A First Data White Paper

Electronic Checks: The Low-Risk, Low-Cost Way to Accept Online Payments

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Introduction

Market research firm Compete reports that 83 percent of consumers are shopping online at least weekly.[i] And they're not just looking—they're buying. A 2011 survey by Javelin Strategy & Research found that 77 percent of consumers made a purchase online within the prior 90 days—and 34 percent had bought online in the last week.[ii]

The payment options offered at checkout can be a key factor in consumers' decisions about where to shop online. For many consumers, the Internet shopping experience may end negatively if they do not find their preferred way to pay at checkout. Research shows that when merchants offer more payment options to their online shoppers, online sales go up.

Traditional credit cards and debit cards are the predominant way that most online shoppers pay for their purchases. According to Javelin Strategy & Research, 77 percent of online payments in 2009 were made using credit and debit cards—however, that share declined from 85 percent the prior year, and is expected to fall to 70 percent by 2014.[iii] To win the business of shoppers who don't have—or don't want to use—credit and debit cards, merchants are expanding their checkout payment options. Accordingly, other payment types—including general purpose reloadable prepaid cards, closed loop gift cards, and a category often called "alternative payments"—are steadily gaining a share of online purchases.

A growing number of online merchants offer a type of alternative payment option known variously as an eCheck, online check, electronic check, direct debit, or Internet check. With an eCheck option, a customer can pay with funds from his or her checking account without using a paper check or card at all. The customer submits the checking account number and bank routing number, and funds are then transferred by sending the transaction through the Automated Clearing House (ACH), an electronic banking network often used for direct deposit and electronic bill payment.[iv]

For merchants, eChecks have considerable benefits:

- **Sales lift.** Online shoppers seek out sites that offer their preferred payment option. Limited payment options are a major cause of cart abandonment during checkout.
- **Faster funding.** eChecks are processed much faster than conventional checks and can simplify accounting and reconciliation processes.
- **Lower processing costs.** Processing fees for eChecks are significantly lower than the card-not-present (CNP) interchange fees. Compared to credit card transactions, electronic checks can provide dramatic savings in processing fees.
- **Minimal risk.** When a shopper enters checking account information, it can be screened against a database of bad checks and other risk assessment parameters. The transaction is approved or denied almost instantly.
- **Easy implementation.** If no customization is needed, merchants can add eChecks as a payment option in just a few business days through a certified gateway partner.

Electronic checks provide a simple and secure way for consumers to pay, and for merchants to accept payment over the Internet. This paper will explore in more detail how eChecks work, their impact on costs and revenues, and considerations for choosing a provider.

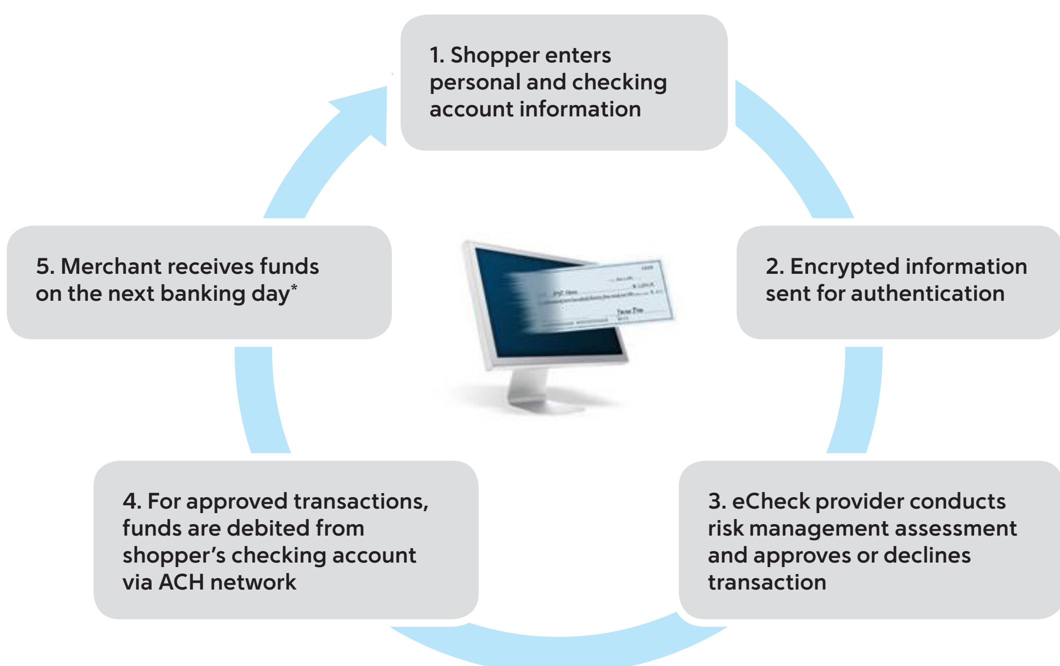
How eChecks work

An eCheck performs the same function as a traditional paper check—transferring funds from one party to another—but the payment is made electronically through the ACH network instead of through the physical acceptance and routing of a paper check. Electronic checks can therefore be processed much faster and more inexpensively than conventional checks. Security is improved over paper checks, too, because electronic encryption of personal and payment information helps prevent data theft and fraud. Moreover, by signing up for a service provider's validation and guarantee services, a merchant can minimize or even totally eliminate the risk of bad checks.

After the shopper selects "Pay by eCheck/Online Check"

Here's a brief overview of how the authorization and funding process works:

1. A consumer shops on an online merchant's website, selects "Pay by eCheck" at checkout, and enters his or her bank routing number and checking account number, in addition to a personal identifier such as driver's license number (in some instances).
2. The merchant's payment gateway instantly transmits encrypted details of the transaction to an eCheck acceptance service for authentication.
3. Using fraud prevention tools and databases, the acceptance service validates the purchaser's identity and makes a determination of the purchaser's checking transaction risk. Instantly, the acceptance service approves or declines the transaction and notifies the merchant accordingly.
4. When the transaction is approved, a message appears on screen asking the consumer to authorize the transaction. When the shopper clicks the appropriate button, it triggers the eCheck provider to draw the funds from the customer's bank account.
5. The eCheck provider delivers the funds to the merchant's bank account, often as soon as the next banking day.



* For transactions received by 4pm CST.

Good News about Bad Checks

The risk of accepting bad checks has always been a legitimate concern for brick-and-mortar retailers, which typically mitigate this issue by using outside services to screen out risky check writers. eCommerce merchants, too, can use check acceptance services to validate a shopper's identity and assess the transaction's risk before authorizing the purchase.

When an eCheck is accepted online without the use of such a service, merchants don't know immediately whether the consumer has sufficient funds on deposit for the check to clear. This creates transaction risk for the merchant (and potential customer service issues during the collection process)—a risk that eCheck acceptance services can alleviate in three ways:

- **Verification.** This relatively low-cost approach to check acceptance involves rigorous validation of a shopper's identity and scrutiny of his or her checking account and payment history. The merchant is notified if the check writer has a history of bad checks or any outstanding bad checks, and can consequently request another form of payment.
- **Collection.** For an optional fee, some acceptance service providers also take a proactive role in the collections process (with warranty services not provided). When an approved electronic check fails to clear, the service provider will perform collection efforts on the merchant's behalf.
- **Warranty, offering 100 percent protection.** Some service providers offer warranties that guarantee the transaction, effectively transferring all transaction risk from the merchant to the service provider. The merchant is funded the next day, and the service provider handles all aspects of collection, absorbing any losses.

Various studies have shown that security fears have a profound effect on consumers' purchasing behavior. Retailers must therefore be sure to select an eCheck acceptance service that employs sophisticated authentication and encryption techniques to validate the legitimacy of the transaction and to protect customers' personal information.

The security of eCheck solutions depends on the strength of the acceptance service's risk management measures. Basic protection usually consists of screening every transaction against negative activity databases.

Security is considered adequate when the provider uses sophisticated identity verification, fraud detection and risk management techniques. Some eCheck solutions, including First Data's TeleCheck Internet Check Acceptance® service, take additional steps to evaluate the purchaser's history and to divert higher-risk transactions to processes tailored for full risk management.

Will Shoppers Feel Safe?

Consumers have come to trust that merchants make strong efforts to protect them from fraud during the purchase process. Fear of fraud does not appear to deter consumers from making direct-debit purchases online: in fact, according to proprietary research conducted for First Data, two-thirds of online shoppers store billing and personal information at merchant sites.

Online shoppers generally perceive electronic checks to be no riskier than paying a utility bill directly from the biller's website through the ACH system. Moreover, consumers are already accustomed to making frequent bill payments online from their bank accounts—something they do an average of 5.5 times per month.[v]

In a recent survey conducted for First Data, 46 percent of consumers said they frequently (33 percent) or occasionally (13 percent) use electronic checks or other direct debit transactions. The same study also found that even though direct bill pay requires consumers to divulge banking information to each biller, consumers strongly prefer to pay bills online at the biller's website rather than at their bank's website.

Retailers can bolster consumer confidence in the security of the checkout process by using advanced authentication techniques and by publicizing the measures they take to protect customers' personal information.

According to proprietary research conducted for First Data, nearly two thirds of online shoppers stated that "seeing a security logo on a retailer's website makes [them] more comfortable shopping there." Seven out of every 10 respondents agreed that the involvement of check verification in the checkout process "adds an additional level of security when making an online purchase."

Impact on Revenues and Costs

Seventy-seven percent of consumers have a debit card, and 72 percent have a credit card—however, nearly 92 percent of consumers have a checking account,[vi] implying the existence of a sizeable portion of the population that would benefit from alternative ways to access their DDA funds online through a mechanism like eChecks.

And while a majority of consumers do have credit or debit cards, many don't want to use them online for a variety of reasons, including:

- At or near credit limit on credit card(s).
- On a budget and prefer to use "pay now."
- Distrustful of providing credit or debit card information.
- Ready to check out, but credit or debit card is not handy.

By adding other payment choices to the standard credit and debit card payment options, online merchants can reduce the risk of turning away prospective customers. The eCheck option gives these shoppers an alternative way to pay, with the same convenience and immediacy as credit or debit cards.

Researchers have found that if consumers had to choose between two websites that offered the same product at the same price, more than half would make their purchase with the merchant that accepts the payment method they wish to use.[vii] The same study also found that offering three or more payment methods increases the rate of completed checkouts by 9 percent over sites that offer only one or two payment methods.

The transaction processing fees for fully warranted eChecks are typically less than comparable credit card processing expenses, which include interchange fees, chargeoffs, and fraud prevention services. So what are the overall potential top- and bottom-line impacts that could accrue from adding the eCheck option?

- According to market researchers, online merchants can expect 3 to 8 percent of their sales to be paid for with eChecks, with at least half of this amount representing sales that otherwise would have been lost.[viii]
- For the portion of existing sales converted from bank card payments to eCheck payments, the merchant would likely save money on processing fees, depending on its average interchange rate and the terms of its eCheck acceptance service agreement.

Getting started with eChecks

Most small to mid-sized online merchants are served by eCommerce payment gateways, which facilitate the transfer of information between a merchant's website and the front-end processor or acquiring bank. These gateway providers can typically help their online merchant clients quickly and easily connect to an eCheck acceptance service. In fact, some of the leading eCheck acceptance services and gateways have partnerships to streamline implementation and ongoing operations. The set-up and integration is simple enough that the merchant can often be operational with eCheck acceptance within a day or so.

A larger online retailer may also work with a gateway provider, or it may prefer to create a direct, host-to-host connection to the eCheck acceptance service instead of going through a payment gateway.

What criteria should a merchant evaluate when selecting an eCheck acceptance service? First Data recommends comparing candidates to these best-of-breed attributes:

- Provides access to histories on at least 97 percent of check writers.
- Supports customers with an experienced, low-turnover staff of fraud, IT, and statistical experts.
- Possesses a history of developing ACH solutions and alternative form factors for merchant payment environments.
- Offers an ACH payments portfolio that encompasses comprehensive verification, fraud prevention, and risk analytics solutions for POS, mail, Internet, and phone channels.
- Employs extensive company-wide internal security measures.
- Uses sophisticated encryption, transaction ID, and data storage techniques.
- Offers multiple levels of risk management services.
- Demonstrates high expertise in preventing and resolving exceptions.
- Provides proof that it dramatically streamlines settlement processes.
- Regarded as an industry leader, as determined by number of subscribing locations, average daily transaction volume, and track record of investment in technology and innovation.

Conclusion

Retailers are always looking for cost effective ways to retain existing customers and find new customers, yet payment choice is an often-neglected aspect of their eCommerce strategies. In every shopping environment, consumers place a high value on choice, convenience and security, and the Internet is no exception. Online shoppers desire flexibility in deciding how to pay at checkout, just as they do in their off-line transactions. With alternative online payments (i.e., other than debit and credit cards) expected to grow to 30 percent of purchase volume by 2014, eCommerce merchants should consider expanding their payment options to take advantage of this consumer trend.[ix] And, in addition to improving sales and customer satisfaction, offering extra payment options may provide new opportunities for merchants to reduce their total cost of payments.

It is extraordinarily easy, safe, and economical for merchants to offer online shoppers another way to make electronic payments from their bank accounts. Electronic checks are typically much less expensive than credit card processing, and for approved transactions, merchants will receive funds quickly, usually within two banking days. Moreover, by implementing eChecks, merchants gain a fast, easy way to increase sales—and eliminate a major reason for cart abandonment during checkout.

Given the sustained growth of retail eCommerce, as well as the continued increase in the popularity of alternative payments at checkout, it is clear that merchants must be committed to providing the full breadth of payment options that their current and future customers expect.

The Global Leader in Electronic Commerce

Around the world every day, First Data makes payment transactions secure, fast and easy for merchants, financial institutions and their customers. We leverage our unparalleled product portfolio and expertise to deliver processing solutions that drive customer revenue and profitability. Whether the payment is by debit or credit, gift card, check or mobile phone, online or at the point of sale, First Data helps you maximize value for your business.

Notes and Sources

[i] Compete, "Eight out of Ten Consumers Shop Online at Least Once a Week." August 27, 2010.

[ii] Internetretailer.com, October 11, 2011, citing research by Javelin Strategy & Research, "2011 Online Retail Payments Scorecard: New Options to Maximize Online Shopping Revenue." October 2011.

[iii] Javelin Strategy & Research. "Online Retail Payments Forecast 2010 – 2014." February 2010.

[iv] The ACH network is an electronic funds transfer system primarily used by U.S. financial institutions for batch processing of electronic payments. Businesses, individuals, financial institutions, and government organizations increasingly use ACH processing to transfer funds quickly, reliably and economically.

[v] Federal Reserve Bank of Boston, "The Survey of Consumer Payment Choice." April 2011.

[vi] Ibid.

[vii] CyberSource, "Insider's Guide to ePayment Management." 2008.

[viii] Ibid.

[ix] Javelin Strategy & Research. "Online Retail Payments Forecast 2010 – 2014." February 2010.

For more information, contact your First Data Representative or visit firstdata.com