Are stablecoins about to upend the Visa & Mastercard duopoly? Not so fast...

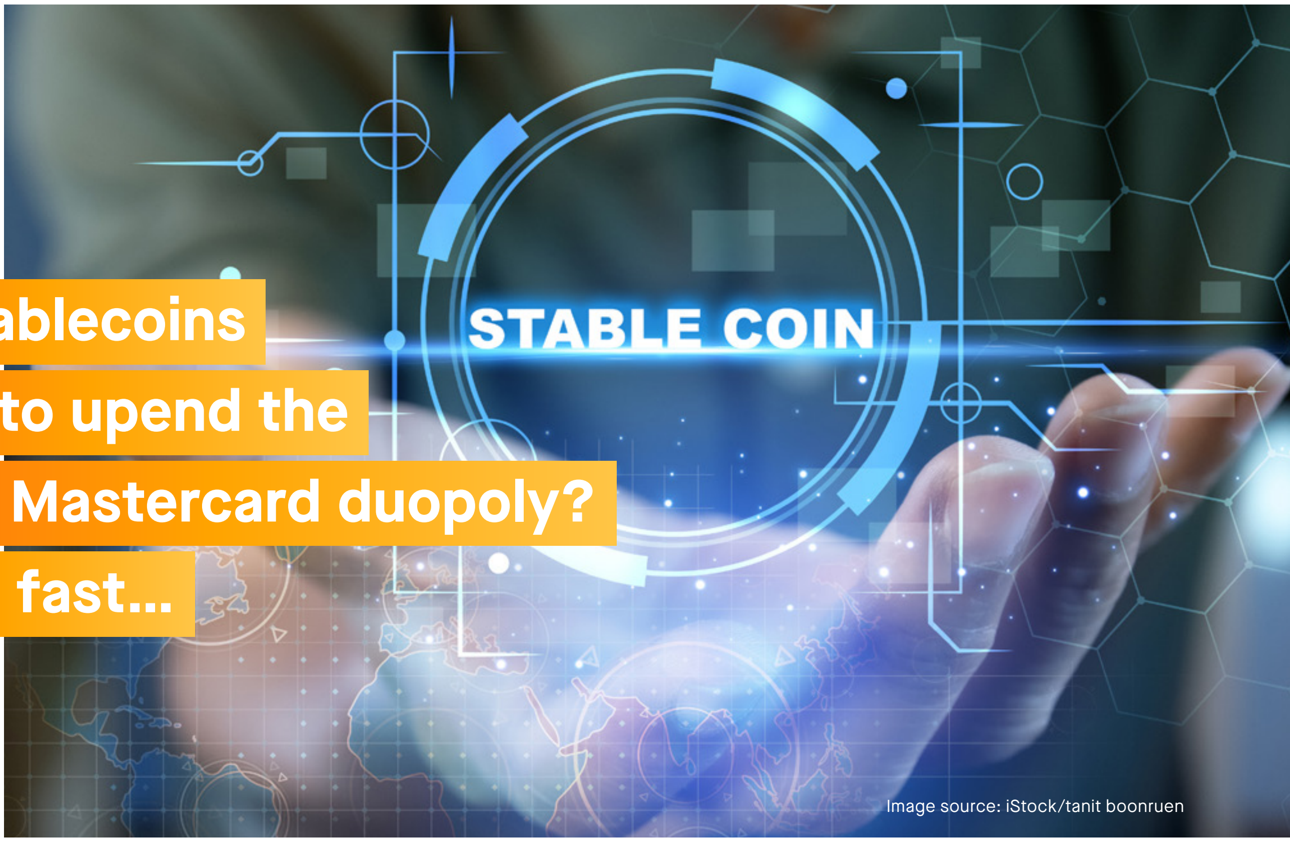

Image source: iStock/tanit boonruen

Visa and Mastercard dominate credit card transactions, charging US merchants significantly higher fees than elsewhere. Unsurprisingly, US merchants are desperate to escape these hundreds of billions in costs.

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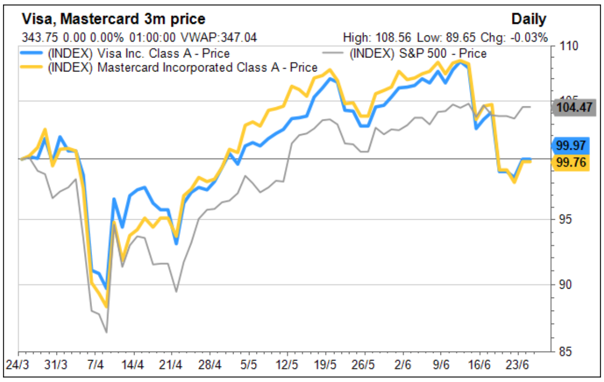
PRIVATE BANKING

Last week, following the GENIUS Act regulating stablecoins, major retailers like Amazon and Walmart announced plans to explore issuing their own digital currencies. This challenges the dominance and profitability of Visa and Mastercard; shares in both sold off sharply. While this risk is real, we contend their long-standing duopoly might prove surprisingly resilient.

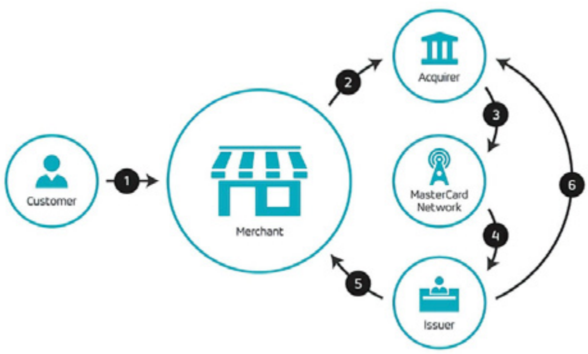


Source: FactSet

How do Visa and Mastercard payments work?

A Visa or Mastercard payment might seem simple and instantaneous, but behind the scenes there's a complex process involving multiple parties and the transaction can take days to fully settle. When you tap or click to pay, four key players are involved: the merchant, the acquirer (also known as the merchant bank), the card network (Visa or Mastercard), and your issuing bank.

Rare earths mine production (2024)

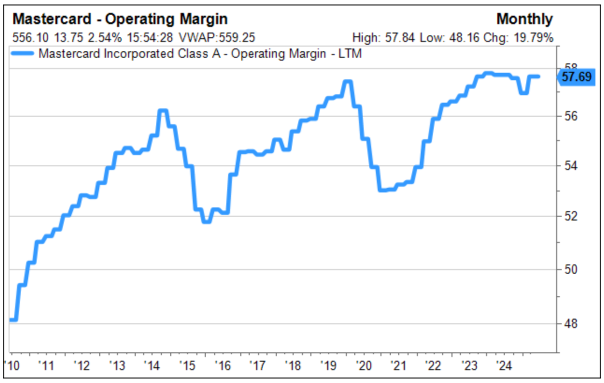


Source: Mastercard

Regarding fees, if you buy an item for $100, you pay $100, but the merchant typically receives around $97.70. Of the approximate $2.30 in fees, the largest portion - about $1.80 - is the interchange fee paid to your bank. Another $0.40 goes to the payment processor, while the remaining $0.10 is received by Visa or Mastercard.

The amount Visa and Mastercard keep per transaction may look small, but their business is incredibly profitable. This is because they provide the technology and network that makes the transactions possible, but they don't lend money or handle merchants' accounts. This means they carry no direct credit exposure or default risk; they're not on the hook if a customer can't pay their bill. Take Mastercard, for example: it consistently reports a strong organic revenue growth and operating margin of c.50%.

So, payment networks like Visa and Mastercard have been long-term "compounding machines" – businesses that continually reinvest their earnings to generate even more growth. But their outsized profits attract fintech disruptors (companies that try to find new ways to disintermediate payment networks and capture some of those profits) as well as regulatory scrutiny (the US Department of Justice's recent lawsuit concerning debit card market dominance).



Source: FactSet

Why stablecoins are seen as a threat to Mastercard and Visa?

Mastercard and Visa's business relies on merchant fees. So, investors are concerned that stablecoins could challenge the networks' long-standing dominance by offering a faster and cheaper alternative.

Major retailers like Walmart, Amazon, Expedia, as well as some major airlines, have all said they are exploring their own US dollar-backed stablecoins to reduce interchange fees. If successful, stablecoins could enable direct-to-consumer payments, cutting out card networks altogether.

Cross-border transactions have been exceptionally profitable for Visa and Mastercard. These transactions are especially vulnerable because of high fees and slow settlement times – two key aspects where stablecoins offer clear advantages.

New regulation - the GENIUS Act recently passed by the Senate and soon to be reviewed by Congress - could encourage tech companies and retailers to enter the payments space. Even without full displacement, the threat of stablecoin alone could give merchants more leverage to negotiate lower fees with Visa and Mastercard.

What payment networks can do protect their business?

The idea that merchants could bypass traditional payment networks by issuing their own stablecoins – or accepting direct wallet payments – is appealing in theory but may prove difficult in practice. Disrupting these established systems requires more than just efficient technology – entrenched consumer habits, loyalty to rewards programs, and regulatory constraints remain significant barriers. As a result, many analysts argue that concerns over stablecoins as a competitive threat to Visa and Mastercard are overstated.

Widespread consumer adoption would demand a fundamental shift in payment behaviour – something that has historically been slow and costly to achieve. Consumers are accustomed to the convenience, familiarity, and benefits of card payments, and have little incentive to change. While stablecoins may offer advantages to merchants – lower fees – and financial intermediaries – faster settlement and improved efficiencies – they offer few compelling benefits to the average consumer.

Moreover, Visa and Mastercard provide far more than the simple movement of money. Their fees cover a wide array of embedded services – fraud detection, identity verification, transaction monitoring, and regulatory compliance – that are essential to the trust and security of the global payments system. These features are a core part of the value proposition for both merchants and consumers. Stablecoins, on their own, do not inherently offer this functionality – and replicating these services at scale would be a significant challenge for any new entrant.

Both Visa and Mastercard are actively adapting. Visa has piloted settlements in stablecoins like USDC, and both firms are exploring blockchain solutions to modernize areas like cross-border payments. This signals a strategy of integration and evolution, rather than complacency.

Finally, history shows that displacing Visa and Mastercard is no easy task. Past efforts by large technology firms and retailer consortia have failed to meaningfully erode their dominance. Global acceptance, extensive merchant relationships, and deeply integrated technology infrastructure provide a structural advantage that is difficult to replicate.

What else Matters for investors in Visa and Mastercard?

While stablecoins are a relatively new area of concern for card networks, investors should remain attentive to several other important factors.

- Consumer data is central to the growth and profitability of Visa and Mastercard. Both companies are highly exposed to consumer spending trends, and any signs of a slowdown in consumption—whether due to weaker macroeconomic indicators or shifting behaviour—could weigh on their share prices.
- Regulatory pressure is another concern. The Department of Justice has taken steps to challenge the duopoly in the debit card market, while the fees charged to small and mid-sized merchants remain a political issue. These factors could increase scrutiny from regulators, particularly under the current administration.
- Rising credit card delinquencies also present a risk. This trend has persisted for several quarters and could signal broader stress in the consumer credit environment, which may eventually affect the entire payments ecosystem.

Our take

Visa and Mastercard have long been investor favorites, thanks to their track records as reliable compounders. Until recently, they have faced few serious threats - whether from disruptive technologies or regulatory action. That may be changing as the threat of stablecoins introduces a new source of risk.

The worst-case scenario, i.e. wide adoption by consumers and elimination of traditional card networks – is probably unlikely. But large merchants such as Amazon or Walmart may leverage stablecoins to negotiate lower fees. While less disruptive, this would still compress margins.

In the short term, investors are likely to focus on the cyclical risks tied to consumer health. Weaker consumer spending might create downward pressure on both stocks. That said, both stocks have historically been viewed as defensive during periods of market volatility, offering some downside protection.

In the medium and long term, investors are likely to continue to question the sustainability of Visa and Mastercard businesses. Today both Visa and Mastercard trade at a premium to the broader market but the risk of disruption, be it technological or regulatory, introduces uncertainty which may weigh on valuation multiples.

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