collective szabo wisdom®
MEDIA COLLECTION PROFESSIONALS
SZABO ASSOCIATES, INC. VOLUME 22, ISSUE 4, DECEMBER 31, 2007

Dear Friends:

Do you remember a time when you didn't carry plastic in your wallet? Credit cards are a way of life for most Americans and American businesses, who use them to pay for everything from lunch to office supplies to . . . advertising. Credit card sales are recognized by many media properties to be a valuable option for both payment-in-advance and payment-on-account. This issue's feature article takes a look at credit card processing in the Internet Age and offers tips to help you choose the service that best meets the needs of your organization.

Our winter Calendar of Events takes us east and west for the Broadcast Cable Financial Management Regional Seminar, January 24 in Burbank, California; RAB 2008 (Radio Advertising Bureau Annual Sales, Management, and Leadership Conference), February 11-13, in Atlanta, Georgia; and TVB 2008 (Television Bureau of Advertising Annual Marketing Conference), March 27, in New York, New York.

All of us here at Szabo wish you a very Happy New Year!

Robin

Robin Szabo, President
Szabo Associates, Inc.

Take Charge!

Consider Credit Cards as a Payment Option

They've been around in some form or another long before most of us were around. In the 1920s, they were used to sell gasoline to a growing number of car owners. The concept evolved into "general purpose" sometime in the 1950s, with Diners Club, American Express, Carte Blanche, and BankAmericard, which later became Visa. MasterCard followed in 1966, and it wasn't long before we were filling our wallets with plastic instead of cash. We're of course talking about credit cards, which few of us leave home without.

Fueled by easy availability, convenience, and the Internet, credit card use continues to soar. Although controversy has raged in recent years about growing consumer credit card debt and credit card contract issues, credit card sales are generally perceived as a boon to American businesses—including media.

Whether your organization already accepts credit cards or is considering accepting them for payment-in-advance and payment-on-account, it is valuable to know how credit card processing technology has evolved in recent years to meet the efficiency and security demands of the Internet Age, how account service providers structure their prices, and what you should consider when choosing (or changing) your card processing service. There are many companies out there that are "biting at the bit" to get your business, and the differences between them can have a big impact on your bottom line.

The Concept

The credit card concept itself has changed very little in the past 50 years. A card-issuing bank (credit provider) approves an application by the cardholder, who is then allowed to make purchases up to a pre-established limit from merchants who accept that particular credit card. By making the purchase, the cardholder agrees to pay back the issuing bank. Unlike a "charge card," which requires the cardholder to pay the balance in full each month, a credit card allows the cardholder to "revolve" the balance, a privilege for which he or she pays interest.

The Benefits

Media can benefit from accepting credit cards in a number of ways. First, the card-issuing bank is the party that grants or denies credit approval for each purchase, thus assuming the risk of the cardholder's default and eliminating that risk for you. Second, you can increase sales by allowing customers whom you otherwise might not attract if they were required to pay cash upfront to buy advertising. Third, credit cards allow customers to place ads through media websites or by phone, offering convenience to the customer and eliminating the wait time for orders to be processed. And fourth, time-to-cash cycle is improved because transactions are authorized in a matter of seconds and funds are deposited in your account within one to three days.

The Players

Of course, the benefits of accepting payment by credit card come at a price (more on that later). In the meantime, it is useful to know all the parties who participate in

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the complex business of credit card processing:

Card-Issuing Bank. The financial institution that issues the card to the cardholder, bills the cardholder for repayment, and bears the risk that the card may be used fraudulently.

Acquiring Bank. The party that accepts payment from the cardholder on your behalf.

Merchant Service Provider. The party that you deal with directly. Through the MSP, you apply for a merchant account, which gives you the ability to accept credit cards. The MSP might be the acquiring bank itself or an independent sales organization that resells the acquiring bank's services.

Credit Card Association. An association of card issuers (Visa, MasterCard, Discover, American Express, etc.) that sets the transaction fees for merchants, card-issuing banks, and acquiring banks.

Affinity Partner. Institutions or organizations that lend their names to the card-issuing bank to attract customers who have a relationship with them. These universities, charities, etc. receive a fee or a percentage of the balance for each card bearing its name.

The Process

In order to accept a particular credit card, you must apply to the issuing bank for a "merchant account" through a merchant service provider (MSP). Once the merchant account is activated, the process is as follows:

If the customer is physically present, he or she presents the credit card, which is swiped through an electronic transaction terminal. If the order is by phone or fax, the order-taker enters the information either directly via the Web or into a PC program that later batches and transports it to the next step. If the customer directly places the order on your website, the customer's browser transmits the credit card information to your Web server, which performs an "authentication code" verification to ensure that the individual making the purchase is in actual possession of the credit card. The transaction details are then forwarded to your "payment gateway," which forwards the transaction details to your acquiring bank. The acquiring bank forwards the transaction information to the card authorization network, which checks to see if the customer's account is valid and the funds are available, then sends a response code via the acquiring bank to the payment gateway. This response code (also called an "authorization code") indicates whether the payment is approved or denied, and if denied, the reason why. It also guarantees authorization to "capture" the funds. The payment gateway receives the response, then sends it to your server, which sends a response to the customer. This entire process usually takes about three or four seconds. At each step, all data exchanged is secured with the SSL (Secure Socket Layer) protocol, a virtually impenetrable system that uses data encryption plus digital signatures.

The transaction and authorization are kept in a "batch," along with all other transactions for that day. At the end of your business day, you send a final request to the processing network to "capture the funds" for which you received authorization. If the requested amount matches the authorizations, you receive an "accepted" response. Usually within 48 to 72 hours, the total amount of approved funds, less the interchange rate you pay to the MSP, are deposited in your account.

The Cost

The majority of the costs for merchant accounts fall into two categories, Assessment Fees and Interchange Rates.

Assessment Fees (sometimes called Transaction or Authorization Fees). These flat fees are set by bank card networks like Visa and MasterCard and are charged each time a merchant accepts one of their cards for purchase. Assessment fees are levied for every transaction, including approved or denied sales, voids, and batch settlements.

Interchange Rates (sometimes called Discount Rates). The interchange rate is applied as a percentage of each transaction amount. Each card and transaction type has a unique cost, resulting in a total of more than 150 interchange rate categories. The categories are based on a number of variables, including the type of merchant, the merchant's average transaction amount, the card brand, and the acceptance method (keyed, swiped, online, etc.).

To simplify things, most MSPs classify each transaction into one of three qualification levels—Qualified, Mid-Qualified, and Non-Qualified—each of which has an associated interchange percentage rate. Typical interchange rates range from 2% to 3%. Generally, most of the interchange fee goes to the issuing bank, but some goes to the processing network, the card association, the merchant's acquiring bank, and affinity partners.

Other Fees. An MSP may also charge monthly fees for account-related services, such as customer service, monthly statements, and network access fees. Additional fees may be assessed for such services as applications, setups, gateway access, chargebacks and reversals, and address verification service (to cross-check your customer's card number with the mailing address). These charges are <u>not</u> set by the bank card networks; rather, they are set by the MSPs themselves.

Some MSPs have an "Interchange and Assessments Plus" pricing structure, which combines interchange fees, assessment fees, and another specified amount added to both. You may also be charged a "minimum monthly fee," which applies if your qualified fees total less than the minimum the MSP requires per month. By law, all fees and charges must be disclosed to you before you agree to your bank's or MSP's terms and conditions.

The Responsibilities

A number of merchant responsibilities accompany the privilege of accepting payment by credit card.

Processing Solutions. As a credit card merchant, you are responsible for providing a processing "solution" to enable the card transactions and other card services. To process credit card payments, you need processing equipment or software. Many MSPs offer the options of either buying or leasing equipment.

The equipment we so often see in retail operations and restaurants are Credit Card Terminals, through which the cardholder's card is swiped. Terminals communicate via phone line, Internet, or cellular network. Another choice is specialized PC software that processes the customer's purchase information, credit card number, address, etc. that is then forwarded to the payment gateway. This software may be either stand-alone or integrated into other business systems. Internet gateways provide security by encrypting sensitive information before it is transmitted over the Internet. Some MSPs have their own payment gateways, but most engage third parties.

Compliance. The merchant account agreement is a legally binding contract. By signing the merchant account agreement, you agree to its terms and conditions, which can vary from institution to institution. Merchants who lose their accounts for noncompliance with its terms and conditions are placed on a list, which is distributed among banks and credit card issuers, thus making it very difficult for them to obtain another merchant account.

A federal law prohibiting merchants from adding a surcharge on credit card transactions expired in 1984, but a number of states have since enacted laws prohibiting the practice. Regardless of the state where your business resides, Visa and MasterCard have rules that prohibit such surcharges (although some merchants circumvent this rule by offering discounts to cash customers).

Because fraud and identity theft are plaguing the credit card industry at an ever-increasing rate, technology companies are continually developing innovations to enable worry-free credit card transactions to businesses and their customers. In the end, however, the security "buck" stops with you. If you receive and/or retain personal information on a customer, you are required to ensure its security and dispose of it responsibly (see *Collective Wisdom*, March 2007).

The Federal Fair and Accurate Credit Transaction Act (FACTA), which has been in effect for all businesses since December 1, 2006, requires that all electronically printed credit card receipts given to customers must shorten, or truncate, the account information. You may include no more than the last five digits of the card number, and you must delete the card's expiration date. Noncompliance with this law could make a company vulnerable to a Federal Trade Commission (FTC) law enforcement action, including civil penalties and injunctive relief. Additionally, the law allows consumers to sue businesses that fail to comply and to collect damages and attorney's fees. It should be noted, however, that the law applies only to electronically printed receipts, not to handwritten or imprinted ones. Also, it applies only to receipts you give the customer at the point of sale, not to any transaction record you retain.

The PCI (Payment Card Industry) Security Standards Council, whose founding members include American Express, Discover Financial Services, JCB, MasterCard Worldwide, and Visa International, developed the PCI Data Security Standard (PCI DSS) to facilitate the broad adoption of consistent data security measures on a global basis. This comprehensive standard is designed to help organizations proactively protect customer data and includes requirements for security management, policies, procedures, network architecture, software design, and other protective measures. The Council updates and enhances the PCI DSS as

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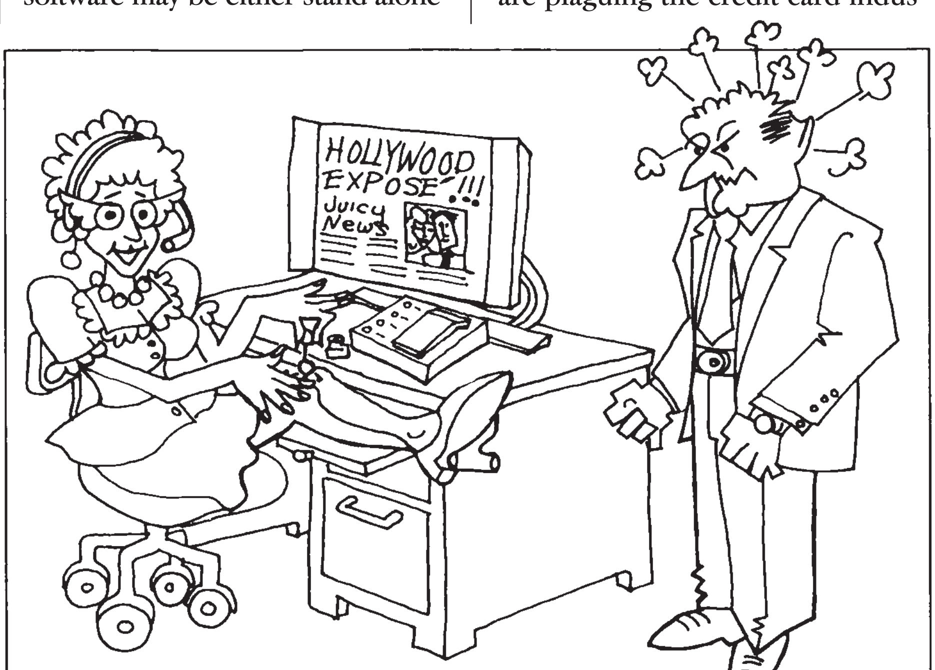

"I'm waiting for Ms. Standish to decide which credit card she wants to pay us with–the new one that charges 0% on transferred balances, another one that gives her cash back on purchases, or a third one that gives her enough frequent flyer miles to go to Vegas."

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necessary to mitigate emerging payment security risks. The most current update is PCI DSS Version 1.1, which must be used for compliance as of December 31, 2006. To further the adoption of the standard, the Council defines credentials and qualifications for security solution providers and maintains a list of approved vendors on its website, pcisecuritystandards.org.

Points to Consider

When you consider the benefits—elimination of credit risk, improved time-to-cash cycle, and increased ad sales—payment by credit card can be particularly ideal for organizations with low-dollar-amount transactions, high-volume sales, and/or customer-driven Internet advertising sites. On the other hand, the implementation costs, assessment fees, and interchange rates associated with credit card acceptance may make make it impractical for some properties—for example, a high-end periodical with a relatively small number of regular advertisers.

If you determine that your organization can benefit by credit card sales, the key to maximizing profits is to make sure you choose the service provider and processing solution that best meet your organization's requirements for cost-efficiency and security. Here are a few general tips:

1. Study and compare contracts. Have your legal counsel review the procedures, restrictions, and rules contained in the agreement. For example, some MSPs charge steep termination fees for cancellation during a contract period. The contract may allow the MSP to increase fees, with little recourse if you become dissatisfied with their service.

2. Get several quotes. The number of companies offering merchant account services is staggering, and the cost structures vary widely. Be aware that companies that seek to entice you with low discount rates may be charging much more in additional fees.

3. Ask for explanations. MSPs' representatives should explain their merchant account offerings to help you determine which, if any, are suitable for your business. Unfortunately, there are many MSPs that are more interested in making money than in being truly knowledgeable about the business. If they cannot adequately answer questions before you become their customer, there's a fair chance that they will not adequately address any problems you might have later.

4. Study equipment options. Leasing is usually more costly in the long run and may involve a long-term agreement that you would prefer not to have. Shop for the best deal in equipment that best serves your needs. Some MSPs threaten to charge a reprogramming fee if you do not buy or lease their equipment. If this is the case, consider taking your business elsewhere.

5. Include "credit card acceptance" terms in your company's credit policy. You might choose, for example, to limit the number of credit card transactions and/or the transaction dollar amount allowed per customer per month.

6. Talk with colleagues. Contact your media organization to see if it has resources to help you. The best sources of valuable information are friends in your industry who have implemented credit card processing successfully! ♦

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