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Merchants Beware of Low Card Processing Rates

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There are some merchants (i.e., retailers, wholesalers, professionals) who have come to view merchant services as a commodity. That is, one service is as good as another and "what you see is what you get." This misconception has allowed otherwise intelligent entrepreneurs to be duped into long-term, terminal equipment leases at outrageous prices and total costs well above contracted discount rates. A typical scenario is described by *The Green Sheet*[1] as follows:

- "Offer a low-ball (even below cost) rate for qualified transactions without disclosing the rate for non-qualified transactions and other fees."
- "Offer this rate with no rate guarantee period without telling the merchant it is a 'teaser rate' over which the Independent Sales Organization (ISO) and/or sales representative probably has no control whatever."
- "Convince the merchant that the equipment he owns (has) must be replaced with new equipment … that the (discount) rate quoted will save more than the monthly payments (on the equipment lease)."

Merchants often obligate themselves to fixed leases for 48 to 60 months and end up paying four to six times more than the equipment cost. With technology changing so fast, four years is a long time. To make matters worse, the equipment or software are sometimes "proprietary" and use is not transferable to other merchant service providers (MSP). Meanwhile, the "teaser rate" period expires and the discount rate goes up. Now the merchant is overpaying for the equipment *and* the processing.

Some merchants have secured their rates in writing. For most, however, the guaranteed rate is merely a "face rate." In addition to a plethora of a la carte charges, the low discount rate only applies to "qualified" transactions. The merchant is then charged an additional 0.5 percent to 2 percent for nonqualified transactions and ends up paying in excess of 3.79 percent for hand-keyed, corporate, frequent flyer or signature debit card transactions, and so on.

So how does one avoid these pricing pitfalls? By understanding that the discount rate is important. The discount rate has three basic components: 1) interchange, 2) assessments and 3) MSP costs and profit. The largest component is interchange.

- Interchange is the portion of the discount paid to card issuing banks. Interchange is set by the Visa and MasterCard Associations (V/MC) and is the same for every member MSP. There are no volume breaks or preferred pricing when it comes to interchange. As of April 1, 2003, the best interchange rate for a $50 card-swiped retail transaction was 1.59 percent (Visa) and 1.60 percent (MasterCard).
- The same rules apply to assessments. Visa charges 0.084 percent and MC charges 0.095 percent for every credit card transaction without exception. Again, let me emphasize that MSPs have no control over these costs.
- On top of interchange and assessment, MSPs have other costs, including: authorization and settlement services, data communications, terminals software, customer service, training, checking account funding, monthly statements, supplies and so on.

Knowing this, is an offer of 1.49 percent by a MSP realistic? No.

Next, downgrades or nonqualified transactions can have a huge impact on card acceptance costs. Both Visa and MasterCard add extra interchange to transactions that do not meet their processing requirements. For example, a restaurant with the wrong terminal software can suffer transaction "downgrades" that increase interchange by 0.75 percent or more. The better providers "pass through" this cost without markup and provide hardware, software and training to ensure that merchants do not incur unnecessary transaction downgrade costs.

Additionally, merchants must recognize that transaction fees and monthly charges can heavily impact their "effective discount rate." For example, a $0.50 transaction fee will add 1 percent to the discount rate on a $50 transaction.

Finally, don't sign a long-term commitment. Most reputable MSPs have contracts that are "at will" or run for 12 months or less. Use common sense. If it looks too good to be true, then it probably is. Work with a trusted partner who will look out for your interests and be there when you need service. Processors such as your bank have a vested interest in the success of your business. Select your MSP with the same care that you apply when making any major business decision. After all, cards are becoming an increasingly popular method of payment. For many merchants, they are already the primary payment method. ■

1 The Green Sheet (The Financial Services Industry Source for Education, Inspiration and Actionable Advice) January 27, 2003. Issue 03:01:02