What China's $6.7 Trillion Market Really Means to Visa And MasterCard

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Last month, Chinese authorities announced that foreign payment processors would for the first time be allowed to operate within Chinese borders. This is the latest step the current regime has taken to open up the country further still to the global economy.

For investors in Western payment processing companies, notably **Visa** (NYSE: V) and **MasterCard** (NYSE: MA) , this opportunity could be a game changer. However, there are enough pitfalls and challenges still to be overcome that the reality of this $6.7 trillion opportunity could prove to be fool's gold.

The initial market reaction was pretty solid
Immediately following the announcement, shares of both Visa and MasterCard jumped sharply. And why shouldn't they? This is a huge market that today is a virtual monopoly for Chinese processor UnionPay.

Until now, if you wanted to use your Visa or MasterCard in China, that transaction would be handled by UnionPay. With this change, now Visa, MasterCard, and others can use their own networks, thus cutting out UnionPay as the middle man.

UnionPay does not report its financials publicly, so it is difficult to discern exactly how large the business really is. That being said, it's probably large. A Nilson report estimated that UnionPay handled about $2.5 trillion in transactions in 2013, which would have been second globally only to Visa's $4.6 trillion.

According to Chinese Central Bank figures, bank card transactions had jumped to $6.8 trillion in 2014, of which UnionPay likely enjoyed the vast majority of that volume. For Visa and MasterCard, winning even a sliver of market share from UnionPay would be enough to materially move the profit needle.

Winning in China is no sure thing
For investors today, that exuberance is all about the potential of this new market. Executing and getting results is a whole other story. Countless large U.S. companies have tried -- and failed -- to carve out market share in the world's most populous country.

Google tried to enter China, only to end its operations there in 2010. Its exit was blamed on censorship concerns, but that masks the struggle Google found in taking market share from leading Chinese search engine Baidu. **eBay** faced a similar fate, struggling and then totally failing in its challenge to Chinese TaoBao.

The consumer companies that have succeeded tend to be well established brands that carry with them either a certain luxury cachet or international brands that aren't afraid to tweak their product to match Chinese preferences.

Yum! Brands' KFC is a great example of the latter. KFC is the top foreign restaurant brand in China in large part because the company successfully merged Chinese taste preferences with its existing fried-chicken offering. Automakers such as **General Motors** have found success by positioning the brand as a status symbol of capitalistic American wealth.

For Visa and MasterCard, it is not yet clear how they can differentiate themselves from UnionPay, a Chinese brand with a huge head start in the market.

It has also been reported that UnionPay routinely waives fees and lowers costs for its customers as a tactic to spur growth even if that limits profits. That's a tactic Visa and MasterCard certainly can not follow, and also serves as a great example of the challenges in competing with a government backed enterprise.

An uphill battle? Yes. But MasterCard may have the upper hand.
As MasterCard and Visa begin to enter the Chinese market over the next year or so, many analysts give MasterCard the early advantage.

In 2010, MasterCard and UnionPay began issuing co-branded cards to Chinese citizens to use when traveling overseas. At the same time, Visa prompted a U.S. complaint to the World Trade Organization about the processor effectively being shut out of the Chinese market.

In other words, MasterCard's brand made massive in-roads in China through their co-branding agreement while Visa sat on the sidelines complaining to the WTO.

Regardless, the opportunity is absolutely huge for both Visa and MasterCard. Thanks to the Chinese decision to allow these foreign payment processors to operate independently, the only question is whether or not these companies can execute and take advantage of this $6.8 trillion market.

Jay Jenkins has no position in any stocks mentioned. The Motley Fool recommends eBay, General Motors, Google (A shares), MasterCard, and Visa. The Motley Fool owns shares of eBay, Google (A shares), MasterCard, and Visa. Try any of our Foolish newsletter services free for 30 days. We Fools may not all hold the same opinions, but we all believe that considering a diverse range of insights makes us better investors. The Motley Fool has a disclosure policy.

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