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E-commerce entrepreneurs ante up for higher risk transactions



E-BIZ

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One of the most vexing challenges for any small business seeking to establish a store on the Internet is obtaining the accounts necessary to accepting credit card orders on-line. These are known as merchant accounts.

One typical problem was expressed by an entrepreneur in an E-mail message: "We are a small business doing business on the Web and find the Canadian banks . . . tend to be the major hurdle in [electronic commerce]." The person wrote that banks "want us to put up collateral before they will let us set up an account with them. Even with collateral, they want to take almost 5 per cent of my business."

I encounter this situation often: people plan to set up an on-line store, only to see their hopes dashed by financial institutions that demand a fairly large chunk of each credit card transaction, or that want a big deposit up front.

This isn't necessarily a situation of "big bad banks" working against entrepreneurs. Financial institutions are faced with a situation that entails much higher risk than with a retail store, where people present credit cards in person. Given the higher risk, it is only natural that they demand more of the merchant.

An Internet-based credit card transaction fits within the "card-not-present" or "mail order telephone order" (MOTO) risk category used by financial institutions for more than 20 years. They have long required more collateral and higher transaction rates from MOTO accounts, given the absence of demonstrable physical proof of the credit card used.

Quite simply, in a retail store, there is physical proof of the transaction: Individuals cannot later say they didn't use the card (unless they can prove it was stolen or lost). This isn't the case with an Internet, mail or telephone order transaction.

So financial institutions consider a MOTO transaction to be of higher risk. If customers state they have not made a charge that appears on their statement, the transaction is charged back to the merchant. That's the nature of a MOTO account.

Therein lies the risk: The financial institution may find itself with a whole bunch of chargebacks that get passed on to the on-line store. And if that store suddenly goes out of business, as some do, the financial institution will be left holding the bag for those chargebacks.

Bankers hate risk. That's why higher risk means higher collateral and larger transaction fees.

So what can you do to deal with this reality? Approach the issue of obtaining a merchant account as though you were applying for a loan: Be professional, and be prepared. This can go a long way to reducing the demands placed on you. If you convince the financial institution that you are a lower risk, it can help substantially.

First, provide the institution with your business plan, income statements, company history and other essential background information about your on-line store when applying for a merchant account. Don't approach the issue lightly.

Second, it can be worthwhile to seek out staff at the institution who are familiar with the Internet and E-commerce. Financial institutions recognize that they have a huge challenge on their hands in educating all of their staff about E-commerce, and acknowledge that there are some people who just aren't up to scratch with regard to the Internet.

You may end up with a better arrangement if you deal with someone who is in the know, and who can more realistically assess the risk of doing business with you.

Third, shop around. You may find that if you approach several different financial institutions, you can reduce what you will pay for each transaction and the collateral required by a very significant degree. Some financial institutions are aggressively interested in the small-business marketplace, and are willing to share the risk.

Fourth, be aware of alternatives to applying for your own merchant account, but understand that you will pay even more to use them compared with what financial institutions may offer you. These organizations will set you up so that you can accept credit card orders on-line without having to obtain a merchant account.

Obtaining merchant status is frustrating and not necessarily easy. But you have a better chance of coming out a winner if you understand the situation from the perspective of financial institutions, and do what is necessary to persuade them you are a good risk.

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