

# Merchant Payment Services

COMPANIES: GPN, MA, V

## Steady Credit Card Usage

Overall credit card volumes during May were flat-up slightly mm because of seasonality and some sector activity.

- Mom-and-pop and high-end retailers and sit-down restaurant credit card volumes remained weak; healthcare, quick-serve restaurants and online sales were strongest
- Merchant credit card payment transaction costs mostly flat yy, but higher issuers' credit card fees are expected
- Upgrades and compliance with Payment Card Industry (PCI) Data Security Standards are expected to encourage some higher processing fees

### EXECUTIVE SUMMARY

Merchant payment executives said credit card volumes during May were flat-up slightly mm but opinions were mixed whether the industry has bottomed out yet. Credit card volumes at high-end retailers and sit-down restaurants remain slow, and many mom-and-pop businesses are struggling to survive. The healthcare industry is helping drive volumes, notably with flexible spending accounts, and quick-service restaurants are enjoying more business as consumers look to spend less. Though upfront transaction costs for merchants have declined yy because of competition, smaller ISOs and processors are making up the difference with additional fees. PCI compliance fees are becoming more common, though some sources said companies are using compliance to drive additional revenue as opposed to covering costs.

### KEY DATA

#### May Credit Card Volume Flat-Up Slightly MM

(number of sources)

	SMALL	MEDIUM	LARGE	TOTAL
Up 6%–10%	1	-	-	1
Up 1%–5%	-	2	3	5
Up	1	-	-	1
Flat	5	3	2	10
Down less than 1%	-	2	-	2
Down 1%–5%	-	2	-	2
Weighted average	Flat-up 4%	Flat	Flat-up slightly	Flat-up slightly

### SOURCES & BACKGROUND

21 executives with ISO or payment processors located in North America, which generate nearly 4 billion in annual credit card transactions, representing 5 mega ISOs/payment processors (more than 100 million); 9 mid-tier (10–100 million); and 7 small-tier (less than 10 million transactions annually)

**INTERVIEWS** Late May through early June

**AVERAGES** Weighted according to each source's 2008 annual transactions

**OBJECTIVE** Assess volumes/fees and what industries are driving credit card volumes and which are falling off with a focus on May compared with April activity

"We have bottomed out. We're at the trough, but it's not getting better."

*President of a top-10 ISO*

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## Slight Optimism in May Card Volumes

Executives and managers within the merchant payment processing sales channels said May credit card volumes were flat—up slightly on average mm. “May was pretty flat [mm] after declines over the last few months,” one said. Roughly one-half of sources said May was flat mm, while one-third reported modest gains. An executive said, “I really only look at my bigger accounts, and there are no huge drops. But I am losing some smaller accounts.”

Source responses were mixed whether May numbers are merely a brief respite in the downward trend (because of seasonality and spring) or a sign of better things to come. Several said the industry has reached a low point in the business cycle. “We have bottomed out. We’re at the trough, but it’s not getting better,” said an executive with a mega ISO. Another said, “We’re seeing signs of life with additional accounts and higher same-store sales. I think the economy is starting to turn.” Another said signing up new businesses is picking up ever so slightly month by month, but there are hardly any new businesses out there. However, several others were hard pressed to come up with anything positive to say about the economy. “I’m not seeing any traction at all in the economy,” said a midsized ISO based on the West Coast. Another said he believes the economy is worse off than what is currently being reported.

## High-End, Mom-and-Pops Struggle

Sources said retail and restaurants, notably high-end and small mom-and-pop businesses are weighing most heavily on overall credit card volumes. “Everyone has been affected [by the economy], but the little mom-and-pops are the ones closing. We’re in our 14<sup>th</sup> year, and this is the first time the economy has really impacted our industry,” an ISO owner said. While credit card transactions from smaller retailers/restaurants are declining as businesses struggle to survive, luxury retailers and high-end restaurants are feeling the pinch as consumers have tightened their purse strings. Several sources said because of lower oil prices, dollar volume for gasoline is down substantially yy, but the number of transactions is up yy. Sources also said transactions from home improvement stores, high-end hotels and automotive dealers are on the decline.

On the plus side, sources said healthcare and quick-service restaurants were driving increases in credit card volumes. Quick-service restaurants are benefitting from consumers spending less when they eat out, while healthcare transactions are being fueled by flexible spending accounts and increased usage at health clinics. Several said online sales are driving business in a down economy. “The margins for retail are very narrow. Internet margins are much better,” one said. Grocery transactions have also improved as consumers are eating out less and automobile repair shops are getting more business as people tend to fix their autos rather than buy new cars.

## Increased Competition, Overall Costs Flat

Slightly more than one-half of sources said 2009 to date average merchant transaction costs are steady yy, while a few reported a modest decline and others said costs have increased slightly. Several said the recession has increased competition for the dwindling amount of new businesses and resulted in lower upfront rates, although other add-on fees have offset those savings. “The effective cost to the merchant is pretty steady. We haven’t changed our rates to take [market] share. Those who are tacking on more fees are smaller ISOs or banks that are pressed for revenues and trying to make up for attrition,” one said.

“Everyone has been affected [by the economy], but the little mom-and-pops are the ones closing. We’re in our 14<sup>th</sup> year, and this is the first time the economy has really impacted our industry.”

*ISO owner*

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Many small to midsize ISO sources said the overall competitive landscape in the industry has increased substantially because of the faltering economy. “The initial discount fees are lower by 5–10 bps, but that is being offset by the additional fees charged for unqualified [rewards] cards. Interchange fees used to be simple, but now there are 50 interchanges and all sorts of different fees for different types of cards. There are very few qualified cards that do not have any surcharges,” one said. Although many small–medium ISOs view the industry as more competitive, several larger players said they do not see much of a change. “Competition is on par with how it’s always been. I have not seen an increase in competitive pressures; it’s just harder to get a merchant’s time,” one said. Another said ISOs who say the current environment is more competitive likely were not priced right to begin with.

Several said merchants are looking for ways to save money, becoming better educated with the payment processing industry, and are looking for better cost transparency. “Processing fees or costs have not changed [year to year], but the trend is going to be down as merchants are getting smarter and more educated about fees and true transaction costs,” one executive said. Another said merchants are becoming savvier with the costs associated with nonqualified versus no-fee qualified cards and are negotiating better upfront as a result.

## Some Fees (including PCI) Increase

Most sources expect merchant transaction costs to remain steady during the next six to 12 months; however, some expect additional fees from credit card companies and processors to increase. Although upfront costs have become more competitive with the slowing of the economy as merchants look for ways to save any way they can, those savings are offset by additional fees from processors and credit card companies.

Processors have already begun to add or increase PCI compliance fees, and the trend is expected to continue. “PCI compliance is a huge issue in the industry right now. PCI costs are very pricey for the processors, and they are passing these new costs on,” one said. However, several sources said companies are using PCI fees to increase revenue as opposed to offsetting costs. “We don’t charge a premium for PCI compliance, but some are trying. The majority of it is at the processor level, and additional compliance fees are purely for profit, but disguised as a fee,” one said. Another said although average compliance costs per merchant can be as low as \$3 per merchant per month, some are charging up to \$15.

Credit card companies are increasing fees for rewards cards as they promote new premium cards, and **Visa Inc.** and **MasterCard Inc.** try to boost rates at least once a year. Some sources expect issuers’ higher credit card fees to put more pressure on credit card processors to reduce charges.

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## ON INDUSTRY/SECTORS

“Mom-and-pop retailers and restaurants are weak. Healthcare is still positive. Petroleum is way down because of lower prices, but transactions are up. Quick-service restaurants are up as people are spending less. Big-box discount retailers are still doing ok.”

“Low-end retail, low-end restaurants and grocers are high. Dropping off are entertainment, travel and high-end retail.”

“Medical is growing with Health Savings Accounts and consumers using credit cards more for payments.”

## ON MAY VOLUME

“Overall, I’m not seeing any signs that the economy has firmed at all.”

“Overall volume hasn’t gone down much, but it’s not booming. I really only look at my bigger accounts, and there are no huge drops. My residual stream is holding its own, but I am losing some smaller accounts. Signing up new businesses is picking up a little bit month by month, but there are hardly any new businesses out there. In the past, I’ve never been concerned with going after [existing business], but I am doing more of that now.”

“A lot of small merchants have gone out of business.”

## ON TRANSACTION FEES

“It’s a balancing act as fees are moving up for most ISOs while merchants are getting smarter and more savvy and challenging fees.”

“Merchants are able to go back to processors and ask for better deals because there are so many processors looking for business.”

“I think PCI compliance [cost] is table stakes for the game. We don’t charge a premium for it, but some are trying. It costs \$50,000–\$100,000 for PCI compliance, so if someone has 100,000 merchants, and they’re charging them \$100 for PCI, you do the math.”

## ON TRENDS

“Processors are going to move away from the ISO model — **First Data [Corp.]** and **Global Payments [Inc.]** have already hinted about this. The ISO model no longer works where ISOs’ reps get paid on POS leases and ISOs make in on the back end, because merchants aren’t leasing [equipment] anymore.”

“There is definitely increased competition with less new business to go after. ISO consolidation has also had an impact.”

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1. What segments of the economy are driving credit card volumes, and which are dropping off? (Some sources gave more than one answer while others did not respond.)

	POSITIVE	NEGATIVE
Healthcare:	4	-
Quick-service restaurants:	4	-
Online sales:	3	-
Discount retailers:	3	-
Retail:	2	-
Grocers:	2	-
Auto repair:	2	-
Home improvement:	1	2
Travel:	1	2
Petroleum:	-	2
High-end hotels:	-	2
Automotive dealers:	-	2
Mom-and-pop retailers:	-	3
Mom-and-pop restaurants:	-	3
High-end restaurants:	-	5
High-end retail:	-	6
Others:	6	6

2. What issues are driving changes in (both merchant and processing) transaction fees? (Some sources gave more than one answer while others did not respond.)

Larger ISOs hold share:	6
Increased competition (some banks more aggressive):	6
Credit card issuers raise fees (promote new premium cards):	5
Processors add PCI compliance fees:	4
Merchants seek greater cost transparency:	4
Smaller ISOs increase fees:	3

3. Did May credit card volume increase, decrease or remain the same mm?

	SMALL	MEDIUM	LARGE	TOTAL
Up 6%–10%:	1	-	-	1
Up 1%–5%:	-	2	3	5
Up:	1	-	-	1
Flat:	5	3	2	10
Down less than 1%:	-	2	-	2
Down 1%–5%:	-	2	-	2
<b>Weighted average:</b>	<b>Flat-up 4%</b>	<b>Flat</b>	<b>Flat-up slightly</b>	<b>Flat-up slightly</b>

4. Have your average merchant's transaction costs (fee per transaction) increased, decreased or remained the same during 2009 to date yy?

Up 1–5 bps:	-	4	1	5
Up less than 1 bps:	-	1	-	1
Up:	-	1	-	1
Flat:	6	2	3	11
Down 1–5 bps:	1	-	1	2
Down 6–10 bps:	-	1	-	1
<b>Weighted average:</b>	<b>Flat</b>	<b>Flat-up slightly</b>	<b>Flat</b>	<b>Flat</b>

5. Do you expect your merchant's transaction cost (fee per transaction) to increase, decrease or remain the same during the next six to 12 months?

Increase:	1	5	-	6
Remain the same:	5	4	4	13
Decrease:	1	-	1	2

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