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Pricing Made Simple

4 Things You Need to Know About Payment Processing Fees

Introduction

From complicated pricing models, to hidden fees, to even more complicated billing statements; the payments industry can be intimidating to say the least. With rapid changes in the electronic payments landscape, more and more consumers are going cashless and merchants are looking for simple and inexpensive ways to accept debit and credit.

While accepting these forms of payment may come with a small cost, the benefits - such as increased sales and customer convenience to improved cash flow and security - quickly outweigh the cost. The struggle is ensuring your payment expenses are as low as possible, while capitalizing from the many innovative technologies and services in this digital payment space.

And that's where a merchant service provider comes in. They not only get you set up with your own merchant account, but they give you access to payment processing tools that help ensure your business is profitable, growing, secure, and protected from fraud.

However, your business is unique, and the ways in which your payments are accepted and the ways you can get charged for accepting payments are very customizable. And therein lies the problem. Many processors will offer discounted rates and fixed costs, without having an understanding on what your business does, and without giving you the knowledge of how or what you will be paying.

This ebook was created to help answer some of your questions and be a comprehensive guide in analyzing the costs associated with processing digital payments. By the end, you will have a firm understanding on:

1. The key players who profit from each payment.
2. The payment process and the variables that affect the cost of each transaction.
3. The different payment processing fees that may show up on a merchant statement.
4. The different pricing models that affect a merchant statement.

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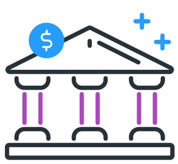
01 | Payments Breakdown

As a consumer, you know who Visa® ("Visa") or Mastercard® ("Mastercard") are, but you have likely never dealt with them directly because your bank takes care of that. As a merchant, it's important to know all the different players in the payments industry and how each player is involved in processing your transactions; especially those who profit from your sales. Let's take a look at the industry and break down where everyone fits in the payment process.

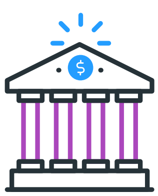
Card Brand (payment brand network or card association)

Common card brands (aka credit and debit card companies) are Interac® ("Interac"), Visa, and Mastercard. They are in charge of overseeing payment processing activity, monitoring the settlement of transactions and clearing of sales, as well as regulating and managing their corresponding compliance policies.



Issuer (issuing bank)

An issuer is a bank or financial institution that offers credit and issues credit cards to consumers on behalf of the payment brand networks. These are specifically the banks that would appear on credit cards, for example, Scotiabank® ("Scotiabank") (Scotiabank Visa).



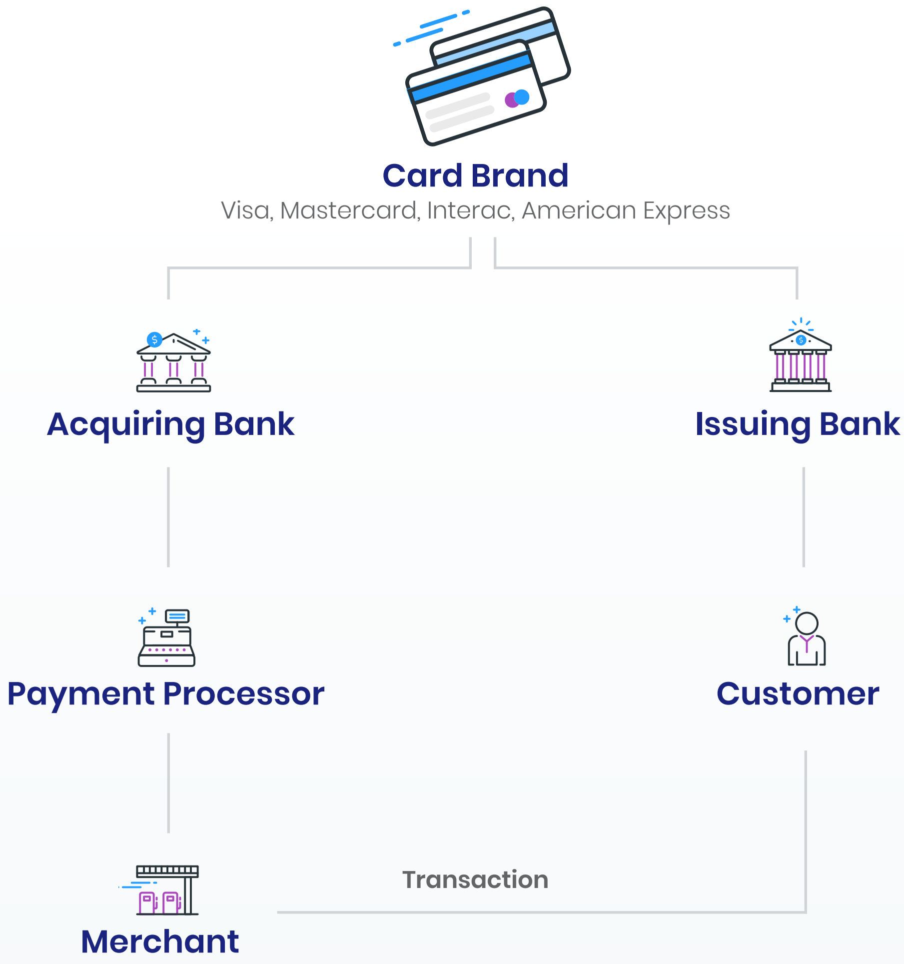
Acquirer (acquiring bank)

An acquirer is a bank or financial institution that permits a merchant the right to process credit and debit transactions. The acquirer assumes the risk and passes the merchant's transaction info to the card brands and the issuers to complete payments. Some acquiring banks are also payment processors, for example, Elavon.

Payment Processor (merchant account providers, merchant service providers, independent service organization, ISO)

A payment processor works with acquiring banks to open merchant accounts, handle payment support, and manage credit and debit processing for merchants. Processors can be ISOs such as Zomaron or acquirers such as Elavon.

PAYMENT PROCESSING INDUSTRY



So, we have card brands (Visa, Mastercard, Interac, Amex) that work with issuing banks to provide consumers with co-branded credit and debit cards and work with acquiring banks to enable merchants to accept these credit and debit cards. Most acquirers work with payment processors and allow them to use their services to bring more value to merchants and consumers through innovative payment products and services.

What even happens when a customer walks into your store and pays with their payment card?

Let's take a look at the PAYMENT PROCESS

01 Customer presents their payment card to the merchant

02 The customer taps their payment card onto terminal

03 The terminal sends an authorization request to the customer's issuing bank via the acquirer

04 The issuing bank approves or declines the transaction

05 The acquirer sends notice to the terminal

06 The customer's funds are removed

07 All transactions sit on the terminal until settled

08 The merchant sends a batch of transactions to the processor to be settled usually at the end of the day

09 The processor deposits funds into merchant's account via acquirer

In Chapter 4 we will dissect a transaction even further to determine how much of the transaction each player receives.

THE COST OF PROCESSING ELECTRONIC PAYMENTS VARY DEPENDING ON A FEW VARIABLES.

Variables of Payment Processing Costs:

Firstly, all credit cards are not created equal. The more benefits or perks a card grants a cardholder, the more expensive the rates are for you, the merchant (see types of credit cards chart below).

Types of credit cards:

BASIC (QUALIFIED)
no points, no perks, no benefits

AFFINITY (NON-QUALIFIED)
on behalf of affiliations, partnerships, brand retailers, small portion goes to organization

PREMIUM (NON-QUALIFIED)
corporate, business, or cards that offer additional perks, cash, points, insurance, discounts, etc. eg. cashback, airline/frequent flyer

Secondly, the rates are dependent on how the card is accepted. Is the card being tapped at a terminal, entered in over the phone, or on your ecommerce site? In card-not-present scenarios, the rates are usually higher due to increased risk of fraud and chargebacks.

Types of Transactions:

CARD **PRESENT**	when the card being used is physically present at the time of the transaction: in-store with tap, or chip.
CARD **NOT PRESENT**	when the card being used is not physically present with the merchant at the time of the transaction: manually entered online on an ecommerce site or over the phone.

In the next chapter, we will define all the different payment processing fees and which fees you shouldn't be charged.

02 | Processing Fees

(Review this section with your own statement)

Running your business can be exhausting and time-consuming. You may find yourself neglecting your payment processing bill month in and month out - especially if you don't quite understand how to read your statement. What does each fee represent? What fees are unavoidable and which are negotiable? To help you understand all the fees on your statement - and the ones that shouldn't even be there - let's start by breaking the fees up into 3 categories: transactional fees, fixed fees, and situational fees.

TRANSACTIONAL FEES

Transactional fees are dependent on variables such as type of card, type of business, industry, and type of transaction, as mentioned in Chapter 1. These fees are the biggest cost to your merchant account and are charged every time a transaction occurs.

Interchange fee (interchange rate)

The interchange fee is set by the card brand networks and represents the base fee or wholesale cost of accepting electronic payments. This fee is what the acquirer pays to the issuer and the rate varies depending on industry, type of business, if the card is present or not present at the time of transaction, etc. The interchange fees are different for each card type and the rate is higher for points and rewards cards.

Assessment fee (card brand fee, card association fee)

The assessment fee is a small percentage that is paid to the card brands (Visa, Mastercard) on every transaction. It is a fixed transactional fee and the same amount is charged no matter the card type or industry.

! *Some payment processors mark this fee up* ***without the merchant's knowledge****.*

Authorization fee (transaction fee)

The authorization fee is represented as a dollar amount and is charged each time a transaction is approved or declined.

AVOIDABLE TRANSACTIONAL FEES

Discount rate (qualified rate or merchant discount rate)

The discount rate is the fee charged for accepting and processing a transaction made with a qualified or basic card. It is represented as a percentage of the total transaction amount where a basic credit card is used. Qualified credit cards are the most basic of credit cards and are rarely used as they give no incentive to the cardholder. They, therefore, serve as a baseline price for all other types of credit cards.

Transparent payment processors will not charge a discounted rate and will instead charge the true cost of the qualified interchange fee. However, most payment processors set their own discount rate, posing as having a rate much lower than the basic interchange fee (which is not possible) in order to attract merchants. For example, a credit card company may have an interchange rate of 1.42%, but your payment processor could have their discount rate advertised as 1.32%, a full 0.10% below what the credit card company has set. In this example, the payment processor would technically lose money on every qualified transaction, so to counter that, these processors will charge hidden and confusing fees to still remain profitable.

Non-qualified rate

The non-qualified rate is charged when a customer uses an affinity or premium card or for card-not-present transactions. Card-not-present transactions are generally associated with a higher risk of fraud and therefore charged at a higher rate. Now, to make things even more complicated, this fee is charged in addition to the discount rate. That's right - the discounted rate is now bundled with a non-qualified rate that is set by the payment processor at whatever rate they choose. The non-qualified rate is pure profit to the payment processor.

Interchange differential fee

The interchange differential is the difference between the base interchange rate (or interchange rate of a basic credit card) and the actual interchange rate of the affinity and premium card being used. However, in complex pricing models where qualified and non-qualified rates are charged, rather than charging true interchange rates, an interchange differential fee is charged on top of the discount rate to recoup the costs associated with affinity and premium cards such as loyalty points, rewards, etc (Air Miles®, PC Optimum, SCENE®). We will discuss pricing models further in Chapter 3.

FIXED FEES

Fixed fees are charged on top of transactional fees. Almost all of these fees are negotiable and not all processors charge them, but you may or may not see these charges on your statements.

Admin fee (monthly fee)

This fee is charged each month for your merchant account provider's services, such as customer support, tech support, portfolio management, etc.

PCI fee

Payment Card Industry (PCI) compliance is mandatory for every business that accepts credit and debit cards, and these businesses must follow PCI rules and regulations. If a merchant does not comply, they will be fined a non-compliance fee every month. Some payment processors charge merchants this fee to help ensure they are PCI compliant each month. (see PCI non-compliance fee)

Terminal fee

If you use a physical terminal in your store to accept electronic transactions, you will likely be charged this fee to cover the cost of renting, leasing or purchasing a terminal from your payment processor.

Payment gateway fee

If you are an eCommerce business, you will likely be charged a fee for the use of your payment gateway. A payment gateway in the online space acts as a terminal does in a brick-and-mortar store.

AVOIDABLE “FIXED” FEES

Statement fee

This fee is charged for printing and mailing your payment processing statements. Although many processors recommend paperless electronic billing, some still charge as much as $10 per month for a paper bill.

Online reporting fee

This fee is charged for the preparation and ability to view an electronic bill and is merely an alternative to statement fees.

Annual fee

This fee is similar to a monthly fee but is charged on a yearly basis to cover the cost of a processor’s services. However, some processors will charge an annual fee and a monthly fee to their merchants.

Batch fee

This fee is charged each time a merchant submits a batch of transactions to be settled. Merchants who are charged this fee resort to only settling transactions once a week. Not being charged a batch fee by your processor means you can settle a batch on your terminal or gateway every day.

SITUATIONAL FEES

And last but not least, are situational or incidental fees. These fees are only charged when an event occurs. Some months you may have none of these fees show up on your bill, other months you will.

Cancellation fee

This fee is charged when processing services are terminated prior to the end date of one's contract.

Chargeback fee

If a chargeback (or dispute) occurs, a chargeback fee is charged to the merchant. For more information on chargebacks, check out our blog.

International fee (cross border fee)

This fee is charged when an international credit card is used for payment. Most processors will markup this fee. For example, when an European Visa is used in Canada.

Foreign transaction fee

This fee is charged on top of an international or cross border fee as a markup for processing a credit card transaction with a foreign issuing bank.

Monthly minimum fee

This fee is charged to merchants who do not reach their total monthly minimum amount of transactions or sales. This amount is usually laid out in a merchant's contract and varies depending on processor. For example, if your minimum is $20/month and you only pay $13 in processing fees that month, your monthly minimum fee will be $7 for that month.

NSF (non-sufficient funds) fee

This fee is charged if a merchant does not have enough money in their bank account to cover that month's payment processing fees.

AVS (address verification service) fee

This fee is charged to eCommerce businesses for the use of this anti-fraud service that verifies identity of a cardholder by comparing the address and name entered with the card brand's data.

AVOIDABLE SITUATIONAL FEES

PCI non-compliance fee

This fee is charged on top of a PCI fee to merchants who are not compliant. You should always pick and MSP that helps in getting your business PCI compliant.

Liquidated damages fee

This fee is another kind of cancellation fee and way for a processor to recoup the loss of your merchant account. It can get very expensive and is usually only in the interest of your payment provider.

THINGS TO LOOK OUT FOR:

Unnecessary fees
Every avoidable fee shown above is just a way for processors to profit even more from you, the merchant. Almost all of them can be negotiated and if they can't, it may be time to look for a new processor.

Hidden fees
It's very important to ask your processor to walk you through your statement and explain each fee and whether that fee is negotiable or if it has been marked up. It is also always a best practice to ask your provider for lower fees where you can.

Discounted rate sales tactics
On average, only 10% of all Canadian consumers pay with a basic credit card and these processors will draw you in by advertising the qualified rate as their only interchange rate, but your statement will surely prove to be more expensive.

03 | Pricing Models

Now we're ready to compare all 4 payment processing pricing models, some more complicated than others, and some much more fair than others. However, it's important to point out that every processor charges different rates, regardless of pricing models, so we're going to use common examples and apply them to a $100 transaction. Let's dive right in and take a look.

Enhanced Interchange Plus (Cost Plus or Pass-Through) **Pricing**

This is by far the most transparent model and is quite easy to understand. The merchant pays the interchange rate of the card plus the processor's markup, which is almost always a fixed percentage (0.20% or 20 basis points). Then you simply add the authorization fee and the assessment fee, which, in a true cost plus pricing model, is always at cost.

You, the merchant, pay the non-negotiable transactional fees, plus the payment provider's markup; no fluff, no hidden fees, easy. However, while this model gives you full transparency into the breakdown of your rates, some processor's bills can be difficult to understand. That's where your payment processor should come in.

PROS

+ Each fee is clearly outlined
+ No hidden fees
+ All costs are transparent including the markup

CONS

- Bills are sometimes difficult to understand
- Never paying the exact same amount each month; can be difficult to forecast

EXAMPLE	**$100 transaction**
Interchange:	1.52%
Assessment:	0.15%
Authorization fee:	$0.10
Markup:	0.30%
Total fees:	**$2.07**
Merchant keeps	$97.93

Discount Rate (Interchange Differential or Base Rate) **Pricing**

This is the most common pricing model among payment processors and acquirers in Canada. This model involves 4 areas in which merchants can be overcharged with hidden fees. The merchant pays the qualified rate (discount rate), the non-qualified rate, the assessment fee, and the interchange differential fee.

Some payment processors set their own discount rate, posing as having a rate much lower than the basic interchange fee (which is not possible) in order to attract merchants and, in turn, will charge hidden fees to still remain profitable.

PROS

+ If you're aware of all the different card types and their interchange rates, and if the majority of your customer base uses basic credit cards (roughly only 10% of Canadian consumers), then this model will work for you

CONS

- Bill statements are extremely difficult to read
- Fees are hard to break down and show true cost, almost
- Always associated with hidden fees, and unnecessary fixed and situational fees are charged on top

EXAMPLE	**$100 transaction**
Discount rate:	1.61%
Non-qualified rate:	0.30%
Assessment fee:	0.14%
Interchange differential:	0.19%
Total fees:	**$2.24**
Merchant keeps	$97.76

Fixed Rate (Flat Rate) **Pricing**

This pricing model is simple and easy to understand. A higher fixed percentage is charged on all transactions, regardless the type of card used and it covers all the fees mentioned above.

The rate is almost always much higher than a cost plus pricing model to help protect the payment processor. This pricing model is used by most aggregators, such as Paypal and square.

PROS

+ Other pricing models can be difficult to understand, this is simple and easy
+ Most beneficial for very small businesses

CONS

- The cost is almost always higher than a cost plus pricing model and the merchant can't take advantage of lower costing basic cards that come through their business

EXAMPLE	**$100 transaction**
Flat rate:	2.65%
Authorization fee:	$0.15
Total fee:	**$2.80**
You keep	$97.20

Tiered Pricing

This pricing model is by far the most difficult statement to decipher because no tiered pricing processor has the same criteria or rates as another. Processors usually group all transactions and their corresponding interchange rates into 3 categories: qualified, mid-qualified, and non-qualified. However, some processors could have many more tiers, or they could group different rates into each of their categories, making this complicated to grasp.

Qualified rates are the least expensive but are only associated with transactions in which a basic credit card is used and only when these transactions are batched that same day. If this is not the case, the transaction would fall into another tier at a higher rate. Mid-qualified rates have another strict criteria that must be met, and so on and so forth. To put it simply, you pay the rate based on the tier that the transaction falls into.

PROS

+ Easy to reconcile fees
+ Predefined tiers
+ Easy to understand what you're paying

CONS

- Processors advertise lowest tier to draw you in, when most transactions will fall into middle tier
- Fees are bundled in each tier making it hard to breakdown true cost of each fee

EXAMPLE **$100 transaction**

Qualifed

Total fees:	**1.71%**
Merchants keeps	$98.29

Mid-qualifed

Total fees:	**2.17%**
Merchants keeps	$97.83

Non-qualifed

Total fees:	**2.83%**
Merchants keeps	$97.17

04 | Dissecting a Transaction

Now that we understand the different transactional fees, the different pricing models, and the different players in the industry, it's time to dive even deeper and completely dissect a transaction using the **Zomaron Cost Plus Pricing Model**. We know many parties get a piece of the pie, but who gets what from each transaction and how much does the merchant get to keep?

WHO GETS WHAT?

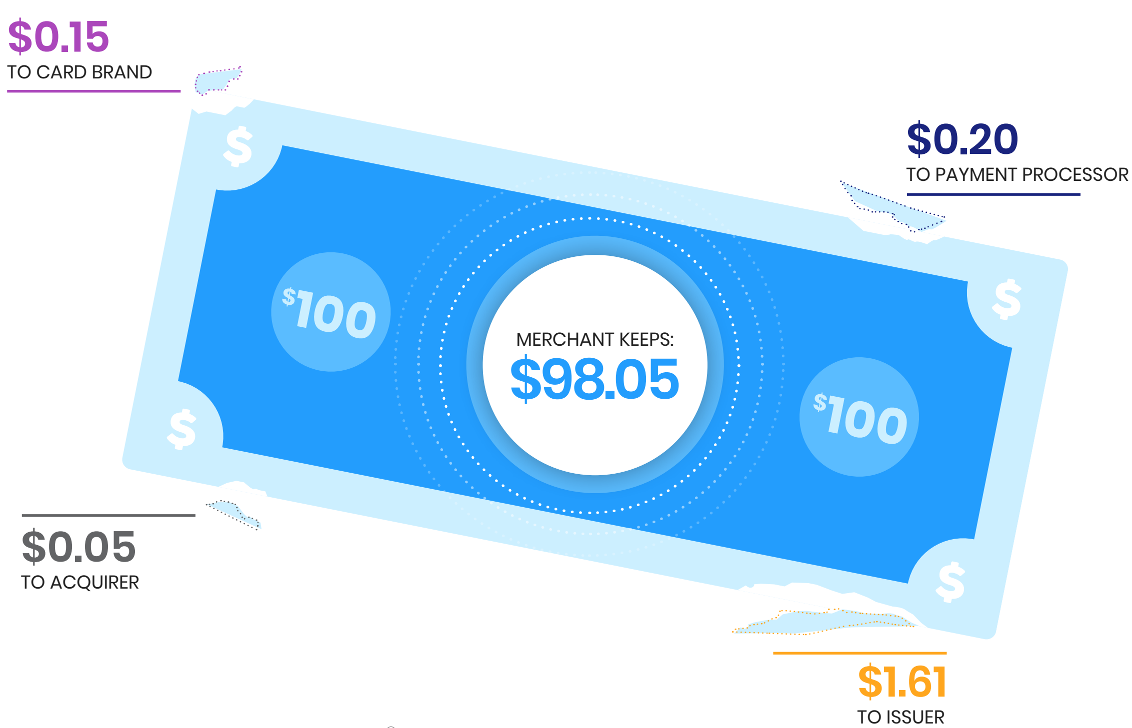
** Interchange rate:* ***1.61%*** → ***Issuing Bank***

Authorization fee: ***$0.05*** → ***Acquiring Bank***

Assessment fee: ***0.15%*** → ***Card Brand***

Markup: ***0.20%*** → ***Payment Processor***

$100 TRANSACTION DISSECTED



* Interchange rate based on VISA Infinite Electronic®

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