Entrepreneur

Considering Credit Card Surcharging? Here's What You Need to Know.

The method of passing the extra costs of credit card usage to customers using credit cards is becoming ubiquitous, but there's still a lot many businesses don't know about the practice.

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In the past decade, the digital revolution has been driving businesses to change the way they accept payments. The number of American credit card users is growing—and merchants are paying for it. Last year, merchants in the U.S. processed $7.58 trillion in card transaction volume and paid over $116 billion in fees. For many merchants, the cost of offering credit cards is the second-highest operating cost after payroll.

These costs are only increasing — total credit card interchange fees collected by Visa and Mastercard more than doubled between 2012 and 2019. Some businesses handle these rising costs by refusing to accept card payments, limiting payment choices for their customers. Others raise their prices for all customers, which forces customers paying with cash and debit to cross-subsidize someone else's credit card rewards.

Some businesses have come to see these fees as an inevitable cost. Still, for entrepreneurs, the hit to the bottom line can be overwhelming, taking away valuable resources from innovation and growth opportunities. Surcharging provides an alternative, allowing businesses to pass on the cost of acceptance to customers who choose to pay with credit cards. With surcharging, customers continue to have no-fee options, like paying with a debit card.

Since surcharging was first introduced to the U.S. in 2013, many states with legacy "no-surcharge" laws, including California, Florida, New York, and Texas, have overturned or narrowed their limitations. This model is now permitted in 46 states, with no signs of slowing down: just last December, Oklahoma Attorney General Michael Hunter reversed the state's ban on surcharging. Surcharging is the rare issue that has policy support across the political spectrum—as I've previously been quoted saying, surcharging may perhaps be the only issue supported by both Senator Elizabeth Warren and the Cato Institute.

It's still a little complicated

With such broad-based support and clear economic benefits, why has surcharging not become ubiquitous already? Many merchants who are eager to get started with surcharging assume that it simply entails "adding a fee." However, through implementation, they quickly realize that this assumption overlooks numerous requirements or best practices in operations and IT — how they will address customer messaging about surcharges, incorporate surcharges into their online checkout experience or invoicing tools, reconcile deposits to their bank account or handle cash application for transactions that now include surcharges, as well as handle the implications for receipts and refunds. On top of these requirements, the staggering compliance overhead raises the barrier to entry for surcharging; card brand rules from Visa and Mastercard, along with the evolving state law landscape, regulate surcharging practices and create complexity for merchants.

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And these rules are being actively enforced.

Take Riverside Cafe, for example. The Wichita-area restaurant paid over $60,000 in a settlement case with their county's District Attorney after implementing a 4 percent credit card surcharge. The restaurant's lawyer said the owner had taken the word of a credit card company who told him that issuing a surcharge was permitted.

Kansas, the home state of Riverside Cafe, is one of the four states that still does not allow merchants to apply credit card surcharges. But among some states that permit surcharging — like California, Maine, Minnesota, New York, and Oklahoma — additional nuance remains. And businesses with locations across multiple states run into the further challenge of ensuring that they are only surcharging in states where this model is allowed and following each of those states' regulations and mandates. Even for very large merchants whose legal departments may be familiar with some of the laws or card brand rules, actually implementing a processing solution that meets all the requirements remains a large operational burden.

Setting the right surcharge is not always a simple equation

As a concrete example, one of these rules prohibits merchants from profiting from the credit card surcharge. The implementation task this creates for the merchant is to determine what amount to set as the credit card fee. Merchants sometimes try to use the average amount they spent on credit card processing fees in the last month or last year, but these fees vary greatly depending on the mix of cards that were used during that period, and it can be especially inconsistent for growing merchants or merchants with cyclicality in their transaction volumes. Since setting the surcharge at a higher fee than what they pay for processing is a violation of the rules, merchants who try to surcharge themselves will usually set a lower rate, which means they continue to bear a portion of the credit card fees. Therefore, most merchants cannot reap the full benefits of surcharging and eliminate their credit card costs altogether without constantly updating their surcharge fee, which should be avoided as it is a disorienting experience for customers.

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In addition, since merchants are only allowed to apply a fee to credit card payments, not to debit cards or prepaid cards, they need to determine what kind of card their customer is using at the time of transaction. Identifying debit and prepaid cards and ensuring they are not charged a fee is a particularly vexing requirement for merchants who take payments online, when the card is not physically present. Some merchants have attempted to use the first six digits of a card to look up the card type in a publicly available database; unfortunately, these databases are imperfect, since credit card companies are constantly issuing new cards and updating their existing card products. More accurate payment technologies use the full card number when determining card type, but doing this themselves would significantly increase the merchant's PCI exposure — raising a whole different set of compliance requirements to deal with. Another card brand rule for surcharging requires merchants to report the surcharge amount in the authorization and clearing message for every transaction, which necessitates controlling the connection to the credit card networks — something very few merchants are in a position to do.

This complex web of rules means that, while surcharging presents many benefits to merchants, they often consider the implementation to be extremely challenging. Finding the right technology provider can help mitigate these challenges, and we recommend that businesses that want to use surcharging look for solutions that automatically comply with all the applicable rules and provide a seamless experience across IT and operations. The only truly compliant way for a merchant to be guaranteed zero-cost credit card processing is to work with a technology partner that detects the card type accurately and instantaneously and applies a surcharge accordingly. Moreover, while building a checkout page that includes the required disclosures and calculations for surcharging may be daunting, these technology providers can offer a drop-in UI, which obviates the need for development work.

In my experience leading a surcharging platform, I've seen businesses successfully use this option to add up to 3.5 percent to their bottom lines — which, particularly in a challenging economic environment, makes a tremendous difference. With the proper support, merchants can use surcharging to accept credit cards at no cost, empowering entrepreneurs to focus on growing their ideas without growing their expenses.