



ISO Metrics

What awaits Independent Sales Organizations in 2008?

By Tom Wright

We sought out industry leaders at various ISOs (independent sales organizations), payment processors and payment research firms across the country and asked them to go out on a limb and provide us with their thoughts on how the world of electronic transactions will look in 2008.

industry. However, that view changed in late 2007 and early 2008 as evidence like reports from Capital One of their approximately \$1.3 billion in charge-offs showed that consumers loaded up on credit card debt to make up for a loss in the purchasing power they once wielded by refinancing mortgages during the real-estate boom.

serious concerns about the economy and its affect on ISOs. “Economic trends are down and we could possibly be looking at a recession,” he says. “We have been in a fairly good business climate for quite a long time, but credit quality is really deteriorating and I see a lot of consumers under economic stress.” He believes that difficult economic conditions could also put merchants under stress, which will naturally have a negative impact on ISOs. He strongly advises ISOs to “be very careful about budgeting and plan for margins to continue to erode for both transactions and hardware.”

“Be very careful about budgeting and plan for margins to continue to erode for both transactions and hardware.”

—Harold Montgomery, CEO, Calpian

Is the Good News Good Enough?

Even the continual rise in PIN and signature debit transactions doesn't bring a smile to Montgomery's face. “Signature debit revenue may be going up, but it doesn't make up for lower credit card revenues.” He notes that merchants are increasingly savvy about interchange and become even more price conscious in a tight economy. Montgomery predicts “a tough year ahead and it is not necessarily true that the value of merchant accounts will continue to grow—it may go down in 2008. ISOs must re-evaluate their budgets and staffing and find creative ways to generate sales at effective price points in order to survive.”

Paul Martaus, president of Martaus & Associates in Mountain Home, Ark., agrees wholeheartedly with Montgomery on the ongoing margin compression problem. “There is going to more consolidation in the ISO world in 2008 because in many respects this is a zero-sum game. There is only a fixed pool of merchants—some 6 million or so—and ISOs are just cannibalizing merchants from

When one considers card statistics alone, the old rock song lyrics come to mind: “the future's so bright, I gotta wear shades.” According to CardTrak.com, Americans put more than \$2.2 trillion on their major credit cards for purchases and cash advances last year, making 2007 the second consecutive year that credit card purchases have topped \$2 trillion. CardTrak doesn't attribute the credit card spending to any specific cause, but notes that the growth of purchases on credit is still outpaced, on a percentage basis, by the growth in spending with debit cards.

Yet, many observers believe that the storm clouds blowing in from the sub-prime mortgage crisis will obviate any need for sunglasses in 2008. As delinquencies on sub-prime mortgages surged in 2007, there were initially few signs that similar problems were leaking into the credit card

Analysts Antsy

In December, analysts at Merrill and other firms downgraded the credit card sector, saying they expected a consumer-driven recession to hit in 2008. Fitch analysts noted in one of their reports that “credit card performance began to deteriorate in the second half of 2007,” and they believe “deteriorating consumer credit trends will continue throughout 2008.” Over at BCA Research, their analysts predict, “the rise in the unemployment rate warns that the rate at which credit card holders repay their debts will fall.” It is obvious that home equity loans will no longer provide a quick fix to consumers looking to consolidate their credit card debts, but the big question is will that stop them from using their plastic?

Harold Montgomery, head of Dallas-based Calpian, is not in complete gloom and doom mode, but he has

each other.” Yet, he sees smaller ISOs that are able to provide personalized service being able to thrive regardless of the economy, and the mid-sized ISOs as being prime targets for acquisition. Montgomery concurs and says that “the sub-1,000 merchant ISOs that take care of their customers will always do fine, it is the ‘no man’s land’ of the 1,000 to 20,000 merchant ISOs that are in trouble because they can’t provide personalized service and don’t enjoy the economies of scale that the large ISOs do.”

Attrition Concerns

Over at TransFirst in Dallas, Senior Vice President for Corporate Development Andrew Rueff also sees increased consolidation and competition and a bit of a rocky road ahead in 2008. He sees “a tough environment for ISOs but lots of activity. Merchant attrition will continue to be a problem, as will compression of top-line revenue and higher operational costs.” He worries about the potential loss of merchants as the economy worsens, but finds solace in the fact that processors may see a spike in volume as consumers use credit cards more in 2008 to help with cash flow issues. On the five- to 10-year horizon, he predicts that “we will see more mid-sized ISO being acquired or going out of business.” Rueff concludes that, “it is going to be tougher to be an ISO in 2008 than it has been in the past, but those that come out at the end of the year will be stronger. They really need to focus on developing a strong sales channel.”

Another area that needs more focus according to many industry observers is specialization. Brian Riley, senior analyst of Bank Cards at TowerGroup, is one analyst who is bullish on ISOs. “They are really relevant to the card industry and add a great deal of value. How well they are able to specialize is going to be a big factor in their success though.” Paul Hunter, CEO and president of Tampa-based Sterling Payment Technologies, confirms Riley’s views. “ISOs must become vertical market specialists, increase their level of

knowledge on various industries and really become experts on the best hardware and software solutions for those businesses.” Greg Cohen, president of Moneris Solutions USA, puts it succinctly. “The ISO of tomorrow must be a specialist, understand niche markets, bundle products in focused segments, and offer the latest technology.”

He also likes the continued growth in debit transactions and the fact that merchants need PIN pads. However, Randel goes against the specialist movement. “I believe in a broad diversity of merchants both in geography and SIC codes. This lessens our exposure when the economy goes down in certain areas or in certain merchant categories.” His advice for ISOs is

“I see terrific growth for ISOs that are creative, fleet of foot, focused and constantly thinking like their customers.”

— Paul Garcia, chairman, president and CEO, Global Payments

Hunter is a huge believer in this last point. “Integrated POS systems are a big part of the future.” Years of experience in the industry have shown him that “non-integrated terminal merchants have the highest attrition rates.” He notes that integrated and PC-based systems are getting more powerful and less expensive everyday. He is convinced that “there are good opportunities in this business for hard working ISOs that have good technology and customer service, and target their sales efforts to the larger merchants who do at least \$10,000 per month in card business. There is more profit and increased loyalty from merchants using integrated systems in this size market.”

Hardware Offers Opportunities

Neil L. Randel, president and CEO of First American Payment Systems in Fort Worth, Texas, also sees good opportunities in the hardware arena. He points out that “American merchants have lot of old hardware still deployed. This represents a good opportunity in the next couple of years for ISOs to replace antiquated and non-compliant hardware and cross-sell those clients other services.”

straightforward. “Get a fair price for your equipment; offer competitive rates; deliver real-time reporting; and have your call center staffed with knowledgeable help desk people that are ready to quickly assist the merchant in any way that they can.”

Service Sets You Apart

It’s not surprising that what works in Texas works in Michigan if you ask Charlie Creamer, past president of the ETA and president of the Midwest Transaction Group in Lansing. “Our goal is to try and overwhelm our clients with customer service, while maintaining competitive pricing.” You won’t find Byzantine phone menus when you call Midwest Transaction Group — a person always answers the phone. The formula appears to be working: The ISO reported significant growth over the past two years and is looking forward to a bright 2008. Creamer notices “more interest from consumers in paying with plastic both for smaller purchases and larger purchases.” For instance, his firm is targeting wedding photographers, and newlyweds are now demanding to pay with credit cards. Additionally, he sees more demand from merchants to handle ACH pay-

ments so he's helping them with this, even though it's a low-margin service. "It's about helping the merchant and building loyalty," says Creamer.

Additional Opportunities

Beyond credit, debit and ACH, there are other sales opportunities in 2008, such as loyalty/gift cards, check services, currency conversion services, remote deposit capture and data-breach insurance. Paul Garcia, chairman, president and CEO of Atlanta-based Global Payments, also likes the possibilities inherent in merchant financing and offering Discover card acceptance. "I see terrific growth for ISOs that are creative, fleet of foot, focused and constantly thinking like their customers. They must be a strong advocate for their merchants and truly interested in taking care of their specific needs and concerns," he says. Garcia is convinced that "inefficient and unsophisticated operations are weeded out by a downturning economy, and those ISOs that remain are the strongest and most focused entrepreneurs."

One analyst that is bullish on ISOs is Paul Grill, a partner at First Annapolis Consulting in Linthicum, Md. "There is a long-term positive growth path for credit and debit transactions. Certainly there will be some tightening of consumer credit, but I am cautiously optimistic," he says. Like Garcia, he likes the opportunities with Discover, as well as with American Express. Like Randel, he also likes incremental upgrade opportunities for hardware with the replacement non-compliant terminals and the growth of cutting-edge contactless devices. Grill remains bullish on loyalty/gift cards, and is a big fan of prepaid and payroll cards. "I see growth in the B2B market, with merchants offering payroll cards to their employees," he says, "and for any ISO that can deliver high touch customer service and technical support, regardless of their size."

Unbanked/Underbanked

A growth area being targeted by Las Vegas-based eCommLink is the

approximately 40 million unbanked and 40 million underbanked people. eCommLink President T. Jack Williams could not be more excited about this consumer segment. "This is going to be a great market for us because we can provide more convenient and lower cost services than banks can provide, and without the punitive fees." Research firm Celent agrees with Williams and believes that payment network-branded prepaid cards geared toward this untapped \$192 billion market represent the next big thing in consumer payment cards.

Statistics Tell the Story

Recent independent research from Edgar, Dunn & Company goes a long way toward dispelling the notion that the approximate 15 percent of the U.S. adult population without a traditional savings or checking account are unemployed, poorly educated and not creditworthy. The company's PaymentDynamics 2007 Preferred Payments Study shows that the conventional wisdom regarding the unbanked is overly simplistic at best and, in many ways, inaccurate. For instance, more than half of the unbanked have attended college and only a third are rated as having sub-prime credit scores. The report concludes that many of these segments may have far greater profit potential and lower risk exposure than previously believed. Riley confirms that his research at the TowerGroup shows that the underbanked represent an excellent and growing market for prepaid cards.

According to Williams, "ISOs need a bag of tricks well beyond simple credit and debit card processing. They should be selling a suite of prepaid cards that are reloadable and personalized." He touts that his firm "offers programs for payroll and business expense, teen/family cash management, health care, not-for-profit fundraising, loyalty and reward programs, all with mobile capabilities that provide the security and features of a bank account."

Williams insists that being able to quickly reload the cards via a cell phone is the key differentiator. He envisions ISOs selling these prepaid products to "convenience stores, gas stations, auto supply stores and anywhere "utilitarian" products are sold. All the while they should be educating merchants on the benefits of these cards: fee income, increased foot traffic and incremental sales."

Williams is also a big fan of travel cards and believes that ISOs should be selling them to travel agents along with lost luggage insurance and medical travel insurance. He concludes that "ISOs that don't get creative and reach out to a larger base will wither and die. Product differentiation is the only way that ISOs can break out of the commodity market of old fashioned credit, debit and terminal sales."

New Frontiers

Cohen also likes to use the word "commodity" when he talks about card processing, as well as the term "mature environment." Yet, there are still new frontiers. Cohen likes the potential in markets like vending, government and utilities.

Other industry pundits are quick to mention the education and medical verticals. Creamer backs up the validity of this last field by noting that, "we have found success working with dentists and doctors." He also is actively pursuing other professionals, such as accountants and small law firms.

Meanwhile, Rueff paints a bright future for cash advances to merchants. "There is good revenue potential there, it builds customer loyalty, and delivers what I like to call a 'consultative' sales approach."

Finally, Martaus claims that there is another trend flying well under the radar. "Some of the larger ISOs are funding top salespeople to go off on their own and start their own ISOs," he says. "The entrepreneurial spirit is alive and well in the ISO community and I am confident that they will always find a way to make money in any kind of economic conditions." **TT**