Overview

Complexity is growing in the world of payment processing. Visa and MasterCard now have over 200 rate categories. Do you know which rate categories affect you? Do you understand the fees detailed on your monthly statement? If not, this tip sheet is for you.

By better understanding how the payment processing industry prices its services, you will be better able to manage this expense and its impact on your bottom line. You will also be better armed to evaluate providers and which program is best for you.

What is Interchange?

Every processor starts with the same underlying rates from Visa and MasterCard. These rates, called Interchange, are then passed on to you with a small margin or they are bundled into a few rate categories, typically "Qualified", "Mid-Qualified" and "Non-Qualified." Interchange includes both a percentage of the sale price and a flat, per transaction fee—typically $0.10 or $0.15.

How to Calculate the Cost of a Transaction

While each merchant processor is free to establish its own rates and fees, most use a similar method for assessing fees on a transaction.

Fee	Description
Interchange Fees	Percentage of the sale + a flat, per transaction fee, typically $0.10 or $0.15. These are the fees charged to the merchant providers by Visa and MasterCard. The merchant provider typically adds a small margin to these fees.
Authorization Fee	Flat, per transaction fee (e.g., $0.10). This is the fee merchant providers charge when authorizations are completed at the time of sale. This is the process by which the card issuer approves (or declines) a card purchase.
Transaction/Settlement Fee	Flat, per transaction fee (e.g., $0.12). This is the fee merchant providers charge when the transaction settles (e.g., automatic batch settlement at night).

Thus, for a typical transaction, the cost is calculated as follows:

Fee	Calculation	Example
Interchange Fees +	(Sale Amount x Rate Category %) + Flat Fee	($100 x 2.0%) + $0.10
Authorization Fee +	+ Flat Fee	+ $0.10
Transaction/Settlement Fee	+ Flat Fee	+ $0.12
Transaction Total	**Total Fees**	**$2.32**

Factors that Shape Your Pricing

The pricing you see as a merchant is shaped by three factors: (1) volume; (2) transaction risk; and (3) card type used.

Factor	Details
Volume	Payment processing is a volume-driven business. Pricing improves as your sales volume increases.
Transaction Risk	Risk is determined by the method used to process transactions. For example, transactions where the card is swiped are less risky, and therefore less expensive, than transactions where the card is not present and authorizations are done over the phone or on the Internet.
Card Type Used	Visa and MasterCard have many different card types in the marketplace, including rewards cards, corporate cards and debit cards, among others. Each card category has its own set of rates.

Key Metrics to Use

At the end of the day, there are two key metrics that are easy to calculate and tell you the bottom line. Knowing these two key metrics helps you price your product profitably and budget for success. These metrics are:

1. **Net Effective Rate:** Your net effective rate is simply all fees you pay for payment processing divided by your total net Visa and MasterCard transaction volume. For example, if you paid $100 in total fees last month and your total sales volume processed with Visa and MasterCard was $5,000, your net effective rate was 2.0%. This is an easy calculation to make with two caveats. One, be sure to determine the impact of any credits. Processors should not (but sometimes do) charge you Interchange on credits. Two, be sure to exclude any Discover and American Express volume and charges from the calculation.

2. **Average Transaction Cost:** Your average transaction cost is calculated by dividing your total number of transactions into your total fees. Like the calculation of your net effective rate, be sure to exclude any Discover and American Express transactions.

Conclusion

Managing your bottom line requires you to understand your net effective rate and average transaction cost. There are a number of things that determine what you pay, including things that you control. It is important to understand these things and work with a processing partner that helps you qualify for the best rates possible.