Demystifying Credit Card Processing for Nonprofits

Most nonprofits accept credit cards. Why? Because donors love the convenience and perks, such as airline mileage, that they get when they pay by credit cards; and because your nonprofit can benefit from the quick collection of funds and the tendency for donations by credit card to be larger (one recent study noted a 20% increase over non-credit card gifts).

Accept credit cards to automate the fulfillment of pledge payments or monthly giving programs!

But with more and more nonprofits offering donors the ability to make various types of electronic payments, there is the potential for plenty of confusion. Your organization could end up with the wrong processing solutions and even end up paying more than you need to for processing transactions. In this article, we'll try to demystify electronic payment technology and provide some useful guidance on avoiding pitfalls.

What types of payments?

The first place to start is to identify what types of payments you will be processing. Here are some possibilities to consider:

- Will the payments be one time or recurring (e.g. monthly pledge payments)?
- Will they be donor-initiated, for instance via your web-site, or processed by your staff?
- Will you usually have a physical card to swipe?
- Will the payments simply be for donations, or is there a product or service involved such as an event ticket or fundraising premium?
- Do you also want to be able to process payments as direct transfers from a donor's bank account?

Why do these questions matter?

They're critical, since the type of payments strongly influences the processing technology you will need, as well as your processing costs. For example, you certainly wouldn't want to have to key every donor's credit card information and payment amount into a credit card terminal each month to process their recurring monthly gift. Not only would this be a lot of unnecessary effort, it is also prone to errors and even presents security risks, since you would need to store the credit card data somewhere.

Recurring vs. One-Time Transactions

For most nonprofits the majority of their payments are one-time in nature, meaning that there is no need to retain the credit card information. However, one of the most beneficial uses for electronic payments is to automate the fulfillment of pledge payments or monthly giving programs. To handle this type of payment efficiently and securely requires a processing solution that makes it easy to store the credit card or banking information for Automated Clearing House (ACH) transactions. That way, payment transactions can be generated automatically – based on the pledge amounts and payment schedule.

Constituent-Initiated vs. Staff-Processed Transactions

Another important factor in finding the most appropriate processing solution is whether you want constituents to be able to initiate a credit card transaction themselves via your website, or if all transactions will be processed by your staff.

For staff processed transactions, the most important consideration is minimizing the effort and risk of errors. The optimal solution will allow you to authorize the transaction in real-time (so you know the information entered is correct and the funds are collectible), and that automatically records the payment onto the constituent's donation record. Solutions that require you to separately record the payment not only mean more work, but also increase the potential of human error. Integrated solutions also make it a snap to reconcile your processing statements.

Constituent-initiated transactions via an organization's web site are certainly one of the fastest growing areas for nonprofits. Although much of the money raised this way has been driven by major disaster relief efforts, more and more nonprofits are discovering ways to make it easier for constituents to make payments online and thus increase their fundraising success.

The three most important considerations for constituent-initiated transactions are:

- ***Ability to handle all the types of transactions needed*** – Although it is relatively simple to allow someone to enter their credit card information and a payment amount, most nonprofits have a need for many different types of transactions (donations or memberships chosen from a variety of participation levels, honorariums/memorial gifts, pledges, special events, fundraising item sales, etc.) It is obviously critical that the solution you choose is capable of presenting the information constituents need to make necessary selections, as well as collecting the myriad of specialized information (t-shirt size, seating preferences, etc.) that can be associated with these transactions.

- ***Process that gives constituent confidence*** – Once you have gotten a constituent to your online form, the last thing you want is for them to be concerned about completing the transaction online or confused with how to proceed. The keys to this are providing a solution that clearly states that all processing is secure (see "Pitfalls" for more on this topic) and to offer a solution that clearly explains each step of the process and does not introduce confusing requirements. Generally, the more flexibility a product offers, the easier you'll be able to create a process that maximizes your results.

- ***Administrative ease and efficiency*** – Optimally, you want a solution that makes it easy to perform all the necessary tasks to track & acknowledge the transaction. Here are a few important aspects to consider:
    - Notification of the transaction
    - Ability to review completed (as well as non-completed) transactions
    - Simple download of transactions (and related information) into your donor management and/or accounting system
    - Easy issuing of any necessary credits/refunds
    - Availability of online tools for reporting and analysis of transactions
    - Ability to acknowledge the transaction (by email and/or letter)

Getting a Merchant Account

Credit card processors label anyone who processes transactions a merchant and hence your processing account is called a Merchant Account. Merchant accounts are financial accounts through which payments are made. Since the financial institutions that issue merchant accounts take some financial risk if the cardholder disputes a transaction, applying for a merchant account typically involves providing information necessary for a credit review.

Some solutions for processing credit cards do not require you to have your own merchant account. This may seem appealing since it can eliminate the time and effort to establish your own account and, in some cases, also eliminates application and monthly fees associated with having a merchant account. These processors accomplish this by using a merchant account that they have established in their own name to process your transactions. However, unless you expect to process very few transactions each month, such arrangements expose you to lots of potential problems, including delays in receiving your funds and constituent confusion when the name associated with the transaction on their credit card bill doesn't match your organization's name. See the "Pitfalls" list below for more problems with third-party accounts.

Understanding Merchant Account Fees

There are many different elements to the fees you will be charged and many nonprofits find it difficult to directly compare various accounts since there is no simple and consistent way such fees are presented. To help you understand, let's first separate fees that are one-time from fees that are ongoing.

One Time Fees - There are frequently fees charged for getting established with a merchant account. They may be called Application Fees, Setup Fees, Gateway Setup Fees, etc., but they are all essentially the cost to get started. There may also be one time costs for software or equipment needed to process transactions. Sometimes the cost of software or equipment will be an ongoing monthly expense if it is provided as a web-hosted solution or if equipment is leased.

Monthly Account Fee - Almost all merchant accounts will have some type of monthly fee. It may be called a statement fee, account fee, reports fee, etc., but regardless, it is simply an ongoing cost of having the account available. Some accounts have multiple monthly charges. These fees typically range from $10-30/month. Other accounts impose a monthly minimum fee as an alternative (or in some cases in addition) to the monthly fees.

Transaction Fees & Discount Rate – Typically, there are two components to the cost of processing each transaction – a per item fee (usually between $0.20 and $0.50) and a fee that is a percentage of the transaction amount, called a Discount Rate. The discount rate can range substantially (usually between 2-4%) based on the type of credit card and the method of processing used. For example, if the discount rate offered is 3%, and you receive a payment of $100 you will be charged $3 as the processing fee. Most of this money goes to the card issuing company such as Visa, MasterCard, etc. (they call this an "Interchange" fee).

The challenge with comparing and understanding these fees is that most merchant statements do not present the fees as simply as this. For instance, often the discount rate is broken into components such as a rate that represents the Interchange rate and another line item that represents the additional charge from the processor (the company that facilitates and sends the transactions to the various credit card companies). In this case, you need to add both fees together to find the true cost. Further complicating matters are the many different rates that can apply to a transaction depending on the type of card used. This is not just if it is Visa, MasterCard, or Discover, but also if it is a Rewards card, Corporate card, Debit card, etc. Other factors affecting this fee include how the transaction is being processed (swiped, keyed in), and even if it passes certain fraud prevention tests such as "Does the address associated with the transaction match the billing address of the credit card?"

According to the credit cards companies, the countless different rates reflect the different levels of associated "risk." For instance, they feel there is a greater risk to transactions done without the physical card being swiped. This penalizes phone, mail and Internet transactions.

Unfortunately for nonprofits, most of their transactions are not done face-to-face and fall into this category called “card not present” or “mail order telephone order (MOTO)” transactions. MOTO processing rates can also vary substantially based on the type of card and your organization’s processing volume - but it will typically be ½ to 1% higher than a physically swiped transaction.

The card types and processing methods will often affect the fees you are charged by dictating if the transaction is treated as qualifying or non-qualifying (for the best rate) transaction. Non-qualifying transactions are charged a higher or additional percentage, and not all processors use the same standards for qualification of transactions.

Pitfalls to Avoid

Third Party Processing, which are solutions that process transactions on your organizations’ behalf through their merchant account. Potential problems with this type of processing

1. **Delayed receipt of funds** – Unlike when you have your own merchant account, where funds collected are automatically deposited immediately, “agent” processors typically mail payments only once or twice a month.
2. **Risk of non-payment** – Since the third-party is holding your money, your organization is also exposed to loss if the third-party is not financially strong.
3. **Chargeback risk** – Donors are far more likely to dispute charges on their credit card statements that do not clearly identify the source of the charge. Having your own merchant account allows your organization name & phone number to be displayed on the donor’s statement. Charges processed via a third-party’s merchant account will typically have the third-party’s name (e.g. Donations-R-Us, GiveNow.Com, etc), which are often not relevant to the cardholder. Often, they will simply call their credit card company and dispute the charge. This will, at a minimum, result in extra charges (called Chargeback fees), as well as extra work for you and your donor, and may result in your loss of the donation.
4. **Inflexibility** – Most third party processors, such as PayPal, offer little if any ability to customize the payment forms. This can limit your ability to collect critical information, such as the person being honored for a memorial or honorarium.

For a glossary of common terms and acronyms associated with credit cards and electronic payments, visit donorperfect.com/ccterms

Debit cards – Banks have done a great job promoting the use of debit cards and they continue to grow as a method of payment. The problem for the organization being paid is that they can be a relatively expensive way to collect funds directly from a person's bank account. Debit cards are processed through the credit card networks, and like credit cards, the fee is a percentage of the amount being charged. Although the discount rate for debit cards can be lower, they are often processed at the same rate as credit cards. So for example, the fees for a $100 donation will be $2-3.

If available, the better alternative is to use what are often called "eCheck" transactions, which are processed through the Federal Reserve ACH (automated clearing house). These transactions normally incur a flat per transaction fee (typically less than $.50). Your savings can become very substantial on larger transactions or with high volumes of transactions.

Security Issues – The protection of credit card information is a paramount concern for the credit card industry and there are many initiatives with numerous acronyms (CISP, PCI) that are imposing tighter rules on the handling and storage of credit card data. The bottom line is that, if possible, you do not want to store credit card information. If you do, it must be secured. In computer form, this means both password protected and encrypted, with similar protection of paper records that include credit card information.

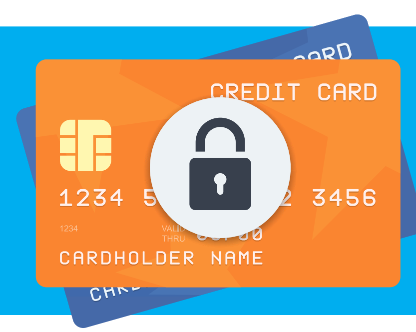
Currently, many of the most onerous rules apply only to organizations that process large volumes of transactions, but there is a clear trend toward continuing to tighten controls throughout the credit card world. As a result, the current practices of many nonprofits, such as keeping a list of donor credit cards to process each month, will need to change. Even worse are web forms that collect credit card information on a non-secure server (note: you can quickly tell if the server is secure by looking to see if the web site address starts with https:, not just http:), or forms that simply generate an email that lists the credit card information.

You simply don't want to put your donor's information at risk or expose your organization to fines.

Shopping carts and other ill-suited tools - There are numerous companies that offer online merchant accounts along with various types of online store or shopping cart applications. These can be an appropriate solution if your nonprofit is interested in offering products for sale, but typically are poor solutions if your organization wants to offer donors the choice of different donation or membership levels or for special event registration. This is because the features of online store/shopping carts include things like shipping options, sales tax, "checkout," etc. that can only serve to confuse constituents and perhaps reduce the likelihood that they will complete the online transaction.

DID YOU KNOW?
Nearly 80% of U.S. non-cash payments are now electronic!

source: www.stlouisfed.org



Final Thoughts

Hopefully, you now have a better understanding of the various tools and technologies that can be used by your nonprofit to efficiently process credit card and other electronic transactions. Here is a quick summary of the most important points:

- The processing technology needed is a function of the type of transactions (recurring vs. one-time and constituent-initiated vs. staff-entered) to be processed.
- Unless your nonprofit will be processing very few electronic payments, it is worthwhile to use a solution that provides for your own Merchant Account.
- Transaction processing costs can be hard to compare and decipher. When comparing alternatives consider all costs – even non-direct ones such as staff time to enter data.
- Don't ignore other types of electronic payment processing such as ACH transactions, which can compliment credit cards and often lower your processing costs.
- The simplicity, security, and administrative efficiency of your online process can often be the most critical aspect of a successful solution.

With a better understanding of the subtleties of transaction processing you are well on your way to ensuring that your nonprofit has the right solution in place. The benefits of convenient & efficient processing of electronic payments can truly be significant for both your constituents and staff.

About The Author

Doug Schoenberg is CEO of SofterWare Inc. He has spent over 20 years working with nonprofit organizations. He currently sits on the board of several nonprofits and is a frequent speaker and author on topics related to nonprofit management and technology.

SofterWare Inc. CEO Doug Schoenberg

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