

More Options, More Issues

When it comes to accepting payments, small retailers face big challenges

by FRED MINNICK

America's Main Streets were once proud and bustling havens for small retailers, the place families went for gifts and necessary provisions, candy and clothing. Over time, though, the advent of big-box stores saw local retailers slowly losing customers to cheaper prices. In order to remain competitive, they cut prices and saw lower profits; many eventually went out of business.

The Main Street-versus-big box dynamic has even generated a subgroup of economists. Some said retail behemoths destroyed small businesses and hurt employment while others said they bolstered the economy and created jobs. All tended to agree, however, that the combination of larger stores and the Internet made it much harder for small businesses to compete.

Today, however, it appears that reports of the death of downtown may have been premature. In the past 10

nearly 4 million. The National Retail Federation estimates that 95 percent of retailers are small businesses with only one location.

So perhaps the demise of small business was exaggerated, but there's no disputing that small retailers face significant challenges, among them how consumers pay for items. And as more shoppers pay with plastic, all retailers face higher credit card fees. While credit card interchange or "swipe" fees average only 2 percent of each transaction, they total an estimated \$30 billion annually. The fees are based in part on a merchant's card transaction volume, so small businesses bear a disproportionate share of the burden.

A REAL CONCERN

Those in the card industry say small retailers that don't accept credit cards are creating more problems than they are solving.

"You are trying to avoid paying a couple percentage points on something that's going to bring you more revenue," says former retailer Jason Richelson, founder of cloud-based iPad point-of-sale system ShopKeep. "Taking credit cards is a service. My grocery store would take credit cards for a \$2 coffee because our customers ... remember that as great service, and then they come back."

NRF Senior Vice President and General Counsel Mallory Duncan, who has become a payments expert through retailers' congressional and courtroom battles with the card industry, disagrees.

"Small retailers need to consider all the issues before deciding to accept credit cards," Duncan says. "They need to know that they are going to give up roughly 2 percent of their revenue to fees and are going to subject themselves to data security requirements. And the idea that consumers

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years, Main Street retailers have enjoyed an incredible resurgence, using the Internet to their advantage and offering goods and services big-boxes lack. Some major metropolitan areas have blocked larger retailers through zoning and launched enthusiastic "buy local" campaigns — American Express got in on the act as well, introducing Small Business Saturday in 2010.

According to the U.S. Small Business Administration, small businesses have created 8 million new jobs since 1990, while large corporations have cut



Gwen Pruitt, Tangible Things



spend more if you accept credit cards is a myth — unless they want to end up bankrupt, consumers still can't spend more than their income, and the various fees and interest paid on credit cards actually reduce their buying power."

Either way, credit card fees are a real concern for small businesses, and it's felt every day.

Take Chicago-based Tangible Things. The small retailer with monthly sales between \$7,500 and \$11,000 offers an eclectic mix of holistic health and beauty products, antiques and collectibles, textiles, locally made jewelry and glassware.

Tangible Things accepts Visa, MasterCard and American Express, but wants to look into other forms of payment to "keep our processing fees low," says co-owner Nancy Jackson.

Bob Jones III runs American Sale, a small pool and patio retailer in Tinley Park, Ill., and he, too, feels the pinch of card fees. Jones, a member of NRF's Small Business Retail Council, says the fees eat into his company's profits.

"We are happy to accept all forms of payment as long as they make sense from a cost standpoint," Jones says.

"The credit card fees we pay now are our fourth-largest cost after product, payroll and rent. This is why retailers are very sensitive to the interchange fees and would be excited to see other payment types competing with Visa/MasterCard that have lower rates and also are more resistant to fraud."

Budding Co., a family run home-and-garden retailer in Horsham, Pa., with close to \$1 million in annual revenue, processes around 1,400 credit card transactions a month during the peak season. Spokesman Hoyt Bangs says credit card sales "have grown exponentially" since 2008, but the company accepts cards only on its website.

"In our stores we accept cash and check, but checks have dropped significantly. The cards act as a [form of] backroom accounting, but the ... transaction fees eat into the gross profit, especially on larger patio jobs."

The fees that impact Tangible Things, American Sale and Budding — three drastically different businesses — have inspired their own subset of small businesses within the card industry.

Interchange fees themselves are non-negotiable, but Fattmerchant, a processor founded by former credit card

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executive Suneera Madhani, claims to save retailers an average of 40 percent on the litany of other line-item fees and hidden charges tacked on by typical merchant service providers, including batch fees, statement fees, maintenance fees, data security compliance fees, monthly minimums and customer service fees.

"For a small business, every dollar counts, so all of these ancillary fees add up," Madhani says. "They're really wringing dry the businesses they work with."

PAYMENT TECHNOLOGIES

With the advent of smartphone-friendly payment systems such as PayPal or Square, small retailers found themselves with more payment options than they could imagine. Many offer no contracts and unprecedented ease of use. But what's really dictating

how small retailers process cards isn't the swiping mechanism or fees — it's the software.

"In the great small retail landscape, there's the definite increase in small businesses adopting web-based POS systems," says Justin Guinn, market researcher for Software Advice, a subsidiary of information technology firm Gartner. "You see a lot of small business retailers looking for inventory management and reporting and analytics built into their POS system, as well as some customer-relation management tools."

Today, small businesses no longer rely solely on accounting programs like QuickBooks. They're using data-mining tools, customer relationship management software and analytics software to study and predict consumer behavior and measure credit card sales performance. Card terminals are far down the priority list.

"There are many payment options available to smaller retailers," says Gordon Russell, CEO and founder of Lilly Pulitzer retail chain In the Pink. "Retailers that don't have sophisticated business requirements such as inventory management, transfer, customer and purchase order management can opt for a simple payments approach like Square or numerous others."

"But retailers who have more complex requirements need to focus on aligning with a modern and flexible software system that enables the growth and profitability of their business," he says. "If they don't have that, they won't need to worry about the payment part. Get the right software system for your business first, then figure out the payments side."

Nonetheless, only 37 percent of respondents in Software Advice's quarterly small business survey actually use POS software; 44 percent don't use software to manage transactions.

This trend might have more to do with the way POS systems are traditionally set up. Guinn says small retailers don't want a main terminal or

"big bulky systems.

"They're really going for something on their smartphone or tablet-based now that they have the ability to turn their entire floor into a point of transaction with a mobile POS system," Guinn says. "That's something that's going to increase in adoption over the next few years."

In fact, the whole payment industry is in the middle of a major shift that's taking out the middleman, Richelson says.

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"Traditionally, point-of-sale software has been a local install," he says. "There's always local people selling those." But with cloud-based technology and tablets, retailers can implement POS software themselves.

BREACHES

Accepting credit cards also subjects small retailers to responsibility for data security, and those issues will become more complicated with new Europay MasterCard Visa cards that add a computer microchip. Under current rules, banks and retailers split responsibility for fraud, with the bank responsible for ensuring that the card is legitimate and the retailer responsible for ensuring that the user is legitimate. Beginning in October, banks will no longer honor their half of the arrangement if a chip card is used to commit fraud and the retailer does not have a chip card reader.

NRF has voiced concern because

most banks have refused to take the additional step of replacing easy-to-forge signatures with personal identification numbers, as is done in almost all other countries where EMV cards are used.

"The October liability shift associated with EMV support is top of mind for retailers of all sizes," Russell says. "It will not be a good day when the retailer receives a chargeback of hundreds of dollars from their bank because they are not compliant with EMV."

"No longer will it be the banks' responsibility if fraudulent activity occurs," Madhani says. "The burden will fall onto the shoulders of the business. This liability shift is the reason businesses should adapt to EMV technology."

NRF's Duncan says small retailers' exposure to increased liability might not be as large as most reports indicate, and depends, in part, on what they sell. To start, banks are moving slowly in issuing the new cards and only about half of consumers are expected to have a chip card by the end of the year. And criminals seeking to commit fraud with chip cards will most likely go after big-ticket merchandise rather than using them at the corner coffee shop.

According to Software Advice surveys, 69 percent of small businesses doubt they will have chip terminals by October. If anything, there's more interest in Apple Pay, Google Wallet and even accepting payment through social media. But regardless of the approach, Richelson says small retailers should be cautious.

"You really can be put out of business if you get breached and get into a lot of trouble," he says. "It is really important to be on some sort of encrypted terminal." **STORES**

Wall Street Journal best-selling author Fred Minnick's latest book is *Whiskey Women: How Women Distilled, Marketed and Bootlegged Bourbon, Scotch & Irish Whiskey*. View his work at FredMinnick.com.