Payment Processors: Everything You Need to Know

As a business owner, there are an overwhelming amount of things to check off on your to-do list before you can run your business. There are many guides and notes to help you get started with inventory and loans. Here is a handy dandy guide on payment processors and acceptable payment methods.

Whether you have a brick-and-mortar store or an online eCommerce platform, arranging a way for your customers to buy and check out is not as a simple as saying it. Instead, picking a payment processor to verify and confirm credit and debit card transactions takes time and research. So let's get started with the basics of credit card processing.

Payment Processors: Basic Concepts

What is a payment processor?

A payment processor is a company that handles transactions so that your customers can buy your products. That means the payment processing company communicates and relays information from your customer's credit or debit card to both your bank and your customer's bank. If there are enough funds in your customer's card and it is valid, the transaction will go through. And all of this all happens in a matter of seconds.

The payment processor also checks for security measures such as making sure that the customer's card data is correct. Fraudulent practices occur sometimes, so the payment processing company's duty is to ensure that doesn't happen.

In addition, if a customer argues and proves that your company incorrectly charged them, the payment processor will take care of the accidental transaction. But that doesn't mean that they'll do it for free. Of course, the customer will not get charged, but your company will. So if you accidentally make an error during checkout or a customer isn't satisfied with an item and returns it, your company will incur a fee for having to transfer money from your account to the payment processor and back to the customer's account.

What is a merchant account?

Merchant accounts are essential to businesses, especially those that accept credit cards online. Without a merchant account, you cannot accept money from a customer's credit or debit card because you have nowhere to put the money. So a merchant account is a bank account that accepts debit and credit card payments. Without it, a business could not accept these payment forms.

What is a payment gateway?

The payment gateway connects the payment processor and merchant account to the credit or debit card companies such as Visa or American Express. In essence, it's connecting your customer's financial account to your merchant account. Without a payment gateway, you would be missing a major part of completing a financial transaction. You would have all the parts needed to move your money or receive money, but without a payment gateway, you cannot receive your customer's payment.

Payment processors and merchant accounts can be combined with a payment gateway. It just depends on if they use a third party source or have a department in-house to do the work. If a third party is used, the third party communicates with the credit card company to complete the transaction.

Who is involved in payment processing?

A payment processor helps your business conduct transactions between your customer and your business. Many players are involved, but there are about five to six key players in any transaction.

1. The customer
2. The business/merchant
3. The payment processor
4. The payment gateway (if not combined with the payment processor)
5. The customer's bank/credit card company
6. The business's bank

Applying for Payment Processors: The Process

Where do I get a payment processor/gateway?

You can apply for a payment processor through a bank, online providers, and companies such as PayPal.

How can I get the lowest pricing for a payment processor?

There's no direct answer, so you're going to have to do some research. Just as there are wholesale options for products, there are wholesale options for processing rates. But keep in mind that you typically won't find them listed as wholesale; instead, they'll be called "interchange fees."

Before you go around asking every company about their interchange fees, go look to see what the company charges normally. You don't want to go in and ask how much they offer because you'll end up paying more than you should. Do your research and haggle the price down to something that both parties can afford.

That said, pricing alone should not be the key criteria for selection. Consider other aspects of their service such as making funds available quickly, batch processing times, and customer support.

Merchant Account Application: Approval Questions

What is the approval process for a merchant account?

Applying for a merchant account combines aspects of applying for a loan and applying for a job into one. A merchant account requires financial statements, processing history, and a cover letter. Explain to the bank through those three items why you should be approved for a merchant account and why you are not too high of a risk for them. While certain banks have different limits for the amount of risk they will take on, you have to figure out how high of a risk is comfortable for you, too. Higher risk means you'll be paying more fees, and you will be earning less money.

What if I get denied? What do I do then?

Getting declined for a merchant account is similar to why you might get declined for a bank loan—you don't have enough history. So if you're starting your first business, the banks can't assess what you've done before, so they'll think of you as a risky investment. If you wait a bit and develop a more extensive financial history, you'll be better off.

If you've been in business for some time and you still get declined, talk to the bank. Ask them to see what's wrong. Find out if there's anything that you can do in the short term or long term for the decision to change. And sometimes talking to them in person might help clear up anything questionable from your financial history or cover letter. Clarifying can convince them to change their decision.

And if all else fails, try a different bank that will take on higher risk. Just keep in mind that there are many negatives such as higher fees every month or year that come with a high-risk merchant account.

Payment Processors: Getting Started

What types of payment methods do payment processors accept?

Depending on the company you use will determine your answer for what types of payment methods payment processors accept. As a general rule of thumb, the typical Visa and Mastercard will be widely accepted while American Express might not be. Different cards have different fees and risks, and payment processors look at those factors. Research which cards your payment processor accepts before locking yourself into a deal that doesn't accept what you want it to.

Debit cards and various other methods will also be generally accepted, but the type of card that businesses accept determines how much they have to pay the payment processor. The cheaper the card fee, the more likely you're going to use them in your business.

What types of fees might I encounter when using a payment processor?

Fees, fees, everywhere should be the phrase of the payment processor. According to About's Business and Finance section, there are 10 widely known fees that occur when using a payment processor.

1. Start-up/annual fee
2. Monthly statement fee
3. Discount rate
4. Transaction fee
5. Minimum monthly fee
6. Credit card processing equipment lease charge
7. Gateway fee if you have an internet merchant account
8. Chargeback fees
9. Address verification fee
10. Termination fees

Online Payment Processing: Another Consideration

What about online payment processing?

Online payment processing follows a similar format as a brick-and-mortar store's payment processing. The main thing to keep in mind is that payment processing online requires a merchant account or an aggregator such as PayPal. And there might be additional fees related to your shopping cart and acceptance of payment methods (Think credit and debit cards).

The process of the payment goes through a similar process as a brick-and-mortar store. Here are the steps:

1. The customer makes a purchase
2. The customer pays using a card
3. The merchant submits a credit card transaction
4. The payment gateway sends off the secure transaction to the processor

5. The transaction, verification process, and approval process occur through the processor
6. The customer's bank sends the money to the processor and then to the merchant's bank
7. The processor sends the gateway an approved or denied status
8. If approved, the message is sent to the merchant
9. The merchant receives the payment

What happens if I already have an eCommerce platform selected?

Leading eCommerce platforms such as Magento and Shopify support a whole host of payment gateways and processors. Keep in mind though that if you want to use the same payment processor as you use with your brick and mortar store, you may have to resort to a 3rd party payment gateway such as authorize.net. Your payment processor may not be supported directly by the eCommerce platform. This will mean more fees for processing credit cards. It is not uncommon for businesses to switch payment processors when getting onto a new eCommerce platform.

Alternative Methods: Further Options

What if I don't use a payment processor? How can I accept payment?

If you avoid payment processors like the plague, you'll be avoiding fees from payment processors and gateways. However, you might be deterring some of your customers away. If your customers can't use widely popular payment methods such as credit and debit cards, what else can they use? Well, typically there are four options: cash, check, money order, or store credit. If you live in a town where credit and debit cards aren't widely used, then maybe a payment processor isn't right for your store. But if you have a brick-and-mortar store in a large town or have an online platform, you may need to rethink the idea of not using a payment processor.

Learn More About Kabbage's Payments Product

Kabbage now offers invoicing solutions for small businesses through Kabbage Payments™! Learn more about payment processors, gateways, funding for essential equipment and more today!