Entry of FinTech firms and competition in the retail payments market*

Jooyong Jun†  Eunjung Yeo‡

Abstract

We investigate the effects of the entry of financial technology (FinTech) based firms on competition in the retail payments market. Specifically, we do so from the perspective of a duopoly between an incumbent and an entrant under vertical restraint conditions. Considering cross-platform externalities in payment processing, differentiated preferences for payment platforms, and the competitive bottleneck on the consumer side, we derive the following results. When only the entry of a vertically integrated (or end-to-end service) provider is allowed, either all merchants choose to multi-home or no entry occurs, regardless of the regulatory requirement. On the other hand, if the entry of a downstream-only (or front-end service) provider is possible, a partial multi-homing equilibrium result could emerge for some conditions where the entry of an end-to-end service provider does not occur. In addition, due to the lowered entry cost, overall welfare is greater when the entry of a downstream-only service provider is possible, although the entire welfare increase goes to the entrant. Without regulation, however, the vertically integrated incumbent does not voluntarily provide the back-end service to the entrant when the merchant’s benefit from the payments service is not sufficiently high. This suggests the need for proper regulatory measures to reach a socially desirable outcome from the new entry in the retail payments market.

JEL classification : L11, G23, G28
Keywords: FinTech, entry, retail payment, front-end, end-to-end

*Thanks to Woon Gyu Choi, Jin Jeon, Byoungki Kim, Juwon Kwak, Inho Lee and Kyoung-Soo Yoon for their valuable suggestions and comments. Support from Hyung-Kwon Jeong and Bokkeun Yu is acknowledged. This paper does not reflect the opinions of the Bank of Korea other than the authors’ personal views.
† Economic Research Institute, the Bank of Korea(jooyong@bok.or.kr)
‡ Corresponding author, School of Business, ChungAng University(ejyeo@cau.ac.kr)