EVOLUTION OF THE AGENT/ISO RELATIONSHIP

By Paul A. Rianda, Esq.

This article gives a broad overview of the financial relationship between sales agents and ISOs over the past ten years. The financial relationship between sales agents and ISO's has changed dramatically over that time period with the sales agents being paid an ever-larger portion of the profits derived from merchant credit card processing. All the examples below are of the sales agent/ISO relationship where the sales agent does not provide first line customer service, risk or chargeback services for the merchants.

The 1990's:

When I first became involved in the bankcard industry, sales agents derived the bulk of their income from leasing equipment to merchants. For most sales agents, the continuing residual stream derived from merchant credit card processing was a secondary concern in regard to their overall strategy to make money. The relationship between the ISO and the sales agent reflected this state of affairs

The typical sales agent paid a large application fee in order to be able to submit a merchant agreement to an ISO, sometimes upwards of $400.00. In addition, in contrast to the typical profit sharing programs of today, sales agents in the late 1990's typically were paid a flat fee per merchant per month. This resulted in a situation whereby sales agents were grossly underpaid if they submitted high volume processing merchants to an ISO.

During this time period, the ISO typically held the upper hand in the sales agent/ISO relationship. As such, the sales agent had little power to change the status quo and obtain a larger share of the profits derived from merchant credit card processing. Due to market factors, such as continuing competition and the education of the sales agents, the market began to change to favor the sales agents and provide them with additional revenue sources.

The 21st Century:

In the late 1990's, and shortly after the turn of the century, sales agents became more and more knowledgeable about the amount of money that ISOs were making from the efforts of the sales agents. As a result, sales agents began to demand more of the profits derived from merchant credit card processing. Application fees paid by sales agents dropped dramatically and were typically in the range of $15.00 to $25.00 per merchant account application.

In addition, sales agents began to derive more revenue from the credit card processing residual streams. Instead of being paid a flat fee per month per merchant, sales agents shared in the profits that were derived from credit card processing. Most of these early profit sharing arrangements gave 50% of the processing profits to the sales agent. In addition, many ISOs started "buy rate" programs where the sales agent earned 100% of the revenue earned from its merchants to the extent the revenue exceeded the cost or buy rate agreed to by the sales agent.

Leasing of equipment during this time period became less and less favored as more sales agents were chasing the same merchants. Merchants began to demand that they receive equipment for free or for substantially reduced price rather than the large monthly lease payments that had been typical in the past. As a result, sales agents began to see that they needed to find an alternative way to make money.

The Current State of Affairs:

For the last 2-3 years, it appeared to me that the financial relationship between ISOs and sales agents had become stagnant. What I mean by that is nearly all the agent agreements that I saw provided for a profit split of 70% of the profits to the sales agent, and 30% to the ISO. In addition, ISOs no longer charged any application fees for merchant accounts. There was not much variation in the financial relationship between the ISO and a sales agent, except some less knowledgeable agents agreed to accept only 50% of the profits derived from the credit card processing attributed to merchants.

This state of stagnation led to a commoditization of the industry. There was no real way to differentiate between the different ISOs from a purely cost basis to determine which ISO was the best one to pick as a long-term partner. As a result, ISOs began to try to offer additional value to sales agents in other ways, such as providing up front bonuses for submission of merchant accounts, providing superior customer service or allowing sales agents to become part owners of the ISO.

In the last few months, I have noticed another change in the industry. Some ISOs are now offering even more aggressive profit sharing packages. Some of the larger ISOs have been offering 80% and even 90% of the profits made from the credit card processing without the sales agent having to take any risk of merchant losses. This aggressive pricing leaves little, if any, profit for the ISO to pay their ongoing costs and expenses.

Of note, these more aggressive pricing structures have only been offered by the larger ISOs. With their large infrastructures and established base of merchants, the larger ISOs do not have to worry about any substantial increase in their costs associated with adding more merchants on their platform. Consequently, even if they make only a small part of the profit derived from the merchants, it still serves to add to their overall profitability.

Given this more aggressive pricing, it appears that smaller ISOs will have difficulty competing with ISOs offering these new arrangements. The smaller ISOs do not have the large established merchant base to be able to allow them to cost effectively offer 80% or 90% of the profits derived from the merchants to the sales agents. This will likely lead to a situation where smaller ISOs will find they are unable to compete unless they consolidate or are bought out. There has been some indication in the industry that this is already happening and I expect it to be a continuing trend in the future.

With little profit left to attract additional agents, ISOs will need to determine what new and innovative ways they can use try to attract additional sales agents to their programs other than just paying the sales agents more money.

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