Merchant Accounts vs. Payment Service Providers: Which Should You Choose?

WHAT'S THE DIFFERENCE BETWEEN PAYPAL, STRIPE, SQUARE, AND A TRUE MERCHANT ACCOUNT… AND WHICH ONE IS BEST?

Have you ever wondered about the differences between a merchant account and a payment service provider? Even more, have you wondered which may better for your business?

You have two options for accepting credit card payments; obtain a merchant account or use an all-in-one payment service provider. How to select the option that is right for you depends on variables that are unique to your business like:

- How you sell your products
- Monthly transaction and volume amount
- Integrations into other software

Payment Service Providers

Several merchant account alternatives exist for businesses that have higher-than-normal requirements to obtain a merchant account or are unable to fit a merchant account provider into their current budget. You can opt for a streamlined payment service provider (PSP). A PSP is a third party that helps merchants to accept payments. Popular examples of PSPs include Stripe, Square, and PayPal.

A PSP and a merchant account aren’t the same thing. With a traditional merchant account, the merchant has its own account. A PSP, on the other hand, combines a variety of different merchants under a single umbrella account. So, instead of getting a specific merchant ID number through a processing bank with a merchant account, you get a license to process payments through the PSP merchant account. You become what’s known as a “sub-merchant.”

Payment Service Provider: Risk and Underwriting

PSPs are free to sign up for and there is minimal documentation that is required to activate your account.

There is no official approval process because there is no "vetting" or background checks. Unlike during the merchant account application process, the PSPs have no information what your company sells, how (or if) you fulfill product orders, or your personal credit or business history of accepting credit card payments. They really don’t know you at all!

Most payment service providers use a flat rate structure for pricing. Basically, this ensures that you pay the same amount for every transaction, no matter what the card type might be. There’s no monthly fee to worry about, and other costs beyond transaction costs or usually non-existent too.

This is a genuine alternative for businesses with a lower-than-average volume of payment transactions or that are trying to avoid the complexities of applications and underwriting that come with merchant account provider services.

Payment Service Providers: The Good

If you sign up with a PSP, everything is handled in house through their customer service and their processing network so you will never have communication with the processor itself.

The good thing about taking card payments through a PSP is that you generally don’t need to pay extra fees for security. Things like PCI compliance are already available within your account.

Another advantage of PSP over a merchant account is that you can purchase a whole tool platform. When it comes to payment processing, the help that an acquirer receives from a PSP is frequently far more thorough. Invoicing and reporting functions are included in tools like Square, Shopify, and Stripe, for example.

Many of these solutions also have a one-of-a-kind gateway that makes it easier for consumers to start selling online.

Businesses without much of a budget to spend on their accounts and point of sale can definitely benefit from a payment service provider. However, you won’t get a lot of support if you need help starting from scratch.

Payment Service Providers: The Not-So-Good

PSPs are convenient, but they can also come with per-transaction fees that can be pretty expensive.

PSPs have their own risk protocols that allow them to retain or freeze your funds if your account has volume changes or chargebacks, or if they see anything suspicious - and they have complete control over the situation.

Any time the exchange of money is involved, there’s risk of financial loss (again because of chargebacks and fraudulent activity) so they reserve the right to hold your funds IF their algorithm detects a red flag.

PSPs, especially PayPal, have been notoriously known to shut down and freeze accounts without any warning. If that happens to you, you’re at the mercy of that PSP’s customer service and it’s just not a good place to be in.

Generally speaking, PayPal, Stripe and Square are looked at as the quick and easy setup options but as we’ve demonstrated, they all have their drawbacks.

Merchant Accounts

Opening a merchant account is the traditional way for businesses to accept credit card payments. A merchant account is essentially a bank account that is used to deposit money from credit card transactions. With this model, the processor (or the Bank) issues a Merchant ID, that is exclusive to your business and no one else.

Because of this, there is a vetting process and formal approval process because you are applying for an account with a bank. So, all those things that PSPs don’t ask for, like your business history and creditworthiness, all come into play here.

Typically, a merchant account application will ask for, your personal credit history, a tax ID number and business history, as well as how you process transactions and other details about your business model.

One of the biggest benefits here is that the merchant account provider actually gets to know you and can gain an understanding about your business and how you operate especially if you’re working with a professional who knows the payments industry.

There are many of merchant account providers available. In most cases, you’ll need to contact a sales professional to get your application started and for assistance throughout the process. Some merchant account providers offer more than just countertop credit card terminals, including mobile card readers and ecommerce payment setup.

Merchant Accounts: The Good

If you have an established business with lots of transactions and/or lots of volume per month, you will almost certainly get a lower rate and effective payment cost by going with a merchant account vs. a PSP. To calculate your effective rate, simply take your total fee and divide it into the total monthly volume.

They can straighten out issues quickly. Here is a place where selecting the right provider can make a big difference. Make sure to select a merchant account provider that offers 24/7 customer service. That way if the business runs into any issues with setup or day-to-day functioning, it can be corrected immediately, before a big sale might be lost.

Having a merchant account gives you the privilege of a more custom and robust account with the ability to add multiple gateways and tie into software or multiple point of sale software and devices.

Your funds can still be held or frozen if you misrepresented your business or you do something that triggers a risk flag like claiming that you’re selling one product, but you’re actually accepting payments for other products.

Merchant Accounts: The Not-So-Good

The underwriting process varies by the bank account provider and can have different requirements for opening an account.

Understanding fees is more complex. There are many fees associated with a merchant account, including a setup fee, monthly maintenance fees and the per-transaction processing fee. Merchant account fees can be structured in three different ways:

Flat-rate pricing: Flat-rate fees charge the same rate for each kind of card transaction you process, no matter what card issuer or card network. Your statement is quite simple, but you can't see the actual wholesale cost behind any of your transactions. This is the model most commonly offered by PSPs.

Cost-plus (interchange-plus) pricing: These are the most transparent transaction fee option. This fee consists of the amount it costs to process the payment (wholesale cost) plus an amount that the merchant account will charge you (the markup costs). With cost-plus pricing, you will be able to see exactly how much each transaction costs your business with an itemized monthly statement. Payway uses a cost-plus price model.

Tiered pricing: Tiered fees classify card transactions into three tiers—qualified, mid-qualified, and non-qualified—based on the risk they pose. Transaction fees will be the lowest for the qualified transactions. This form of pricing is pretty specialized and hard to understand.

Summary

Should You Use a Payment Service Provider? Here are the pros and cons:

Pros:

- Easier to get set up for beginners
- Excellent for flexibility when you're not sure what you need long-term
- Lots of extra features built in as standard for companies

- Fewer fees to worry about in general
- Great for credit card payments online and offline

Cons:

- Not as much customer support for beginners
- Could risk frozen or cancelled accounts
- Less specialist guidance

If you’re a smaller company without a lot of money to spend, you’ll usually get a lot less support working with a PSP. On the other hand, if you’re generating a high monthly revenue, a merchant account provider might be the better choice.

Once your business has reached a certain level of steady revenue, you'll likely discover that having a merchant account provides you with more flexibility and offers up new opportunities for expansion.