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Are You Paying Too Much For Credit Card Processing?

Choosing the wrong merchant services provider may cost you thousands of dollars a year

by Janet Attard

Although we may never see a cashless society, many businesses today could not stay in business without accepting credit cards. In fact, credit cards are so commonly used by consumers, businesses and government agencies, that credit card purchases may account for 65 to 100% of many companies' sales.

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For the most part, that's good news for merchants and services providers. Credit card customers often spend more than their cash-wielding counterparts, and merchants can capture sales from internet and mail order customers immediately -- instead of hoping the customer actually does mail in a check to make a purchase.

But like all solutions, the ability to accept credit cards has its price. Besides the initial installation of software, Internet storefront (for online merchants) and equipment for bricks and mortar stores, there are the ongoing fees a business has to pay on every credit card transaction they process. These fees can vary by hundreds of dollars a month -- or more - depending on sales volume and which merchant services provider the merchant chooses to provide their credit card processing services.

How Credit Card Processing Works, and Why Fees Vary

The credit card processing industry is complex, with several parties making money on each transaction your business processes. On a very simplified level, you pay two sets of fees:

- An Interchange fee, which is the fee the credit card companies charge for each transaction. This fee is set by the credit card networks and split between the networks and the credit card

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issuing banks. It consists of a percentage of the transaction plus a per-transaction fee. The exact percentage of the transaction varies according to a wide range of specific criteria such as what type of credit card it is, what is being purchased, who issued the card, and many other factors.

- An additional fee charged by your merchant service provider, which may be the merchant bank (the bank that provides the merchant account that allows you to accept credit cards) or an authorized independent sales organization (ISO) of the merchant bank. This fee is also a percentage of the transaction and may also include a per-transaction amount.

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Small and mid-sized merchants are seldom told about the Interchange rate. Instead, they're presented with a single base rate called the "discount rate," which includes both the Interchange rate and whatever additional fee the merchant services provider charges for each transaction. Because the Interchange rates aren't disclosed, the smaller merchant generally has no idea what percent of the "discount rate" goes to the merchant service provider. And that -- the fee paid to the merchant service provider -- is what accounts for the bulk of the differences when different merchants are charged different rates for otherwise identical transactions.

Qualified Confusion

Adding to the difficulty in determining exactly what's getting paid to whom on each transaction, is the qualification system that's used to categorize transactions and determine the underlying Interchange rate on each sale.



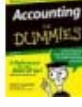

"There are over 125 interchange categories that each have different fees based on how card processed, what kind of card is being used, the nature of the merchant's business, and other factors," explains Henry Helgeson, CEO of Merchant Warehouse (<http://www.merchantwarehouse.com>) a merchant services provider located in Boston, MA.

What small to mid-size accounts don't realize," Helgeson says, "is that many merchant service providers condense these 125-plus categories into three tiers called Qualified, Mid-Qualified and Non-qualified. They average out the many Interchange rates in each tier, then add a margin."

Under this kind of system, the averaged tier rate is often higher than the actual Interchange rate would be for an individual transaction. That's something like putting a dollar bill into a vending machine to buy a \$.75 piece of candy and not getting any change.

Sometimes that margin can be quite substantial, resulting in a "discount rate" to the merchant that's double or more than double the Interchange

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rate. "The mid and nonqualified Interchange rates may only go up a few basis points on MasterCard, but may increase by 200 basis points on processor side," explains Helgeson. "So, the merchant might be paying up to 3.5% and 35 cents per transaction."

Size and Age Matters

The bigger the company and the higher the total dollar amount of transactions processed each month, the more room there is for negotiating fees. Businesses doing about \$20,000 or more a month in transactions, should be able to negotiate something known as an Interchange Plus fee. Under this system you pay the actual Interchange rate for the classification of transaction, plus a flat additional fee.

Smaller businesses, and businesses new to processing credit cards, will usually have to settle for some sort of three-tiered pricing structure (qualified, mid-qualified and non-qualified rates), but that doesn't mean you have to settle for sky-high discount rates. Talk to several merchant services providers and negotiate the best possible rates before making your final decision.

Service is Critically Important, Too

Avoid dealing with independent sales people who know little about the credit card processing industry or your industry. Instead, look for larger organizations that understand your industry and the credit card processing industry and that has the staff available to offer support when you need it.

"Ask questions -- and use common sense," says Helgeson. "Call the contact a couple of times and see if your call gets answered immediately or if you get voice mail. If it's 5 pm and you have a queue of cars waiting to exit and your terminal goes down, you don't want voice mail. You need someone to solve the problem right away."

Avoid Leases for Low-Cost Equipment and Software

The equipment or software to process credit cards for small businesses can usually be purchased for as little as \$100 to \$400. But some salespeople will try to talk you into leasing the software or equipment. Don't do it. The only one who benefits from this type of lease is the salesperson who gets a fee for selling you the lease. A lease on a \$400 piece of equipment is usually noncancellable and can wind up adding \$1,000 or more to the actual price of what you leased.

Read the Small Print

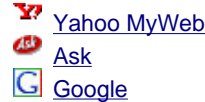
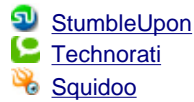
Carefully read all applications, forms and contracts mailed. Read *all* of the small print. Find out if you'll have to pay any penalties if you want to change processors or stop accepting credit cards. Many merchant services providers include a penalty clause in their contracts that kicks in if you want out in less than two to three years. Be sure all fees listed in the contract are the same as what you were quoted. If there's ever a dispute, the issue will be decided on the basis of the printed contract, not what you say the salesman told you on the telephone.

Check to see under what conditions the company can terminate your account, and, whether there are monthly minimums or maximums.

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Janet Attard is the founder and owner of BusinessKnowHow.com, a small business website that provides practical advice, tools and resources for starting, running, marketing and managing small businesses.



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