

## Overview: Credit Card Case

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- Market Definition
  - Review
  - Market Participants
  - Pricing Discussion
- Other Issues in Case
  - Timing and Strategic Interaction
  - Market Power
  - ...

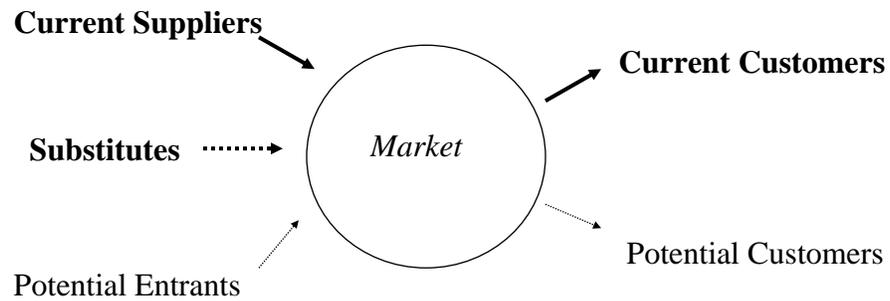
## Market Definition : Review

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- Definition : collection of buyers and sellers that, through actual or potential interactions, determine the price of a product
- Point of departure:  
`If I try to raise (lower) prices, where will current customers go (new customers come from)?'
- Remarks :
  - Always relative to a specific question
  - Important for business strategy, pricing, anti-trust

## Market Definition

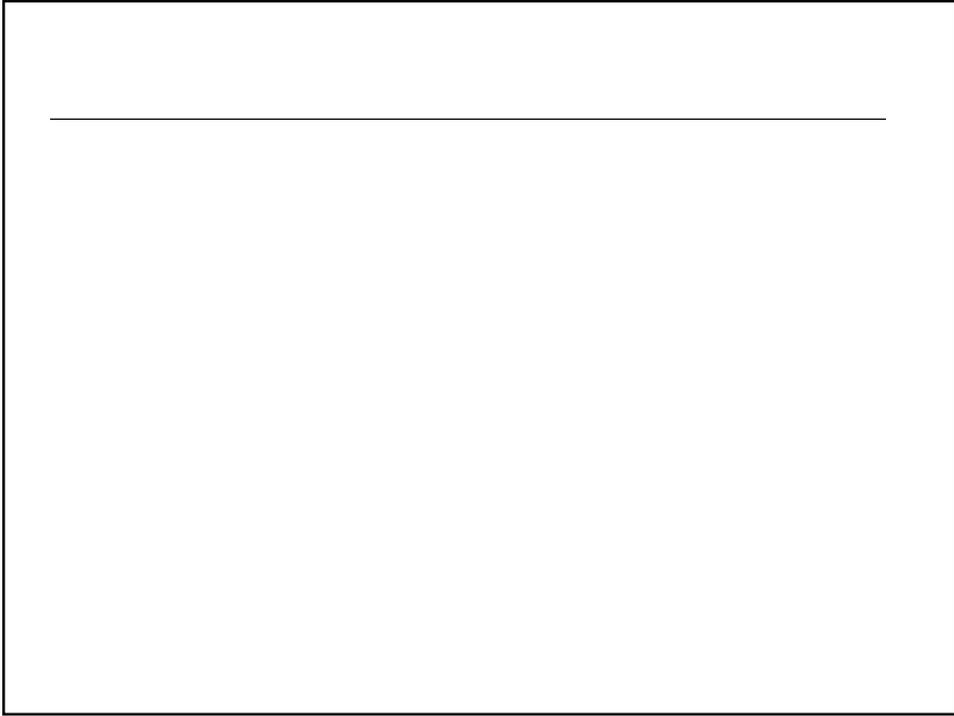
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## U.K. Credit Card Industry

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- Who are the players?
- What are the issues?



The Product 'Credit Card'

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## Direct Substitutes

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## Longer-range Substitutes

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- Note : Lecture 7 discusses network effects

## Increasing the Interest Rate

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- Note : Lecture 19 discusses adverse selection

## Important Consumer Characteristics

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## Charging a Fixed Fee

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- Note : Lecture 9 and 10 discuss pricing schemes

## Profitability : Assumptions

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- APR : 26.8%
- Cost of Money : 10%
- MSC : 2% of sales
- Cost : 3.1% of sales (Exhibit 5)

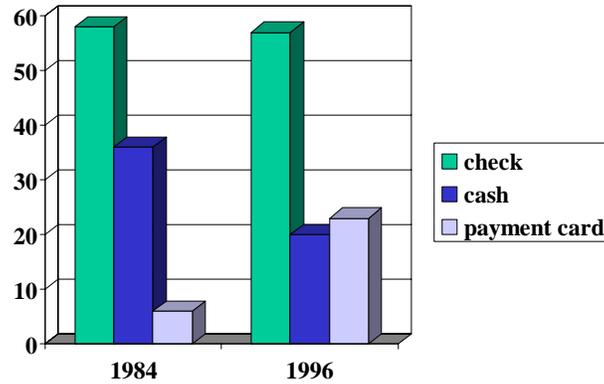
- Note : Lecture 4 discusses economic costs

## Measuring Substitutes

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- Cross-price elasticity
- Correlation of Prices
- Correlation of Market Shares

## Payment Mechanism Substitution



Evolution of \$ volume shares of different payment mechanisms in US (in %)

## Timing

- Should Barclays go first?

- Barclays payoffs :

		Other Bank	
		Move now	Wait until other moves
Barclays	Move now	+2	-4
	Wait until other moves	+10	-2

- Note : Lectures 12 and 13 discuss game theory and prisoner's dilemma

## Further Issues

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- System level and market power
- Market of retailers: Incentives in negotiating
- What happened in the U.K.?

## System Level & Market Power

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- What if Visa imposes the annual fee on all the issuers?
- Definition of market power (US DoJ):  
*"ability of one or more firms profitably to maintain prices above competitive levels for a significant period of time"*
- Does Barclays have market power? Visa? Visa and MasterCard?
- Note : Lectures 14 and 15 discuss collusion and anti-trust

## Market of Retailers

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MSC are negotiated by acquiring banks but get passed on to issuing banks

- Do these banks have the right incentives in negotiation? More or less, because they are also issuers.
- With specialized acquirers as in U.S, you need different system: MSC goes to acquirer (who now pays interchange fee)
- BUT, the acquirer still does not take into account the effect on the whole system. The choice of interchange fee is key to this.

- Note : Lectures 18 and 20 discuss incentives and externalities

## What Happened in the U.K.?

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- Feb '89 : Barclays considers an annual fee
- Aug '89 : Lloyds announces annual fee, Barclays waits
- Feb '90 : Annual fee takes effect; Lloyds estimates loss of 10% of its credit card customers
- Mar '90 : Lloyds loss of 20% of its customers; Lloyds credit card profits declined substantially relative to other banks
- Apr '90 : Barclays announces annual fee, to take effect in June
- During '91 : Midland and Natwest also introduce annual fees

## Take Away Points

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- Market Definition can be complex
  - be clear about the question
  - be clear about the product (function)
  - consider both supply and demand
- Economics is directly relevant to business decisions
  - economic cost
  - pricing
  - sorting
  - game theory
  - incentives

## For Next Time

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- Sugar Industry Case:
  - Study the case
  - No need to prepare answers to the questions in the case