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Leap Payments Touting Simple Pricing

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By Sara Lepro

Will Detterman, the chief executive of Leap Payments Inc., admits he's taking a big chance in adopting a payment card acceptance pricing model that bucks the traditional formula.

"We make less money," Detterman said.

But the potential upside of offering merchants of all sizes what's known as "interchange-plus" pricing will hopefully pay off in the long run, he said.

Leap Payments, an Agoura Hills, Calif., company Detterman founded a year and a half ago, announced last month that it would begin charging merchants the interchange rate on card transactions plus a small markup in an effort to simplify the fee structure and be more transparent. The markup is the same for every transaction but the exact mark up depends on the size of the business.

Interchange-plus pricing is not unheard of in the industry, but it's historically only been offered to large companies with high card volume. It's also not the typical model used by independent sales organizations like Leap Payments.

Historically ISOs — one of the many groups in the payments space — have made their money by charging a variety of fees and with complex pricing schedules, analysts said.

Detterman is trying to set his business apart with a more transparent pricing model, which analysts said might trigger a pricing war among ISOs and force companies in other parts of the payments industry to rethink their pricing. It's also a sign of how tough the current market is.

"Here in the United States, most merchants accept credit cards," said Thomas McCrohan, an analyst with Janney Capital Markets. "Signing up merchants now is a takeaway game. Third-party resellers, ISOs, those are the ones getting squeezed by the current market."

Sanford Brown, the chief sales officer of Heartland Payment Systems Inc., a Princeton, N.J. acquirer and processor, agreed.

"I think as merchants become more educated they are going to demand to know what they're paying and why," he said. The poor economy has "driven more merchants to pay attention to this and ask questions."

"It's tougher and tougher for independent sales organizations to survive," he said. Heartland has offered interchange-plus pricing exclusively for the past five years, Brown said.

Leap Payments offers clients processing services from Elavon, U.S. Bancorp's merchant processing unit.

Merchants may choose to go directly to Elavon for processing, or, they could work through Leap Payments, which says it now offers even the smallest merchants the type of pricing that is typically only offered to large companies that process a higher volume of card transactions.

"There are a lot of variables that are considered when we offer interchange-plus pricing," said Holly Lytle, a spokeswoman for Elavon.

Rod Brown, the chief financial officer of MadeToOrder Inc., a customized apparel maker in Pleasanton, Calif., said interchange-plus was not an option for his company with Elavon, so he switched to Leap Payments at the end of last year.

MadeToOrder, with revenue of between $10 million and $15 million a year, does about $1.5 million to $2 million in credit card transactions a year — about the size of business that Leap Payments is targeting.

"Typically those with $50,000 or less" in monthly card volume "are never offered this type of pricing," Detterman said.

MadeToOrder spent about $70,000 to process credit card transactions last year, or nearly $6,000 a month in transaction fees, Brown said. Since switching to Leap Payments, Brown said the company now pays "$5,000 and change" a month — a nearly 20% savings.

Leap Payments serves more than 2,000 merchants that average between $500 and $500,000 in credit card transactions a month.

Interchange rates, which are set by the major credit card processors like Visa Inc. and MasterCard Inc. and funneled back to the consumer's bank, vary depending on the type of business, the method the merchant uses to process the card and the type of card used during a transaction. For example, rewards cards often carry higher interchange rates than a basic card.

Instead of merchants trying to keep track of every rate for every different kind of transaction — Visa and MasterCard's lists of rates are several pages long — processors generally follow a blended pricing model where they group certain rates together and charge a set rate. So, for example, for every type of transaction that has a rate of 1.10% or less, the company may charge a rate of 1.20%.

"It makes it easy for the merchant, very convenient," said Adil Moussa, an analyst at Aite Group. "But for the acquirer, they make a lot of money that way."

This model, though, has tended to hurt smaller business owners that process fewer card transactions.

"Historically, the biggest clients have gotten the lowest price per transaction," said Rafi Mohammed, the author of "The 1% Percent Windfall," a book on pricing strategy. "And since it's been less competitive to have smaller businesses, there's been more room for margins and pricing schemes."

Detterman, who has held senior management positions at Wells Fargo & Co., Citigroup Inc. and Intuit Inc., also said his pricing model could be a benefit to clients if pending legislation changes the way the interchange rates are set.

If Visa and MasterCard were to lower their rates at some point because of public pressure or policy changes, Detterman said his simplified model would not require merchants to deal with a lot of complex changes. Whereas a company that offers blended pricing might have to reshuffle how it groups rates.