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Go Vertical, Young ISO

This year's ETA meeting was very interesting—of the many new and emerging angles we encountered in terms of what were the most sought after acquisitions, there appeared to be one common theme amongst acquisitive ISO's – niche specialization. Being an industry insider and dealing with buyers and sellers every day, I have been accustomed to seeing a merchant portfolio's value enhanced through a broad spectrum of diversified SIC codes, geographic locations, and a large component of traditional brick and mortar businesses. Well, times are changing. Welcome to the dawn of enhanced value through NON-diversification, specialization and ancillary products.

Let's face it, the product that most ISOs are selling is a pure commodity. When you're selling a commodity for a living, the only way to take yourself out of the realm of competition based solely on pricing is to find a way to differentiate your product and or services. Typically, this type of differentiation or enhanced value is sold to a merchant in the form of a higher level of quality customer support and or service. Essentially, ISOs are de-commoditizing what essentially is a homogenous product. Much of the value created by better customer support and service manifests itself in minimal losses of merchant accounts. Yes, that's right, good old attrition maintenance (a.k.a. retention) is the end game which creates value (especially in the eyes of a buyer). Successful ISOs have effectively managed to brand themselves or at the very least differentiate themselves from the pack. I've learned to have tremendous professional respect for those who have managed to do that against all odds.

The problem is that most of the other ISOs have become aware of this methodology as well, and now what we're seeing in the market place is a commoditization of high quality service and support, which was the next level of differentiation in the ISO world other than just superior pricing. This leaves the ISO's with several questions: "How do I differentiate my ISO now?", "Where do we go from here?", and "How do I (once again) de-commoditize my offering to merchants?"

We are now seeing ISOs and processors looking towards all sorts of verticals and specialties. As an established ISO with a substantial base of merchant accounts, you've already successfully managed to push your way into the lives and day-to-day operations of your merchants. If you can successfully find ancillary office goods or services to offer your merchants – that also generate recurring revenue, then you can successfully leverage your existing merchant base and expand your revenue stream. For the same reason that accounting software manufacturers have had interest in the processing and ISO world, we are seeing larger ISOs and processors now looking at related back-office products and services as a way to permanently entrench themselves with the merchant.

ISOs are looking toward specific verticals such as niche segments within various industries. ISO's are availing themselves of a specific knowledge they may have within a certain sector, a technology piece which allows them to integrate into a niche market, or sometimes even the fact that they have implemented bi-lingual speakers into their service and tech support allowing them to cross into what was previously considered to be a demographic they couldn't make inroads into. There are ISOs now focusing exclusively on Chinese restaurants, for example. These ISOs have built out the appropriate

multilingual support necessary to keep their clients happy and thereby have relatively low attrition, other than natural attrition due to business closings. There are ISOs focusing exclusively on service stations. Other ISOs are focusing on becoming the merchant processor of choice for specific trade associations and industry groups. The underlying portfolios of these ISOs, therefore, are focused on a particular niche – which is different from what we saw a few years ago.

The successful ISOs that are going after trade associations are not only using phone, direct mail, and email campaigns, they're going to the trade shows. They are forging the relationships with the association members and leadership that will not only help them land accounts, but they are forming relationships that will help them with merchant retention, when a merchant is approached by a competing ISO via the phone, who "has a better deal for them". Some of the more creative approaches also include offering ancillary goods and services that the particular association members routinely have to use or reorder on a regular basis.

Another trend we're now seeing is that non-traditional portfolios with e-commerce books of business are coming into their own. We were used to encountering portfolios that may have had a component of internet and/or MOTO business in the past as part of their overall portfolio. And make no bones about it, this had a deleterious effect on a valuation do to the fact that e-businesses are/were traditionally viewed as higher risk (card-not-present) and not as "sticky" as brick and mortar. The increased risk associated with that flightiness of e-commerce companies drove down valuations. But now there are more and more ISOs that are focused exclusively on one or both of these card-not-present areas. And considering the huge shift in consumer online purchases that is still underway, why wouldn't an ISO be interested? Attitudes towards e-commerce have just changed from undesirable to acceptable; in some cases they've shot right past acceptable and now reside in the "most wanted" category for many ISO's- and firms acquiring ISOs and portfolios.

More and more firms are availing themselves of some type of proprietary technology, whether it is software, hardware, or even a gateway which allows them to integrate with the needs of a niche market. Regardless of the method, market pressures have forced ISO's to think outside of the box in identifying and capitalizing on new areas for revenue growth. The old adage "grow or die" has never loomed more ominously on the horizon. Today's ISO is all about growth and retention and going vertical seems to be the current pathway towards that end.

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