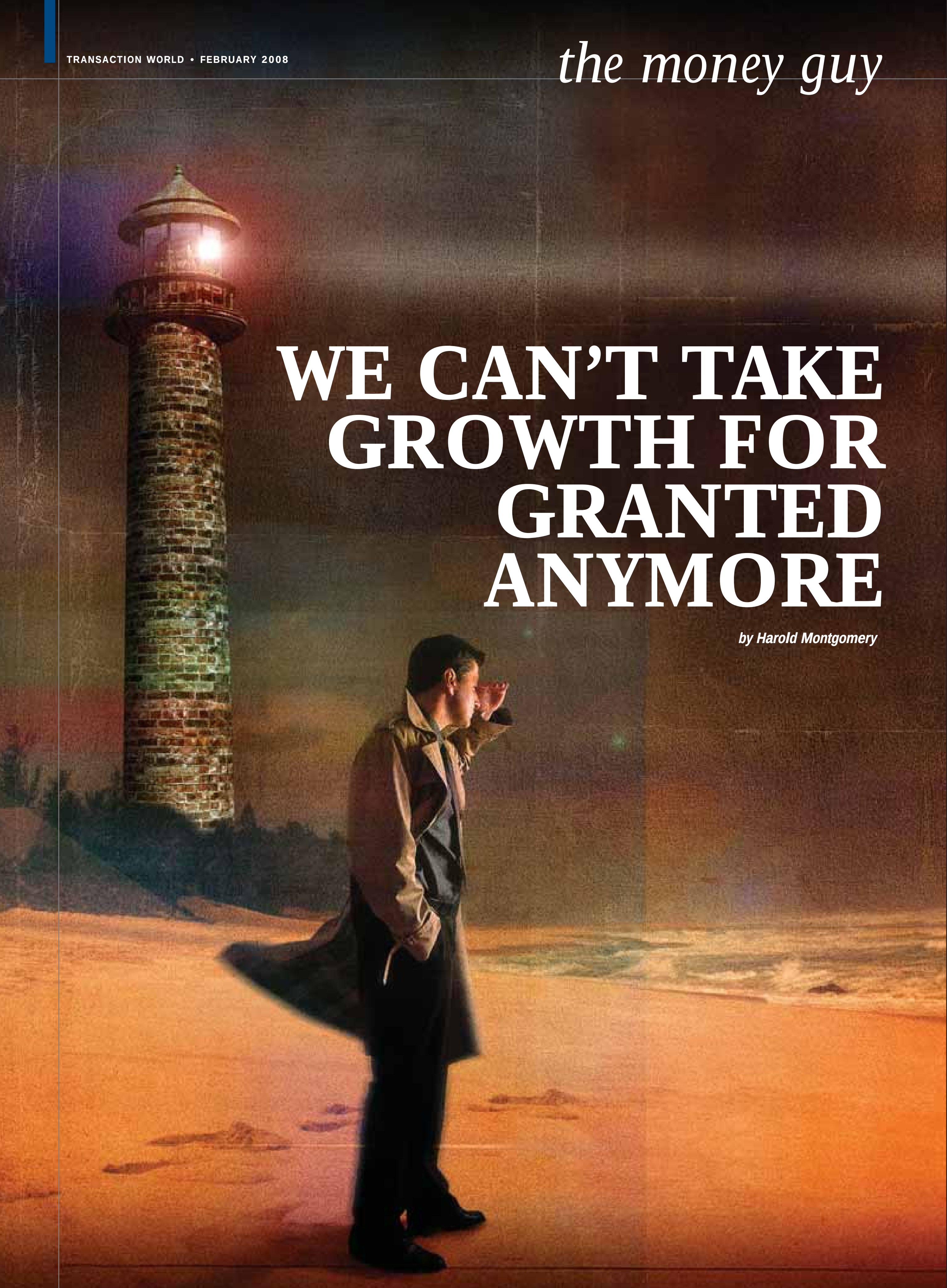
the money guy

WE CAN'T TAKE GROWTH FOR GRANTED ANYMORE

by Harold Montgomery



2008 is going to be a different kind of year for the Acquiring industry and ISOs in particular. We're facing a number of circumstances that have not appeared before. Together, with the trends that are appearing, they will make for a rough year.

First for the first time I can recall, it appears that consumer spending using credit cards slowed in late 2007. Recent Federal Reserve data indicates that credit card spending increased at an annual rate of 2.3% in October, 2007. While that was faster than September's 1.6%, it was less than half the pace of earlier in the year.

"Furthermore, credit card issuers have been pulling back with approval rates across the industry dropping to 33% from 41% a year ago", according to Robert Hammer, CEO of RK Hammer, a bankcard advisory firm. That means the pool of consumers with cards is not growing as fast as it has in years past. It also means issuers are more conservative.

Of course, we still have the sub prime lending debacle coursing through the economy and producing unexpected results. That and high gas prices combined with the perception of falling home values conspired to keep holiday sales down. By early December, it was clear this year's holiday season was getting off to a slow start. Many retail chains reported same store sales for November were flat to down. Given the weekend after Thanskgiving has the biggest shopping days of the year, that's not good news.

Can this be a surprise? Well, no, not really. Anyone who has been looking has noticed that the typical American consumer is stretched thin financially. Add that into this brew of bad economic news, and the result is weak retail sales. It may be adding up to a recession.

In past slowdowns, our industry has compensated for a flattening or declining amount of consumer spending through two magical forces: Increasing card penetration among consumers and increasing acceptance in stores. These two miracles pulled our industry toward consistent double digit growth year after year. Life was beautiful.

Things are a little different now. Retail stores that need credit card acceptance have it. The market is substantially saturated. There's not a great expectation that the pool of accepting merchants will grow appreciably. It seems to me that for years, our industry has claimed more 'new' merchant applications than there are truly new merchants – meaning that we're stealing merchants from our competition.

If weak fourth quarter retail sales are followed by weak sales into 2008, we could see small retailers close their doors in large numbers. Many small retailers count on the holiday season to make their profit for the year, and without it, they can't survive.

As for the expanding market share of payments overall, the main battle going on now at the point-of-sale is to convert cash to debit, not credit. All of Visa's advertising I see is geared toward the cash-to-debit conversion. That's not all bad for us, because we still get residuals from debit transactions. But it does show that the last frontier (cash) is upon us, and that credit as a product is moving from adolescence to middle age fast.

What does this mean for our industry? It's not good. A sustained slowdown in retail sales plus fierce price competition in our market is the double whammy we've never seen before. Because of pressure on consumers, this could be the year in which per merchant residuals don't grow, and they could even shrink. This industry has never seen anything like it before and most people have no previous experience to cope with a trend like that. We'll all be making it up as we go, I think.

Small retailers going out of business, flat consumer spending, a general recession all combine to scare people away from our business. Nowhere is a cliché more appropriate than in finance: "Capital is a Coward." Investors are not looking for risky deals right now. The markets just don't have the go-go attitude they did in 2000. Investors have either taken a beating or have seen someone near them take one. They're not in an aggressive mood right now, and they probably won't be for the next year or maybe two.

That caution is exactly what prolongs a recession, but it also saves investors from losing money. It also means capital, which is hard to get in our business in good times, will be very scarce indeed. That means fewer deals getting done and less money to do them. That means there is the potential for falling prices.

When investor uncertainty rises due to adverse economic conditions and lack of clarity on basic elements of our business like growth, capital hesitates. And when it hesitates, prices fall or transactions don't get completed.

Smart entrepreneurs know where they can find enough cash to make one months' expenses fast. In this environment, I would recommend two months as a cushion. What used to be a rainy day fund is now a survival fund.

2008 has the early makings of being a watershed year for our industry. Look for tough times ahead and difficult conditions. And look for them to persist. Buckle your seatbelt and hang on to some cash. It's going to be a bumpy ride.

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