Arkwright

MDR REGULATORY INTERVENTIONS

ANALYSIS OF THE EFFECTIVENESS OF REGULATORY INTERVENTIONS ON MDR IN EMERGING MARKETS

REPORT — JUNE 2025

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Arkwright

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Analysis of the Effectiveness of Regulatory Interventions on MDR in Emerging Markets
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Published By
Arkwright Consulting AG
Fischertwiete 2
20095 Hamburg
Germany

Written and edited by:
Francesco Burelli
Patricia Pohl
Lena Büttner
Sofia Castillo-Roman

To request an electronic copy and for more information on the topics of this report please contact:
francesco.burelli@arkwright.de

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1. EXECUTIVE SUMMARY

In 2023, we analysed the evolution of merchant acquiring business models and new value propositions addressing merchant needs.[1] In 2024, we explored the merchant segment, which prioritises fraud mitigation, payment innovation, and data analytics.[2]

This report examines the impact of regulatory interventions on Merchant Discount Rates (MDR) in the acquiring segment of the payment value chain. Although policymakers introduce such initiatives to promote payment acceptance and competition, research from the two countries studied suggests that they do not seem to achieve their objectives.

This report investigates whether MDR caps effectively promote point-of-sale (POS) terminalisation and greater adoption of digital payments by consumers and merchants or whether other factors have a greater impact on developing card payment acceptance. Based on interviews with in-country industry experts and analysis of acceptance and economic market data, this study evaluates MDR regulation in Nigeria and Iraq.

Policymakers typically have two objectives when enacting MDR caps: (i) growth of card payment acceptance, and (ii) increased payment industry competition. The payment value chain involves two sides – issuing and acquiring (see section 3 for more details) – and therefore we must understand the knock-on effects of MDR regulatory intervention on issuers and their cardholders.[3]

This report addresses three research questions, presented below, with top-level preliminary conclusions based on research in the two countries in scope. Detailed assessments and analysis of our findings are provided for each country.

[1] Arkwright in partnership with Merchant Payments Ecosystem (March 2023), "Merchant Acquiring Industry Dynamics".

[2] Arkwright in partnership with Merchant Payments Ecosystem (March 2024), "Payments from a Merchant's Perspective".

[3] A part of the MDR rate is transferred to the issuer as compensation for services provided (e.g. payment guarantee). A reduction in MDR, whether through regulation or extreme competitive dynamics that drive rates even below the required level, can negatively impact the issuer's economics.

Research question 1: Do MDR caps enable the growth of card payment acceptance?

— No, in the countries studied, other regulatory measures, such as acceptance mandates for digital payments, were consistently cited as the key drivers of payment acceptance growth, rather than MDR caps.
— Across both markets, acquiring businesses reported to be relying on alternative revenue streams – such as value-added services, merchant lending and cash-out services – to grow POS terminalisation and not MDR mandates to meet these objectives.

Research question 2: Do MDR caps reduce issuers' economic incentives to promote card payments among cardholders due to low or negligible interchange revenue?

— Answer: Yes, in the two countries studied, MDR caps create a knock-on effect, reducing issuers' economic incentives to innovate in products and services, such as cashback programs, that benefit cardholders. These caps appear to artificially suppress the economics of the payment ecosystem.

Competition in the digital payments sector appears to be consistently already driving MDR low to price points below MDR caps. There is no evidence to suggest that regulation capping MDR is driving competition.

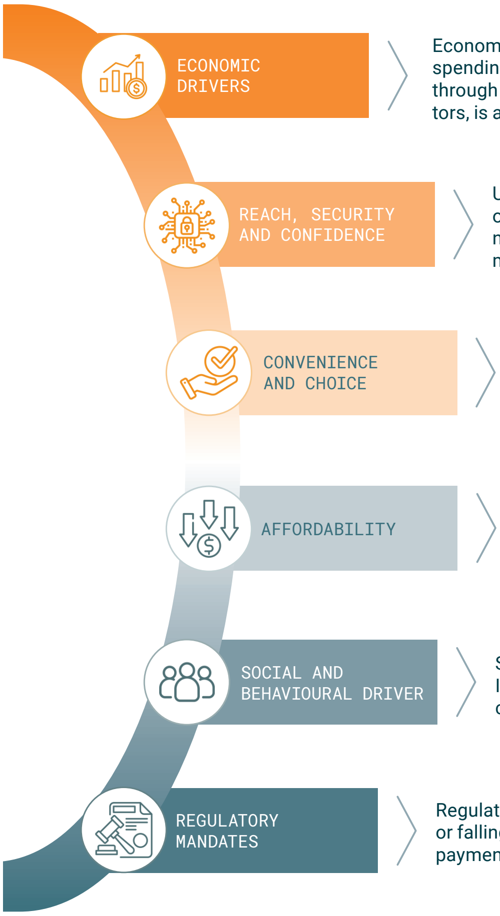
Research question 3: Do caps on MDR diminish issuers' financial motivation to encourage card payments among cardholders when transaction related revenue is low or negligible?

— Yes, in the two countries examined, MDR caps reduce issuers' incentives to develop innovative cardholder benefits. These caps seem to artificially constrain the payment ecosystem's economic viability.

2. INTRODUCTION DRIVERS OF CARD PAYMENTS ADOPTION

The adoption of card payments is influenced by multiple interconnected factors. This report categorises these drivers into six key groups, as shown in Figure 1.

Economic drivers play a crucial role in the adoption of digital payment methods. As economies grow, retail develops into ecommerce and technological innovation flourishes, which attracts increased consumer spending and enables the development and adoption of convenient digital payments.



Economic growth drives retail development and technological innovation, attracting consumer spending and promoting convenient electronic payments. Furthermore, financial inclusion, achieved through affordable financial services and the economic sustainability of banks and payment operators, is a key factor in driving the adoption of these modern retail payment systems.

User adoption depends on confidence in payment solution security, maintained through operators' investments in merchant services and cybersecurity measures. Advanced technologies such as biometric authentication, fraud detection systems, and fraud prevention measures play a crucial role in enhancing trust and safeguarding transactions.

Similar to the retail sector, convenience and choice are paramount in the payment industry. The expansion of ecommerce has provided customers with a broader selection of goods, at competitive prices. Likewise, the availability of diverse payment methods, including contactless options, mobile payments, and digital wallets, enhances customer flexibility.

Convenience and choice apply to the retail industry as well to the payment industry. The rise of ecommerce provided customer with wider choice of goods, often at a lower price. The availability of multiple payment options such as contactless, mobile payments, wallets enhance flexibility.

Social influence, peer behaviors as well as personal habits are key drivers of daily choices. Incentives, gamification, rewards or just necessity, like in the case of the Covid pandemic, can change habits in favor electronic payments.

Regulation requiring that certain transactions, for example, those above a specified value or falling within particular categories, must be completed using a designated electronic payment method.

Fig. 1 — Key drivers of digital payments adoption.[4]

[4] Arkwright analysis.

Financial inclusion, facilitated by affordable financial services and sustainable banking systems, is key to the adoption of modern payment systems.

The success of digital payment systems depends heavily on their convenience and security features. Safe, user-friendly, and accessible payment solutions are critical to driving widespread adoption.

Social and behavioural drivers influence the adoption of digital payments. Peer behaviour, personal habits, and social influence significantly impact daily choices. Incentives, gamification, rewards, and even necessity (as seen during the COVID-19 pandemic) can shift habits towards digital payments.

Regulatory initiatives have supported digital payment adoption in various countries. For example, acceptance mandates, tax incentives and requirements to provide for cashless options have significantly influenced usage in countries such as India,[5] South Korea[6] and Uruguay.[7]

[5] For example: Digital Payments driving the growth of Digital Economy | National Informatics Centre | India; The Impact of Digital Payments on India's Cashless Economy Push: By Ruchi Rathor.

[6] For example: Can Tax Incentives for Electronic Payments Reduce the Shadow Economy?: Korea's Attempt to Reduce Underreporting in Retail Businesses by Myung Jae Sung, Rajul Awasthi, Hyung Chul Lee :: SSRN; Digital Dominance: The Growth of Digital Payments in South Korea: By Jamel Derdour.

[7] For example: World Bank Document; Exploring models to promote digital payments adoption in the era of DPIs.

3. MDR CAP REGULATIONS

A visualisation of the four-party payment model, a common payment processing architecture (e.g. most card payments systems) is provided in Appendix 2. It involves four key participants: the cardholder, the merchant, the issuer and the acquirer. The cardholder initiates a purchase with a merchant, who then processes the transaction through their acquiring bank. The acquirer communicates with the issuing bank via the card scheme network for authorisation. If approved, the issuer transfers funds to the acquirer, who then pays the merchant, minus applicable fees.[8]

Regulations affecting the merchant acquiring industry can be broadly categorised into six categories, as shown in Figure 2, though these are not exhaustive.

Fig. 2 — Types of regulatory intervention in the payment acceptance industry.

Competition and market access regulation
Anti-steering rules, market entry requirements, interoperability mandates are examples of these types of regulations aimed to foster competition within a market

Consumer and merchant protection regulation
Transparency and disclosure requirements, right to dispute and resolution rules, prohibition of unfair practices are included in this category

Security and fraud prevention
Authentication requirements, PCI DSS compliance, AML and KYC requirements fall in this category

Electronic payments mandates
In this category there are laws obliging payments within a set criterion (e.g., of a certain value or within a specific merchant category or use case) to be completed through a defined payment type

Pricing regulations
Interchange caps and related regulations and Merchant Discount Rate (MDR) regulations fall within this category

Innovation and alternative payment related regulation
Wallet-specific, Open Banking, and CBDCs related regulation fall in this category

[8] These are interchange and acquirer's fees as the MDR is typically composed of three parts: 1) Interchange Fee – paid by the acquirer to the cardholder's issuing bank; 2) Acquiring costs – costs incurred for the provision of the payment acquiring services; 3) Acquirer Margin – retained by the acquirer for their services. Source: BIS Report – Retail payments interoperability (2023).

This report focuses on MDR caps as a form of pricing regulation applied to card payment acquiring services, limiting the total fee a merchant pays per transaction to their acquirer.

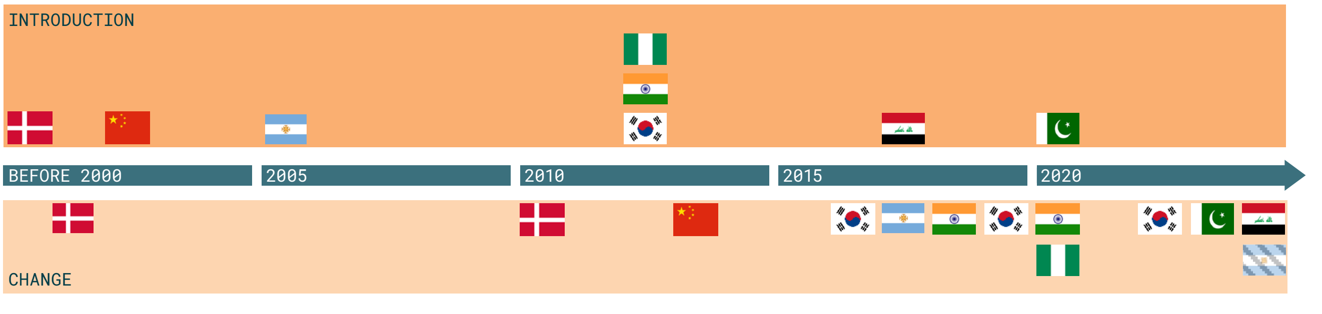
One of the drivers for policymakers to consider MDR caps is the belief that they will reduce the costs of merchant acceptance and thus grow card payment acceptance by merchants and its related adoption by consumers.

Have MDR caps accomplished their intended purpose? Have they brought more payment options and innovation to a given country? How have issuers been affected by these measures in terms of incentivising card usage among consumers? These are the key overarching questions that this report addresses.

The timeline in Figure 3[9] illustrates a subset of countries that have introduced an MDR cap, as well as changes over time.

It is important to distinguish MDR caps from price transparency initiatives aimed at the public disclosure of MDR by acquiring service providers to merchants. Figure 4[10] illustrates some countries where disclosure obligations have been mandated.

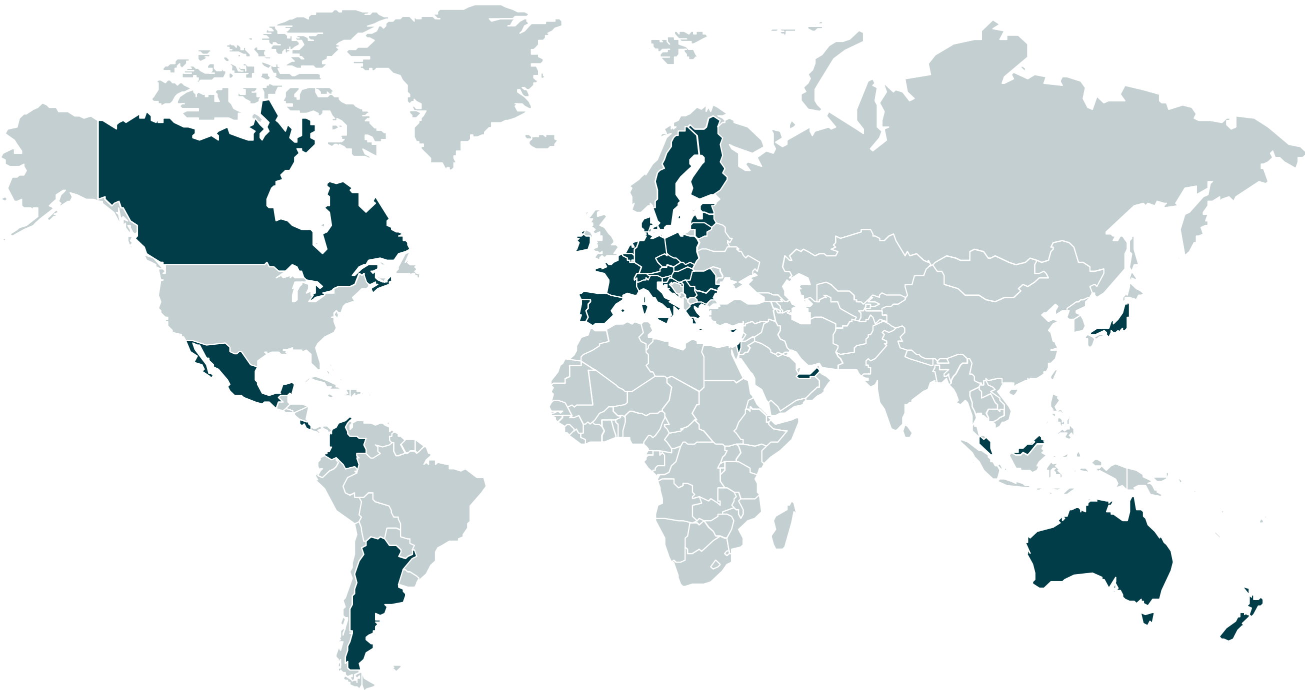
Fig. 3 — Timeline of some examples of MDR regulation across the globe (Non-Exhaustive).



[9] Ibid.

[10] Arkwright analysis.

Fig. 4 — Map of some countries with MDR disclosure obligations (Non-Exhaustive).



DISCLOSURE REQUIREMENTS

4. RESEARCH APPROACH

Typically, policymakers have two objectives when enacting MDR caps: (i) growth of card payment acceptance, and (ii) increased payment industry competition. When discussing the payment value chain, there are two sides to consider: issuing and acquiring (see section 3 for more details). We should therefore understand the knock-on effects of MDR regulatory intervention on issuers and their cardholders.[11] This research is structured around three research questions (**see Figure 5**).

A portion of the MDR rate is transferred to the issuer from the acquirer, namely the "interchange fee",[12] as compensation for services provided (e.g. payment guarantee). A reduction in MDR, whether through regulation or competitive dynamics, can negatively affect issuer economics.

Primary Research: We conducted over 40 interviews – under the Chatham House Rule – with payments industry executives from countries with MDR caps, focusing on two selected countries with emerging economies: Nigeria and Iraq.

Secondary Research: We analysed a comprehensive set of publicly available sources, including official central bank statistics from the selected markets, industry press, international and local news outlets, research from think tanks and supranational organisations, banks' disclosed terms and conditions, and other relevant sources related to this topic.

Country Selection: We chose countries where MDR regulations have been in place long enough to potentially demonstrate their effects on market dynamics and where such regulations could be correlated with market developments over time as well as where sufficient historical data was available.

[11] A part of the MDR rate is transferred to the issuer as compensation for services provided (e.g. payment guarantee). A reduction in MDR, whether through regulation or extreme competitive dynamics that drive rates even below the required level, can negatively impact the issuer's economics.

[12] "Interchange fee: a fee paid by the merchant's bank (acquirer) to the cardholder's bank (issuer) for each card-based transaction. It helps cover the costs of processing payments and the risks associated with lending". Source: Bank for International Settlements (BIS), "A glossary of terms used in payments and settlement systems".

	1	2	3
RESEARCH QUESTION	DO MDR CAPS ENABLE THE GROWTH OF CARD PAYMENT ACCEPTANCE?	DO MDR CAPS ENCOURAGE INDUSTRY COMPETITION?	DO ISSUERS CONTINUE TO HAVE ECONOMIC INCENTIVES TO PROMOTE CARD PAYMENTS AMONG CARDHOLDERS DESPITE LOW / NEGLIGIBLE INTERCHANGE REVENUE?
RESEARCH METHODS	• **Review of all available official (Central Bank) statistics:** • Number of terminals • Terminalisation by merchant segment (including government) • Contribution of Ecommerce to retail sales • **Card penetration rate (via PCE)** • **Acquiring practices in terms of disclosing MDR to merchants (based on surveys of acquirers)** • Do acquirers set MDR at the maximum level allowed? • Are acquirers being transparent with merchants? • Do acquirers charge MDR based on minimum volume of sales? Do they charge for renting POS terminals?	• **Surveys among leading acquirers, payfacs and issuers** • How do acquirers compete if there is a convergence towards price caps? (e.g., in quality of service, value-added services etc.) • Do MDR caps allow acquirers to cover their operating costs, including expansion into new segments of small-medium businesses? • Are there any general concerns regarding digital payments growth and what can be improved? • Is there still a business case for new entrants (fintech on both acquiring and issuing)?	• **Survey among leading issuers** • Debit card use at POS vs ATM • How have MDR regulations been beneficial to P&L? (e.g., through increased payment volumes?) • Have MDR caps resulted in a change of approach towards authorisation decisions, fraud management? • How have cardholder fee structures (such as annual card fees, account fees, late fees, interest rates etc.) been affected after MDR caps are implemented? • How have card rewards / benefits provided to cardholders changed after the MDR caps?

Fig. 5 — The three research questions.

Fig. 7 — Evolution of card payments in Nigeria.

5. MDR REGULATION IN TWO EMERGING COUNTRIES

5.1 Nigeria

Nigeria has implemented regulatory interventions designed to promote payments. The Central Bank of Nigeria (CBN) implemented MDR caps as part of its broader Cashless Nigeria Policy initiated in 2012 with the objective to minimise cash handling, accelerate the adoption of digital payment methods and enhance financial inclusion.

Initially, the MDR was limited to a max of 1.25%, capped at N2,000/ / USD 1.3 per transaction, in 2011; in 2017, the MDR was reduced to a maximum of 0.78% (with a maximum fee of NGN 1,200/USD 0.75 per transaction and further reduced in 2019 to no more than 0.5% capped at N1,000/0/ USD0.65 per transaction) to lower transaction costs for businesses. In 2012, the guidelines for card acceptance established the distribution of MDR revenue along the payment value chain based on fixed allocations: 30% to the issuer; 32.5% to the acquirer; 25% to the payment terminal owner; 5% to the local switch.[13] The current distribution is as follows: 30% to the issuer, 7.5% to acquirer, 25% to the payment terminal owner, 5% to the local switch, 7.5% to the payment terminal service aggregator, 25% to the payment terminal service provider.

Figure 6[14] illustrates the regulatory timeline of major initiatives related to POS terminalisation objectives.

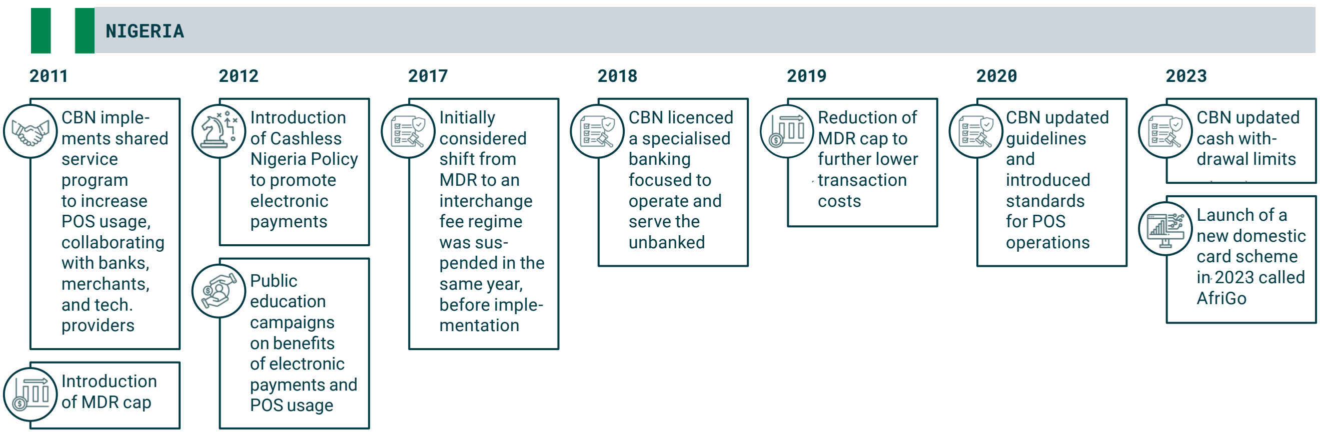


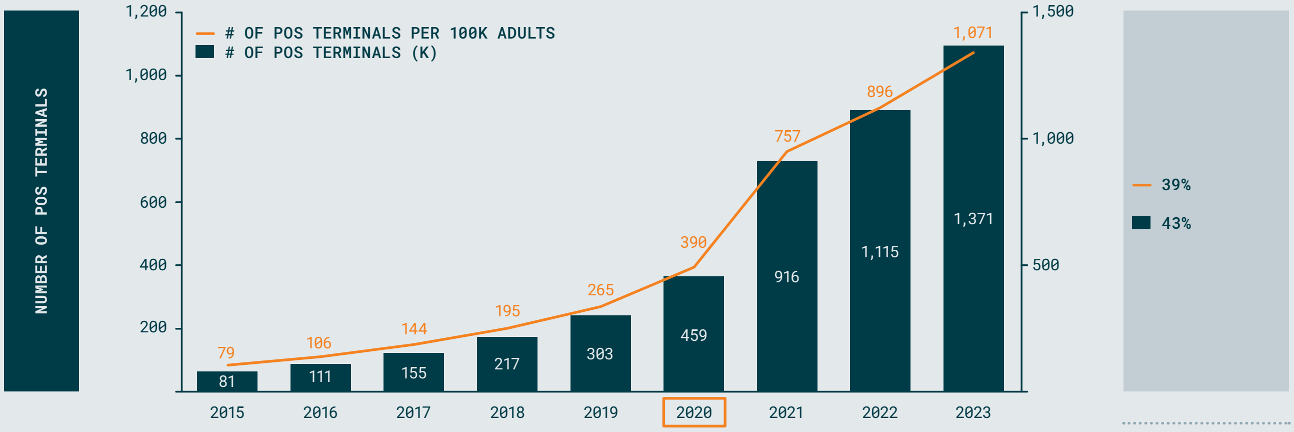
Fig. 6 — Timeline of regulatory initiatives in Nigeria (please refer to Appendix 3 for more detail) (Non-Exhaustive).

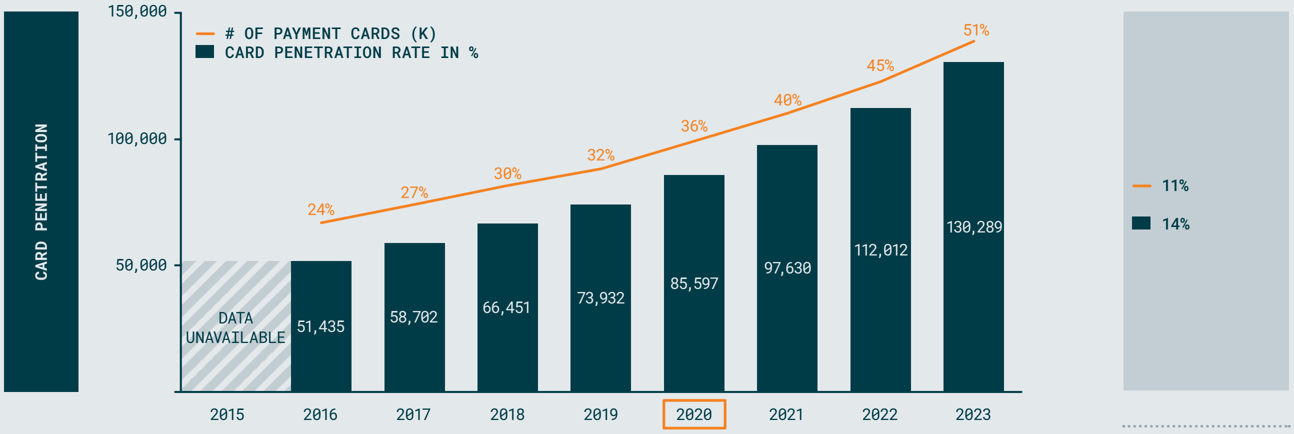
[13] Central Bank of Nigeria (2011) Guidelines on Point of Sale (POS) card acceptance services.

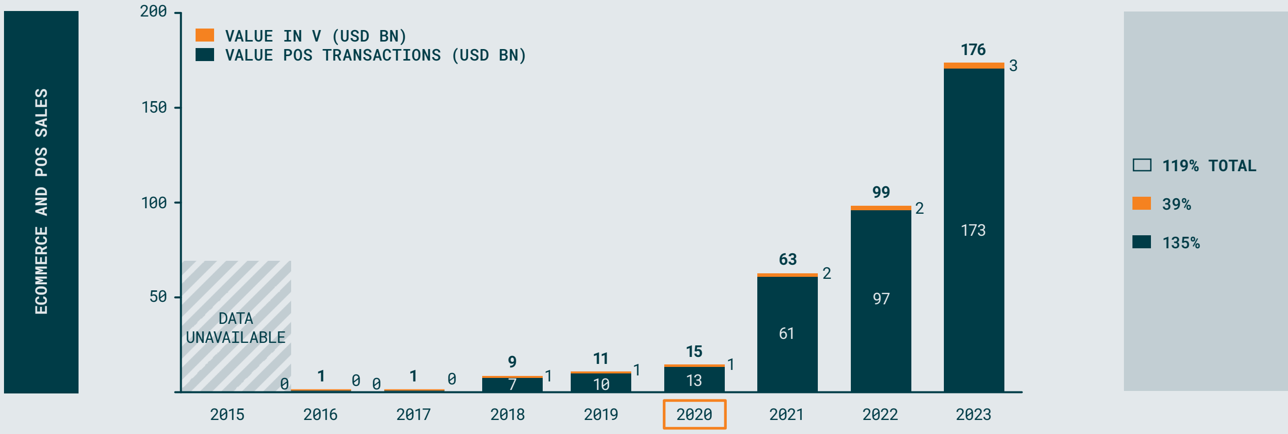
[14] Sources provided in Appendix 3.

INTRODUCTION MDR CAP 2012

CAGR (2016-2023)







PCE AND SHADOW ECONOMY

INFLATION	15.7%	16.5%	12.1%	11.4%	13.3%	17.0%	18.9%	24.7%

	2017	2018	2019	2020	2021	2022	2023
TOTAL CARD PAYMENT VALUE – PCE PENETRATION RATE	N/A	2.9%	3.3%	5.4%	23.0%	31.9%	79.2%
SHADOW ECONOMY	56%	56%	56%	55%	N/A	N/A	N/A

INCLUSION (2023 ACCESS TO FINANCE)

64% WITH BANK AND FINTECH ACCOUNTS (OF WHICH 52% BANKED)

Figure 7[15] illustrates how POS terminalisation, card penetration, the value of in-store card transactions and ecommerce have evolved in Nigeria.

The data suggests a limited correlation between MDR caps and POS terminalisation. The caps introduced in 2012 did not result in substantial growth in the number of POS terminals; POS terminal penetration only began to grow from 2021 due to other factors, such as an increase in agency banking and the continued roll out of initiatives aimed to increase electronic payment methods.[16]

Regulatory interventions other than MDR caps have supported card payment growth

Payment industry executives interviewed consistently emphasised that regulatory initiatives other than MDR caps and broader developments have been key drivers of payment growth in Nigeria. For example, in 2017 – later updated in 2023 – the CBN enforced cash withdrawal limits and imposed penalties on high-volume cash transactions, pushing more transactions into digital channels. In 2018, the CBN mandated Payment Service Banks (PSBs) to operate in rural areas, increasing card issuance and POS penetration in underserved regions and enabling the growth of acceptance.

Other POS-related services are driving terminalisation

In Nigeria, card payment acceptance is increasingly seen as an entry point to a broad range of financial services, particularly merchant lending and cash-out at POS services. These services have become primary revenue drivers, while acquiring itself is seen as a “cost centre”.[17]

Cash-out at POS, which was largely unregulated until 2023, has emerged as a significant growth driver. Unlike traditional payment acceptance, where merchants typically absorb the costs, consumers bear surcharge fees in cash-out at POS transactions. These transactions operate under a fixed-fee system and reports indicate that PSPs, acquirers, and merchants often have informal agreements to surcharge customers. According to interviews, agents often bundle purchase transactions into cash-out at POS.

[15] Number of POS terminals: Nigeria Inter-Bank Settlement System PLC, Statista; adult population (>15 years): World Bank; number of payment cards: Global Data; POS transaction value: Central Bank Nigeria; ecommerce transaction value: Argus Media; personal consumption expenditure (PCE): National Bureau of Statistics (NBS), Nigeria; shadow economy: Elgin, C., M. A. Kose, F. Ohnsorge, and S. Yu. 2021. “Understanding Informality”, C.E.P.R. Discussion Paper 16497, Centre for Economic Policy Research, London; inclusion (banked people): EFInA Report - Nigeria’s formal financial inclusion 64% in 2023 (intended as access to an account fueled by marginal growth in the banking population and growth in the use of non-bank financial institutions – Mobile Money / Fintechs). Access to Finance: EFInA Report 2024. Calculation card penetration rate: number of payment cards per adult population (>15 years), assuming 2 cards per person; calculation total card payment value: retail sales value (total POS and ecommerce transaction value)/PCE.

[16] Interviews with banking executives in Nigeria.

[17] Quote from interviews with bank executives across all three markets in scope.

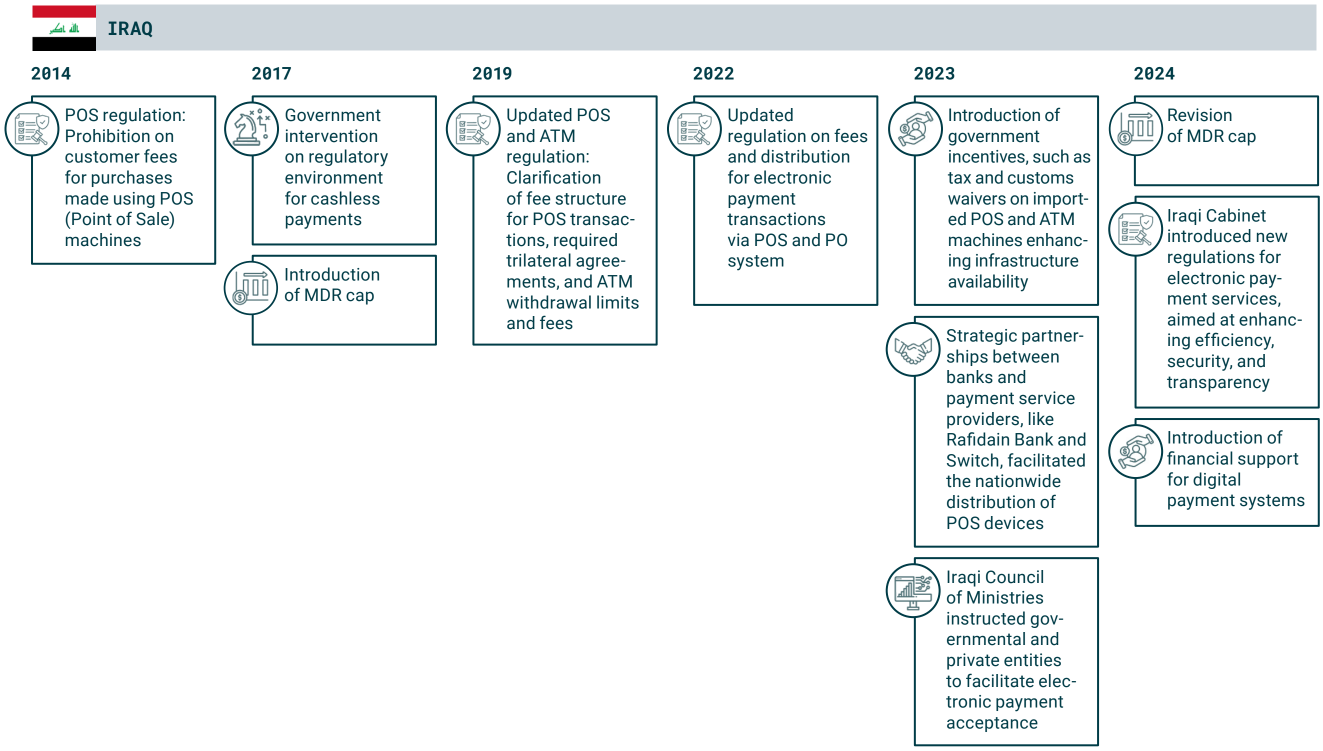
5.2 Iraq

In Iraq, MDR caps were first introduced in 2017, and recently updated in 2024, introducing a range of changes designed to modernise the financial system. The 2017 cap, initially set at 2%, was brought down to 1% in 2024 with no charge for transactions below IQD 5,000 and a maximum amount that can be charged of IQD 10K (approximately USD 7.60) for government transactions and IQD 50K (approximately USD 38) for commercial transactions. The allocation of the 2024 capped MDR value is also regulated with 75% going to the acquirer and 25% distributed to the issuer as the interchange fee for domestic transactions.[18]

In 2024, the Iraqi government updated MDR cap provisions and implemented broader regulatory reforms in the payment sector to enhance efficiency, security, and transparency. Despite these efforts, consumer distrust in banks remains prevalent, with many individuals withdrawing their full salary at ATMs on payday, limiting the effectiveness of financial inclusion efforts. Similar to trends observed in other developing countries, POS terminals in Iraq are increasingly used for cash-out services rather than card payment acceptance, reflecting a broader shift in how acquiring infrastructure is being leveraged.

Other regulatory interventions influenced payment acceptance in Iraq. In December 2023, the Iraqi Private Banks Association reported that the significant surge in bank accounts, debit cards, and digital payment devices followed substantial support from the Central Bank of Iraq for the banking sector. Point-of-sale devices experienced a remarkable 117% growth from January to September 2023.[19]

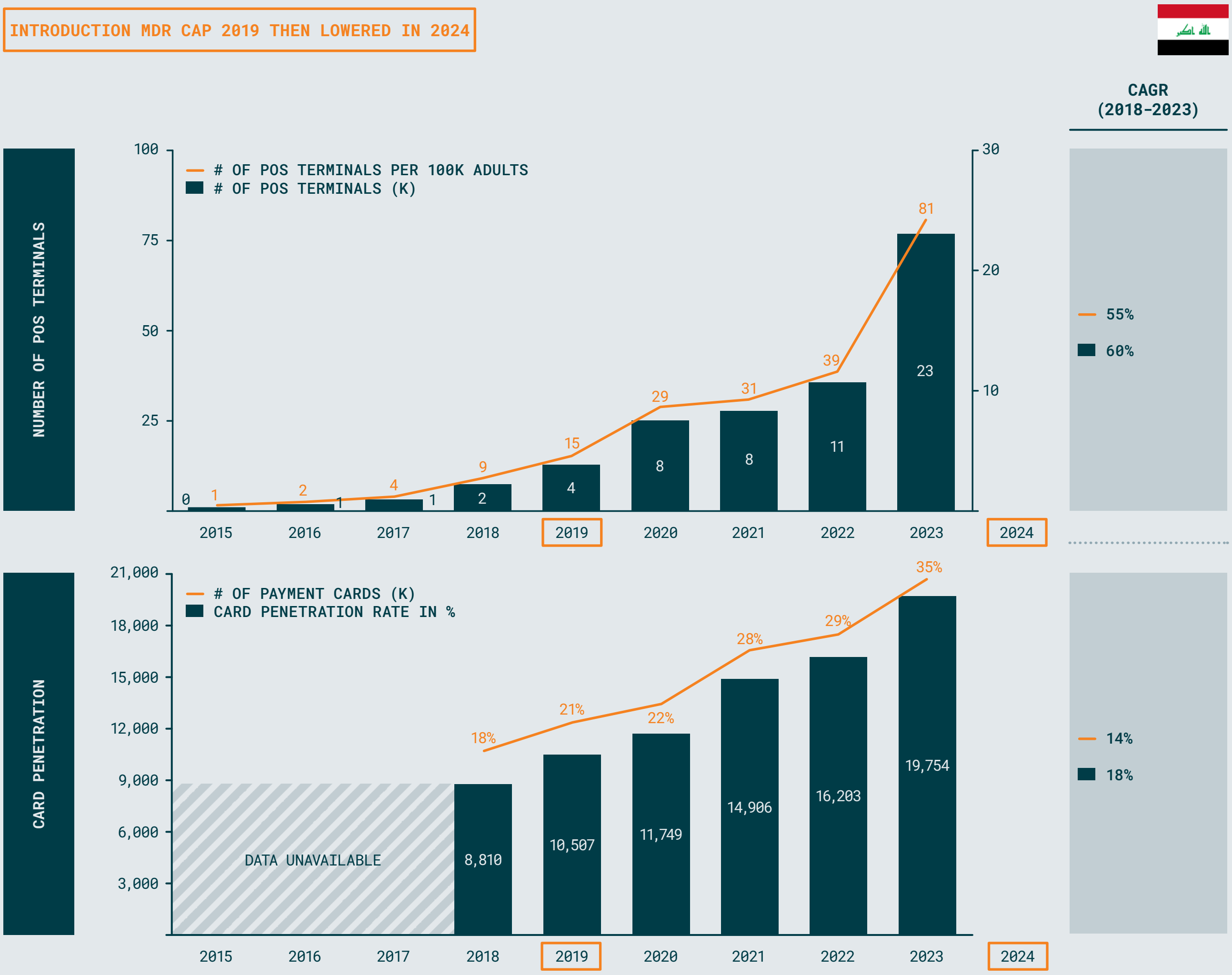
Fig. 8 — Timeline of regulatory initiatives in Iraq (please refer to Appendix 4 for more detail).



[18] Central Bank of Iraq, CBI Circular 14/752 from February 27, 2024.

[19] Shafaq News (2023) Private Iraqi banks established +1.2 million accounts in 9 months, official says; World Bank (2023) Iraq Economic Monitor Reemerging Pressures: Iraq's Recovery at Risk.

Fig. 9 — Evolution of card payments in Iraq.



INCLUSION (2021 WORLD BANK)

19% POPULATION WITH BANK ACCOUNTS

Figure 8[20] illustrates the regulatory timeline with the major initiatives related to the terminalisation objectives.

Figure 9[21] illustrates how POS terminalisation and card penetration have evolved over time in Iraq.

Competition is driving MDR, not caps
Payment industry executives in Iraq consistently reported that MDR caps have not meaningfully reduced merchant costs. Instead, competitive market forces have driven actual MDR rates below the regulatory cap, as service providers commonly offer rebates or paybacks to attract or retain merchants, returning up to 50% of the MDR.

Core acquiring services are increasingly seen as a cost centre rather than a revenue driver. A senior payments industry executive emphasised that banks prioritise current accounts and card issuance, with most payment revenue derived from consumer fees rather than payment acceptance. Both banks and monoline acquirers are shifting their focus to alternative revenue streams, including merchant lending, Buy Now Pay Later (BNPL) services, and vouchers (prepaid solutions) to monetise merchant relationships.

Despite these challenges, POS terminal deployment expanded rapidly, growing at a 55% CAGR between 2018 and 2023. However, card use has not kept pace, with penetration increasing by only 14% CAGR over the same period, highlighting persistent consumer reliance on cash. Interviewees widely agreed that, despite efforts to drive card adoption, consumers continue to favour cash, ultimately limiting the benefits of financial inclusion.

[20] See Appendix 4.

[21] Number of POS terminals: Central bank Iraq; adult population (>15 years): World Bank; number of payment cards: Central Bank Iraq; inclusion (banked people): World Bank - Global Findex Database 2021; calculation card penetration rate: number of payment cards per adult population (>15 years), assuming 2 cards per person.

		NIGERIA	IRAQ
ISSUANCE FEE / E-ISSUANCE	CREDIT CARDS	• Standard: $0-$3.0 • Premium Products: $40-$200	• Standard: $20-$50 • Premium: $50-$100
	DEBIT CARDS	• Standard: $0.6 - $3 • Premium:$3 - $160	• Free
ANNUAL FEES	CREDIT CARDS	• Standard: free - $10 / year • Premium: $50 - (Infinite membership) $2.000 / year	• Free except Cihan Bank IIF ($ 25-$ 112 / year but with issuance fee)
	DEBIT CARDS	• Standard: Free - $ 10 / year • Premium: $40-$2.000	• Free except Cihan Bank IIF ($ 25 - $ 112 / year but with issuance fee)
ATM FEE	NATIONAL	• (on-us and off-us) Free to $3 or 3% of withdrawal value	• On-us free • Off-us (3-5% with minimum $1.9-$5.0)
	INTERNATIONAL	• Credit $0.15 to $5 or between 3%-6% • Debit: $3-$3.5 or 0.6%	• $10 or up to 5%-6% (varies on bank and product)
POS FEE	NATIONAL	• Free	• Cihan Bank IIF 0% • Other banks 0%-3%
	INTERNATIONAL	• Free	• Not always disclosed • Otherwise 0%-2%
ECOMMERCE FEE		• Free	• Not always disclosed • Otherwise 0%-2%
DISPUTE FEE		• Not disclosed	• $15
LATE PAYMENT FEE		• Standard: $1.28-$30 or 1% • Premium: $20-$100 or 1%	• 5% of due amount with a minimum of $25
BENEFITS		• Premium credit and debit: airport lounge access, travel and health insurance, concierge etc. • Standard credit none	• Standard debit none • About half of card analysed no benefits; other half lounge access, travel and health insurance, concierge, etc. • Standard credit none • Debit none

Fig. 10 — Summary of issuing fees (not exhaustive) in the two deep dive countries (from a sample of issuers).

5.3 Unintended consequence of MDR regulation

In Nigeria and Iraq, a portion of the MDR is allocated as revenue for issuers, which is a de facto regulated interchange rate pegged to the MDR, maintaining constant margins for acquirers but undermining interchange revenue for issuers causing negative knock-on effects for cardholders, as issuers increase their fees – a development widely documented in jurisdictions with regulated interchange rates (e.g. Australia[22] and the European Union[23]).

A review of disclosed issuing fees across Iraq and Nigeria reveals a consistent pattern: annual card fees are common, while cardholders are not provided with benefits aimed to incentivise everyday card use for payments (e.g. cashback). MDR regulation is therefore having an indirect impact on cardholder fees. Figure 10[24] summarises the card offerings identified during research that took place in Q4 2024.

As discussed above, an increase in cardholder fees aligns with findings from prior research in countries where regulatory caps on interchange prompted issuers to adjust their cost structures. Cardholders faced increased fees and reduced benefits, as issuers sought to recalibrate their cost structures. Figure 11 presents quotes from research conducted in other countries, highlighting these outcomes.

Fig. 11 — Quotes from research on the effect of regulatory caps on cardholders.

1

EFFECT ON CARDHOLDER FEES

In the U.S. and Australia, interchange fee caps led issuers to offset revenue losses by **increasing various cardholder fees**, including annual and maintenance fees, as well as account-related charges, in order to maintain profitability.

Interchange Fee Reforms in Various Countries. In: Interchange Fee Economics. Palgrave Macmillan, 2018

Some issuers offset reduced interchange income by **increasing cardholder fees**, including annual and maintenance fees.

An empirical analysis of debit card interchange fee regulation: Evidence from Brazil, Latin American Journal of Central Banking, 2023

Evidence from three EU member states as well as other jurisdictions shows that customers are likely to face **higher annual costs for their cards** and lower benefits because of the interchange fee regulations. This might have somewhat offset issuers' losses from lower interchange fees.

The impact of EU price rules: Interchange fee regulation in retail payments, CEPS-ECRI, 2020

2

EFFECT ON CARD BENEFITS AND REWARDS

Debit card rewards have diminished following fee caps, as issuers adjusted to lower interchange income by **scaling back or removing reward programs** to control costs.
This trend particularly affected debit cardholders who previously enjoyed loyalty benefits.

Interchange Fee Reforms in Various Countries. In: Interchange Fee Economics. Palgrave Macmillan, 2018

Rewards programs were scaled back due to lower MDRs, especially in debit card segments, as issuers adjusted benefits to align with decreased revenue.

An empirical analysis of debit card interchange fee regulation: Evidence from Brazil, Latin American Journal of Central Banking, 2023

[22] (Illustrative and non-exhaustive reference) Reserve Bank of Australia (RBA), "Reform of Australia's Payment System: Interchange Standards", 2016.

[23] (Illustrative and non-exhaustive reference) Regulation (EU) 2015/751 of the European Parliament and of the Council.

[24] Arkwright Analysis: Bank websites, Terms & conditions and disclosure of card fees in the three deep dive countries.

Fig. 12 — Effects of MDR regulatory intervention (Non-Exhaustive).

5.4 Effects of MDR regulation

The effects of MDR caps discussed in Nigeria and Iraq are not unique to emerging markets. Global research shows that such interventions can lead to similar unintended consequences in other countries, potentially reducing service quality for merchants.[25]

Figure 12[26] highlights risks associated with MDR regulation, particularly its effect on incentives and card payment acceptance.

[25] Source: acquirers' interviews in the three countries in scope

[26] **Argentina**: Gobierno de Argentina (2004) Ley26.010; Gobierno de Argentina (2018) En enero bajaron los aranceles que pagan los comercios a las tarjetas.; Mayora, Melhem, Moretto (2023) Modifications to the Credit Card Law. Allende & Brea; Beccar Varela (2024) Boletín del Departamento Fintech: Novedades legales Fintech en Argentina N°24. **India**: Reserve Bank of India (2012) Merchant Discount Rates Structure for Debit Card Transactions.; Reserve Bank of India (2016) Special measures upto March 31, 2017: Rationalisation of Merchant Discount Rate (MDR) for transactions upto ₹ 2000/-.; Reserve Bank of India (2017) Rationalisation of Merchant Discount Rate (MDR) for Debit Card Transactions.; Reserve Bank of India (2022) Discussion Paper on Charges in Payment Systems.; Julian Morris (2024) The Effects of Payment-Fee Price Controls on Competition and Consumers. International Center for Law & Economics; PWC (2022) Union Budget 2022–23: Impact on digital payments with a focus on the digital rupee. **South Korea**: Government of South Korea (Korea.net) (2012) New Rules on Credit Card Merchant Fees.; Financial Services Comissiom (2018) FSC Reforms Card Processing Fee Rates; Minjoo Kim (2024) Maeil Business News Korea & mk.co.kr; Han Sangheon (2024) Maeil Business News Korea & mk.co.kr; Jhoo Dong-chan (2019) Card firms slashing customer benefits to cut costs. The Korea Times; Fitch Ratings (2012) Merchant Fee Rule to Hurt S. Korean Credit Card Companies.

COUNTRY	DESCRIPTION	UNINTENDED CONSEQUENCES
ARGENTINA	• 2005: INTRODUCTION OF MDR CAP AT 3% (CREDIT CARDS) AND 1.5% (DEBIT CARDS) • 2017-2021: GRADUAL REDUCTION OF MDR CAP • 2023: RELEASE OF CAP AND INTRODUCTION OF DISCLOSURE REQUIREMENTS	**RAISED COSTS FOR SMALLER MERCHANTS** REMOVAL OF REGULATIONS ON DIFFERENTIAL RATES RESULTED IN HIGHER DISCOUNT RATES FOR SMALL MERCHANTS. INSTEAD OF GAINING BARGAINING POWER, **SMALL BUSINESSES FACED CHALLENGES AS ACQUIRERS AVOIDED THEM**, AND AGGREGATORS OR SUB-ACQUIRERS CHARGED HIGHER FEES
INDIA	• 2012: INTRODUCTION OF SLAB-RATE MDR FOR DEBIT CARDS • 2016-2017: INTRODUCTION OF TEMPORARY MEASURES AND DIFFERENTIATED MDR • 2020: INTRODUCTION OF ZERO MDR ON ALL UPI AND RUPAY DEBIT CARD TRANSACTIONS	**IMPACT ON COMPETITIVE LANDSCAPE** MARKET INTERVENTION HAS IMPACTED THE COMPETITIVE LANDSCAPE, LEADING TO A **CONCENTRATION OF INFLUENCE** AMONG A FEW LARGE ENTITIES IN **THE UPI SPACE**. THIS MAY CAUSE CHALLENGES TO BANKS AND PSPS, FORCING THEM TO **RECOVER LOSSES THROUGH OTHER FEES** ULTIMATELY POTENTIALLY IMPACTING LOWER-INCOME ACCOUNT HOLDERS AND UNDERMINING FINANCIAL INCLUSION **REDUCED CARD HOLDER BENEFITS** MDR CAPS ON UPI HAVE **REDUCED** THE **ECONOMIC VIABILITY OF OFFERING CONSUMER INCENTIVES.** AS A RESULT, THERE IS A SHIFT FROM PROVIDING CASHBACK TO CONSUMERS TO REWARDING MERCHANTS **SUBSIDISATION OF MDR** **GOVERNMENT SUBSIDISATION** OF MDR TO **OFFSET LOSSES** FROM THE 0 MDR REGIME FOR ACQUIRERS
SOUTH KOREA	• 2012: INTRODUCTION OF MDR CAP AT 1.5% FOR SMALL MERCHANTS • 2013-2025: GRADUAL REDUCTION & DIFFERENTIATION OF THE MDR CAP • STARTING FEB 2025 CAPS WILL RANGE FROM 0.4% TO 1.45% DEPENDING ON SALES VOLUME	**REDUCED BENEFITS, FEWER CARD OPTIONS, COST CUTS & CHANGED FOCUS** IN RESPONSE TO CAPPING, COMPANIES REDUCE CUSTOMER BENEFITS, DISCONTINUE MANY CARD PRODUCTS, CUT COSTS, AND FOCUS ON STRENGTHENING OTHER OFFERINGS, SUCH AS LOANS

6. CONCLUSIONS

This study provides a snapshot of the effects of regulatory interventions on MDR, based on qualitative and quantitative research, drawing insights from a sample across Iraq and Nigeria. Although policymakers introduce such initiatives to support increased payment acceptance and competition, research in the two countries studied suggests that they do not achieve these objectives.

Primary research included interviews and surveys with payment industry executives that were consistent across the two countries, revealing similar trends and challenges. Secondary research analysed publicly available historical acceptance and economic data from official government sources and other sources. The two markets were chosen because MDR regulations were in place long enough to potentially demonstrate their effects on market dynamics.

Policymakers typically aim to achieve two objectives with MDR caps: (i) growth of card payment acceptance, and (ii) increased payment industry competition. The payment value chain involves two sides: issuing and acquiring (for more details see Section 3). We must understand the knock-on effects of MDR regulatory intervention on issuers and their cardholders.[27]

This report is structured around three research questions with the following findings.

6.1 Do MDR caps enable the growth of card payment acceptance?

— No, in the two countries studied, other regulatory measures, such as acceptance mandates for digital payments, were consistently cited as the key drivers of payment acceptance growth, rather than MDR caps.

— Acquiring businesses rely on alternative revenue streams – such as value-added services, merchant lending and cash-out services – to grow POS terminalisation and are not relying on MDR mandates to meet these objectives.

[27] A part of the MDR rate is transferred to the issuer as compensation for services provided (e.g. payment guarantee). A reduction in MDR, whether through regulation or extreme competitive dynamics that drive rates even below the required level, can negatively impact the issuer's economics.

6.2 Do MDR caps encourage industry competition?

- No, in the two countries in scope competition is driven by merchant services provided beyond core acquiring, such as value-added services (e.g. Buy Now Pay Later, loyalty, mobile top up, etc.), cash-out at POS, and merchant lending, rather than MDR.
- Competition in the digital payments sector drives MDR to low levels. There is no evidence to suggest that regulation capping MDR drives competition in the three countries in scope.

6.3 Do MDR caps have a knock-on effect on issuers continuing to have economic incentives to promote card payments among cardholders despite low or negligible interchange revenue?

- Yes, MDR caps reduce issuers' economic incentives to innovate on in products and services that could benefit cardholders such as cashback. In the two countries in scope, MDR caps appear to artificially stifle the economics of the payment ecosystem.

6.4 Final Considerations

There are multiple drivers behind the growth in electronic payment acceptance. In the two countries analyzed, increased competition has driven pricing significantly below regulated caps, affecting the economic sustainability of monoline or bank-led acquiring models. This, in turn, may hinder investment in acceptance infrastructure and potentially limit competition.

At the same time, the evolution of retail channels toward online commerce, modernization of checkout experiences, expanding financial inclusion and hence demand to pay electronically, and the broader range of services now available to both merchants and consumers at the point of sale have all played an effective role in accelerating adoption.

While well-intentioned, regulatory initiatives should consider the full spectrum of market dynamics to avoid unintended consequences.

Fig. 15 — Acquirer's revenue and cost lines.

APPENDIX 1

ECONOMIC DRIVERS WITHIN THE MERCHANT ACQUIRING INDUSTRY

The acquiring industry, like any other industry, has its own specific operations and economics. For simplicity, this section provides a high-level description, avoiding a complex description of permutations across various business models (e.g. merchant acquiring, orchestrators, processors, terminal management, various types of payment facilitators) and various sets of complementary activities (e.g. different types of fraud checks) that are required for the successful completion of an electronic transaction acceptance on behalf of a merchant. Key activities include:

- Merchant on-boarding
- Authorisation request capture
- Switching and transaction routing
- Fraud prevention and monitoring
- Settlement and clearing to merchants
- Exceptions management (e.g. reversals, refunds, dispute management)
- Reporting and analytics
- Provision of Value-Added Services (VAS), including loyalty platforms, inventory management, accounting support, etc.

These activities have associated revenues and costs, as illustrated in **Figure 15.**[33]

Core revenues for an acquiring business are MDR and terminal fees. The costs include fixed (CAPEX) and variable (OPEX) components. Fixed costs are depreciated overtime and attributed to the cost of transaction services charged to merchants.

These costs are relevant due to their profit and loss impact and the importance of scale. As highlighted in the earlier report "Merchant Acquiring Industry Dynamics" (2023), merchant acquiring is an industry with significant barriers to entry due to licensing, compliance, technological and operational costs requiring highly specialised knowledge and skills with a low margin. The industry has undergone the unbundling of its value chain with reconfiguration driven by specialisation on one side and scale on the other.

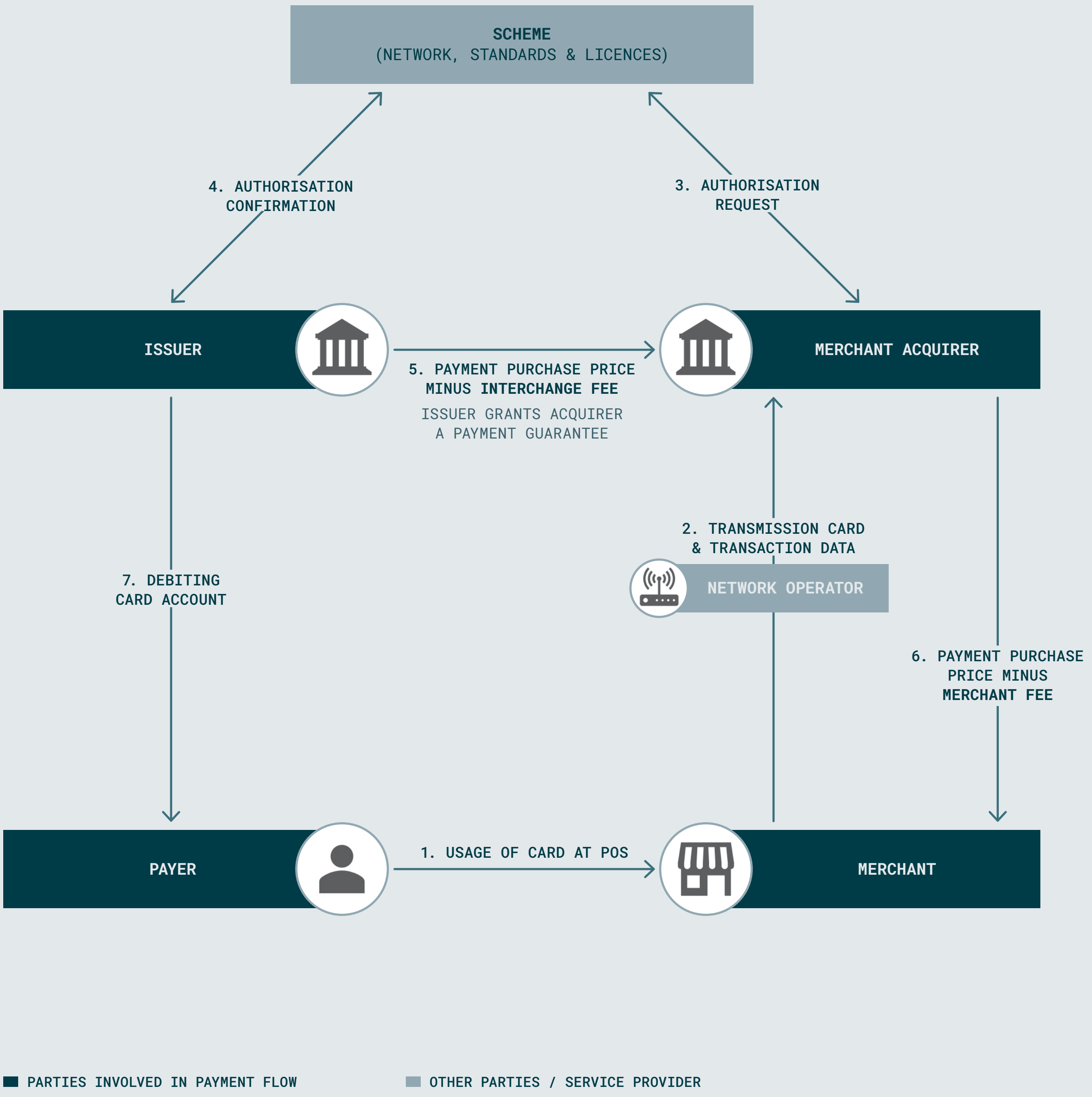
[33] Arkwright Analysis.

REVENUE LINES	
MERCHANT DISCOUNT RATE (MDR)	This is the fee charged to merchants for processing card transactions. MDR can be a fixed amount, a percentage of the transaction value or a combination of the two
TERMINAL RENTAL, SALES, OR LEASE FEES	Fees charged for point-of-sale (POS) terminals provision either as a one-time purchase, monthly rental, or leasing agreement. These fees vary based on hardware type (traditional POS, mobile POS, or smart POS)
OTHER SERVICE FEES	These are additional charges for services such as chargeback processing, compliance audits, PCI DSS certification, settlement reports, or foreign exchange conversion for international transactions
VALUE-ADDED SERVICES (VAS) FEES	Fees for optional services that enhance merchant operations, such as data analytics, loyalty programs, fraud prevention tools, BNPL (Buy Now, Pay Later) integrations, and dynamic currency conversion (DCC), etc.

COST LINES	
LICENCE AND REGULATORY COSTS	Fees paid to regulatory bodies and payment market infrastructures for acquiring and related licences (e.g. PSP or banking licences), maintaining certifications, and adhering to financial regulations (e.g. PCI DSS)
SALES, MARKETING, AND MERCHANT RECRUITING	Expenses related to acquiring new merchants, including advertising, onboarding incentives, and partner commissions
TERMINAL COST	Cost of purchasing, leasing, or maintaining POS terminals, including software updates, repairs, and connectivity expenses
COMPLIANCE COSTS	Ongoing costs for regulatory compliance, such as KYC verification, fraud monitoring, AML (Anti-Money Laundering), and periodic security audits
PAYMENT PROCESSING COSTS	Fees paid to payment processors, gateways and banks for transaction authorisation, clearing, and settlement
INNOVATION COSTS	Costs incurred in developing new services including research in security and fraud prevention solution or new services (e.g., softPOS)
SERVICE COSTS	Expenses related to customer support, dispute resolution, merchant training, and account management
VAS-RELATED COSTS	Costs incurred for value-added services (e.g., loyalty programs, analytics, fraud prevention, and BNPL integrations), including development, licensing, and operational expenses

APPENDIX 2

FOUR PARTY MODEL OF PAYMENTS PROCESSING



APPENDIX 3

REGULATORY EVENTS IN NIGERIA

YEAR	REGULATION / EVENT	DESCRIPTION	SOURCE
2011	CBN implements shared service program to increase POS usage, collaborating with banks, merchants, and tech. providers	The Central Bank Nigeria (CBN) implemented a shared service program mandating NIBSS as the central aggregator for POS transactions, aiming to strengthen monitoring and efficiency of electronic payments. NIBSS manages the industry Terminal Management System, overseeing POS performance.	Central Bank Nigeria "Guidelines on operations of electronic payment channels in Nigeria", 2011 & 2016
2011	Introduction of MDR cap	CBN issued Point of Sale guidelines that capped the maximum merchant service commission that acquirers could charge merchants at 1.25% or a maximum of NGN2,000.	Central Bank Nigeria "Guidelines on POS card acceptance services", 2011
2012	Introduction of Cashless Nigeria Policy to promote electronic payments	CBN released its cashless policy with the aims of developing and modernising Nigeria's payment system, providing more efficient transaction options and greater reach to achieve a reduction in the cost of banking services, while driving financial inclusion, and improving the effectiveness of monetary policy in managing inflation.	Central Bank Nigeria "Cashless Nigeria", n/a
2012	Public education campaigns on benefits of electronic payments and POS usage	CBN launched extensive information campaigns through various media channels to promote its "cashless policy" and encourage the adoption of electronic payments.	Central Bank Nigeria, Paper "Why The Central Bank of Nigeria made the Cash-less Policy", 2012
2017	Considered shift from MDR to interchange cap	Initially considered shift from MDR to interchange fee regime was suspended before implementation	Central Bank Nigeria "November Circular" 2017 BPS/DIR/GEN/CIR/03/004
2018	CBN introduced a new banking licence category called Payment Service Banks (PSBs). This initiative was aimed at advancing financial inclusion in rural areas and serve the unbanked	The key aspects of this development include: 1. PSBs were required to operate mostly in rural areas and unbanked locations, targeting financially excluded persons. 2. They were mandated to have at least 25% of their financial service touch points in rural areas as defined by the CBN. 3. PSBs were allowed to deploy ATMs and Point of Sale devices in rural areas. 4. The introduction of PSBs opened opportunities for other players, such as telecom companies, to deliver financial services.	Central Bank Nigeria "Supervisory framework for Payment Service Banks", 2021
2019	Reduction of MDR cap to further lower transaction costs	Banks shall unbundle merchant settlement amounts and charge applicable taxes and duties on individual transactions as stipulated by regulations. Merchant service charge has been reviewed downwards from 0.75% capped at N1,200 to 0.5% capped at N1000.	Central Bank Nigeria "Review of process for merchant collections on electronic transactions", 2019
2020	CBN updated guidelines and introduced standards for POS operations	CBN issued the "Guidelines on Operations of Electronic Payment Channels in Nigeria 2020," which superseded the 2016 version of the guidelines.	Central Bank Nigeria "Guidelines on operations of Electronic Payment Channels in Nigeria", 2020
2023	CBN updated cash withdrawal limits	1. The revised limits set the maximum cash withdrawal across all channels for individuals at ₦500,000 per week, up from the initially proposed ₦100,000. 2. For corporate organisations, the limit was set at ₦5,000,000 per week, increased from the initially proposed ₦500,000. 3. The maximum daily cash withdrawal via ATM was set at ₦20,000, with a weekly limit of ₦100,000. 4. Point of Sale (POS) terminal cash withdrawals were limited to ₦20,000 daily.	Central Bank Nigeria Circular "Naira Redesign Policy - Revised Cash Withdrawal Limits", 2022
2023	Launch of a new domestic card scheme in 2023 called AfriGo	CBN officially unveiled the Nigerian National Domestic Card Scheme, known as AfriGo, on January 26, 2023. The new card scheme aims to address local peculiarities of the Nigerian market, promote financial inclusion. AfriGo is expected to function as both a credit and debit card, offering various solutions including virtual, loyalty, and tokenised cards.	Central Bank Nigeria "CBN Gov, Emefiele Unveils Nigerian National Domestic Card Scheme AFRIGO", 2023

APPENDIX 4

REGULATORY EVENTS IN IRAQ

YEAR	REGULATION / EVENT	DESCRIPTION	SOURCE
2014	POS regulation: Prohibition on customer fees for purchases made using POS (Point of Sale) machines	Circular 23/309 established that merchants cannot charge fees to customers for any purchases using electronic payment methods (via POS machines)	Central Bank of Iraq Circular number 23/309 dated 7 March 2014
2017	Government improves regulatory environment for cashless payments	The Central Bank of Iraq (CBI) initiated the Salary Domiciliation Project, which aimed to pay state employees' salaries using cards issued by Iraqi banks. CBI issued a consumer protection guide for banks, money transfer companies, and electronic payment companies to improve banking services, especially in electronic banking and payment settlements.	Worldbank; Central Bank of Iraq Article on Interview with Dhuha Abdul Kareem Alatta: Director General of the Payments Department in the Central Bank of Iraq (CBI)
2017	Introduction of MDR cap	Introduction of MDR cap: The fee deducted by acquirers and licenced banks from merchants is capped at 2% of the transaction amount, aimed at encouraging the shift to electronic payments	Central Bank of Iraq Payments Department / Supervision and Compliance Division No. 23/309; dated 07 March 2017; Subject: Electronic Payment Services
2019	Updated POS and ATM regulation: Clarification of fee structure for POS transactions, required trilateral agreements, and ATM withdrawal limits and fees	POS regulation: 1. Banks must partner with licenced payment processors integrated with the National Switch System, formalising relationships through trilateral agreements between the parties. 2. The no-fee rule for customers (from Circular 23/309, 2014) is reaffirmed. 3. Merchant fees are split: 50% to the collector, 40% to the card issuer, and 10% to the National Switch. 4. Banks can partner with multiple providers and must report POS deployment. ATM regulation: 1. Banks can set withdrawal limits for their own customers and charge fees accordingly. 2. The daily withdrawal limit for customers from other banks is 2,000,000 IQD, with a max fee of 0.004 per withdrawal transaction and a minimum fee of 1,000 IQD within the National Switch.	Central Bank of Iraq Payments Department / Supervision and Compliance Division No. 23/2003; dated 12 November 2019; Subject: Electronic Payment Services
2022	Updated regulation on fees and distribution for electronic payment transactions via POS and PO system	1. CBI Fee: 5% of the fee charged on all transactions processed through POS and POC systems via the National Switch System. 2. POS Machines: The merchant fee is capped at 2%, with 65% allocated to the collector (payment processor/bank) and 30% to the issuer (issuing processor/bank). 3. POC (Points of Cash Withdrawal) Machines: The fee distribution allocates 70% to the collector (payment processor/agent) and 25% to the issuer (issuing processor/bank).	Central Bank of Iraq Payments Department / Supervision and Compliance Division No. 23/512; dated 29 March 2022; Subject: Regulating Electronic Payment Services
2023	Introduction of government incentives, such as tax and customs waivers on imported POS and ATM machines enhancing infrastructure availability	The Iraqi government introduced several incentives to enhance the availability of electronic payment infrastructure: 1. The Iraqi Cabinet approved measures to encourage the use of electronic point-of-sale (POS) terminals, including tax exemptions for electronic payment transactions using POS devices. 2. The government issued a decision to waive taxes and customs on imported ATM and payment POS machines. This implementation was set to take effect on June 1, 2023. 3. These measures were part of a broader initiative by the Central Bank of Iraq and the Iraqi Council of Ministries to promote digital financial services and expand the adoption of POS and eWallet solutions. 4. As a result of these incentives, there has been an increase in the deployment of POS machines across the country, with over 13,000 POS machines deployed by licenced payment service companies.	Iraqi Innovators "Iraq's Electronic Payment Acceptance Landscape" 2023

YEAR	REGULATION / EVENT	DESCRIPTION	SOURCE
2023	Strategic partnerships and licensing of new players to promote digital financial services	Strategic partnerships between banks and payment service providers, like Rafidain Bank and Switch, facilitated the nationwide distribution of POS devices; Licensing of new players, including 17 digital wallet providers, strengthening the demand-side ecosystem by expanding the cardholder base and fostering electronic payment adoption.	Iraqi Innovators “Iraq’s Electronic Payment Acceptance Landscape” 2023
2023	Iraqi Council of Ministries instructed governmental and private entities to facilitate electronic payment acceptance	The Iraqi Council of Ministers issued several executive measures regarding the electronic payment system and point of sale (POS) devices. Additionally, in April 2023, Iraqi Prime Minister Mohammed Shia al-Sudani ordered a series of measures to promote the use of electronic payments and point-of-sale (POS) systems in the country. These measures included: 1. Limiting cash transactions, 2. Establishing a joint committee to address security concerns, 3. Reducing mobile payment fees, 4. Enhancing security by tasking relevant authorities to address electronic payment fraud To encourage adoption, the government further mandated that educational institutions, medical facilities, hotels, restaurants, and other businesses must adopt e-payments to renew their licences.	Shafaq News “US Ambassador praises Iraq's official adoption of E-payment system Economy breaking US”, 2024 “Iraq's August electronic transactions surpass $1.5 billion”, 2024
2024	Revision of MDR caps	Central Bank of Iraq updated MDR regulations (March 2024): 1. Government sector: 1% for each transaction, with a maximum limit of (10,000) Iraqi dinars 2. Private sector : 1% for each transaction, with a maximum limit of (50,000) Iraqi dinars The MDR is divided among the issuer (20%) and acquirer 70% and the National Switch (10% - which is distributed equally among the issuer and acquirer)	Central Bank Iraq General Secretariat of the Council of Ministers No. Sh. g. L / 10 / 1 / Circulars / 5728 dated 2/1/2024 and attached to Cabinet Resolution No. (24058) of 2024 and to Cabinet Resolutions 23044 and 23620 of 2023
2024	Introduction of regulations for electronic payment services, aimed at enhancing efficiency, security, and transparency	Iraqi Cabinet introduced new regulations for electronic payment services, aimed at enhancing efficiency, security, and transparency in the financial sector. These regulations include technical standards for digital systems, as entities offering electronic payment services must comply with the Central Bank of Iraq's standards and regulations.	STA Law Firm “Overview on new regulatory landscape for electronic payment systems in Iraq”, 2024
2024	Introduction of financial support for digital payment systems	Iraqi government directed the Ministry of Planning, in partnership with the Central Bank of Iraq and the World Bank, to create a national budget specifically to support and develop digital payment systems. The regulation was supported by funding from the United States Agency for International Development (USAID) and the UNDP, indicating international collaboration to enhance Iraq's digital payment ecosystem.	UNDP Iraq “The Turning Point: Iraq’s Leap into the Digital Economy”, 2024

ABOUT ARKWRIGHT

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AUTHORS

Francesco Burelli
Partner
–

Patricia Pohl
Associate
–

Lena Büttner
Associate
–

Sofia Castillo-Roman
Associate
–

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