

Object Lessons

KEY NOTES

- ▶ Smart start-up strategies include a constructive business plan, sales reps and vendors that share the company's values, and a unique BIN and ICA.
- ▶ When acquiring an existing operation, look beyond portfolio size. Buyers need to consider debt-to-equity ratio, net profitability, and operating expenses.
- ▶ Retaining a "holdback" until buyers can convert merchants to their own portfolio can be a losing proposition for sellers should excessive merchant attrition result from the transaction.

Experienced entrepreneurs share secrets for avoiding pitfalls when buying and selling

By Julie Ritzer Ross



Many players in the electronic payments arena have, at some time, contemplated either starting an ISO/MSP operation or selling an existing one. However, establishing a business of any kind is, for lack of a better term, risky business: More than 50 percent of small businesses fail in the first year and 95 percent fail within the first five years, according to the U.S. Small Business Administration. Mergers and acquisitions don't fare much better: By most estimates, 50 to 80 percent of companies formed as a result of such deals never generate any value. Even if a venture does beat these odds, completing the start-up or sales process is a learning experience from which other ISOs/ MSPs can benefit.

"Whether you're just beginning or getting out of the business, there's no such thing as a perfect sequence of events," says Richard Brennes, president of The Brennes-Jones Group, a Dallas-based ISO. "There are always things that could—and probably should—have been done differently, as well as things that were handled exactly right."

Launching Smart

Experienced ISOs/MSPs offer some critical advice based on lessons learned in the trenches:

1. Resist the temptation to pursue a broad business focus. When Brennes founded The Brennes-Jones Group, he hired in-house staff to handle terminal deployment and customer support. However, compensating these employees soon put an undue strain on the company's finances.

"Cash flow is critical to ISOs, especially at the outset, and we experienced a cash crunch because we spread ourselves too thin," Brennes asserts. He notes that in hindsight, he would have formulated a more conservative business plan, outsourcing the equipment installation and support functions until a more-than-adequate cash flow warranted otherwise.

Harry Johnson, president of Money Transfer Systems Inc., experienced a similar misstep in founding his Clearwater, Florida, MSP a few years ago. Instead of targeting

merchants in one vertical segment and expanding only after establishing a firm foothold, the company immediately pursued two different markets. "We received a lot of inquiries from each of the two 'mini-channels,' but didn't see a lot of business until we narrowed our focus," Johnson recalls. In general, he says, trying too soon to be "all things to all merchants" is not in ISOs' and MSPs' best interests.

2. Exercise great care in hiring sales agents—despite any level of eagerness to get the ISO or MSP ball rolling.

One small ISO, which asked not to be named, learned this the hard way when an "obsession with revving up fast" spurred him to hire a few applicants whose understanding of the need to "provide more service for merchants than showing them where to sign on the dotted line" soon proved minimal or non-existent. The company's first year in business was fraught with merchant attrition; only after purging its ranks of the offenders and hiring more customer-savvy replacements did it truly get off the ground.

Experience also taught Ravi Chatani, president of Clearwater, Florida-based ISO Vanguard Payment Systems, to rank hiring due diligence above eagerness to move forward with a new sales agent. "Sometimes, work ethic supplants experience, and it's better to choose sales representatives with a good attitude and little or no hands-on exposure within the industry than those who have been around the block many times and are operating on auto-pilot," Chatani asserts. Another advantage of hiring less seasoned sales personnel, he has discovered, is that they, unlike their more experienced counterparts, have generally not worked with larger and/or established ISOs. As such, they are less likely to insist on using sales strategies that, while appropriate for companies of long standing, may not work for entrepreneurial operations.

Additionally, Chatani learned the hard way that new ISOs and MSPs might do better to hire sales agents on an independent contractor basis rather than as employees—at least, for the first few months after opening their doors. "We didn't—and

goes
where



others
can't.

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instead went straight for the W-2 sales force,” he notes. “Going the 1099 route would probably have allowed the business to be built up less expensively.”

3. Implement appropriate pricing structures. The Brennes-Jones Group has always utilized a tiered pricing structure, a move Brennes made after seeing other ISO startups suffer the consequences of not doing so.

“Without tiered pricing, it’s impossible to be truly competitive for merchant accounts,” he says. “Tiered pricing also adds a critical element of profitability that’s especially important at the beginning. All those half-cents knocked off the price eat into the bottom line.”

4. Pursue viable partnerships with third-parties. Neglecting to forge strong alliances with several value-added resellers (VARs) constitutes a misstep Chatani took in setting up Vanguard Payment Systems. While partnering with such entities necessitates that ISOs engage in revenue-sharing, significant return exists in the form of steady streams of merchant referrals, he states. “Sterling Payment Systems and Mercury Payment Systems follow this partnership model with great success,” Chatani adds. “As we’ve learned, it’s just an easier way to drum up business.”

On the flip side, the executive went the extra mile to align his company with the proper processor partners. The latter were carefully evaluated to ensure they were willing to offer sufficient support and the level of service needed to help a fledgling ISO quickly gain momentum and continue on an upward growth curve.

Johnson did the same in selecting vendor partners for Money Transfer Systems. “In this business—and particularly when you’re starting out—you can’t afford to have vendors whose focus doesn’t mirror the direction you’re planning to take,” he says. “Too many of them, and it is impossible to serve customers properly.”

5. Own a BIN and ICA number from the starting gate. Brennes notes that of all the things he believes he did right in preparing for The Brennes-Jones Group’s inception, obtaining a unique Bank Identification Number (BIN) and Interbank Card Association (ICA) number was by far the most important.

From past experience, Brennes knew that BIN and ICA number control would allow for mass portability of the merchants in his company’s

portfolio should its bank affiliation change or in the case of a sale down the road. "We didn't want to be forced to ever move a large number of merchants individually, because that leads to merchant attrition and/or forces the acquirer to grant price concessions to merchants or to the next acquirer that accepts them," he explains.

The Brennes-Jones Group was initially sponsored by an Illinois bank, which failed a few years after the ISO's inception. Having its own BIN and ICA number permitted all merchants to be transferred without loss when a new bank sponsorship agreement went into effect.

Selling Smart

As for selling an existing operation, ISOs/MSPs outline several additional critical points:

1. Consider factors other than portfolio size in calculating a selling price. Tribul Merchant Services, an ISO in New York City, is not currently on the market. However, Mike Berman, COO of parent company Outside Ventures LLC, has been approached several times recently about

purchasing it. Not once, Berman states, has a prospective buyer included such factors as debt-to-equity ratio, net profitability, and operating expenses in its offer for the business.

"All these prospects want to discuss in terms of purchase price is the size of the merchant portfolio and what it is worth," Berman asserts. "Were we to be entertaining an offer that didn't take into account the other factors—particularly whether the price would cover our debt—we would truly be shortchanging ourselves. This is a mistake I have seen many companies make over the years."

2. Carefully negotiate "holdbacks" for merchant conversion. Buyers of ISOs/MSPs typically insist on retaining a "holdback"—or percentage of the sales price—until they can convert the merchants from the seller's portfolio to their own. However, this can be a losing proposition for sellers should excessive merchant attrition result from the transaction.

Such was the case for one small ISO. After the business had been sold, its portfolio began to shrink. The purchaser didn't

want to remit the entire holdback amount, and a dispute ensued. "Had we negotiated more up front, we would not have lost any money on the deal," the ISO executive laments.

3. Ensure a "strategic fit" exists between the buying and selling parties. Even after an ISO/MSP changes hands, during a "payback period," the seller will be passively involved in the business. "I've seen it many times: If buyer and seller aren't aligned in terms of everything from how they run the business from day to day, to the way in which various merchant situations are going to be handled, there will be an erosion of business and the seller won't get the agreed-upon amount," Berman says. "Remember, buyers pay on net effects."

No ISO/MSP who opts to get into—or out of—the electronic payments business will do so entirely unscathed. But heeding these lessons will surely stack the odds in favor of success. **TT**

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