

WHAT IS A MERCHANT WORTH?

There is a considerable difference in the value of a merchant to the typical sales agent versus the value the very same merchant has to an ISO, bank or credit card processor (collectively referred to herein as “ISO”). Market forces have created a situation where although it originates the merchant, the sales agent receives little value for its interest in the merchant as compared to the value the ISO derives from the merchant. Below I will discuss the respective roles of the ISO and the sale agent along with the value that each derives from merchants.

Defining the Sales Agent:

The sales agent is responsible for originating the merchant application. In order to do so, the sales agent must, either through face-to-face sales or through advertising, get the merchant’s attention to solicit it for credit card processing. If the sales agent is successful in its efforts, it will complete a merchant application, submit it to the ISO and when the application is approved, place the credit card processing equipment or software with the merchant.

The sales agent is also the party responsible for initial training of the merchant on the use of the credit card processing equipment or software. After the merchant has been trained, the sales agent is not usually required to provide continuing customer service to the merchant under its agent agreement with the ISO. Although the sales agent may be the person the merchant contacts if it has a problem, the sales agent still has no real contractual obligation to service the merchant. In addition, the sales agent is almost never a party to the merchant agreement. As a result, the sales agent has little, if any, contractual rights to ownership of the merchant.

The main right that a sales agent has is the right to continuing payment of its residuals under the agent agreement. This is the only real tangible asset the sales agent is entitled to for placing the merchant with the ISO. The sales agent does not generally obtain the right to move the merchant to another credit card processor. Even if it does, logistical issues related to incompatibility of platforms and the need to actually rewrite merchant applications makes it extremely difficult for a sales agent to move merchants to a different credit card processor.

As a result, the sales agent has little, if any, “ownership” in the merchant and therefore the market place does not value the sales agent’s relationship with the merchant very highly. The only asset that the sales agent is able to sell is its right to a continuing residual stream, assuming it even has that right under its agent agreement. It cannot sell any contractual ownership right to the merchant nor any ability to move the merchant’s current ISO.

The value of this residual stream is also reduced by the fact that any buyer who takes the right to the residual stream is subject to the terms of the agent agreement. A major concern for any entity purchasing residual streams is that the sales agent, after receiving an up front payment for the purchase of its residuals, will move the merchants to another processor. If this happens, the ISO will terminate the residual payments. This will result in the purchaser of the residual payments having paid for a residual stream and then losing all the money it has just invested.

Given the potential for losing the residual stream and the nature of the asset that the purchaser can obtain, most purchasers are not willing to pay the sales agent a very high price for the right to receive residual payments. The purchase takes the form of the sales agent receiving a multiple of the average monthly residual payment multiplied times a factor to derive the payment price to the sales agent. Once the sales agent has been paid the purchase price for the residual stream, all further residual stream payments are made not to the sales agent, but to the purchaser.

ISO Valuation of Merchants:

In contrast to valuing a sales agent's interest in the merchants, the market determines the valuation of an ISO portfolio much differently. The merchants associated with an ISO are valued for the revenue stream that is derived from them as a first measure. But, an ISO can obtain additional value in the market because of the value of the ISO as a complete entity. This "entity" value is the distinction that leads to ISO being valued at a much higher multiple than the residual stream of a sales agent.

The reason for this higher valuation is that the ISO has a much more tangible and valuable relationship with the merchant. The ISO is an actual party to the merchant agreement and hence, has a contractual relationship with the merchant. In addition, the ISO is the one providing customer service, risk and all other ongoing support to the merchant. As such, the ISO is able to maintain a much closer relationship with the merchant that is much more valuable than the sales agent's single right to continuing a residual stream.

In addition, if properly set up, an ISO has the added benefit of allowing a potential purchaser to move the merchants to its own platform. What this means is that an ISO can look to acquire other ISOs and add value to its company. This method of growth through acquisition allows for an ISO to grow quickly. As an added benefit, oftentimes an acquired ISO will have its own agent base that can be used by the acquiring ISO to increase the number of merchant applications it adds to its portfolio each month.

With a public company, the stock market values its merchants through the stock price. One can take the market capitalization of a publicly held company in the bankcard industry and divide it by the number of merchants that the company has to determine a

market value per merchant. In a previous article, based on then current information, the public market valued merchants at anywhere from \$2,300 per merchant to \$6,350 per merchant for the selected companies. See “Transaction World Portfolio Valuation Techniques,” *Transaction World Magazine*, March, 2005.

The goal of these public companies in making acquisitions is to pay less per merchant than the public market is valuing the acquiring ISOs merchants. As a general rule, the smaller the ISO the less value its merchants have in the marketplace. The larger ISO can buy the smaller ISO and make the value of the larger ISO increase more than the price it has to pay per merchant. Consequently, a large ISO under most circumstances can increase the value of its company by buying a smaller ISO.

Conclusion:

The reason for the large disparity in the value that the market places on an agent’s interest in merchants versus the ISO’s interest in merchants is fairly simple. The ISO is the one with the real relationship with the merchant that is portable and that will most likely last the longest time. In addition, the ISO has additional value it adds through its operations and its ability to continue to service the merchants. The markets value these items much more than the typical sales agent’s right to a continuing residual stream. As such, unless sales agents are able to either move up the ladder and become ISOs themselves or enter into some type of consortium where they obtain equity in the merchants, it appears that ISOs will continue to enjoy greater value from merchants than the originating sales agents.

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