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Merchant Processing 101
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Thinking about adding electronic processing capabilities?
There's a lot you should know.

There are countless reasons why a business should add credit card and electronic payment processing capabilities — transactional speed, convenience, increased customer satisfaction, improved cash flow, views into sales data and more. But perhaps the most important consideration is the sheer volume of consumers who use non-cash methods as their primary form of payment.

In 2005, credit card and electronic transactions accounted for an overwhelming $3.4 trillion of total U.S. payments, according to The Nilson Report. That's 50 percent of all transactions nationwide for that year. More recently, Visa USA estimated that nearly 60 percent of U.S. consumers aged 18 to 25 use cards as their primary payment method.

So while the reasons for adding payment processing are clear, understanding all your options and which are right for your business is far more complex. This article will give you the information you need to get started in setting up payment capabilities for your business, and it will provide some of the essential details you need to consider when selecting a provider.

How Payment Processing Works
Some form of the modern credit card has been in use since the late 19th century, mostly as department store charge cards representing lines of credit. Things have changed and today, the step a merchant needs to take in order to accept credit card payments is to establish a merchant account with a bank or third-party payment provider. Once your account is live, the transaction process generally works as follows:

1. A customer presents a credit card for payment.

2. By swiping the credit card through an electronic point-of-sale (POS) transaction terminal, typically provided by the bank or payment provider, an electronic request is submitted to the processing network for authorization.

3. The processing network receives your electronic request and determines if the cardholder's account is valid and if the funds are available. If so, a response called an "authorization code" is transmitted, guaranteeing your access to the funds.

4. A receipt is then printed for the customer using the POS terminal or your computer. The customer then signs the receipt and, for their part, the transaction is

complete.

5. At the end of the business day, a merchant will electronically submit a final request to the processing network to "capture the funds" for all authorized transactions in a given day. This process is referred to as settlement. Once approved, a response is generated to your electronic terminal or computer.

6. From there, the funds associated with the batch you settled are deposited electronically into your business bank account, usually within 48 to 72 hours. Typically, the rate and any fees paid to your merchant account provider are deducted from your account at the end of the month.

7. At the end of the month, your merchant account provider will send a statement to you, detailing the credit card activity for the month and the associated fees you've been charged.

This process describes what happens in a traditional retail, or "bricks and mortar" sales environment. For Internet and e-commerce merchants, the set-up process requires a few additional steps.

Retail Terminals vs. e-Commerce Processing
Because they do not have access to the purchaser's physical card, Internet and e-commerce merchants rely on specialized software that allows them to capture and process credit card information on their Web sites instead of through a POS terminal. There are two basic software programs needed to enable online commerce:

- **Shopping Cart:** A secure series of scripts (or coding) that keep track of items a visitor chooses to buy from a site until they proceed to checkout. On the checkout screen, the shopping cart collects the credit card number, billing address, authorization number and expiration date.

- **Payment Gateway:** When the online shopper is ready to finalize the transaction, the information collected in the shopping cart is transferred to a payment gateway for authorization. It is the equivalent of a physical POS terminal used in a retail setting.

Another situation where a purchaser's card is not physically present happens with MOTO or Mail Order and Telephone Order. Here, touch-tone processing or an automated response unit (ARU) allows for credit card authorization and processing over the telephone. This type of processing does not require a shopping cart or payment gateway.

Pricing Basics
Now that you know how processing works and what the available options are, you're probably wondering how much all this will cost. While service fees and rates vary from provider to provider, "bundled" pricing is the most common type of agreement used in

determining which per-transaction rate applies to which type of merchant. In the simplest terms, pricing is based on risk: the higher the risk involved in the transaction, the higher the rate the merchant will have to pay:

- **Qualified Rate** applies primarily to card-present or traditional card-swipe (not key-entered) transactions. This is the lowest possible rate a merchant will incur when accepting a credit card. Telephone and e-commerce transactions cannot receive the qualified rate because they are unable to swipe a customer's card.

- **Mid-Qualified**, or partially qualified rate, is the percentage a merchant will be charged if they accept a credit card that does not qualify for the lowest rate. This may happen if a consumer credit card is keyed into a credit card terminal, virtual terminal (online) or via a shopping cart. This is the best rate that a telephone or e-commerce business can receive.

- **Non-Qualified** is the highest percentage rate a merchant can be charged and applies to those transactions posing the greatest amount of risk. This rate would apply if a special kind of credit card is used like a rewards card or business card or if address verification is not performed, or a merchant does not settle its daily batch within the allotted time.

Again, these rates are used to determine the cost to the merchant on a per-transaction basis. There are additional costs associated with payment processing, including start-up fees, equipment costs, chargeback fees and more. Stay tuned for the next e-newsletter installment for additional processing tips and useful information for merchants and business owners.

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