

THE IMPACT OF ECONOMIC TRENDS

The recent negative economic trends are certain to have an impact on the bankcard industry. Below, I will discuss the potential impact of these economic changes on residual payments, sales opportunities and merchant losses.

The Impact On Residual Payments:

For the past 5 or more years, Americans have felt they were wealthy which in part fueled an economic boom. Real estate prices were continually climbing which led to a “wealth effect” in the economy. People thought they were wealthy because on paper they were due to the run-up in real estate prices which was magnified by the increase in wages for most people. In addition, homeowners were able to use their houses like piggy banks. Mortgage lenders were more than willing to allow people to utilize the increased value in their homes by letting homeowners take cash out of their homes through increasingly larger mortgages.

With increased wealth (at least on paper) came increased spending. People were buying up all kinds of expensive appliances, plasma televisions, cars, boats and other toys. This increased spending has a direct increase on the overall volume of credit card payments made in our country. We have been on a run for many years where the overall volume of credit card purchases increased every year. As a result, the overall pool of residuals, which are directly related to credit card spending, has increased year over year. This has led to a bigger pie for everyone in the bankcard industry to divide up. But, is the party over?

Now the economy is struggling and people are talking about an impending recession, if we are not in one already. Consumer confidence has plummeted as a result and spending is slowing. Mortgage companies have tightened up their lending criteria and people are no longer able to use their homes as piggy banks. So, it is inevitable, and leading economic indicators support the conclusion, that consumer spending is no longer growing and in fact will shrink for the next few years. If consumers are spending less overall, one conclusion is that their credit card spending will also decrease, leading to a reduction in most residuals payments. But, will this actually occur?

The one thing that may increase credit card spending, and therefore increase residual payments, is the fact that as people have less cash, they might be more inclined to use their credit cards. Trends are also showing that people’s overall credit card balances are increasing. This increase in overall credit card debt could help offset some of the losses in residuals due to people spending less on such things as appliances and eating out because they do not have as much money. It remains to be seen whether or not this will offset the reduction in spending due to the harder economic times.

Sales Opportunity?:

Another important aspect of the economic downturn will be its impact on sales and new merchant accounts in the industry. In an economic downturn, merchants will be making less money and hence looking for ways to cut costs to increase profits. Lowering their merchant account fees is one way that merchants can reduce their costs without having to give up anything such as product quality in return. As a result, it is likely that we will continue to see downward pressure on merchant pricing that we have seen in the past few years.

Although interchange may be continuing to increase, the actual profit spreads that are available to be divided up between the street level sales persons and their ISOs continues to decline. This has led to a situation where it has become more and more difficult to make money with everyone competing on price to the merchants. In addition, fewer people will be willing to make the plunge on starting a new business during these bad economic times, possibly leading to less sales opportunities. This unhealthy situation seems likely to continue and accelerate as the economy gets worse.

Merchant Losses:

A disturbing trend I have been seeing is that more and more of my clients are suffering losses due to merchants going out of business. The economy has been going well for so many years, merchants just took it for granted their sales would increase every year. As a result, they did not plan for these bad times and as a result a considerable number of merchants have been going out of business. This has had an impact on chargeback losses. Merchants take deposits for things like furniture and travel sales. If the merchant goes out of business, all the people that paid by credit cards charge back their transactions resulting in large losses to the credit card processors. I have been getting more and more inquiries from my clients about these types of losses.

Another area where the economic downturn and resulting business failures have had an impact is in the growing merchant advance business. The whole premise of the merchant advance business is that the merchant has to stay in business and keep processing credit cards or the merchant advance company will not get paid back its investment. Regrettably, many businesses without the ability to get credit anywhere else, are looking to the merchant advance industry to fund their businesses. However, when they get these merchants advances many companies are barely in business. The merchant advance only staves off the inevitable business failure for a short time, leaving the merchant out of business and the merchant advance unpaid.

The way to combat these losses is through thorough underwriting of accounts and also through continued diligence during the life of the accounts. As in the mortgage industry, merchant account providers and merchant advance companies need to modify

their underwriting procedures to fit the economic times. Whereas companies may have been more willing to provide a merchant account or merchant advance in the past, they need to be more picky in the merchants they accept or they can expect greater losses.

There is an argument to be made that during this transitional time period the business losses will be at their worst. Companies that were barely able to make a profit in the good times logically will be the first to go out of business in these harder economic times. Certain market segments will also inevitably suffer. Since people do not have as much money, they will be less likely to buy things that they do not need, leading to the inevitable bankruptcy of many businesses that catered to people with lots of discretionary income to spend. However, once this transitional period is over, the strong will have survived and likely will continue to at least stay in business. We may have a bad stretch of business failures for a while but hopefully things will stabilize.

The changes in the economy will likely lead to less money overall being available in the bankcard industry. But, if you plan carefully this, like anything else, could be an opportunity for you.

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