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Cash advance crossroads: High commissions or more sales?

By Woochae Chung
American Microloan LLC

The merchant funding industry's landscape has changed drastically since its introduction. There are many new cash advance companies and scores of processors, ISOs and merchant level salespeople (MLSs) using cash advance as a way to generate revenue and get new merchants.

It has become an everyday event to find out you just lost your merchant to another company because the merchant took a cash advance from a company not affiliated with you.

There have also been developments in the legal arena. Rewards Network Inc. settled a class action lawsuit in California for a sizable amount.

And AdvanceMe Inc. just had its patent invalidated in the U.S. District Court, Eastern District of Texas. AdvanceMe is appealing the case, but many think it is a long shot.

This ruling will undoubtedly bring on an influx of cash advance companies.

(For more information on legal issues, see "AdvanceMe patent ruling opens merchant funding floodgates," *The Green Sheet*, Sept. 10, 2007, issue 07:09:01 and "Time's up for one cash advance patent," by Adam Atlas, *The Green Sheet*, Sept. 24, 2007, issue 07:09:02.)

As ISOs and MLSs, your greatest dilemma in selecting a cash advance affiliate relates to commissions. Should you go with the company that pays the highest commission? It seems like a simple question, but here is the catch. ISO commissions have a direct relationship with merchants' cost-of-capital.

In most cases, the more expensive the advance is to the merchant, the higher the commission to ISOs and MLSs. And the more expensive it is to the merchant, the more difficult it is for ISOs and MLSs to close a deal. Commissions can range from 4% to 6% or higher.

That brings up the second question. What is your primary goal: growing your portfolio or growing short-term revenue?

Many payments professionals who have been providing cash advance as a value-added service have found that merchants will immediately move their processing business if they find another service provider offers a lower-cost cash advance company or can provide more money even if it is at a higher funding cost.

The ones moving to the lower-cost cash companies even for a slightly smaller advance amount are usually in better financial condition than those seeking more money. The more solvent merchants are likely to borrow again, and more often. They also tend to be higher volume, which means larger advances.

If your primary goal is to grow your portfolio and help your merchants prosper, which will inevitably increase their credit card volume, you must take on a fiduciary responsibility to your merchants. You must think long-term for their businesses, as well as your own. Ask yourself this question: Would I take this cash advance for my own company?

Also think about your closing success rate. Would it be easier to sell a lower-cost item if the underlying item is the biggest commodity of all, money? Wouldn't I be able to sell a lot more if it is easier to sell? The answers to these questions are obvious.

The next question would be the size of the potential market. The hospitality industry alone reaches $400 billion a year. If you add retail to this equation, the total market is huge. Now, what percentage of this immense market would accept the cash advance product and at what price?

Let's use the most common cash advance pricing as an example: $13,500 of future revenue for $10,000 cash now. I know cash advance companies are very sensitive about the terms they use. But to a merchant, it means one thing. The cost of capital for $10,000 is $3,500.

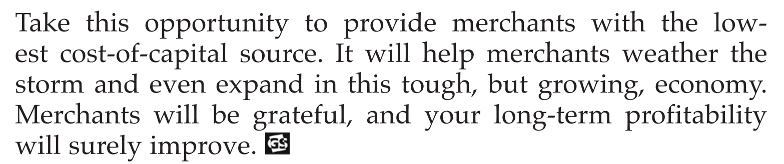
The number of merchants who will accept that kind cost of capital is much smaller than the number of merchants who will accept $2,000 per $10,000 cost-of capital, and so on. The higher the cost of capital, the lower the number of willing merchants and vice versa.

This applies to all of us as consumers. I am sure you have done price-comparison shopping. Wal-Mart Stores Inc. and Target Brands Inc. didn't become the largest retailers in the United States by charging as much as they can. The less you charge, the more you make.

The cost of capital for $10,000 can vary from $1,200 to $7,000 or higher. Market conditions are constantly changing, and

you must adapt to them. The recent gas price hike, credit crunch and mortgage crisis probably made smaller merchants suffer the most.

Consumers just don't have the discretionary spending ability they used to have. The money they used to spend on dining out and high-definition TV is now earmarked for gas and mortgage payments. Even the larger and well-established merchants are feeling the shift in consumer spending patterns.



Take this opportunity to provide merchants with the lowest cost-of-capital source. It will help merchants weather the storm and even expand in this tough, but growing, economy. Merchants will be grateful, and your long-term profitability will surely improve.

Woochae Chung is Managing Director of American Microloan LLC. Contact him at wchung@americanmicroloan.com or 201-592-9925.

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