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The Price of Credit

Weighing the costs of credit card processing fees against the business you might lose by accepting only cash. By Nick DiUlio

It's been 41 years since Denis Branco opened his namesake neighborhood pizza shop in Medford, New Jersey. Forty-one years of trends that have come and gone. Forty-one years of economies rising and falling. Forty-one years of customers old and new. And through it all one detail always remained constant: the sign next to his register that read "Cash Only."

No more.

"When five out of 10 customers are coming up to the counter with their charge cards in hand, you can't keep turning that many people away," he says. "So you have to give a little to get a little, and that's what I'm doing. I have to go with my customers."

Industry analysts say Branco's conversion is in lock step with a trend that began more than seven years ago, when an increasing number of quick-service restaurants began allowing customers to pay for transactions with credit and debit cards. And while a 2008 consumer payment study by Hitachi Consulting says 66 percent of fast-food transactions still involve good old-fashioned legal tender, every indication is that this number is shrinking each year.

Or is it?

Against the backdrop of an increasingly bleak economic landscape, analysts are now beginning to wonder whether operators like Branco will buck the electronic trend in order to save money on the transaction fees associated with accepting card payments. Some experts say such fees can add up to more than $10,000 per year for small operations like Branco's.

"Cash certainly could make a comeback, but I think it's going to be very difficult for merchants to start pulling back on allowing electronic payments," says Jeff Davis, president of Sandelman & Associates, a marketing research and consulting firm for the foodservice industry. "But this doesn't mean it can't happen."

In 2005 Sandelman conducted a national survey to identify electronic purchasing habits in the quick-service industry since 1997. According to the study, credit and debit purchases at fast-food restaurants increased by 36 percent between 1997 and 2005, and Davis says there is little indication the trend is slowing.

"Frankly, it was weird in 1997 to think of using a credit card to buy a hamburger or french fries. It would have been like writing a check for a pack of gum," Davis says. "But it's a convenience issue now. We just don't have as much cash in our pockets."

Annika Stensson, spokeswoman for the National Restaurant Association, echoes this sentiment. According to Stensson, today's troubled economy has led quick-service merchants to focus even more intently on customer satisfaction, and diverse payment options play a significant role in that calculation.

But that ubiquitous drought of pocket cash comes at a cost to quick-service merchants, as every swipe of the card causes a complex web of transaction fees to unfold. These charges typically involve a merchant processor, an issuing bank, and a card brand (such as Visa or MasterCard) and include interchange fees from both the card brand and percentage costs levied by the merchant processing companies. Moreover, the charges a merchant will encounter vary depending on the type of transaction (i.e. credit or debit), the brand of card being used, and the rates set by both the processor and the issuing bank.

To be sure, it's a sticky set of equations, and these variables make it difficult to obtain consistent, nationwide figures on how much individual restaurants pay for every processed electronic payment. That's why firms like Transparent Financial Services (TFS) in Chicago try to provide examples of the monetary impact electronic payments have on quick-service outlets.

For example, TFS says the average interchange rate for a pizza or hoagie shop is about 12 cents plus 1.56 percent for transactions greater than $15, and about 4 cents plus 1.6 percent on transactions less than $15. Assuming a restaurant's average bill is $14, the average interchange rate for this restaurant would be about 2.16 percent. If one assumes the average restaurant also pays a .75 percent plus 20-cent markup over the interchange rate (or 2.2 percent for a $14 sale) based on additional fees, this sets the overall transaction fee rate at 4.36 percent for every $14 transaction.

Over the course of a year, this can add up, and particularly in a down economy, it could start eating away at the bottom line.

"While fees can be a concern, it is more a question of customer service," Stensson says. "Our research shows that 75 percent of consumers say they would be likely to use a credit or debit card at a quick-service restaurant as an option. If those customers don't see their option of preference, no matter what it is, they are quick to vote with their feet and go somewhere else."

That's what eventually motivated Branco, and according to William Collins, senior director of market strategies for Heartland Payment Systems, the customer convenience outweighs the potential fees for many other operators as well.

"We're continuing to see a steady increase of merchants switching from cash to electronic payments because it's all about convenience for the customer," says Collins, whose processing company specializes in the quick-service food industry. "I don't think it's scaling back. If anything not accepting credit or debit purchases can be a business decelerator because customers will find merchants who do accept them."

Major credit-card companies are also quick to reinforce the strength of the electronic payment trend. Tristan Jordan, spokesman for MasterCard, says the fees merchants pay for every quick-service transaction are still greatly outweighed by both the convenience for the customer and, to some extent, the convenience for the proprietor. For example, electronic payments mean less cash handling, fewer accounting mistakes, and less manpower required to actually count the funds in the register.

"The motivations that drive quick-service owners to accept cards in the first place are just as true in today's difficult economic climate, if not more important," Jordan says. "Their decision to accept electronic payment is a business decision because the benefits outweigh the negatives."

This doesn't mean quick-service owners shouldn't strive for a better understanding of the fees they pay for the convenience of electronic transactions. At Heartland, Collins says his company continually strives to educate its clients about the myriad of surcharges levied by card brands and processors. For example, he says it's important that cashiers swipe the card every time instead of manually punching the credit card numbers into the machine. Typing the numbers manually yields a higher interchange rate.

The Merchant Bill of Rights

1. The right to know the fee for every card transaction—and who's charging it.
2. The right to know the markup of Visa and MasterCard fee increases.
3. The right to know all Visa and MasterCard fee reductions.
4. The right to know all transaction middlemen.
5. The right to know all surcharges and bill-backs.
6. The right to a dedicated local service representative.
7. The right to encrypted card numbers and secure transactions.
8. The right to real-time fraud and transaction monitoring.
9. The right to reasonable equipment costs.
10. The right to live customer support 24/7/365.

SOURCE: WWW.MERCHANTBILLOFRIGHTS.COM, HEARTLAND PAYMENT SYSTEMS

Also, if there's an option to process the transaction as either debit or credit, always choose debit. Credit transactions yield higher interchange rates because the funds are not being directly withdrawn from the customer's bank account.

And because quick-service merchants are often confronted with sudden, superfluous fees that are expensive and difficult to understand, Collins says Heartland has written a Merchant Bill of Rights, which aims to assure all small and mid-sized business owners accepting electronic payments have a clear and straightforward presentation of processing costs, enabling the merchants to make more educated decisions about how to handle electronic payment options.

Collins says a small percentage of merchants will opt to stick with cash during the economic downtown, fearing the fees and the complexity of it all. But that, he cautions, would be shortsighted.

"In a down economy, you want every customer in that door," Collins says. "And it's a lost business opportunity if you don't accept credit or debit."