White Paper

How to choose a payment processor for your subscription-based business

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Choosing the right payment processor is critical to your business success

As an online digital business, choosing the right payment processor may surprisingly be one of the most important decisions that you make.

Many businesses, especially ones built on a subscription or recurring revenue business model, find this out the hard way. For the uninformed, 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.

To make the proper determination about your future acquirer, you need to perform the kind of due diligence that leaves no stone unturned. You should also 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.

Payment processor terminology

One of the first challenges that your subscription business will face is the confusing colloquialism of the payments industry. The terms "acquirer," "processor" and "gateway" are often used interchangeably and erroneously. Here are some basic definitions to rely on in regard to the payment industry:

- **Acquirers** are entities that interface directly with card company systems (e.g., Visa, Mastercard, etc.) and may or may not interface directly with businesses on the other end
- **Processors** may be acquirers but could also be entities that deliver transactions to acquirers on behalf of businesses
- **Gateways** are middlemen, dispersing client transactions to either processors or acquirers
- **Independent sales organizations (ISOs)** can originate a relationship with any of the above and may also be actual handlers of transactions

Each entity type will take 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 possible financial deal for your business. But price is only one of the considerations in making a smart decision. The right way to frame your search is to seek out a relationship with the best partner, at the best price, deploying the best practices for your business. All three are desired, but 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.

The key, therefore, is to figure out which acquirers allow you to incisively use the recurring revenue industry's best practices. How can that be determined? Make a list of the recurring/subscription/continuity businesses that you admire – and call them. Find out which processor they use and whether they are satisfied. Digital businesses that join relevant industry organizations such as the Direct Response Forum and the Merchant Risk Council are afforded great opportunities to network and find out which processors stand above the rest.

The art and science of recurring billing

Subscription and recurring revenue businesses face immense challenges because subscriptions are subject to external risks that do not exist in one-time payment scenarios. For example, fraudulent activity, portfolio flipping, mergers and acquisitions among issuers, and also simpler things like replacing a lost or stolen card, are just some of the reasons for the vast industry of re-issuing cards. Also, consumers exceeding their credit limits can cause recurring charges to be rejected. These and similar challenges can be compounded if your business does not implement the best practices that have been designed to help you overcome such challenges.

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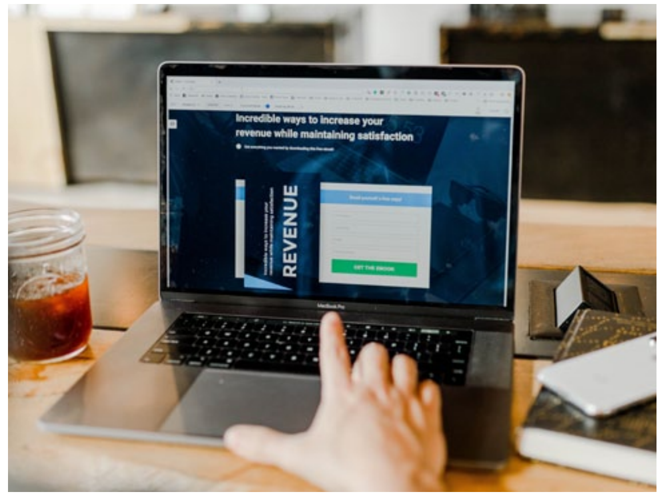

Eight best practices and capabilities your payment provider should support

As part of your evaluation, check if your candidate payment provider can support your key needs. Here is a checklist to get you started:

1. Comprehensive payment decline recovery

Payment declines are an inescapable and significant element of doing business using a recurring revenue model. Fortunately, technology advancements have created the opportunity to recover these failures via a well-designed recycling strategy and application of payment intelligence. Such a strategy is to an extent predicated on your processor providing granular payment 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 payment 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 businesses to successfully procure refreshed expiration date information from customers was recognized long ago 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. Processors that are not experts in recurring processing will 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 often re-issued, within an issuing brand, because of portfolio changes, fraud and other issues. Many issuers are providing 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 you select a processor that has a fully developed account updater solution.

4. Recurring indicator

Issuers and card companies recognize the lifetime value and downstream revenue of recurring customers and provide a lower barrier for approval of transactions carrying the recurring indicator. This is such a basic best practice that processors who do not accommodate, or are unaware of it, are probably not a good choice for your business.

5. Soft/flexible/dynamic descriptors

The clearer any digital business is with its 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 the business. Although obvious, the more accurate the descriptor, the lower the chargeback risk.

6. International processing

International processing capabilities are obviously important if your business has – or desires to have – a global presence. If your company has international aspirations, you need to select an acquirer that allows you to settle and present Visa and Mastercard charges in the local currencies where you 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 others, as well as having the ability to support recurring charges. Finally, it is in the best interest of your business to confirm that the germane best practices listed above are available internationally. For example, whether the processors support account updater services in the new geography.

7. Multi-level accounts

The best acquirers minimize charges and foster greater depth of knowledge through the setting up of a multi-level merchant business – instead of separate merchant accounts. For example, if you are a subscription-based business with several different services or publications – or have several different business units – the acquirer should be able to accommodate a single-account set-up that allows for underlying divisions that represent the services, publications or business units. This is a great way to be able to see, through reporting, how your individual business units are doing, as well as your company as a whole.

8. Interactive, flexible reporting

A good acquirer should provide interactive and flexible reports that allow your subscription business to have a complete understanding of how you 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 you can fully understand issues and problems. This kind of information should be accessible through real-time, online reporting tools. Every processor serious about recurring revenue excellence must make these best practices and capabilities available to your business in order to be worthy of your consideration.

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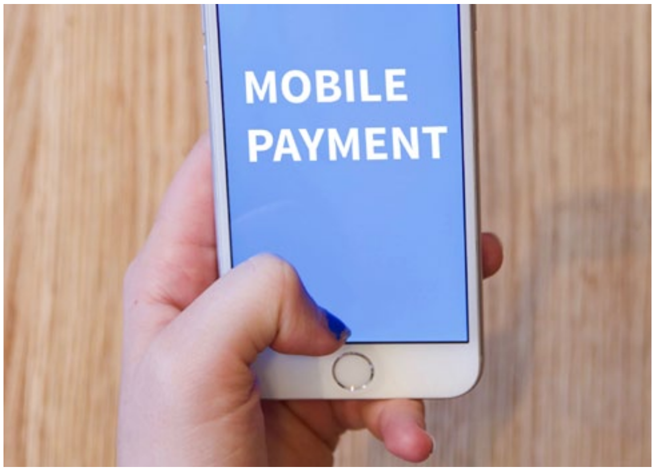
Understanding and negotiating the acquirer's offer

Once you have chosen an acquirer, the application process begins. Expect it to be rigorous. That is what you want. A loose and lax application process in which little is required from your business portends a loose and lax relationship in which little in the way of assistance will likely be offered by the acquirer later.

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 digital businesses – it is incumbent upon the processor to scrutinize your business every bit as much as you scrutinizes the acquirer. A partnership that begins with mutual transparency has a much better chance to thrive.

Here are some additional points to discuss, once you receive an offer from your acquirer:



Alternate payment methods

Alternate payment methods are growing in popularity, especially with mobile transactions. You business needs to consider including alternate payment methods in your payment method mix.

First, determine which payment methods are conducive to recurring payments for your particular product/service, client base and geographical markets. 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.

Discount rate vs. interchange plus

A new set of semantic challenges potentially surrounds the offer you receive from a processor. 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 business sales dollars that will be divided up by the processor among the card brand (e.g., Visa, Mastercard), the card-issuing banks, and the processor itself. In this model, your business 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 your business exactly the interchange that is passed on by Visa or Mastercard on behalf of the card issuers, where the "plus" is the fee the acquirer will keep for itself. Businesses 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. If your business needs to know exactly what you are paying to whom, the interchange plus model helps clear the air on merchant processing fees.

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Small- to medium-sized businesses are usually offered the blended type of discount rate, whereas larger companies 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.

Exclusivity and contract length

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 company's business, while the company wants to have some flexibility.

In the same vein, processors want all of a company's business for as long as they can get it, while companies want as short a commitment term as possible. Unfortunately, many companies that have been subject to exclusive, longer-term contracts believe that 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.

Your business needs to perform the due diligence to find a recurring revenue champion that will take care of your business processing needs through a well-developed, two-way street partnership. So, is the demand for exclusivity valid? Perhaps it is understandable, not only because of the time and effort companies invest supporting processes to multiple, less-than-stellar acquirers but because, primarily, of risk.

Processors are responsible for the obligations of companies they process for. Not only that, they are responsible for working with their clients to ensure that they transact according to industry regulations and thresholds.

What happens if a business 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 company to become unviable? Each processor gets hurt, even the one that worked hard to help the business operate appropriately.

Therefore, since your business should be looking for solutions and not workarounds, exclusivity should not necessarily be automatically rejected, but should only be granted if you are convinced that this is the best deal to be had.

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Today, processing is to a large extent commoditized. Your subscription business has the leverage to make your processors earn your business every day. And you need to look after your own best interests.

This means you should be aiming for the best terms you can get – one year, renewable deals, with no exclusivity and no liquidated damages. You can then negotiate with multiple processors and offer flexibility on deal length or exclusivity to reduce pricing.

One final recommendation: Check references

Here is perhaps the most neglected part of the process: checking references. Your business should call all of the references provided by the acquirer. If the processor does not proactively provide them, then you should ask for three reference that are similar to your business – digital, subscription, auto-renew, etc.

In addition, try to find two other subscription-based companies that use them, but are not on the processor's list. This may take some time, but it will be well worth it because it is here, down in the trenches, that you will find out whether you will have a processor that will truly be your partner in developing the future of your company.

About Vindicia

Vindicia offers comprehensive subscription management solutions that help businesses acquire and retain more customers. Providing much more than just a billing and payments system, the company's SaaS-based subscription management platform combines big data analysis, strategic consulting and proprietary retention technology. Vindicia provides its clients with more recurring revenue, more customer data, better insights, and greater value throughout the entire subscriber lifecycle. To learn more visit www.vindicia.com.

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