

Optimized Payments Consulting, Inc.

Comparing Merchant Services Across Wholesale Clubs

November 17, 2008

Anand Goel

www.optimizedpmts.com

anand@optimizedpmts.com

404-542-8520

Wholesale clubs like BJ's, Costco and Sam's provide fantastic value when you want to buy in bulk, but how competitive are they when you are looking to buy merchant services for your business?

Payment processing, specifically credit card processing, is one of the most confusing and complex services that businesses buy today. Although the top seven payment processors control over 90% of Visa and MasterCard credit/debit transactions processed in the U.S., there are thousands of resellers and referral companies. In fact, 99% of banks today resell merchant services or refer their customers to an outside processor. For example, Wachovia refers business to Elavon (formerly Nova Information Systems) and SunTrust refers business to First Data Merchant Services.

Given the competitive nature of payment processing, it is possible to get a good deal for your business. It is also very easy to get lost and taken in by all the marketing, teaser rates and complex rate structures. As The Wall Street Journal noted in an article titled "Charge It!" on Aug. 20, 2007, "navigating the payment-card processing system can be an overwhelming and costly burden."

Wholesale Clubs simplify the process by offering standardized pricing to all of their members. Moreover, Wholesale Clubs are aligned with some of the largest processors in the U.S., so you can expect reasonable and comparable levels of service (see Table 1).

Table 1: Wholesale Clubs & Processor Partnerships

<u>Wholesale Club</u>	<u>Processing Partner</u>	<u>Relationship with Processor</u>
BJ's	Chase Paymentech Solutions	Referral Partner
Costco	Elavon (formerly Nova Information Systems)	Referral Partner
Sam's	First Data Merchant Services	Reseller

So how do these clubs stack up when it comes to price and overall value? That's a complex question but we have tried to answer it by running a sample retail and Internet merchant through the pricing of all three Wholesale Clubs. Table 2 shows the sample credit card processing profile of these merchants.

Table 2: Sample Merchant Profile

	Retail	Internet
Annual Visa/MC Net Sales	\$250,000	\$250,000
Average Ticket	\$40	\$80
Visa %	67.0%	67.0%
MasterCard %	33.0%	33.0%
Settle/Auth Ratio ¹	96.0%	93.0%
Number of Settled Transactions	6,250	3,125
Number of Authorization Attempts	6,510	3,360
Annual Returns ²	5.0%	7.0%
Key Entered Transactions w/AVS ³	5.0%	100.0%

¹For every 100 authorizations attempted, the number of transactions that are settled

²Product returns for refund

³Percent of transactions not swiped through a magnetic reader and require address verification

Merchant Pricing Comparison

One of the most challenging aspects of comparing pricing across different payment processors is that they not only bundle their pricing and fees differently, but they also use different names for similar fees. Sure, if you invest the time you could understand all the nuances and find the common denominator but who has the time?

With that in mind, here are the **retail** and **moto** (or mail order/telephone order) rates you will get when you call the toll-free number advertised at these clubs.

Table 3a: Retail Credit Card Processing Pricing

	<u>BJ's¹</u>	<u>Costco</u>	<u>Sam's - 3-Tier</u>	<u>Sam's – 2-Tier</u>
Qualified Rate	1.69% + \$0.15	1.64% + \$0.20	1.64% + \$0.19	1.64% + \$0.19
Mid-Qualified Rate	2.86% + \$0.15	2.83% + \$0.31	2.64% + \$0.29	n/a
Non-Qualified Rate	3.37% + \$0.15	3.69% + \$0.31	3.39% + \$0.29	3.53% + \$0.29
Rewards Rate	2.56% + \$0.15	1.78% + \$0.20	N/A	1.88% + \$0.19
Non-Qualified-Commercial Rate	N/A	3.41% + \$0.31	N/A	N/A
Check Card Qualified Rate	1.67% + \$0.15	1.64% + \$0.20	1.64% + \$0.19	1.64% + \$0.19

¹BJ's uses differential pricing with 1.69% as base rate for "qualified transactions." All other transactions are charged 1.69% + interchange differential + 0.75%. All downgrade rates are representative.

Table 3b: MOTO Credit Card Processing Pricing

	BJ's¹	Costco	Sam's - 3-Tier	Sam's - 2-Tier
Qualified Rate	2.20% + \$0.15	1.99% + \$0.27	N/A	1.98% + \$0.26
Non-Qualified Rate	3.55% + \$0.15	3.69% + \$0.31	N/A	3.87% + \$0.26
Non-Qualified Commercial Rate	N/A	3.41% + \$0.31	N/A	N/A
Check Card Qualified Rate	2.18% + \$0.15	1.99% + \$0.27	N/A	1.98% + \$0.26
¹ BJ's uses differential pricing with 2.20% as base rate for "qualified transactions." All other transactions are charged 2.20% + interchange differential + 0.75%. All downgrade rates are representative.				

In a retail environment, most basic swiped Visa and MasterCard transactions will fall into the qualified category, and everything else “downgrades” to mid-qualified or non-qualified rates. Typically, key-entered transactions are mid-qualified and rewards cards either fall into their own category, as they do for Costco and BJ’s, or fall into the non-qualified category as they do for Sam’s. Most of Optimized Payments’ retail clients see less than 60% of their transactions fall into the qualified category. Therefore, the low qualified rate can be misleading since a large percentage of the overall transactions are charged rates high as 3.69%.

Adding to these rates are various additional fees noted in Table 4.

Table 4: Miscellaneous Fees

	BJ's	Costco	Sam's
Statement Fee*	\$0.00	\$4.95	\$4.95
Chargeback Fee	\$10.00	\$10.00	\$9.95
AVS Fee	\$0.00	\$0.00	\$0.10
Deposit/Batch Fee	\$0.15	\$0.00	\$0.29
*Waived for Costco Executive members and Sam's Club Plus members			

In order to compare pricing across these Wholesale Clubs, a sample retail merchant noted in Table 2 is put through a pricing model containing all the pricing and fees from Tables 3 and 4. For our sample retail merchant, BJ’s and Costco seemed to have the most favorable pricing (Table 5). Costco is only \$9 more per year and Sam’s two-tier pricing is only about \$250 more per year. Obviously, the results and cost differences will vary with retailers with different profiles, qualification levels and average tickets. For instance, merchants with lower average tickets (less than \$40) will benefit from BJ’s pricing due to their lower per item fees, and merchants with higher average tickets will benefit from Costco’s pricing due to their lower qualified rate. Sam’s three-tier pricing is beneficial for retailers who key-enter significant number of sales. Otherwise, its two-tier program is more competitive. Sam’s falls to the back of the pack since it charges an AVS fee and higher batch fee.

Table 5: Retail Pricing Comparison Summary

Retail Summary			
	<u>Total Annual Cost</u>	<u>Effective Rate</u>	<u>Rank</u>
BJ's Wholesale	\$6,802	2.72%	1
Costco Wholesale	\$6,811	2.72%	2
Sam's Wholesale - 2-Tier	\$6,730	2.69%	3
Sam's Wholesale - 3-Tier	\$7,576	3.03%	4

The same analysis conducted for a sample Internet or Mail Order/Telephone Order merchant reveals similar results (Table 6). BJ's and Costco are very close in overall cost and value. BJ's ranks higher due to its lower per-item fee and lower non-qualified rates even though its qualified rate is higher. BJ's updated its pricing while data for this analysis was being gathered. Its new pricing with Chase Paymentech allows it to be much more competitive with Costco and Sam's.

Table 6: Internet/Moto Pricing Comparison Summary

Moto Summary			
	<u>Total Annual Cost</u>	<u>Effective Rate</u>	<u>Rank</u>
BJ's Wholesale	\$7,061	2.82%	1
Costco Wholesale	\$7,120	2.85%	2
Sam's Wholesale - 2-Tier	\$7,951	3.18%	3
Sam's Wholesale - 3-Tier	n/a	n/a	n/a

Each of the Wholesale Clubs has certain strengths but, collectively, they also have significant shortcomings because of their one-size-fits-all programs. Table 7 outlines their individual strengths.

Table 7: Wholesale Club Strengths

<u>BJ's</u>	<u>Costco</u>	<u>Sam's</u>
low per item fee - great for merchants with lower average tickets	no AVS fee - great for key-entered transactions	3-tier program competitive for retailers who key enter more than 5% of their sales but swipe more than 85% of their sales
no AVS fee - great for key-entered transactions	no batch or deposit fee	2-tier program competitive for retailers who accept large percentage of rewards cards and have minimal keyed sales. It is difficult for most merchants to know which cards are rewards cards.
most competitive pricing for merchants with average tickets of less than \$40	most competitive pricing for merchants with average tickets of more than \$40	

Merchant services offering from these clubs provide reasonable and competitive pricing for smaller merchants. Moreover, these clubs ensure that a business doesn't get gouged by deceptive offers or unscrupulous resellers.

The downside of the merchant offerings from these clubs is that they present one pricing program (or two in the case of Sam's) regardless of the size and dynamics of your business. Even if your business grows from \$250,000 to \$1 million in annual sales, you will still get the same rates. If your business does more than \$1 million in annual credit card sales, you can get a much better offer in the marketplace. Specifically, here are three areas where you can save thousands of dollars:

1. **Discount rate refunded for sales returns.** When a customer returns \$100 worth of goods to your store, you refund the customer \$100. However, the fee you paid to process the original credit card transaction (let's say 2.0%) is still kept by your payment processor. This is pure profit to your processor. A competitive program will return the 2.0% back to the merchant. The processor will keep the original per-item fee and may charge \$0.10 - \$0.30 to process the refund. Paying \$0.10 - \$0.30 to get \$2.00 back is not a bad deal. A merchant with \$1 million in annual sales and a return rate of 5% paying 2.0% discount rate could save \$1,000 per year.
2. **Lower rates or a completely different pricing plan.** Merchants with more than \$1 million in sales could save at least 0.20% in overall processing costs from the current pricing offered by Wholesale Clubs. This could result in \$2,000 in annual savings for a merchant with \$1 million in sales.
3. **Significantly lower signature debit rates.** Signature debit transactions cost payment processors about 0.50% less in a retail environment and about 0.30% less in an Internet/Moto environment compared with credit cards. Costco and Sam's do not offer lower signature debit rates, and BJ's signature debit rates are only lower by 0.02%. A merchant doing \$1 million in business with 20% signature debit sales could save \$400 per year if the signature debit rate was lower by 0.20%. This is reasonable to expect in today's marketplace.

Comparing Merchant Services programs from BJ's, Costco and Sam's is not as clear-cut as one might expect. BJ's and Costco seem to have the most competitive offering with Sam's not too far behind. All Wholesale Clubs offer reasonable levels of service backed by the largest processors in the industry. However, these offerings are less competitive for larger merchants or merchants with unique needs.

Anand Goel is an expert in the payments industry and founder of Optimized Payments Consulting. Optimized Payments helps companies increase their profitability by reducing credit card processing costs on a risk-free basis.