

The Little Guys

Why Small Merchants Are Worth the Risk

As credit and debit card use increases, so does the number of small merchants interested in upgrading or adding electronic card devices to their businesses. This target group's emergence is also due to a greater willingness of the transactions industry to deal with risk management concerns and to demonstrate new equipment and processing capabilities to the little guys.

Typically, small merchants (often referred to as mom and pops) are single retail locations that are non-chain, non-franchise operations, according to Lisa Shipley, Hypercom's senior vice president. These businesses could produce as few as 10 to 20 transactions a month and often use dial-up modems.

From a volume standpoint, processors see small merchants as those producing less than \$1 million in card volume annually, says Douglas J. Byerley, vice president of First Data Enterprise Payments. Within that category are microbusinesses that generate \$150,000 to \$200,000 a year in bankcard business.

Some independent sales organizations (ISO) define small merchants in other ways. Mike Murray of American Credit Card Services (a Vital Processing ISO) categorizes a small merchant as anyone that does \$5,000 to \$15,000 per month in MasterCard/Visa volume. Broken down even further, most businesses average \$70 per charge, says Joe Crowley, director of ISO relationships for SIA Select Services (which he describes as a "VeriFone shop"). With small merchants, the per-charge average is usually less than \$15.

While the small merchant model is changing continuously, its importance to the industry, particularly ISOs, is not. Merchants signed by ISOs generate more than \$100 billion in bankcard gross dollar volume annually, according to MasterCard International's research.

Much of that comes from small merchants. "The foundation of this business is the small business," says Crowley.

Mitigating the Risk

"Small merchants were a segment of the industry that banks typically ignored," explains Don Headlund, senior vice-president of Cardservice International, a First Data Corp. ISO.

"They were reluctant to get involved with small merchants because the risk management factor was a little intimidating for the acquirer," says Doug McNary, CEO of Cardservice International.

When a merchant encounters financial difficulty or fails, a characteristic result is a surge of credits or chargebacks that the ISO and acquirer might have to eat. Cardservice was a pioneer in handling higher-risk businesses, according to McNary. To offset the risk factors, they built in safeguards. "We put a tremendous amount of resources on the back end to manage the merchant's behavior [regarding chargebacks and other fraudulent activities]," he says.

Dealing with the risk is worth it because small merchants embody opportunity and better margins. "A high-percentage of profits come from this marketplace," explains Byerley.

Michael A. Murray, president of American Credit Card Services (a Vital Processing ISO), agrees. "We get the best margins from the mom and pops," he says. "If you service them, they will stay with you. Higher margins are the foundation of small merchant business."

"Small merchants are really our core business," says McNary. "We play the numbers game. We sign a lot of merchants, but you don't have all your eggs in one basket." In this

way, losing one account does not affect the bottom line as much. "We've diversified our revenue sources across a large revenue stream; it is a goal, a recurring revenue model."

What Merchants Want

While regional and national accounts often have sophisticated point-of-sale (POS) systems, smaller businesses are generally terminal-based. Still, the mom and pops are starting to see the advantages of payment types such as PIN debit, EBT (electronic benefits transfer), check verification, automated clearing house (ACH) transactions and gift cards.

"Merchants want terminals that will support multiple applications and value-added services," says Jae Haas, vice president of sales and marketing for Transnational, a VeriFone ISO. "Being a one-stop shop for our customers is extremely important these days, and we have to deploy terminals that give us this competitive edge."

Hypercom's T7 terminal is an easy-to-use solution for small merchants.



Offering just credit card services is not enough anymore. "Leading in with Visa/MasterCard is quickly becoming a thing of the past," says Haas. "Smaller merchants are becoming increasingly interested in value adds, such as gift card, check conversion, time and attendance, virtual terminals, etc." He also sees more interest in Ethernet-based POS terminals for maximum transaction speeds.

While small merchants want a variety of services, the equipment still has to stay simple enough for the average small business to use and train employees on. "The terminal is the scariest part of the POS process," says Hypercom's Shipley. "We specifically designed the T7 Plus to go after this market." The low-cost T7 terminal features one-step initiation of all daily functions and transaction types. "We try to take the fear factor out of it."

Simple traditional workhorse terminals are also a logical starting point for the micromerchant. "As you go up from there you look to add increased sophistication such as IP instead of dialup, PC integration and wireless," says Byerley.

The small merchant marketplace has undergone other subtle changes. "You see much better educated merchants than five years ago," suggests Murray. Many of these new entrepreneurs are the result of corporate downsizing and enter into business more Internet savvy and aware of what drives commerce.

Finding Prospects

"We don't put a label on small merchants. Any size is of value," explains Crowley. "I encourage sales reps to go after these small merchants, because they add up."

Not every merchant needs all the latest bells and whistles, but a visit could pay off anyway. Crowley explains how he called on a restaurant/bar that used a slow, antiquated device. "All I had to do was demo a newer terminal with a printed receipt popping up in a few seconds," he recalls. "That sold the deal." At a visit to an eye doctor, Crowley observed his card processed through a knuckle-buster. That also gave him the opportunity to demo some newer technology.

There is also Web-based business potential. "We do a significant

Internet business," says McNary. "We developed the Link Point Gateway, a little turnkey package for people to start their services." The product provides online merchants with a shopping cart and payment gateway.

"We have found the small to medium-size business market less competitive but in more need of help," says Haas. He adds that Transnational earns trust within the marketplace by educating the smaller merchant on topics such as hidden charges, PIN-based debit savings and downgrading.

Another approach is to identify specific markets to pursue. "More and more I am seeing ISOs and sales agents market to niches or verticals," says McNary. "The ISO that identifies its niche is more successful than those that try for everything."

"This is a very viable marketplace," says Shipley. "There are a lot of 20-year-old terminals out there running on 30-baud modems." **TT**

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