

# Selecting a Payment Processor for Subscription-based Businesses

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## Introduction

Many merchants, especially recurring ones, find out the hard way that selecting a credit card processor is among the most important decisions to be made when choosing to conduct business online. For the uninformed or ill-advised merchant, it may seem like a fairly simple task: find a processor that offers a combination of the lowest possible fees and easiest connectivity. But basing a decision on just those criteria can, and probably will, have a devastating impact on your bottom-line.

Making the proper determination about your future acquirer demands that you perform the kind of due diligence that leaves no stones unturned. It also requires the merchant to view the process **in terms of selecting a partner**, not a vendor, because the payment processing artery through which your lifeblood (money) flows needs to be cooperatively and rigorously maintained by both you and your processor. Failure to understand this will inevitably put a merchant in the unenviable position of being successful *despite* their payments processing infrastructure, not because of it.

## Scaling the Language Barrier

One of the first challenges a merchant faces is the confusing colloquialisms of the payments industry. The terms “acquirer”, “processor” and “gateway” are often interchangeably and erroneously used. Here are some basic definitions to rely on when discussing the payment industry:

- **Acquirers** are entities which interface directly with card company systems (e.g., Visa, MC, etc.) and may or may not interface directly with merchants on the other end.
- **Processors** may be acquirers but could also be entities that deliver transactions to acquirers on behalf of merchants.
- **Gateways** are middle-men, dispersing merchant transactions to either processors or acquirers.
- **Independent Sales Organizations (ISOs)** are sales organizations that can originate a relationship with any of the above and may also be an actual handler of transactions as well.

Each entity type takes a toll (in more ways than one), so it makes the most sense to develop a partnership directly with an acquirer so that the process will be more efficient and effective - not to mention, less costly.

## Narrowing Down the Field

### *Defining the Objectives*

Of course, you want the best deal possible. But price is only one of the considerations in making a wise decision. The right way to frame your search is seeking out a relationship with the best partner, at the best price, deploying the best practices for

your business. You want all three, but the ***best practices must drive your search for the best possible partner***. If that can be accomplished, the pricing issues are often resolved without much difficulty.

So, the key is to figure out which acquirers allow you to incisively use the recurring industry's best practices. How can you figure that out? Make a list of the recurring/subscription/continuity merchants you admire and respect - and give them a call. Find out who they use and whether they are satisfied. Merchants that join relevant industry organizations such as the Direct Response Forum, Marketing Sherpa and Merchant Risk Council are afforded wonderful opportunities to network and find out which processors stand above the rest.

### *The Art and Science of Recurring Billing*

Recurring merchants face immense challenges because subscriptions are subject to external risks that do not occur in one-time payment scenarios.

First, the re-issuing of cards is pandemic, a result of fraudulent activity, portfolio-flipping and mergers and acquisitions among issuers. Secondly, Americans continue their unabated love affair with credit limits. Thirdly, where the soft-economy has exacerbated things is in the area of late payments, with delinquent payments at their highest level since 1997. The final reason, though, is the most exasperating one of all: the merchants themselves - because of their failure to optimally implement the best practices which have been designed to help them meet and overcome these challenges.

Here are some of the best practices that you need to be able to deploy with your payment solution provider:

1. **Comprehensive Decline Recovery** - As the volume and percentage of declines has risen significantly, so has the opportunity to recover them with a well-designed recycling strategy. Such a strategy dictates that your processor provide granular decline response codes in order to allow you to apply targeted recycling tactics based on the type of decline. Processors that fail to succinctly define declines force you into a sub-optimal and more-expensive position of recycling all-or-nothing.
2. **Expiration Date Optimization** - The devastating bottom-line impact of requiring merchants to successfully procure refreshed expiration date information from customers was long ago recognized by issuers and card companies. The 'blank expiration date' field policy was created, in tandem with the recurring indicator, to help work around the need to retrieve this information from customers. Today, the best-in-class recurring processors accommodate this policy, helping effect 90%+ retention rates on accounts that have stale expiration dates. Processors not expert in recurring processing force you to make an educated guess about the new expiration date, cutting the retention rate in half - or more.

3. **Account Updater Programs** - Cards are re-issued, within an issuing brand, at extremely high levels because of portfolio changes, fraud and other issues. Many issuers are contributing updated card number information to Visa and MasterCard databases in order to help proactively prevent customer relationships from involuntarily coming to an end because of this type of churn. Since these Updater programs are only available through the merchant's acquirer, it is essential that recurring merchants select a processor that has a fully- developed Updater solution.
4. **Recurring Indicator** - Issuers and card companies recognize the lifetime value and downstream revenue of recurring customers and affect a lower barrier to approval for transactions carrying the *recurring indicator*. This is such a basic best practice that processors who do not accommodate or are ignorant of it are probably not a good choice for your business.
5. **Soft/Flexible/Dynamic Descriptors** - The clearer any merchant is with their credit card descriptors (the description that appears on a customer's credit card statement), the less likely customers will be driven to charge back or cancel because of statement confusion. Most processors restrict descriptor usage to an association between merchant accounts (or divisions) with default descriptors. Experienced processors allow an override of those defaults at the purchase level, so that a succinct descriptor can be used to assist both the consumer and merchant.

These are several of the best practices every processor serious about recurring excellence must make available to you, to be worthy of your consideration.

### *Alternate Payment Methods*

It is an almost universal truth for ecommerce merchants: the more payment methods available for consumers to use, the better. Therefore, it makes sense to factor Alternate Payment methods into the choice-equation for processors. First, determine which payment methods are conducive to recurring payments for your particular product and client base - there are many to choose from but most are barely emerging on the scene and there is a point of diminishing returns so it is important to choose carefully. Then, find out from the processors that have risen to the top of your list because of their best-practices capabilities whether they can handle these alternative payments, from beginning-to-end, for you as well.

### *Other Considerations*

- **International processing capabilities** are obviously important to merchants who have - or desire to have - a global presence. It is incumbent upon a merchant with international aspirations to select an acquirer that allows them to settle and present Visa and MasterCard charges in the local currencies where they will be marketing. But that is not enough. The acquirer needs to be able to process charges for payment methods that are unique to those areas of the world as well, such as Direct Debit and Switch/Solo. Finally, it is in the best interest of the merchant to confirm that the germane best practices listed

above are available internationally as well. For example, Account Updater just became available for the UK but very few processors support it.

- **Account Setup** - The best acquirers minimize charges and foster greater depth of knowledge through the setting up of a multi-level merchant account - instead of separate merchant accounts. For example, if a subscription merchant has several publications - or a merchant has several different business units - the acquirer should be able to accommodate a single-account set-up that allows for underlying divisions which represent the publications - or business units. This is a great way to be able to see, through reporting, how the individual publications are doing as well as the business as a whole.
- **Reporting** - A good acquirer provides interactive and flexible reports that allow merchants to have a complete understanding of how they are doing with regards to chargeback rates, approval rates, decline rates, refund rates and interchange qualification rates. In addition, the reporting should break down chargebacks and declines by type, so that issues and problems can be understood and addressed by the merchant. This kind of information should be accessible through a real-time, on-line reporting tool. Sadly, many processors do not provide adequate reporting tools.

## Submitting Applications and Negotiating the Best Offer

### *Application Expectations*

Once you've decided which acquirer(s) you are most interested in, you will need to go through their application process. Expect it to be rigorous. That is what you want. *A loose and lax application process in which little is required from the merchant portends a loose and lax relationship in which little in the way of assistance will be offered by the acquirer later.* You should expect to be asked for a number of months' of incumbent-processor statements and corporate financial statements, among other documentation, that will help the acquirer put forth their initial offer and reserve requirement (if any). Remember, since this will be a partnership - and the acquirer will be responsible to the card companies for you, the merchant - it is incumbent upon the processor to scrutinize the merchant every bit as much as the merchant scrutinizes the acquirer. A partnership that begins with mutual-transparency has a much better chance to thrive.

### *The Acquirer Offer*

A new set of semantic challenges potentially surrounds the offer you could receive from a processor. You see, there are different pricing models, but they primarily fall into one of two categories - the *discount rate* model and the *interchange plus* model. The "discount rate" (also called *bundled, blended or tiered pricing*) is usually presented as a percentage of the merchant's sales dollars that will be divided up by the processor between the card brand (e.g., Visa, MasterCard), the card-issuing banks and the processor itself.

In this model, the merchant pays a single percentage that covers all the fees and is only provided a murky view into exactly how those fees are distributed. With "interchange plus", the practice is for the acquirer to charge the merchant exactly the interchange that is passed on by Visa, MasterCard on behalf of the card-issuers, where the "+" is the fee the acquirer will keep for itself. Merchants that take advantage of this pricing model negotiate how much the processor will charge to authorize and settle transactions and usually have a clearer view of how they are spending their credit card processing dollars and cents because, with nothing to mask, most *interchange plus* processors provide incisive reporting on fee-distribution. Since companies need to really to know exactly what they are paying to whom, the *interchange plus* model helps clear the air on merchant processing fees. Small to medium sized merchants are usually offered the blended type of rate whereas larger merchants typically get Interchange Plus pricing and should demand it.

### *The Reserve Question*

Having cash-flow eroded as a result of a holdback or reserve required by an acquirer is never ideal. But for many, it is a reality - and rightfully so. Processors are responsible for fulfilling the obligations of companies they process for, even if they become unviable - and unfortunately, that happens all too often. Therefore, sensible acquirers must assess the risk and, if necessary, ask for a reserve. That being said, reserve is only one of the components of pricing from an acquirer and should be negotiated as part of the whole - all along remembering that performance is the foundation upon which the partnership will be built - and thrive, long-term.

### *Contract Details*

Other than price, the two issues related to proposed agreements that result in the most debate are *exclusivity* and initial *contract-length*. Naturally, acquirers want all of a merchant's business while the merchant wants to have some flexibility. In the same vein, processors want all of a merchants business for as long as they can get it while merchants want as short a commitment term as possible. Unfortunately, most merchants that buck the idea of exclusive, longer-term contracts come out of situations in which they believe they were badly handled by their previous processor and cannot imagine being subject to that all over again - so they understandably want to hedge their bets with shorter, non-exclusive deals.

The truth is, that it is encumbering and, ultimately, self-defeating to operate in such a fashion. Instead, it is much better to perform the due diligence of finding a recurring 'champion' that will take care of a merchant's processing needs through a well-developed, two-way-street partnership. So, is the demand for exclusivity valid? In a word, 'yes'. Not only because of the time and effort merchants waste supporting processes to multiple, less-than-stellar acquirers but because, primarily, of risk. As we said, processors are responsible for the obligations of companies they process for. Not only that, they are responsible for working with their merchants to ensure that they transact according to industry regulations and thresholds. What happens if a merchant processes with two processors, one of which keeps them operating within industry regulations while the other allows (either willfully or through ignorance) reckless activity - and the reckless activity causes the merchant to become unviable?

Each processor gets hurt, even the one that worked hard to help the merchant operate appropriately. Therefore, since a merchant should be looking for solutions and not workarounds, exclusivity should not necessarily be an objection.

But what about *contract-length*? Acquirers these days are pushing 5 year deals. Merchants want 1-year deals. Neither is normally tenable. Five years is a long time and what happens if you grow - a lot!? Unless the merchant can attain a very detailed volume-threshold pricing model that has been well-thought-through, five years is too long. Yet, 1 year arrangements are too short - too short a time frame to develop the kind of partnership necessary for success in this volatile payments environment. It is also unfair to the acquirer, who will have poured much intellectual and educational capital into the first year of the partnership - only to have the merchant jump ship for a 'better deal'! An optimal compromise is a 3 year contract, renewing automatically each year after that. This will allow for the investment that each party needs to make into the partnership to grow.

## The Final Decision

To recap, merchants should be looking for an acquiring *partner* that deploys the best *practices* at an attractive *price*. As previously stated, no stone should be left unturned in determining who that partner should be - which leads to a final recommendation, which is perhaps the most neglected part of the process: **checking references**. Of course a merchant should call *all* of the references provided by the acquirer. If the processor does not pro-actively provide them, then the merchant should ask for three that are similar to them - continuity, subscription, auto-renew, etc. In addition, try to find two other merchants that use them that are not on the processor's list. This takes some time but it is well worth it because it is here, down in the trenches, that you find out whether you will have a processor who will truly be a partner with you in developing the future of your company.

## About Vindicia

Vindicia offers an integrated, on-demand billing and fraud management solution for online merchants. Vindicia CashBox™ is a best-of-breed billing system for creating and managing recurring payments and helps merchants improve customer retention and maximize profit. Vindicia ChargeGuard™ provides automated fraud screening and chargeback management services that enable merchants to recover lost revenue. A PCI Service Provider Level 1 company and SAS 70 Type II audited, Vindicia is a key payment management resource for some of the best-known brands on the Internet.