DATOS INSIGHTS PERSPECTIVE

What is next for Capital One and Discover

By David Shipper, strategic advisor, Datos Insights

In February 2024 Capital One and Discover announced a merger that could reshape the competitive landscape of banking and payments. The deal is yet to be approved, but the announcement has sparked speculation across the financial services industry and drawn ire from politicians. Let's explore four key considerations of this historic union.

Lower expenses and higher revenue

As in most mergers, the two companies will streamline operations, creating efficiencies and lowering costs. However, what is unique here is the ability to create new revenue by leveraging a loophole in the US interchange regulations that excludes debit and credit cards from interchange revenue caps when the issuing bank owns the card network. At present, this protection is only available to American Express and Discover, for the cards that they directly issue. When the merger is complete, and Capital One transitions its debit cards to the Discover network, this loophole will create hundreds of millions of dollars in annual new interchange revenue.

Improved merchant acceptance

Discover has broad global acceptance but lags Mastercard and Visa. However, the merger will benefit Discover's merchant acceptance, as Capital One plans to move over 7 million debit cards and a portion of its credit cards to Discover. Once that occurs, merchants that do not accept Discover will risk losing sales. The result will be a sharp increase in Discover merchant acceptance even if the merger does not move forward as merchants pre-emptively prepare for an influx of Discover-branded cards.

Issuer data privacy concerns

Pulse (owned by Discover) is a popular PIN network for many debit cards in the USA. Privacy protections may already exist for Pulse issuers, but FIs that see Capital One as a competitor will not want Capital One to access their debit card PIN transaction data. Pulse issuers will demand safeguards to ensure transactional or client data is not used for competitive purposes. The new company will likely be happy to comply and add protections to existing agreements if necessary.

Regulatory and political hurdles

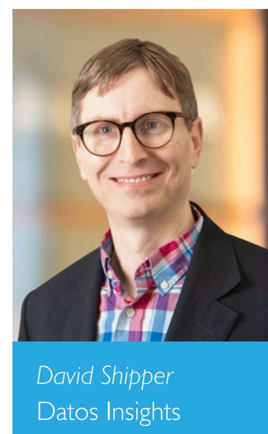
There are compelling arguments for and against this merger. First, the USA has taken an anti-consolidation stance, and the Federal Trade Commission (FTC) has sued to block large mergers in recent years. Furthering the odds of denial is the fact that President Biden and several elected officials have expressed concerns over the merger. Political pressure combined with an FTC known to take action to stop mergers indicates a considerable risk of denial.

However, the combined company will enhance competition in a way that is unique to this merger. Multiple politicians have characterised the 'duopoly' of Visa and Mastercard as anti-competitive and responsible for elevated merchant processing costs. Increased competition among card networks could persuade some politicians to support the merger since the new company will become a stronger rival to Visa and Mastercard.

What happens next

Approval is just the first hurdle. The new organisation's leadership must then combine two quite different companies, cultures, systems, procedures and products, which could take years and come at a significant cost. Ultimately, the merger will shift power dynamics within banking and payments and create a new global financial services juggernaut well-positioned to compete against the world's largest financial institutions and card payment networks.

For more on the potential merger, please read 'What's Up With Capital One and Discover?' by Thad Peterson. ■



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