particularly given their existing platform, brand and customer base. The large non-payment providers have similar advantages in terms of brand and customer base.

(c) Switching

- 4.18 The cost of switching between providers is low: both PayPal Here and iZettle operate on PAYG contracts with no minimum sign-up periods so the cost of switching away to another provider (whether mPOS or non-mPOS) is minimal. On this basis, one would expect merchants to switch

⁵⁰ https://www.firstdata.com/en_gb/products/small-business/all-solutions/mobile-card-machine-clover-flex.html.

⁵¹ <https://www.clover.com/shop/product/clover-go/reader>.

⁵² <https://sumup.co.uk/3g-credit-card-reader/>.

⁵³ <https://www.shopify.co.uk/pos/retail>.

⁵⁴ <https://www.mobilepaymentstoday.com/news/stripe-debuts-mpos-product/>. See also <https://stripe.com/terminal>.

⁵⁵ <https://stripe.com/gb/payments/features>.

⁵⁶ <https://www.enfore.com/global/>.

⁵⁷ <https://www.cardtek.com/media-center/cardtek-in-the-news/smartphones-turn-into-a-pos-terminal-with-the-collaboration-of-cardtek-samsung-and-first-data>.

⁵⁸ If Apple were to change its policy, its phones would be capable of accepting tap on mobile payments in the same way as Android phones today, which may further accelerate the growth of tap on mobile technology.

⁵⁹ <https://www.techspot.com/news/77534-amazon-wants-bring-amazon-pay-technology-brick-mortar.html>

to rival providers if they become unsatisfied with the service they are receiving or become aware of a better offer (and indeed it is not unheard of for merchants to have a number of devices⁶⁰).

- 4.19 Indeed, the Parties' churn rates are high: under a six month definition of churn (i.e. merchants which have not completed a transaction within the previous six months), the average monthly churn rate in 2017 was [§<] for PayPal and [§<] for iZettle.⁶¹ While much of this churn will reflect merchants who have gone out of business or alternative factors other than switching, the Parties internal churn surveys confirm that a material proportion of leavers have switched to other service providers.
- 4.20 The Parties' churn survey data (the same surveys discussed above) shows that merchants are willing to switch in response to a range of issues. In the case of PayPal Here the most common reasons cited were [§<]. In the case of iZettle, switchers were more likely to [§<].

(d) Closeness of competition

- 4.21 The evidence shows that PayPal Here and iZettle are not the closest of competitors, even if one only considers supply of mPOS devices:
- (a) they do not play an important role in determining each other's commercial decisions⁶²; rather the historic pricing data submitted in the P1D Response are consistent with PayPal in [§<], charging higher prices and [§<], while iZettle, SumUp and Square compete more generally (alongside the major acquirers) – competition that will remain post-Merger;⁶³
 - (b) PayPal Here's product is [§<].⁶⁴ For example, [§<]; and
 - (c) they have different customer bases.
- 4.22 This last point is particularly important, as the majority of PayPal Here's newly acquired customers are [§<]⁶⁵ [§<].⁶⁶

(e) No potential for customer detriment

- 4.23 On top of the fierce competition to provide offline payment solutions to small businesses, there is no obvious route to customer detriment as a result of this Merger, in a context where the merged entity will continue to be faced with significant competitors, where demand is price elastic and where rapid new customer acquisition is essential (and possible for a provider with a competitive product to achieve quickly by reducing prices⁶⁷).
- 4.24 Crucially, the merged entity will have no incentive to target price rises at the smallest merchants – [§<].⁶⁸
- 4.25 In addition, the merged entity will continue to have incentives to grow and innovate. The market for card payments is expanding rapidly⁶⁹ and the technology is developing quickly. As a result, providers must keep up with the pace of change to be competitive. Any player that stands still (or goes backwards) will be quickly overtaken by those that are continuously seeking innovative ways

⁶⁰ See PayPal response to Phase 1 S109 Annex S039, slide 14, and PayPal response to Phase 1 S109 Annex S026, page 19.

⁶¹ During the interval July 2015 to May 2018.

⁶² See P1D Response, paragraphs 5.19-5.22.

⁶³ See P1D Response, Figure provided underneath paragraph 5.22.

⁶⁴ See P1D Response, paragraph 5.5 and 5.21.

⁶⁵ See P1D Response, paragraphs 5.24-5.26. See also Phase 1 Issues Paper Response, which states that PayPal Here estimates that [§<]. This is evidenced in PayPal response to Phase 1 S109 Annex S113, page 3.

⁶⁶ At PayPal's site visit, [§<].

⁶⁷ See the analysis of what might have led to SumUp's rapid rise in new customer acquisitions in 2018, at paragraphs 5.15-5.17 of the P1D Response.

⁶⁸ See P1D Response, paragraph 7.5.

⁶⁹ A total of 13.2 billion debit card payments were made in 2017, a rise of 14% on 2016 – see <https://www.bbc.co.uk/news/business-44496513>.

to exploit new payment technologies and the many new methods of payments that are emerging.⁷⁰

- 4.26 This is particularly the case given the high level of customer churn in this sector (as explained in paragraphs 4.18-4.20 above) in combination with price reductions from providers such as SumUp and BarclayCard. Providers have to continually attract a significant number of new customers just in order to keep a constant net customer base ([8<]⁷¹). Any move, such as introducing less attractive pricing, which could slow down customer acquisition, would be commercially risky in this context.

5 TOH 2: Horizontal unilateral effects in the supply of omni-channel payment services to small, micro and nano customers

Market context and development

- 5.1 UK consumers increasingly desire and expect to engage with their favourite merchants from wherever they are: online, in a store, or on the go. Therefore merchants increasingly demand commerce solutions which allow them to engage customers, promote and sell their products through multiple channels. Historically, service providers developed solutions tailored to a single channel, so if a merchant wished to sell across channels, they would often have multiple commercial agreements with multiple providers, even for a similar business function. This led to fragmented experiences for their customers and disjointed operational processes for merchants. As the need to sell across channels has grown, service providers have adapted to deliver omni-channel solutions, allowing merchants to sell their products across multiple channels, while centrally managing inventory, sales, and customer data.
- 5.2 This is well described by Shopify on their website.⁷² They explain the stages of a business, and the services they offer at each stage:

***“Start** your business journey: find a business name, buy a domain, and create a brand with our free tools.*

***Sell** everywhere: use one platform to sell products to anyone, anywhere – online with your ecommerce store, online marketplaces, and social media, and in-person with point of sale.*

***Market** your business: take the guesswork out of marketing with built-in tools that help you create, execute, and analyse campaigns on Facebook and Google.*

***Manage** everything: use a single dashboard to manage orders, shipping, and payments anywhere you go. Gain the insights and knowledge you need to grow.”*

Omni-channel solutions and relevance of size

- 5.3 To help enable omni-channel commerce for merchants, two major areas of omni-channel offerings have formed: omni-channel sales management and omni-channel payments.
- 5.4 As explained during the site visits, running a small business is complex. Omni-channel sales management seeks to address this complexity. The business owner needs to manage multiple ongoing tasks (some of which are mentioned in the Shopify website extract above), including bookkeeping, stock management, staff management, invoicing, website content, digital and other marketing and sales follow-up. A small business owner may have limited time (and limited ability to delegate) to focus on these tasks on top of the job of actually running the business, and especially if this requires dealing with multiple different systems. Omni-channel sales management provides a platform offering an integrated approach to the various tasks, increasing

⁷⁰ See P1D Response, paragraph 7.6.

⁷¹ See Phase 1 Issues Paper Response, paragraph 151 and Figure 47; P1D Response, paragraph 5.11; and PayPal site visit presentation, slide 11.

⁷² <https://www.shopify.co.uk/>.

efficiency and allowing the business owner to focus on optimising the performance of the business.

- 5.5 An omni-channel payments offering seeks to allow the merchant to accept payments in a variety of ways (e.g., cards, cash, invoicing, recurring billing) and across multiple sales channels (e.g., online, in a store), including the ability to view and manage those payments in a single place. Instead of multiple disjointed payment solutions to address specific methods or channels for payment, omni-channel payment solutions manage everything through a single platform.
- 5.6 Some omni-channel solution providers choose to specialize in and focus exclusively on the provision of omni-channel services in one of these categories, or even a sub-set of one of these categories (e.g., dynamic currency conversion, invoicing, accounting software, inventory management). However, more commonly we see a natural convergence and cross-over, especially for serving smaller businesses.
- 5.7 While merchants of all sizes share many of the same functional needs (e.g., payments, inventory management, accounting), different-sized merchants may differ slightly in terms of how they choose to meet those needs and the value they place on aspects of the service offering. Larger merchants tend to value control (e.g., over risk, customer experience), customization, and the ability to choose a “best-of-breed” service provider for each major function. Smaller merchants more highly value the convenience of handling as many of their business needs as possible in a seamless, automated, centralized fashion. This minimises the number of different suppliers and complex integrations required (and staff to manage them). The Parties see growing demand from small merchants for a “one stop shop.” In an increasingly complex business environment, small businesses seek increasingly streamlined, simplified, and holistic solutions, unifying as many of their omni-channel commerce needs as possible through a single provider.
- 5.8 The convergence of different omni-channel services is enabled through organic product development, partnerships, acquisitions, or, most commonly, combinations of the three. Therefore, competition involves a far broader range of suppliers than pure omni-channel payments players.

Competitors

- 5.9 There are many existing and emerging competitors providing omni-channel solutions. Given the breadth of services relevant to a holistic omni-channel commerce offering, these competitors stem from a variety of different backgrounds (e.g., acquirers, POS vendors, ISOs, payment service providers, commerce platforms and business management companies). While these players began with strong foundations in either sales management functions or payments services, as explained above, they are now broadening their service offerings across these boundaries. Many of these players already offer a broader range of omni-channel services than PayPal will gain through the Merger. A range of examples were referred to during the PayPal site visit on the slide below:

[X]

- 5.10 Many active omni-channel service providers have a background in providing payment services. Major acquirers (such as WorldPay and Barclaycard) offer the ability for merchants to accept payments across multiple channels, all with integrated back-end software. Both WorldPay and Barclaycard have invested heavily and spent years developing payment platforms to support omni-channel sales for merchants (and this level of investment is indicative of the effort PayPal would have to make in order to compete effectively in this space). These platforms include merchant lending and a full suite of business services, on top of offline and online payments capabilities. Another payment provider, Square, recently acquired Weebly to give it the capability

to create online stores, manage inventory, shipping and marketing, and seamlessly take payments online and face-to-face.⁷³

- 5.11 A strong example of an active omni-channel provider that started as an e-commerce platform is Shopify. Originally founded to allow small merchants to design and host websites, Shopify now offers a complete omni-channel service package, including the ability to accept payments online, offline (using the same Miura card reader used by PayPal Here, Barclaycard, and WorldPay) and “everywhere in-between”⁷⁴. Shopify positions itself as “one platform with all the ecommerce and point of sale features you need to start, run, and grow your business”.⁷⁵
- 5.12 The provision of omni-channel service offerings is an emerging marketplace and the shape of the competitive landscape is likely to evolve significantly over the coming years. In particular, the Parties anticipate global, non-payments players such as Amazon, Apple, Google, and Facebook to become highly relevant. All four are already investing in commerce and payment capabilities that cross channels. As explained at the PayPal site visit, these players have the scale, resources, and massive small merchant customer bases to have a significant impact in a relatively short amount of time. PayPal’s [redacted]⁷⁶ [redacted].⁷⁷
- 5.13 In fact, Amazon has already entered the UK payments market with Amazon Pay, offering merchants a method of taking payments through their website using the customer’s existing Amazon account details, without the customer needing to enter credit card or shipping details.⁷⁸ Amazon Pay is designed to integrate with existing e-commerce platforms used by merchants, such as Shopify. Amazon has also announced an intention to roll out its Amazon Pay technology to brick and mortar retailers.⁷⁹
- 5.14 This is not just speculation by the Parties – it is a view that is echoed by the FCA:

“Technology firms are becoming increasingly important in the payments sector... While existing providers in the sector range from global banks to more specialised firms, technology firms are becoming increasingly important. Google, Amazon, Apple and Facebook all now offer some form of payment functionality to UK consumers.”⁸⁰

Relevance of existing customer base

- 5.15 As in most markets, there are benefits to a provider in having a strong existing customer base that may be a source of emerging demand for omni-channel services. This allows the provider to cross-sell the new service, targeting advertising effectively and building on customer trust in the brand with which the merchant is already familiar. However, there is no single model that is necessary for an omni-channel provider in this context, and this is demonstrated by the diversity of backgrounds from which suppliers have emerged to provide omni-channel services (as described above). Providers are building effective omni-channel offerings based on acquiring platforms (e.g. WorldPay); ecommerce solutions (e.g. Shopify) and even accounting software (e.g. Sage). All of these backgrounds give access to an existing base of relevant customers.
- 5.16 Among omni-channel service providers today, banks and the large acquirers likely benefit the most from existing customer relationships; business banking relationships tend to be long-lasting and historical levels of switching are low.

Barriers to entry and expansion

⁷³ <https://squareup.com/gb/en/press/square-to-acquire-weebly>.

⁷⁴ <https://www.shopify.co.uk/omnichannel>.

⁷⁵ <https://www.shopify.co.uk/>.

⁷⁶ See P1D Response, paragraph 8.8.

⁷⁷ PayPal response to Phase 1 S109 Annex S097, slide 27. See also PayPal response to Phase 1 S109 Annex S149, slide 36, on [redacted]; PayPal response to Phase 1 S109 Annex S193, slide 22, on the competitive threat of [redacted]; and PayPal’s response to Phase 1 S109 Annex S097 at slide 29: [redacted].

⁷⁸ <https://pay.amazon.com/uk/merchant>.

⁷⁹ <https://www.techspot.com/news/77534-amazon-wants-bring-amazon-pay-technology-brick-mortar.html>

⁸⁰ See FCA’s “Sector Views”, January 2018, page 17.

- 5.17 The barriers to entry in omni-channel are considerable. To provide an omni-channel service, a provider needs to be able to address seamlessly the multi-channel needs of the merchant for that service. Smaller merchants are likely to increasingly favour single provider solutions for all services.
- 5.18 It is not easy for a provider with a single channel heritage to become an omni-channel provider. Some of these difficulties, as they apply to the Parties, have been set out in more detail in section 3 above. Becoming omni-channel requires considerable investment and planning or an acquisition. There are similar barriers facing suppliers when trying to move from the provision of one type of service to another (e.g. from payments into sales management or vice versa). However, partnership models may work well to enable an omni-channel service provider of one type to be able to offer other services alongside its core proposition. For example, an omni-channel payments provider might partner with a commerce provider as a route to market.⁸¹
- 5.19 Nevertheless, despite the difficulties, a number of players have achieved an omni-channel offering – for example, Barclaycard and WorldPay have developed new online payments platforms over several years and some players have acquired payments or sales management capability to be able to offer an omni-channel service (some examples were referred to at PayPal's site visit and include Square acquiring Weebly, Ingenico acquiring Bambora and Stripe acquiring Index).

First-mover advantage

- 5.20 The Parties do not believe that this is a market with network effects or other inherent first-mover advantages which could be difficult for later entrants to overcome. However, in any emerging and fast moving market there are benefits to being among the early established providers in terms of building a customer base and establishing brand recognition as a leading provider of the service in question, and to "learn by doing" so as to understand and keep up with merchants' evolving needs and the pace of innovation. For this reason, [X]. Even with the iZettle acquisition, it will take time for PayPal to integrate iZettle's offline payments platform. PayPal cannot risk losing existing customers to competitors that are further advanced or missing out on the anticipated growth in demand for this type of service.

Benefits of the Merger for merchants and competition in omni-channel

- 5.21 The fundamental impact of the transaction is pro-competitive: it creates an opportunity to integrate the Parties' complementary services into a cohesive omni-channel payments offering which merchants increasingly demand and which will allow PayPal to partner with commerce platforms. [X]. Even if they could do so, it would take much longer than the timescale for the Parties to build an integrated offer, therefore potentially allowing those players with holistic omni-channel commerce enablement capabilities (i.e., omni-channel payments and beyond) to capture significant share. Merchants are more likely to see benefits in the shorter term from additional competition to the active and emerging competitors in this market, driven by the Parties' integrated offer, than from the longer-term, [X] separate offerings.

⁸¹ [X].