Visa
Strategy Report

Brian Shain

Angel Rojo

Nick Gentili

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Contents

Executive Summary

Visa (NYSE: V) operates the largest payment network in the world. Consistently profitable, Visa went public in 2008 in the largest American IPO of all time, and since then, the stock price has appreciated by approximately 400%. Despite being tied heavily to consumer spending, Visa's revenue has been growing at over 13% annually and is expected to continue to do so into the future.

Visa's strengths lie in its financial solidity, numerous partnerships around the world, and ability to leverage its size in an industry that experiences economies of scale. Advancement in mobile and electronic payments as well as the expansion of credit and debit card usage in the developing world means there is ample opportunity for future growth. However, Visa does face challenges, such a recent antitrust lawsuit alleging Visa fixed prices. The world's largest developing market, China, remains closed to Visa, and the Dodd-Frank Act has hurt Visa's U.S. debit card market share along with posing numerous other risks to Visa's core business.

The card provider and transaction processing industry is more competitive than ever before, with major card providers scrambling to develop the most advantageous partnerships and outbid each other for business. Bank consolidation and the advent of collective bargaining for merchants have hurt Visa's position at the negotiating table and it must now accept lower fees. Newly popular electronic payment processing companies currently exist as complements to Visa's business, but have the potential to become competitors in the future.

In order to protect its leading position in the industry and ensure long-term growth, Visa must continue to develop partnerships in developing markets around the world, and do so before its competitors. Despite regulatory issues, Visa should find a way to enter the Chinese market. To attract new domestic customers and counteract its losses in the debit card market, Visa should expand its number of college-aged credit card users, a currently underserved cohort. To protect against new technology circumventing Visa's services, it should become a valued partner of electronic payment processing firms and provide those firms no incentive to become competitors. Finally, Visa should halt its share-repurchasing program until after it has paid for its looming acquisition of Visa Europe.

Company Background

Company History

Visa's story begins with the origins of the credit card. Prior to 1958, the idea of charge cards and revolving credit existed, but not to the extent we currently have with modern credit cards. Individual merchants issued their own credit cards, but the result was that customers had to carry a large number of cards and pay many bills every month. Bank of America solved this problem when it introduced BankAmericard in 1958 in Fresno, CA. BankAmericard's introduction was executed by a card "drop," in which actual cards with real credit were mailed directly to consumers. The following year, these drops occurred throughout the rest of California. By the end of 1959, there were two million cards issued that were accepted by 20,000 merchants. Initially, Bank of America only planned to provide the system across the state (Bank of America was a California bank and could not expand out-of-state at the time).

While the card program grew quickly, it did not do so without problems: 22% of the accounts did not pay their balances and credit card fraud was common, with consumers liable for all fraud. However, Bank of America improved its card program and in 1965, it started to sign licensing agreements with a collection of banks outside California. Later that decade, the card went international. At the same time, Dee Hock, head of a group of BankAmericard licensee banks, suggested that the banks create an association. This association would act like a joint venture, allowing members to gain advantages of a centralized payment system while also competing fairly for their personal benefit.

The unsolicited "drop" method of sending out credit cards was banned in 1970, but by then, everyone in America knew about credit cards. 1970 also marked the creation of National BankAmericard Inc. (NBI), when Bank of America and other banks issuing the cards relinquished control of the credit card program. NBI managed, promoted, and developed the BankAmericard system in America. By 1972, licenses were granted in 15 countries. Due to the rapid expansion, IBANCO, an international member corporation, became the organizing corporation for all BankAmericard products outside of the United States. The term Visa (Visa International Service Association) was introduced in the mid-1970s as the card issuers realized the value in a standardized name for their product that would earn credibility across the world.

Visa joined forces with the PLUS ATM network in 1986. This move allowed cardholders convenient access to cash. Around this time, more banks started offering debit cards, which gave account holders direct access to their money.

By 2006, Visa was a private membership association owned by more than 20,000 member financial institutions across the globe. Visa went public on March 18, 2008 with an IPO of half its shares. The IPO performed better than analysts' predictions and the company raised nearly $18 billion in the first day of trading, making it the largest U.S. IPO of all time.

Business Model

Visa operates the largest payment network in the world and is a major player in the credit and debit card field of the financial services industry. With a current market cap of approximately $105 billion, Visa is one of the 30 largest American companies by that measure. In 2012, Visa had $10.4 billion in revenue and $2.1 billion in net income. Its stock price has outperformed the market considerably, rising from $120 to $160 in the previous 12 months.

Visa is not a bank itself that issues credit, debit, and prepaid cards directly to consumers. Rather, a network of over 15,000 financial institutions provide consumers with Visa's offerings and then process payments over Visa's global payment network. Visa earns revenue on payments processed through this network, known as VisaNet. 55% of Visa's revenues currently come from the United States, but global revenue is growing quickly and the company expects revenue from the rest of the world to exceed domestic revenue by 2015.

Financial Analysis

Liquidity & Solvency

Visa finances its current operations and liabilities mostly from cash at hand and cash flows from operations, which in their 10-K they state is enough to meet its liquidity needs for more than the next 12 months. Table 1 confirms this statement and shows that, historically, Visa maintains positive cash flows and a sizeable amount of cash at hand. If need be, Visa can also issue debt or equity (common stock) in order to raise capital. As of now, Visa is in great standing in regards to liquidity and solvency, with zero debt and $2.78 billion cash on its balance sheet. Visa's current ratio as of FY2012 Q4 is 1.97, and overall for FY2012 it is 1.5. The current ratio is current assets over current liabilities, with a ratio of around 2 indicative of sound financial health, indicating that Visa's assets are worth one and a half times the amount of its short-term debt. Furthermore, taking into account Visa's credit rating of A-1 and A+ by S&P, with equivalent ratings from Moody's, Visa will have little difficulty obtaining outside sources of financing if the need arises.

Profitability & Shareholder Returns

Visa had record-setting revenues in FY2012. Both operating income and revenues experienced an increase of 13% from FY2011 to FY2012 -- operating income increasing from $5.75 billion to $6.57 billion and operating revenues increasing from $9.19 billion to $10.42 billion. However, due to a non-recurring cost of $4.40 billion stemming from its antitrust settlement, profits in FY2012 were lower than FY2011. Since this cost is non-recurring, little weight should be given to its one-time effect on income, as it does not change Visa's true profitability and financial health.

The main force driving Visa's revenues is payment volumes on Visa-branded cards for goods and services, as well as the number, size, and type of transactions processed on their payment platforms. Examining the numbers more closely, Visa's operating revenue can be divided into four components which each increased for distinct reasons: service revenues, data processing revenues, international transaction revenues, and other revenues. Service revenues are earned for providing clients with the necessary global business infrastructure and services to support the various product platforms that enable clients to deliver Visa products and payments services. Service revenues experienced growth mainly due to a 10% increase in nominal payments volume.

Data processing revenues are revenues accrued due to authorization, clearing, transaction processing services, network access and other maintenance and support services. In an effort to minimize the negative effects of the Dodd-Frank Act, Visa modified pricing and worked with clients to win preference in routing transactions through their network. As a result of this strategy, as well as an overall growth in processed transactions of 5%, data processing revenues increased from FY2011.

The final two components that contribute to Visa's operating revenues are international transaction revenues and other revenues. International transaction revenues are earned for processing cross-border transactions and any currency conversion activities, while other revenues come mostly from licensing fees. International transaction revenues increased due to an 11% increase in nominal cross-border payment volumes while other revenues also grew due to an increase in licensing fees stemming from the rise in payment volumes.

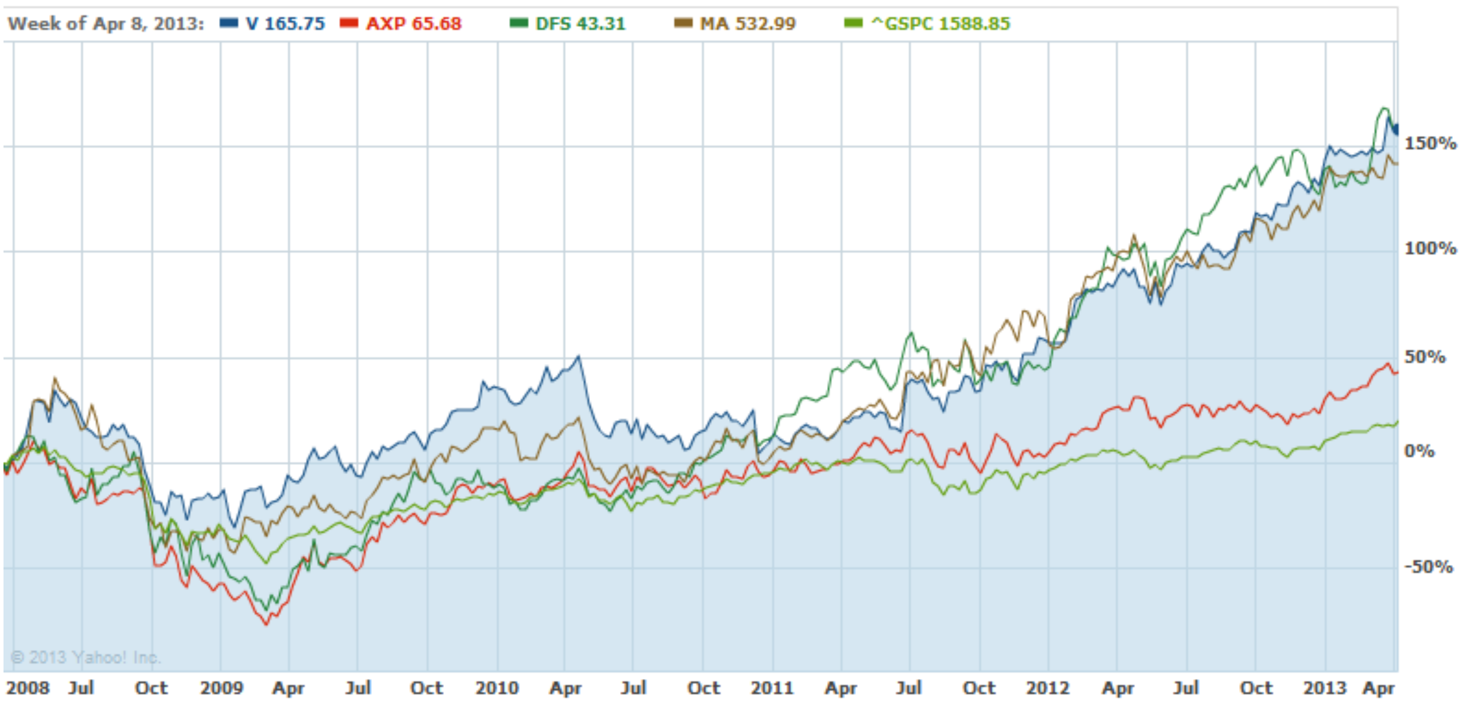
The S&P Cap IQ stock report on Visa predicts continued growth of operating revenues. S&P expects a revenue increase of 11% in FY2013 and an increase of 10 to 12% in FY2014. The increase is driven by economic recovery of the U.S. as well as overseas emerging markets, as improved economic conditions result in higher payment volumes. Furthermore, S&P also believes that mobile payments will become a larger share of payment volumes in the future, and as seen by Visa's recent exclusivity arrangement with Samsung to be the sole provider of NFC payments, Visa is already implementing its strategy to capture the mobile payments segment.

Stock Performance

Visa (NYSE: V) has outperformed the S&P500 but has not out-performed Mastercard (MA) or Discover (DFS) since the beginning of 2011. As of April 12, Visa closed at a price of $165.75 per share, just shy of the $169 twelve month target price set by the S&P Visa stock report in February. Visa's stock price has been in an upward trend since its low-price of $42.42 per share in January of 2009.

Furthermore, as can be seen in Table 1, the price to earnings (P/E) ratio and price to sales ratio have been increasing since 2010. Visa's P/E sits at 46.11 compared to an industry average of 28.64, meaning that it trades at a premium in comparison to the rest of the industry. However, according to the S&P Cap IQ Visa stock report and other analyst expectations, Visa is considered fairly priced – with an S&P fair value of $158.50 as of February. As such, the high P/E is more reflective of Visa's $4.4 billion non-recurring expense due to litigations as opposed to Visa being an overvalued company.

Graph 1: Visa stock prices, 2008 to April 2013



Source: Yahoo Finance

Table 1:Expanded Ratio Analyses

	2012	2011	2010	2009
Price/Sales	9.86	7.81	6.45	9.59
Price/EBITDA	15.64	12.48	10.82	17.60
Price/Pretax Income	46.57	12.69	11.21	16.57
P/E Ratio	47.93	19.67	17.54	28.17
Avg. Diluted Shares Outstg (M)	678.0	707.0	739.0	758.0

Figures based on calendar year-end price

Source: S&P Cap IQ Stock Report

Table 2: Company Financials

Per Share Data (U.S. $)	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
Tangible Book Value	5.96	4.22	2.45	2.48	NM	NM	NA	NA	NA	NA
Cash Flow	3.65	5.73	4.52	3.40	0.95	NA	NA	NA	NA	NA
Earnings	3.16	5.16	4.01	3.10	0.96	-1.15	0.60	NA	NA	NA
S&P Core Earnings	6.97	5.06	3.95	2.67	1.95	1.87	0.57	NA	NA	NA
Dividends	0.88	0.60	0.50	0.42	0.11	NA	NA	NA	NA	NA
Payout Ratio	28%	12%	12%	14%	11%	NA	NA	NA	NA	NA
Prices:High	152.51	103.45	97.19	89.69	89.84	NA	NA	NA	NA	NA
Prices:Low	98.33	67.51	64.90	41.78	43.54	NA	NA	NA	NA	NA
P/E Ratio:High	48	20	24	29	94	NA	NA	NA	NA	NA
P/E Ratio:Low	31	13	16	13	45	NA	NA	NA	NA	NA

Income Statement Analysis (Million U.S. $)	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
Revenue	10,421	9,188	8,065	6,911	6,263	5,193	3,899	2,641	2,409	1,963
Operating Income	6,572	5,751	4,809	3,766	3,106	2,238	1,419	1,271	1,063	537
Depreciation	333	288	265	226	237	NA	NA	686	593	451
Interest Expense	NA	32.0	72.0	115	143	NA	104	108	111	61.1
Pretax Income	2,207	5,656	4,638	4,000	1,336	-1,007	738	456	355	-1,456
Effective Tax Rate	2.95%	35.5%	36.1%	41.2%	39.8%	NM	37.0%	40.2%	37.3%	NM
Net Income	2,144	3,650	2,966	2,353	804	-892	465	265	216	-885
S&P Core Earnings	4,724	3,559	2,909	2,033	1,787	1,574	476	NA	NA	NA

Balance Sheet & Other Financial Data (Million U.S. $)	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
Cash	2,817	3,398	4,051	4,732	6,287	7,935	NA	822	340	NA
Current Assets	11,786	9,190	8,734	9,241	11,174	11,321	NA	1,432	898	NA
Total Assets	40,013	34,760	33,408	32,281	34,981	33,250	NA	2,745	2,294	NA
Current Liabilities	7,954	3,451	3,498	4,442	7,165	6,541	NA	1,275	1,047	NA
Long Term Debt	NA	NA	32.0	44.0	55.0	40.0	NA	73.6	106	NA
Common Equity	27,630	26,437	25,011	23,189	21,141	19,747	NA	126	-230	NA
Total Capital	27,630	26,437	25,058	23,249	26,143	24,560	NA	254	-81.2	NA
Capital Expenditures	376	353	241	306	415	NA	NA	119	122	164
Cash Flow	2,477	3,934	3,231	2,579	1,041	NA	NA	951	809	-434
Current Ratio	1.5	2.7	2.5	2.1	1.6	1.7	NA	1.1	0.9	NA
% Long Term Debt of Capitalization	Nil	Nil	0.1	0.2	0.2	0.2	Nil	29.0	NM	Nil
% Net Income of Revenue	20.6	39.7	36.8	34.1	12.8	NM	11.9	10.0	9.0	NM
% Return on Assets	NA	10.7	9.0	7.0	2.4	NA	NA	NA	NA	NA
% Return on Equity	NA	14.2	12.3	10.6	3.9	NA	NA	NA	NA	NA

Source: S&P Cap IQ Visa Stock Report

Competitive Analysis

Internal Rivalry

The threat of internal rivalry to Visa's position is moderate to high. The financial transaction processing industry is fairly concentrated. Visa and its major competitors, such as American Express, MasterCard, and Discover, control the bulk of credit and debit cards, and across the entire payment processing industry, the 50 largest firms make up 85% of the industry's revenue.[1] Among payment card firms, competition is high to create partnerships with banks so that a company's cards will be offered to the bank's customers. As banks consolidate post-recession, there are fewer banks to partner with and each successful partnership yields a greater reward, so competition has increased. However, from the recently settled antitrust lawsuit alleging that card providers colluded with banks to keep merchant swipe fees high, it would appear that the large payment companies recognize that they do not need to ward off new entrants with low prices and that aggressively competing against each other on the basis of price is bad for profits.

Along with other major payment card companies, Visa faces competition from private-label credit cards, which are not issued by banks, but rather by merchants (such as a gas station or department store). These cards can only be used at one brand of store, but certain consumers may have credit cards for all the stores they frequent, shifting transactions away from the major card companies.

With a move to mobile payments, payment card companies have sought to partner with mobile phone makers to use their cards in digital wallets or with integrated near field communication systems (NFC). In this sense, there is great internal rivalry, as these partnerships are often all or nothing (Visa will be the sole card provider available on all Samsung NFC phones). Mobile payments have introduced new competitors into the payment processing market such as PayPal and Square, which do not issue credit cards but can shift transactions away from the traditional card providers. These electronic payment processors are not purely competitors, however, as many of the payments processed by these online platforms are made by consumers using their credit and debit cards, which generates revenue for traditional payment card companies.

[1] Hoover's Financial Transaction Processing Industry Report

Entry & Exit

The threat of entry and exit to Visa's position is low. There are economies of scale in this low-margin business and it is unlikely a new entrant can succeed against the current major players who command such a large percentage of the market. As a card provider grows in size, more consumers possess the company's cards and demand that merchants accept the cards. This provides large providers such as Visa with more leverage when negotiating fees with merchants, whereas a very small card provider would not be able to achieve its desired fees.

Chargebacks, where consumers contest charges on their credit cards, also pose a risk that threatens smaller card providers more greatly. If credit card companies cannot collect the chargeback money from the merchant, they must cover the cost themselves. Large card providers can self-insure against these risks and are more likely to be able to force merchants to return the money in the first place, whereas a small provider would struggle. There is also a significant amount trustworthiness required to create bank partnerships and convince consumers that their money is safe when using payment cards. Visa and other established players have strong reputations around the world that offer much value and prevent new entry.

There are certain geographical barriers to entry that even a company as large as Visa faces. Governments may support a particular domestic company, like China UnionPay, and prevent other card providers from competing. Despite a World Trade Organization ruling against China UnionPay's government-mandated monopoly, foreign card providers have still not been able to enter the Chinese market. A different type of barrier emerges in countries with weak banking systems. Traditionally, card providers do not issue cards to consumers directly, but rather partner with banks that offer their customers the cards. However, there are many nations where the average person does not have a bank account. In these countries, card providers must innovate, such as partnering with mobile phone companies and banks to allow consumers to use payment cards without ever having to walk into a bank. Nevertheless, developing these solutions takes time and the R&D costs are considerable, meaning smaller firms will struggle to enter these new markets.

Substitutes & Complements

The threat of substitutes to Visa's position is moderate to low, and complements stand to help the card provider business greatly. The most basic substitutes to credit and debit cards are cash and checks. Within developed markets, credit and debit cards are not going anywhere, and cash usage continually decreases. For consumers who do not want credit or debit cards, prepaid cards are gaining in popularity, and Visa's prepaid cards dominate the market. Services such as PayPal and Square may become more common, but for the most part, mobile payments involve merely using one's existing payment card. These mobile payment technologies may end up as complements to card providers, as the ease of mobile payments may shift additional transactions away from cash.

In developing markets, payment cards are not as strongly embedded in society. Credit and debit cards may not be trusted, so cash can remain a strong substitute for payment cards. For these markets, mobile phones serve as a complement to Visa's products. Mobile phones are increasingly widespread and trusted for business and payments, with prepaid phone minute cards sometimes being used substitute for cash in areas where inflation is high or counterfeit money is a threat. This reliance on mobile phones means consumers will likely be amenable to payment card solutions offered purely through mobile phones, opening an untapped market of growth for card providers.

Supplier Power

Supplier power is low in the financial transaction processing industry. Outside of plastic to produce its cards, Visa does not use raw materials to produce goods. Visa's employees are not unionized and its payment services are designed internally, without reliance on other firms. As a company in need of innovative computer programmers, Visa likely struggles to find enough qualified employees in the United States like many technology companies. However, this is not a major risk, and Visa should be able to outsource jobs easily if necessary.

Buyer Power

Buyer power for Visa's products and services is high. Card provider companies gain access to customers mainly through banks, and now, mobile phones. Therefore, large banks and mobile phone companies can negotiate advantageous deals in return for providing their customers with the payment company's products. The recent antitrust settlement limits the fees Visa can charge merchants, and smaller merchants may now engage in collective bargaining to reduce Visa's size advantage during negotiations. The Dodd-Frank Act imposes changes to the industry that also lower Visa's bargaining power. Debit interchange reimbursement fees have been limited, and Visa reports that it has been forced to lower fees for certain commercial customers looking to offset their own revenue reductions.[2] Visa is also no longer able to negotiate exclusivity contracts with banks as a result of Dodd-Frank.

For individual consumers, there is very little cost to switching credit cards; in fact, introductory offers often making switching to a different card appealing. While consumers may want to remain with one of the major card providers in order to have the most universal access for their cards, Visa is not the only option.

[2] Visa 10K, 2012

SWOT

Strengths	Weaknesses
•Finances •Size •Partnerships	•China •Antitrust lawsuit •U.S. debit cards
Opportunities	**Threats**
•Visa Europe •Mobile and electronic payments •Prepaid cards	•Dodd-Frank •Visa Europe •Identity theft

Strengths

•**Finances:** Visa's finances are extremely strong. Despite paying $4.4 billion in the recent antitrust lawsuit settlement, Visa has $2.78 billion in cash on hand and zero debt. This offers Visa excellent liquidity should any short-term costs arise, plus it gives Visa the opportunity to make small acquisitions without needing outside financing. Another sign of Visa's financial strength is its stock repurchasing program. Visa already had $1.1 billion set aside for repurchasing its own stock at the end of 2012, and in 2013, it was decided that another $1.8 billion in repurchases could be made through January 2014. Simply having the ability to make these purchases is impressive, but it also shows that Visa believes in its own business and wants to increase its own profits from anticipated future stock price increases.

The strength of Visa's balance sheet also means it should be able to loan money at a low rate if necessary. Banks will not worry about Visa's ability to pay off loans, so if outside funding is needed to purchase Visa Europe, for instance, it should be readily available at a reasonable price.

•**Size:** Visa is the largest payment processor in the world and considerable economies of scale exist. After payment technologies are developed, Visa's costs per transaction are low—mainly the cost of computers and staff required to remedy any problems. Therefore, the cost per transaction processed lowers with every additional transaction, and Visa processes the most transactions in the world. Visa's size adds value for consumers as they can expect their credit and debit cards to be accepted at most merchants around the world. The ability to have just one card and make just one payment per month is a plus for consumers.

With so many consumers using its cards, Visa also has greater bargaining power than its smaller competitors. Merchants feel great pressure from their customers to accept Visa's cards, so even in an era where Visa's fees are decreasing due to government rulings, bank consolidations, and collective bargaining among merchants, Visa has a stronger position than most card providers.

•**Partnerships:** Visa has been extremely aggressive in securing partnerships recently. Its most significant deal is with Samsung, where Visa cards will be the sole option provided for all Samsung smart phones enabled with near field communication (NFC) technology. Samsung is the world's largest producer of smart phones, so this is a major coup. Visa certainly had to provide incentives to Samsung to seal the partnership (these details are not presently available), but the ability to gain all of these new customers while completely shutting out its competitors must be seen as a positive.

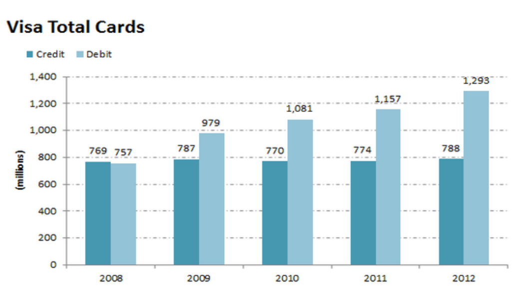
Learning from its failure to gain access to the Chinese market, Visa has moved to create partnerships in foreign countries that will ease political difficulties while entering new markets. Visa will be entering the Indian market via a partnership with the national government and five large banks, and deals with mobile phone providers in both India and Rwanda will allow for new accounts from people who do not even have bank accounts. QIWI is one of the largest payment companies within Russia, and Visa has signed a deal with the Russian firm to use Visa's digital wallet technology.

Weaknesses

•**China:** Visa currently does not have a major presence within China, one of the world's largest and fastest growing markets for payment cards. China UnionPay dominates the market, and at approximately 3 billion, actually has the most credit and debit cards in circulation of any payment firm in the world. China UnionPay gained its dominance through a government-mandated monopoly. In July 2012, the WTO noted this protectionism and ruled that China has to allow foreign providers to issue payment cards within China. However, the Chinese government still prohibits all companies except China UnionPay from processing any transactions denoted in the yuan, which essentially prevents all foreign providers from competing. The WTO may realize this loophole to its previous ruling and force China to open its payment card market, but by then, the Chinese market may be saturated with China UnionPay cards and prove difficult to penetrate.

•**Antitrust Lawsuit:** In 2012, Visa, along with its codefendants, agreed to the largest antitrust settlement ever in the United States. Visa paid $4.4 billion to plaintiffs in late 2012, which made a major impact on its net income. The lawsuit contended that Visa and other card processors colluded with banks to set the fees merchants face when they swipe customers' cards. Instead of engaging in a lengthy lawsuit that could have cost the defendants as much as $300 billion[3], the defendants chose to settle at a combined $7.25 billion. Complaints by plaintiffs that the settlement is too low suggest Visa struck a good deal, but the settlement agreement includes additional measures that hurt Visa. The fees Visa is legally allowed to charge merchants have been capped, and small merchants are now allowed collective bargaining. Previously, Visa could dictate its fees to small merchants and expect no pushback, but collective bargaining eliminates much of Visa's size advantage.

•**U.S. Debit Cards:** Following the recession, the credit card market has not been growing as it once was. Consumers are shying away from credit and moving toward debit cards. The graph below on the left shows that the number of Visa credit cards in circulation has stayed approximately the same since the recession began, but growth in debit cards has been much stronger. Additionally, debit cards are Visa's largest source of revenue, and it processes more debit card transactions than credit. The Dodd-Frank Act has hurt Visa's position in the U.S. debit card market by eliminating exclusivity agreements between Visa and large banks. Visa still controls more than half the U.S. market, but in a period of debit card usage growth, Visa moved in the opposite direction, processing 7% fewer transactions in 2012 than in 2011. It is unclear how much market share Visa will lose as a result of Dodd-Frank, but it is a worrying sign that Visa's competitors are eating into its strongest position.



	U.S.		
	3 months ended September 30, 2012 (2)	3 months ended September 30, 2011 (2)	% Change
Nominal Payments Volume			
Consumer credit	$ 191	$ 172	11 %
Consumer debit(3)	248	267	(7)%
Commercial and other(3)	82	78	6 %

Source: Visa 10-K, 2012 and 10-Q, Q1 2013

[3] Business Week, "Visa, MasterCard $7.25 Billion Fee Deal Wins Approval", 11/10/2012

Opportunities

•**Visa Europe:** Visa provided Visa Europe, a separate company, with a put option for 2013 where Visa Europe could force Visa to purchase the entire company. Visa Europe is owned by its member banks all throughout Europe, and with European banks needing extra cash during the current financial downturn, the banks are expected to exercise the put option soon.

Purchasing Visa Europe would improve Visa's overall brand. Visa mentions in its most recent 10-K that Visa Europe can use Visa's name and technology however it wants, which sometimes conflicts with Visa's branding strategy. Visa seeks to maintain a peerless record of integrity at all times, but Visa Europe could not be controlled and did not always have the same standards. Purchasing the European part of its business will also help Visa compete with competitors such as MasterCard that already operate as a single entity throughout the world.

•**Mobile and Electronic Payments:** Globally, 85% of payments are still made with cash.[4] Consumer spending will drive growth for Visa in the developed world, but the potential for much greater growth exists in the developing world as people switch from cash to card and mobile payments. Visa's exclusive partnership with Samsung guarantees itself 20% of the global smart phone NFC market, and agreements with Indian and Rwandan mobile phone providers to offer payment systems without even having a bank account show innovative technological development. While there are 1.3 billion active credit and debit accounts in the world, the number of mobile phone accounts far outweighs that number at 5 billion.[5] Tapping into consumers who have mobile phones but not credit and debit card accounts means Visa can win new business without having to steal it from competitors.

To move into this new field, Visa has acquired a South African company, Fundamo, for $110 million. Fundamo specializes in providing financial service offerings to mobile phone operators in developing countries, and with its base in Africa, it understands regional means of business and

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[4] Forbes, "Visa And MasterCard Will Use Mobile Phones To Tap Developing Economies Growth", 3/6/2013

[5] Forbes, "Visa And MasterCard Will Use Mobile Phones To Tap Developing Economies Growth", 3/6/2013

will assist Visa in moving its products into new countries. 5 million consumers already use Fundamo's services, and it has the existing capability to service 180 million people.[6]

•**Prepaid Cards:** The use of prepaid cards is increasing rapidly as consumers fear using debt following the recession. Annually, the amount of money put onto prepaid cards is increasing by 42%[7], and Visa is a strong player in the market. Visa is using Fundamo's technology to introduce prepaid cards to developing markets where Visa's product may be seen as more safe and reliable than cash. Prepaid cards are not purely issued through banks, so Visa can avoid some of the increasingly aggressive negotiating process and keep fees higher. Prepaid cards are easily available to consumers; Visa's website listed 21 retail outlets within a 2-mile radius of Pomona College, and can be found in banks, but also big-box and convenience stores such as Walmart and 7-Eleven.

Threats

•**Dodd-Frank:** The Dodd-Frank Act poses the single largest risk to Visa. Dodd-Frank has forced Visa to lose part of its debit card business and has greatly limited fees within the payments industry. These fee reductions have primarily hit banks, but those banks have been able to pass the impact of lower fees on to Visa in negotiations over Visa's services. Visa provides incentives to banks to offer its cards, and currently those incentives are equal to 16% of Visa's revenue. However, as competition for banks' business increases and banks demand better deals, Visa expects its percentage of revenue spent on incentives to increase to 18% within a year.[8]

Another threat with Dodd-Frank is the cost of compliance. In order to avoid costly penalties resulting from breaking the rules of Dodd-Frank, Visa must increase its compliance budget. The company lists numerous possible risks stemming from Dodd-Frank in its most recent 10-K, but it appears unsure as to what effect Dodd-Frank will actually have on its business. This indicates that Visa does not completely understand Dodd-Frank, increasing the possibility that it will find itself in violation of the rules.

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[6] TechCrunch, "Visa Acquires Mobile Financial Services Company Fundamo for $110M in Cash", 6/9/2011

[7] Hoover's Financial Transaction Processing Industry Report

[8] Visa 10-K, 2012

•**Visa Europe:** While the potential acquisition of Visa Europe is seen as a positive by analysts and will make worldwide operations work more smoothly, it also presents a considerable financial risk. The put option specifies that the purchase price will be determined partially by Visa's price to earnings ratio, and with that statistic at an all-time high, Visa Europe will extract the highest purchase price possible from Visa. The total cost is expected to be near $7 billion for a Visa Europe, which has $1.2 billion in annual revenue. Visa Europe's profit margin of 23% is also much lower than Visa's current 60% mark[9], meaning there are improvements that must be made to the business. To fund such a large purchase, Visa will likely need to gain access to debt, hurting its current balance sheet of significant cash reserves with zero debt.

•**Identity Theft:** Cyber crime is becoming increasingly more frequent and complex. If consumers develop enough fear of identity theft, they may switch away from using payment cards and return to cash. This threat is particularly great for Visa because it cannot prevent identity theft. The chance of Visa's systems being compromised by cyber criminals is unlikely, but its partner banks and merchants with weaker security systems are at risk. Even though Visa itself is not at fault, consumers hear that their Visa products have been compromised and associate that with a failure on Visa's end.

[9] Investor's Business Daily, "Visa Europe Marriage Seen as Big Positive for Visa" 3/26/2013

Strategic Recommendations

Continue to aggressively develop partnerships in developing markets

The advantage to having a partner with local connections in developing markets is significant. In some cases, having government connections is required to operate within a country. Instead of waiting for WTO rulings to open up markets, Visa should attempt to create deals with national governments and become a "favored" company that is allowed access to the nation's consumers before anyone else. It may be against capitalistic ideals, but the best-case scenario for Visa in the developing world is that it achieves government mandated monopolies à la China UnionPay.

Government partnerships are likely to be rare, but as Visa has shown with its bank deals in India, mobile phone partnership in Rwanda, and joint digital wallet development in Russia, there are partnerships to be made all around the world. Visa needs to now find companies to collaborate with in every other market it hopes to enter. Most importantly, it needs to create these partnerships as quickly as possible.

There is a large first mover advantage when it comes to entering new markets. Look at Burma, for instance. Burma opened its markets to foreign card providers only late last year. On March 14, 2013, Visa announced a partnership with a company called Payment Planet that works with Burmese banks to offer Visa's services. However, Visa is likely too late of an entrant to become the dominant player in Burma. MasterCard was the first mover, offering services as early as November of last year. China UnionPay moved in soon after and already has 200 working ATMs for its customers. Internal rivalry in the card provider industry is extremely high for entering new markets, and there may be a limited number of banks and other partners within those countries that uphold the same high standards for financial security that Visa requires in a partner. If Visa can claim these few high-quality banks as partners and distribute its products to consumers first, it will be in an excellent position to gain significant market share. However, if consumers already have another company's cards, they may see no reason to switch to Visa, resulting in Visa essentially being shut out of the entire country.

Develop a strategy to enter the Chinese market

Due to a government ban on foreign companies processing transactions denoted in the yuan, Visa cannot currently operate within China. The WTO will likely revise its ruling at some point in the future to allow entry for foreign card providers, but Visa cannot wait until then to make a move. By that point, China UnionPay will control the entire country's payment card services, and making headway into a saturated market difficult.

China is simply too large of a market to ignore, but Visa cannot process any yuan-denominated transactions. Therefore, Visa should look to work with Chinese companies that focus on exports and receive payment in other currencies, such as dollars or euros. With much more international experience than China UnionPay, Visa should be able to attract Chinese companies to use its commercial services. This will allow Visa to establish its name within China, so when consumer markets eventually open, the Chinese populous will know about Visa and be more likely to adopt its products.

Partner with leading electronic payment companies

As it stands today, electronic transaction processing firms such as PayPal and Square are not direct competitors to Visa. Many of the transactions these companies process involve consumers using their credit and debit cards, and Visa gets a cut of all of those transactions. In fact, if the convenience of Square and PayPal's products encourage consumers to use cash less often, the electronic transaction processing industry will be a complement to Visa as it boosts the total number of transactions using Visa's cards.

Despite comments from Square's CEO that the company has no interest in becoming a card providing company and cutting Visa out of the payments loop[10], Visa must be wary of these firms becoming competitors in the future. Visa has noted in its 10-K that it does not have the technological capabilities to stay on the forefront of electronic payment technology. Therefore, it should seek to ensure that large electronic transaction processors do not have a reason to begin competing with Visa. If Visa is able to co-develop products that best suit the electronic transaction processors' needs and offer advantageous rates, these companies will see Visa as a partner and not a

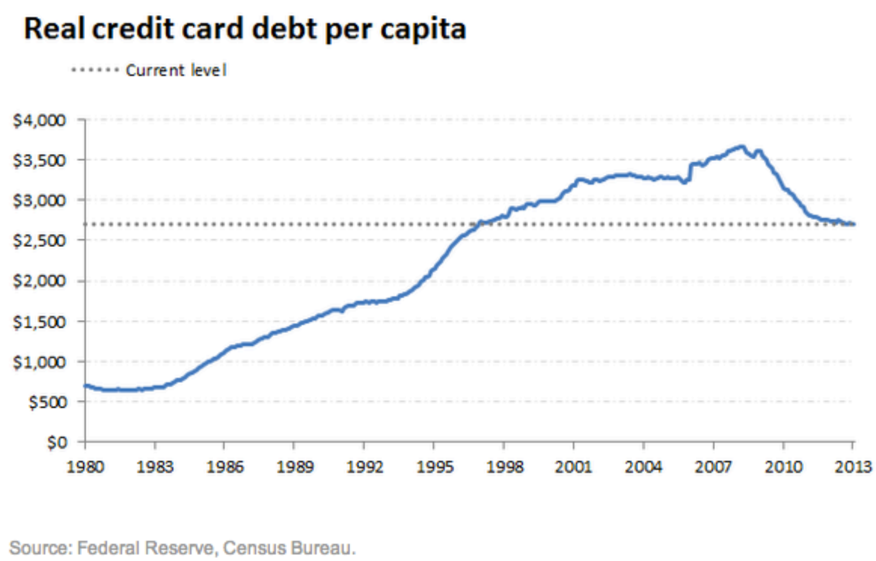
[10] CNBC, "Square to Push Beyond Just Payments," 3/2/2013

competitor. This will allow Visa to maintain its market share in the payment world without fear that these new companies will replace Visa.

In the case that new technology arises that allows consumers and merchants to bypass Visa's services for electronic payments, Visa should look to quickly acquire a firm with an electronic payment platform. Visa does not have the capability to design such a platform on its own, but by tailoring its current offerings to work on an existing platform, Visa could hopefully leverage its size and current deals with merchants and banks to gain a piece of any new type of payment market.

Engage in marketing campaigns to show that credit cards are safe and advantageous

Americans are moving away from credit cards to debit cards, and with Dodd-Frank hurting Visa's ability to gain or even maintain its market share in the debit card field, this is problematic. Card providers make money off interest when consumers go into credit card debt, so as long as consumers are not defaulting in mass, credit card debt is good for providers. The table below shows how Americans have lowered their credit card debt following the recession.



For Americans under the age of 25, the move away from credit cards is more extreme. 80% use debit cards, but credit card usage is only 60%[11]. This cohort's credit card usage is also likely to fall in the future. 2010 legislation required a cosigner for a credit card to be issued to anyone under the age of 21 without significant income (i.e. students). Due to the cosigner requirement, young Americans have found it difficult to obtain credit cards while they are still in school, and if people

[11] Hoover's Financial Transaction Processing Industry Report

grow accustomed to only using debit cards in their college years, there is a chance they will never adopt credit cards later in life.

Despite the regulatory difficulties, Visa should find ways to tap into the college student market for credit cards. Having a credit card at an early age helps to build one's credit score and makes applying for future car and home loans easier. Paying off a credit card each month is also an excellent exercise for young people to develop financial literacy and responsibility. Visa should introduce a marketing campaign with this information targeted toward college students. Additionally, Visa should partner with colleges to provide free financial literacy seminars. These seminars will not purely be advertisements for Visa (which will convince colleges to offer them), but after explaining the benefits of credit cards, students should receive information on how to get a Visa card. Once students are made aware of the benefits of credit cards and are provided with specific steps on how to obtain a Visa card, Visa should gain market share among young people in the credit card market. While college students will not charge as much to their credit cards as the average American, Visa can develop brand loyalty, and when students graduate and increase their spending, they will already have a Visa card.

End share buyback due to the financial outlay from Visa Europe put option

Visa has held large amounts of cash in recent years, and buying back stock was a smart move when it did not need the cash for other uses. However, with a $7 billion purchase of Visa Europe looming, it can use some of that cash to reduce the size of the loan it will require. One of Visa's great strengths is the solidity of its balance sheet, and although it will need to take out debt to purchase Visa Europe, that debt should be limited to as little as necessary. Share repurchasing agreements signal to investors that Visa believes in its future growth, but at this point, Visa has already repurchased over $1 billion of its own stock, and investors' opinion of Visa's future growth is already high.