

Choosing a Growth Strategy for Your ISO

There are two primary ways to grow your ISO- organically, through your existing sales efforts, and through acquisition. There is a trade-off between the two strategies: on the one hand you could ratchet up your existing marketing efforts with additional financial investment, and on the other hand you could appropriate additional funds towards an outright ISO or portfolio acquisition. In contemplating an acquisition, you need to do a significant amount of evaluation, not the least of which is your internal client acquisition costs. You need to know how much it presently costs your firm to acquire an individual merchant account including all marketing efforts and overhead. With this information, you can begin to evaluate the trade-offs between expanding your existing sales operation and purchasing an ISO or portfolio.

Generally speaking, expect to pay significantly more money on a per-merchant-account basis to acquire an ISO or portfolio as compared with your own internal merchant account acquisition costs. If you find that you are able to acquire ISOs or portfolios at a lower per-merchant acquisition cost than you can internally, you may want to reevaluate your sales operation's cost structure or eliminate your sales efforts and grow through external acquisitions alone. The more typical scenario is the case where an ISO determines an equilibrium between external acquisition and internal growth, as opposed to the acquisition-only scenario.

Your per-merchant account acquisition cost of buying a portfolio or ISO will normally be a multiple of your internal acquisition costs if you're running efficiently. Assuming that the costs are higher to acquire externally, you might ask why so many companies acquire portfolios and ISOs? There are many reasons; the ability to grow significantly faster than would be possible by internal growth alone, the ability to achieve significant growth in profitability by taking advantage of more favorable processing terms, the ability to take advantage of market "arbitrage" opportunities by purchasing smaller portfolios and ISOs at lower multiples than the multiple your company is valued at, and the ability to diversify/expand into new or unique markets.

The first of these four reasons is self explanatory. If you are boarding 100 merchants a month, and you purchased an ISO that is also boarding 100 merchants a month, then you've effectively doubled your monthly account growth – at a price. You've sacrificed capital in an effort to save time. You paid a multiple of your internal account acquisition costs in order to double the speed of your future growth. It may have taken you a year to board 1,200 accounts previously whereas now with the new acquisition you can board 2,400. There may also be some additional economies of scale which allow you to board even more accounts by leveraging off the resources of the combined operation.

The ability to increase bottom line profitability through acquisition may not be as clear. How can I increase profitability if I'm paying a higher multiple per-merchant account to acquire another ISO than my current per-merchant acquisition costs using my own internal sales force? The answer typically lies in the underlying ISO agreement of the potential acquisition target. Let's say that you own a First Data

ISO and you're contemplating purchasing another First Data ISO. The idea of purchasing to increase profitability revolves around the fundamental idea that your ISO agreement is superior to the one in place at the prospective acquisition target. If the prospective acquisition target's transaction costs are significantly more than yours, due to an inferior ISO agreement, and you can move the accounts to your agreement (check with your attorney) at a preferential pricing structure, despite the fact that you may pay more on a per account basis, the acquisition may bring immediate profitability by extending the strength of your ISO agreement to those newly acquired accounts, which falls directly to your bottom line. I can't stress enough the importance of having a strong group of knowledgeable advisors to assist you in your analysis. An attorney who specializes in negotiating and understanding merchant processing ISO agreements is a good place to start.

Market "arbitrage" is the ability to take advantage of the spread between the lower multiple valuation of small portfolios and ISOs and the higher multiple your company is or will be valued at as you continue to grow in size. A portfolio or ISO with 100 accounts will typically sell for significantly less on a per-account basis than a portfolio or ISO with 5,000 accounts. If you can purchase an ISO or portfolio at 20-30 times monthly residual and if your company (being larger) is valued at 50 or 60 times monthly residual (these numbers are for illustrative purposes), then the acquisition will be accretive to the value of your firm. For each \$1.00 you spend, you're theoretically adding \$2.50 to the value of your ISO or portfolio.

Finally, the ability to diversify or expand into new or unique markets is one of the other major reasons for making the decision to acquire an ISO or portfolio – the acquisition being "strategic". Let's say your merchant accounts are presently concentrated in a certain geographical region or a certain industry sector. You may contemplate diversifying by purchasing an ISO or portfolio which helps you to spread the risk either geographically or across another industry. Perhaps your portfolio is primarily composed of MOTO or card-not-present merchants. You may contemplate acquiring a brick-and-mortar ISO or portfolio to diversify the risk. Alternatively, maybe your base is primarily brick-and-mortar retail, and in order to avoid some of the risks of a recessionary contraction in those areas, you decide to try and find an ISO or portfolio consisting primarily of petroleum accounts or online sales.

In all of these cases, you have to pose a very clear understanding of many factors; understanding your ISO agreement, the ISO agreement of the portfolio or ISO you are looking to acquire, attrition, average age of the accounts, account make-up (brick and mortar, internet, MOTO, etc), account activity (whether or not the account is processing a healthy amount of transactions every month), geographic and industry diversification, and risk concentration (is there an inordinately large percentage of the monthly residual being produced by a very small subset of accounts)- to name a few. A thorough understanding of these factors will allow a prospective buyer to begin to evaluate whether or not acquisition is the right strategy for them.

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