

Squeezing the Transaction Turnip

Dissecting the elements of a credit card transaction and making it work for you.

BY MARY L. GERDTS

Being the fiscally responsible hotel manager that you are, every year during the dreaded budget period you start crunching and forecasting numbers. You rack your brain trying to figure out just how costs could have risen so much from last year. You check each line to see which categories have been naughty and nice. You stare at the stark white report with its dreary black bottom line like a child cursed by a failing grade on a report card. Then you see a "chunky" difference in your budget for your credit card fees and are in utter disbelief. What could have gone so wrong and how could you have been so far off budget? If you are like most hotels, you are looking to squeeze more money out of this year's budget than last. A great place to start is by paying closer attention to the manner in which you process and manage your Visa and MasterCard transactions.

While you might be longing for the good old days of cash, today credit cards reign supreme, even though they have gotten a bad rap since the 1970s. Hotels began taking credit cards not out of choice, but out of fear that their competition was offering something they were not. Most hotels still view credit cards as a necessary evil second only to a high-maintenance, low-profit, direct-bill group who everyone knows is going to stiff the hotel in the end. Everyone dreads them, nobody wants to deal with them, but everybody wants to squeeze the last drop of blood they can from the turnip. The reality is that credit card revenues account for more than 70 percent of most hotels total revenue and more than 50 percent of that credit card revenue is generated from Visa and MasterCard transactions. Credit cards are here to stay. So it is high time you embrace this form of payment and

welcome it into your hotel like a long lost guest. View credit cards not as a burden, but as an opportunity to increase your



overall income and better manage costs.

To understand the controllable cost elements of your Visa and MasterCard transactions, you must first understand a little bit about how the industry works. There are basically two different segments to the credit card industry: issuing and acquiring. Issuing is the process of "issuing" a plastic credit card to a consumer. Acquiring is the process of "acquiring" that credit card transaction once the credit card has been presented at your property for payment, and processing that transaction for payment back to your property. In short, your "acquirer" (most often referred to as your "merchant processor") is the company that funds your hotel's credit card receivable. In this article, I will focus solely on the costs related to processing Visa and MasterCard transactions.

Visa and MasterCard do not directly issue credit cards or acquire their respective transactions. Visa and MasterCard are actually owned and operated by an "Association" of banks that issue and/or acquire credit card transactions. In order

for a bank to associate itself with Visa or MasterCard, it must be a member of either the Visa and/or MasterCard Association. A "member bank" of Visa and/or MasterCard can both issue credit cards to individuals and/or acquire credit card transactions from merchants, such as you. The member bank that issues the credit card is rarely the same member bank that acquires the credit card transaction. A common misnomer is that all banks that issue Visa and MasterCard credit cards also acquire and process Visa and MasterCard transactions. In actuality, there are thousands of issuers in the United States today, while there are just a mere handful of acquirers in comparison.

Due to this unique association setup, the costs associated with your Visa and MasterCard transactions are a controllable/variable expense, much like labor or food costs. In order to understand how to control costs, you must first understand what makes up a rate. Even though you may not see these categories broken out separately on your monthly statement, there are three major components that make up your Visa and MasterCard rate: discount, assessments, and interchange. Based on a \$100 Visa CPS Hotel qualified transaction with a discount rate of 20 percent, the fees are allotted as follows: discount (10 percent), assessments (5 percent), and interchange (85 percent).

Discount is the portion of the rate charged by your merchant processor to cover the cost of actually processing the transaction for payment. Discount may be billed as a percentage, a per transaction fee, or a combination of both. This fee is usually a set rate and varies from processor to processor. Many people are often surprised when they realize just how little of their fees actually go back to the

merchant processor. Because your merchant processor's name appears on your credit card statement along with all your fees, it makes the merchant processor appear to be the bad guy when there are really three parties with their hands in your pockets: your merchant processor, the Associations, and the issuers.

Like all associations, Visa and MasterCard need money to fund their administrative, operating, and marketing expenses. As a member of the Association, your merchant processor is required to collect assessments on behalf of Visa and MasterCard. These assessments are passed directly to the Associations to cover their expenses. Assessments are a set rate and are actually a nominal amount of your total rate. Today, Visa's assessment fee is .084 percent or \$0.084 per hundred dollars processed and MasterCard is slightly higher at .095 percent or \$0.095 per hundred dollars processed.

Now for the most complicated component of your rate: interchange. As a result of the numerous Association member banks that issue and acquire on behalf of Visa and MasterCard, exchanging the credit card transaction data is quite complex. The technical communication process of authorizing and settling a Visa or MasterCard transaction looks like a masterfully spun spider web with transactions bouncing all over the world from data center to data center, bank to bank, acquirer to issuer. That is what makes Visa and MasterCard so unique and challenging. This process has also led to what hotels know all too well today as "interchange," which is the process of exchanging or rather interchanging this data from acquirer to issuer. Interchange has become a frustrating and evil word in the hospitality industry due to its varying cost structure, but it need not be.

Interchange is not only the largest cost component of your overall rate, but is also the only rate component that is truly controllable. As a member of the Association, your merchant processor is required to collect Interchange on behalf of Visa and MasterCard. The Interchange charged to you by your merchant processor is actually paid to the bank that issued the card in which your guest presented for payment at your property. Interchange represents the card-issuing bank's

incentive fee for getting the card into the marketplace. For example, if one of your guests were to use their CitiBank Visa card at your property, the interchange fee related to that particular transaction would actually be returned to CitiBank via the interchange process.

The amount of interchange you are charged is determined on a transaction by transaction basis. Both Visa and MasterCard have numerous interchange levels (i.e. rates) with varying regulatory requirements related to each level. The limited length of this article does not allow me to go into interchange with much detail. However, I will focus on some quick fix operational procedures you can implement today to more efficiently manage your Visa and MasterCard transactions and reduce overall costs related to interchange.

Operationally, there are a few things you can do at your property to ensure you will receive the lowest interchange rate possible on a transaction by transaction basis. First off, always swipe the card whenever possible. Both Visa and MasterCard offer lower rates and increased chargeback protection for those transactions that are swiped versus key-entered. Regardless of whether you use night audit or day accounting, it is imperative that you settle your credit card transactions on a daily basis, including over the weekend. The Associations have an interchange timeline regulation that can only be met if you are submitting your transactions every day.

From a management prospective, it is important to look at your Visa and MasterCard fees in the same way you consider other controllable/variable operating cost. The problem with this is that a typical hotel P&L statement does not breakout Visa and MasterCard fees from other credit card fees. Thus, a quick glance at the credit card fee line of a typical hotel P&L does not tell the whole story. An easy way to get around this is to calculate your "effective" Visa and MasterCard rate each month.

Most hotels have a "bundled" rate from their merchant processor in which the discount, assessment, and interchange fees are combined under a single rate. In this scenario, in addition to your base rate, you will see a separate billing

on your statement for "non-qualified" interchange, which is the difference between the interchange fee assumed in your base rate and the actual interchange level at which a particular transaction qualified. In order to calculate your effective rate, divide your total credit card processing fees on your monthly statement into the net Visa and MasterCard volume processed. This gives a figure that represents the total dollars spent on processing those receipts.

If the effective rate is calculated each month, an ongoing comparison can be performed and a benchmark established after the first few months. If any particular month significantly exceeds this running average, it can indicate that there is an interchange qualification problem and further action may be necessary. While this method gives you a good "birds eye view" of a potential problem, it does not allow you to pinpoint the exact interchange category contributing to your increased costs.

When your rate is bundled, you have no ability to directly calculate or manage your variable cost of interchange.

The first step to truly monitoring your interchange is to request your merchant processor to bill your property on what is known in the credit card industry as interchange and assessment pass through. This not only ensures you pay the true costs of these fees, but it also allows you to monitor the costs of these fees separate from your discount rate.

If interchange is broken out separately, you can quickly identify a major problem if the majority of your transactions are qualifying at a higher interchange rate when they should be qualifying at a lower rate. This allows you to more closely pinpoint the problem (which is more than likely a technical issue) and work with your merchant processor to resolve the issue as quickly as possible.

Most importantly, don't fall victim to rising transaction costs. Take control and squeeze that transaction turnip until it bleeds! Your budget (and your owners) will thank you. ■

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