ISO Corner

ISO Globalization Hits Snags

The made-in-America ISO model meets resistance abroad

By Richard H. Gamble

ISO leaders who thought the grass was greener on the other side of U.S. borders have discovered parched revenue prospects there. While long-term opportunities remain promising and a few ISOs make some headway abroad, those with experience concede that the ISO model that has worked so well in the United States is not ready for export.

Markets outside the United States are relatively small. Entrenched players have tied up much of the business; merchant contracts are much less lucrative; foreign customs, regulations, currencies and languages present obstacles; and knowledgeable salespeople are hard to find.

Bank Dominance

The major difference between the United States and other countries, explains consultant Les Riedl, president of Speer & Associates, is that in the U.S. many large banks abandoned the acquiring business 15 to 20 years ago, creating space where ISOs could flourish. But foreign banks are hanging on to their close relationships with merchants, leaving little room for ISOs to make money, he explains.

The United States is the only market with a well developed third-party sales channel, agrees Joel Van Arsdale, senior manager at First Annapolis Consulting. Everywhere else, the business is bank centric, with inbound leads coming from bank branches. And not many banks. Outside the United States, the acquiring business is highly concentrated. (Just three acquirers account for 90 percent of the U.K. market, he notes.) That means few points of access. And "just a handful of banks outside the United States have enough acquiring business to consider developing an ISO channel," he reports.

To succeed outside the United States, you have to recognize the role banks play in the payments system and build your model around their business model, says Donna Embry, senior vice president of Payment Alliance International. "The models that evolve and work overseas will be generated by the banks there."

But if they got a chance, ISOs would bring a more muscular sales effort. Foreign banks are not nearly as aggressive as ISOs in making outbound sales, Van Arsdale says. There are merchants to enroll, but so few ISOs have had a chance to show their stuff.

Commission-based comp drives U.S. ISO sales but lags in most other countries, Van Arsdale reports. "They don't have a lot of roving sales agents looking for work. Theoretically, an ISO could outsell a bank by providing more lucrative incentives for a sales force, but the small market share they could get at first means less money to throw around."

Large U.S.-based acquirers and processors, such as First Data, Nova and Global Payments, are making inroads in Europe, Canada and Asia and could open doors there for a U.S.-style ISO model. With the right formula, United States acquirers could do well in foreign markets, but they'd need local bank connections and a different toolkit, Van Arsdale says.

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>
> —Paul Campbell, First Data Systems

But if acquiring and processing is a scale business, then no other country offers the scale to be found in the United States—$7 billion annually in acquiring revenue, compared with about $1 billion annually for the U.K. and Canada, the next-biggest markets. After that, it falls off sharply, Van Arsdale reports. Peru, for example, has a total of 60,000 merchants with terminals in the country, Riedl points out.

Connections are another challenge. "Other countries don't welcome outsiders," Riedl observes. "To even have a shot at success in another country, an ISO has to size up a prospective market and determine what player they'd have to buy or what persons they'd have to recruit to establish credibility and get the contacts and the knowledge of the local scene they'd need to attract business."

Prospects for ISOs are brightest in Europe, Canada and Asia, each of which has its own attractions and obstacles.

Europe

"Most ISOs looking to enter Europe have chosen the U.K. as their beachhead," reports Paul Campbell, vice president of business development for merchant acquiring in the EMEA region (Europe, Middle East and Africa) for First Data Systems. And most of them

have "folded their deck chairs and left," he notes. "There are a couple of ISOs operating in the U.K. that have decent size—about 25,000 merchants—but most of the rest didn't last. They were discouraged because the payback period was too long to suit their investors."

The U.K. is most appealing simply because it has the largest market outside the United States, but even there credit cards take a back seat to debit cards, which account for 55 percent of card payment volume. The second-largest market, France, doesn't favor consumer credit and is virtually closed to acquirers other than French banks. Then comes Germany, which is more open, Campbell reports. Two German nonbank acquirers, Concardis and B&S Card Services, are thriving. But Germany is a small market compared with the United States.

After the U.K, France and Germany, there is a second, smaller tier, consisting of Spain, Italy and the Netherlands, and an even smaller tier occupied by Austria, Switzerland and Poland.

Throughout Europe, merchants have more bank loyalty than U.S. merchants do. "Most merchants would take an ISO quote straight to their bank to validate it," Campbell explains. "And the bank might match the offer or might tell the merchant that if they take the ISO deal, the bank might reconsider other aspects of the relationship."

But Campbell holds out hope that "with the right model, with local knowledge and with enough resources, a U.S.-based ISO could succeed in Europe." One reason things look brighter is the coming of the Single European Payments Area (SEPA), which aims to create a single payments system across the European Union countries. "That should open markets that have been closed to competition and dominated by restrictive national policies," he says. "Already, American issuers are jumping in. Acquirers will follow," he predicts.

Eastern Europe presents another kind of opportunity, Riedl reports. "The payments industry there is blossoming. The market is expanding rapidly, and businesses are not so much sewed up by established players." There is room in those markets for ISOs to succeed.

Canada

"If a U.S. ISO hopes to succeed in Canada, it will have to change its model," says David Ades, senior vice president for sales at Moneris Solutions. For one thing, the huge distances between relatively few metropolitan centers make face-to-face selling difficult and expensive. And terminals are built with encrypted keys that work with only one processor. To switch a merchant, you have to install a new terminal, Ades says. You can't just reprogram an existing terminal quickly like in the United States. "Merchants don't like the disruption of replacing POS terminals, which makes them reluctant to change," he says.

The difference in bank attitudes is huge. In Canada, banks covet close ties to merchant customers and resist anything that will disintermediate them. In the United States, it's fine with banks to let ISOs own the merchant contracts. Canadian banks insist on owning the contracts, Ades says.

There is also a compensation disincentive. U.S. ISOs use revenue-sharing arrangements that run forever. Canadian banks will share revenue only for a limited period, usually less than three years, Ades reports.

Finally, there is networking and lead generation. Moneris has an advantage because it is a joint venture owned by the Royal Bank of Canada and Bank of Montreal, two of Canada's largest banks. "We can leverage off the branches and networks of both our parent banks. They both supply leads to us," Ades explains. Global Payments has Canadian Imperial Bank of Commerce as a partner and source of leads, but Nova has struggled without a bank partner that brings a large distribution channel, he notes.

Canada may look attractive with 800,000 to 900,000 merchants with terminals. But with banks owning most of those relationships, ISOs seeking to enter the Canadian market face strong competition and, at best, an opportunity to "niche in," Riedl says.

Asia

Global Payments entered Asia by buying a majority stake (56 percent) and taking over management of HSBC's merchant portfolio of more than 60,000 merchants. While ISO development in Asia is "embryonic, there's no reason why the U.S. ISO model won't replicate in Asia," says Ian Courtnage, managing director in Global's Hong Kong office and an HSBC merchant acquiring veteran. He suggests that it will take about five years for that model to take hold.

That is due to a lack of consolidation. In the United States, Courtnage notes, banks merged and acquiring portfolios were sold or consolidated. That left many experienced bankcard executives unemployed. Some started their own companies, and the third-party channel flourished. Similar consolidation is coming slowly to other parts of the world, and could produce similar results, he suggests.

Global has an Asian sales force of 260 full-time equivalents, Courtnage says. Compensation is salary with a 20 to 30 percent incentive bonus tied to revenue targets. A small base salary with large commission potential "wouldn't work here for cultural reasons, but we're ramping up the commission component, and it will come to dominate sales compensation over time," he predicts.

An ISO approach seems to be working in China, where a Shanghai-based company called Sand has built a portfolio of 60,000 points of sale. "They have contracts with the leading Chinese banks," Courtnage reports, "but they're not a sophisticated, full-service ISO like you'd find in the U.S. It's still very much a work in progress."

And ISO global expansion remains a work in progress. While the road has been rocky, pioneer ISOs have learned valuable lessons. "Most ISOs," Riedl says, "are now pretty realistic about how their business works and what they'd need to succeed. They're able to size up a situation and see whether the rewards would be worth the effort." ***TT***

Richard H. Gamble, Ph.D., is a financial writer based in Colorado.