A First Data White Paper

August 2009

Increasing Online Checkouts With E-checks

Most online merchants accept debit and credit card payments, but many do not offer an e-check option for their customers. E-check acceptance is easy to implement, and studies show that offering additional payment options can increase transaction completions significantly.

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Introduction

Internet retailers expend tremendous resources driving consumers to their sites, ensuring that the sites are aesthetically pleasing and easy to navigate, and merchandising them with desirable products at attractive prices—only to have many of those potential customers leave the site after they have placed items in their virtual shopping carts and proceeded to the checkout. When the marketing research firm MarketingSherpa surveyed 1,100 online merchants, Anne Holland, the firm's president, was stunned by one finding. In her popular blog, she noted that based on anecdotal information, she had expected that the study would find a shopping cart abandonment rate of 20 percent to 30 percent.[1] The results of the survey, however, proved that hypothesis wrong: Respondents reported an average cart abandonment rate of nearly 60 percent.[2] Similarly, a May 2009 comScore/PayPal survey reported that 45 percent of online shoppers had abandoned a shopping cart multiple times over the prior three weeks.[3]

Recommended remedies for dealing with high cart abandonment rates involve giving shoppers free shipping, alleviating their security and privacy concerns more persuasively, promoting liberal return/exchange policies, and keeping abandoned carts available for shoppers who return.

There is another partial cure to this problem that may not be so obvious: *Give shoppers more payment options.* Almost all online merchants accept debit and credit card payments, but only 20 percent offer an e-check payment option to their customers.[4] Electronically initiated checks, called e-checks, are an easy-to-implement, user-friendly way for shoppers to pay for their purchases. Large online merchants like Amazon.com and Overstock.com have been accepting e-check payments for years, and other retailers are increasingly augmenting their payment option mixes with e-checks.

Is the e-check payment option popular with shoppers? Yes, because e-checks serve a large group of consumers who, for various reasons, prefer not to use credit or debit cards at Web sites. They also provide a payment mechanism for consumers who have checking accounts but do not have a credit or debit card. Offering multiple payment types is an effective way to expand a retailer's total available market, improve customer satisfaction and reduce shopping cart abandonment. In fact, studies show that having three or more payment options available will increase an online merchant's transaction completions by 9 percent.[5]

The online payments landscape is evolving to provide considerably greater choice and flexibility to consumers. Mercator predicts that by 2014, 35 percent of online purchases will be made with alternative payments (such as PayPal™, Google Checkout™ and e-checks)—up from just 14 percent in 2009.[6] In the midst of sluggish consumer spending, online retailers clearly must implement creative tactics to gain new customers and reduce shopping cart abandonment rates—as well as to plan for emerging payment trends and changing consumer preferences. This white paper seeks to help retailers devise new strategies to maximize current and future eCommerce revenues by explaining:

- → The advantages of offering an e-check option to customers
- → How e-checks work
- → How intermediaries known as e-check acceptance services, working with gateway providers, can help merchants rapidly implement an e-check payment option

The Missing Online Payment Method

Online consumers who are most likely to embrace the e-check option at checkout can be divided into two primary categories: the cardless and the cardholders.

The Cardless

Forrester Research recently studied online consumers who have never purchased goods or services online.[7] This group, Forrester found, resists eCommerce for several basic reasons, as shown in Figure 1. The third most popular reason on the list, mentioned by 22 percent of respondents, was "I don't have a credit or debit card."

Why haven't you bought products or services online?

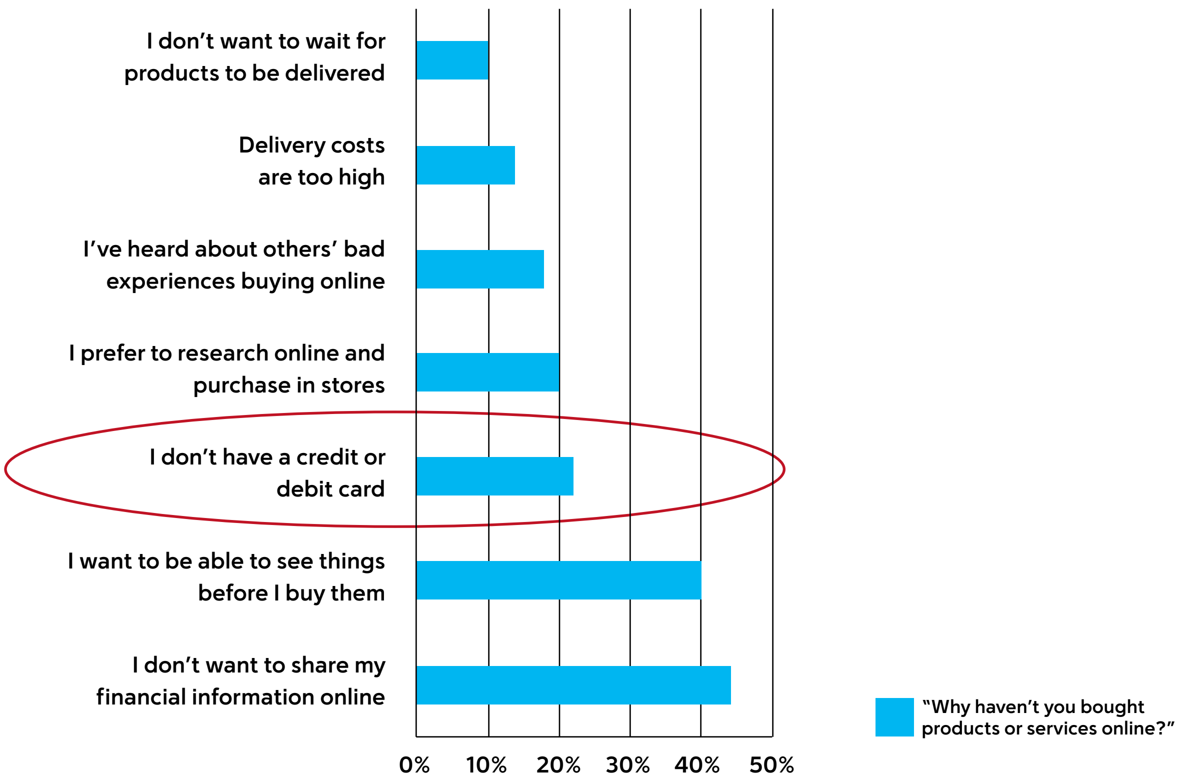


Figure 1: Online shopping holdouts resist eCommerce for many reasons. (Source: Forrester Research)

In fact, 27 percent of U.S households do not have credit cards, according to a study conducted by the Federal Reserve (and this number may be rising due to regulatory changes and tightening credit).[8] Recent research performed by Javelin and PULSE has indicated that the penetration rate of debit cards is roughly equivalent.[9] That's a significant percentage of U.S. consumers who cannot check out at many eCommerce Web sites. Meanwhile, nearly 90 percent of households do possess a checking account, indicating that there exists a considerable number of consumers for whom an alternative form of payment—such as e-checks—is potentially the only convenient way they can make purchases on the Internet.[10] Accordingly, a consumer survey by JupiterResearch found that 14 percent of Web users lacked a consistent way to pay for online purchases.[11]

The Cardholder "Holdouts"

While the majority of online consumers do have credit or debit cards, some periodically or habitually refrain from using them for online purchases. The reasons can be many; here are some of the explanations we hear:

- → The consumer is ready to check out but the credit or debit card isn't handy.
- → The consumer has a credit or debit card but is near his or her credit limit.
- → The consumer has a credit card but prefers a "pay as you go" approach.
- → The consumer is distrustful of providing his or her credit or debit card information

The continued weak economy may also cause worried consumers to forgo using their credit cards. Reluctant to add to existing credit card balances, they have ratcheted back their spending. And when they do spend, they may impose a "pay-as-you-go" discipline on themselves—by using debit cards if they have them or other payment types such as PayPal accounts or e-checks. According to a June 2009 Mercator report, "Statistics are clear that consumers are saving more and, most importantly for alternative debit payment products [i.e., e-checks], are turning away from credit."[12] Tighter bank credit underwriting requirements have also led to a downturn in total credit card accounts outstanding, average credit limits and new credit card offers.[13] Add to that recent credit card legislation that may further inhibit credit card issuance, and it becomes clear that the ongoing incremental changes in the online purchase payment mix may intensify.

It is clear that for an increasing number of consumers, the Internet shopping experience at many sites will end negatively if they are not offered an easy, alternative way to pay at checkout. In the comScore/PayPal survey mentioned in this paper's opening, "Couldn't find preferred pay option" was cited by 24 percent of respondents as a "very important" reason for abandoning their shopping carts.[14] Commenting on this finding, Econsultancy's Graham Charlton wrote, "To combat this [shopping cart abandonment], retailers should look at their customer base and decide whether offering alternatives to debit and credit cards would help them to attract extra business."[15]

By adding other payment alternatives to the standard credit and debit card payment options, online merchants can potentially avoid turning away prospective customers. The e-check option gives these shoppers an alternative way to pay, with the same convenience and immediacy as credit or debit cards. Furthermore, accepting e-checks can potentially be less expensive to the merchant than other alternative payment methods like PayPal, Bill Me Later® and Google Checkout.

How Additional Payment Options Increase Checkouts

eCommerce solutions provider CyberSource recently surveyed online merchants to find out how many payment methods they offer.[16] Payment types in the survey included:

- → General purpose and bank cards, such as Visa®, MasterCard®, Discover® and American Express®
- → Private-label cards
- → Gift certificates and gift cards
- → Electronic checks
- → Subscription billing and installment payments
- → Instant credit arrangements, such as Bill Me Later™
- → PayPal or other non-card payment types

The survey found that offering three or more payment methods increases the rate of completed checkouts by 9 percent over offering only one or two payment methods. It should also be noted that "payment methods" in this case does not refer to multiple card brands. It means offering different types of payment altogether (cards, e-checks, PayPal, etc.). In addition, the study determined that online merchants that implement an e-check payment option typically experience 3 percent to 8 percent of sales coming through e-checks, with at least half (1.5 percent to 4 percent) representing sales they would otherwise have lost.

The survey also revealed this surprise: Shoppers prefer diversity of payment options over future discounts by almost a two-to-one margin. Consumers were asked to identify which of three factors would influence their decision to buy at one site versus another offering the same product at the same price. Their responses:

- **"Accepts the payment method I want to use" 56 percent**
- "Keeps my financial information secure" 54 percent
- "Discount on next purchase" 31 percent

Clearly, consumers value choice and convenience. By offering more payment options at checkout, online merchants can expect to see fewer cart abandonments and more sales.

E-check 101

An e-check performs the same function as a traditional paper check—transferring funds from one party to another—but the payment is made electronically instead of by physically routing a paper check. Using the Automated Clearing House (ACH) network, e-checks can be processed days faster and much cheaper than conventional checks, with no degradation in security.

The ACH network is an electronic funds transfer system primarily used by U.S. financial institutions for batch processing of electronic payments. The system is an integral component of the U.S. transactional ecosystem: Over 18 billion transactions passed through the ACH network in 2008, accounting for nearly $30 trillion in payments.[17] In recent years, it has been used increasingly for consumer payments, both online and at physical points of sale. Consumers have rapidly embraced the reliability of the ACH network, rating it higher than debit card and credit cards for safety, privacy and accuracy in a recent survey conducted by the Federal Reserve.[18]

E-check acceptance and processing via ACH does pose certain challenges to merchants, however. When an e-check is accepted online, by phone or at a brick-and-mortar retailer's point of sale, 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—a risk that e-check acceptance services can alleviate in three ways:

- Through meticulous validation of a shopper's identity and scrutiny of his or her checking account and payment history
- Through collection efforts on the merchant's behalf when e-checks are returned
- Through warranties that effectively transfer transaction risk from the merchant to the service provider

E-checks can be initiated online by shoppers at the merchant's Web site or by a phone call to the merchant's call center. In both cases, the consumer provides the same information. Processing of the payment occurs in the same manner, with two exceptions:

- For payments by phone, the shopper calls a merchant phone number instead of using a Web site's checkout page.
- Online shoppers key in information themselves. For phone payments, a call center representative of the merchant keys in the same information on behalf of the purchaser.

Most e-check acceptance services generally offer merchants both of these methods. This paper focuses on the Internet method.

An e-check acceptance service is a firm that performs most or all of these services for online merchants and store retailers: identity validation and authentication; risk determination and scoring; transaction authorization; ACH clearance and settlement; reconciliation and reporting; and bad debt recovery services.

The security of e-check solutions depends on the strength of the acceptance service's risk management measures. Security is considered high when the provider uses sophisticated identity verification, fraud detection and risk management techniques. Some acceptance service providers will screen every transaction against negative activity databases. First Data's TeleCheck® Internet Check Acceptance® service takes additional steps to evaluate the purchaser's history and to divert higher-risk transactions to processes tailored for full risk management. This is especially important given the pervasive nature of identity theft and fraud in today's eCommerce environment. Consumers are all too aware of this threat, and it has a profound effect on their purchasing behavior: According to a recent Javelin survey, online merchants collectively lost $21 billion in potential sales in 2008 due to the impact of identity theft and consumers' fear of lax security on the Internet.[19] Given these fears, retailers must be sure to select an e-check acceptance service that employs sophisticated encryption and authentication techniques to protect customers' personal information.

If you are considering adding e-checks as an online payment option for your customers, consider this the key message that you need to reflect upon: *For any card-not-present situation, whether it's over the phone or on the Internet, it is extraordinarily easy and safe for your customer to pay by check. Either way, it will typically be less expensive than credit card processing and you will receive funds quickly if the transaction is approved. Moreover, by implementing e-checks, you gain a fast, easy way to increase sales—and to reduce your overall eCommerce transaction costs (which include not only processing fees, but also chargebacks and fraud-related expenses).*

Surging Growth for E-checks

E-checks have been around since the late 1990s. Usage of e-checks by brick-and-mortar merchants, spurred by Wal-Mart's chain-wide implementation of the technology to reduce check processing costs, began to take off after

Are checks "dying"?

Some online merchants say they are reluctant to offer e-checks because the usage of checks is in a long-term decline. Their rationale: "Why invest in a payment category that is dying?"

The perception is false. While it is true that the use of traditional paper checks is declining, the various forms of electronic check payment methods are surging.

Consumers have dramatically changed the way they pay for goods and services. Paper checks written will decline from 38.3 billion in 2000 to about 25 billion in 2012, according to Aite Group. More dramatic is the off-the-cliff drop Aite sees for paper checks cleared: from 95 percent of all checks written in 2000 to 25 percent in 2012.

Meanwhile, as eCommerce soars, so does the use of electronic checks. Mercator Advisory Group reports a compound annual growth rate (2003-2006) of 18.6 percent for ACH payments. Growing even faster is the ACH category representing consumer-driven eCommerce. These Internet-initiated ACH transactions are growing about 22 percent annually, according to Mercator.

"The growing attraction of alternative payments is a combination of merchants seeking protection from increasing interchange fees and consumers demanding more secure and flexible online payment options," states Mercator's September 2008 report, *The ACH Network: The Bedrock of Alternative Payments.*

Bottom line: Consumers will always need to have a way to pay from their demand deposit accounts; what is changing is how they execute the payment.

the turn of the century. In fact, 17 percent of chain-store retailers say they now have up-to-date technology in place for POS e-checks, and another 22 percent either have started a major technology upgrade or plan to do so within the next two years.[20]

In spite of the dramatic growth of e-check transactions in recent years (see sidebar), today only about one in five online merchants offers an e-check payment option. Major online retailers have begun to add e-checks to their checkout options, and smaller Internet merchants are starting to realize that they must follow suit in order to remain competitive and serve the needs of their customers. Widespread adoption by online merchants has been relatively slow, due in part to the perceived transaction risk associated with check acceptance. However, as discussed earlier, a full-service e-check acceptance service can alleviate this risk through sophisticated verification processes and warranties.

ABCs of Processing an E-check Transaction

What happens when an online shopper opts to pay with an e-check? Here's a brief overview of how the authorization process works.

1. A **consumer** shops on the online merchant's Web site and selects "Pay by Online Check" at checkout. Then he or she enters bank routing and account numbers from the magnetic character recognition, or MICR, line printed on the check, and a personal identifier such as driver's license number.
2. The merchant's **eCommerce payment gateway** transmits the identifying information and transaction details to an e-check acceptance service, such as TeleCheck.
3. The **e-check acceptance service** goes through various proprietary steps to validate the purchaser's identity and to make a risk determination on the purchaser's reliability in check transactions.
4. Within sub-seconds, the acceptance service **approves or declines the transaction** and notifies the merchant accordingly. The shopper clicks "Authorize" to acknowledge the ACH transaction and, as required by law, that the payment is being made electronically.
5. The acceptance service then **electronically settles approved transactions** using the ACH network. Acceptance service providers are often evaluated based on how well they perform these functions (and on the additional services they offer, such as payment warranties).

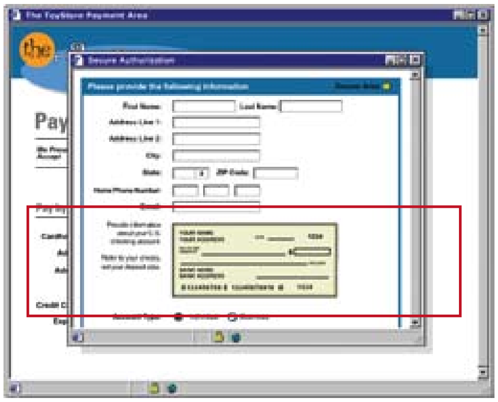
Consumer and Merchant Experiences

In most cases, the only involvement online merchants have in the entire e-check transaction process is seeing daily reports of authorized transactions and denied transactions. Then, usually within two banking days of a transaction's approval, funds will be credited to the merchant's bank account.

The consumer's experience is fast and convenient, too (see Figure 2 on next page). He or she will be involved in four simple, intuitive events:

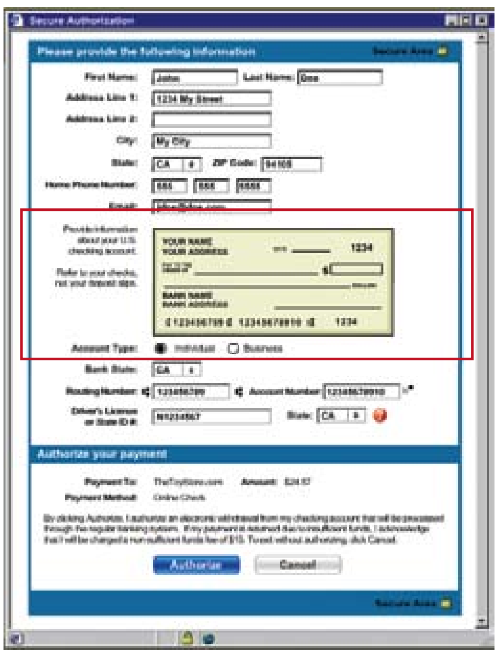
1. At checkout, the consumer opts to "Pay by Online Check."
2. Using visual prompts, he or she inputs a small amount of personal and bank account information (which, in most cases, is not stored by the merchant).
3. Seconds later, the consumer finishes the transaction by clicking "Authorize" and printing a receipt if desired.
4. A few days later, the transaction debit will appear on the consumer's checking account.

The Consumer Authorization Experience



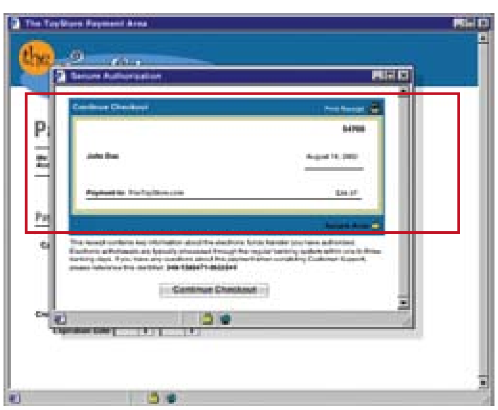
1. Merchant Checkout Page

Customers see and select new payment option – Pay by Online Check



2. Online Check Authorization

Customer enters personal and financial information (including MICR and driver's license number) into the authorization window



3. Payment Receipt

The receipt summarizes the terms of the authorization, includes the merchant's Order ID Number and meets all NACHA regulations

Figure 2: The Consumer Authorization Experience

The Role of E-check Acceptance Services

Online merchants (and indirectly, their customers) rely heavily on e-check acceptance services to ensure flawless, seamless processing of e-check transactions.

For the e-check acceptance service provider, they are slightly more involved in the authorization process than what is mentioned above. Take step 4 from page 7, for example: "Within sub-seconds, the acceptance service **approves or declines the transaction** and notifies the merchant accordingly."

To make this automated decision, the acceptance service's risk management engine may review data involving hundreds of variables in various negative and other activity databases. Transactions are then scored based on the acceptance service's proprietary rules. In some cases, the service may provisionally approve a high-risk transaction, but the merchant is instructed to delay shipment until funds are received.

For approved transactions, the acceptance service oversees **the settlement process**, which involves:

- → Creating and scrubbing ACH files
- → Ushering each transaction through the ACH network until the consumer account is debited and the merchant account is funded
- → Providing detailed daily transaction and funding reports to facilitate merchant reconciliation

Some acceptance services take a proactive role in **the collections process**, too. Depending on the contractual agreement in place, when an e-check fails to clear, the service provider may perform up to 180 days of collection efforts on the merchant's behalf.

Collection efforts can range from re-presentment and re-deposits to collections analytics, scoring and use of letters and telephone calls to establish debtor contact and collect unpaid balances. TeleCheck, which has been providing e-check services for merchants for more than a decade, even offers a transaction warranty that removes the risk of loss from the merchant. Generally, a warranty service transfers the risk of returned checks from the merchant to the service provider. With this level of service, the service provider handles all aspects of collection and absorbs any losses. The merchant is worry-free, knowing that funding is guaranteed for all approved check payments. Fees for warranty services vary by the loss experience of the merchant's industry. High-risk industries, such as electronics or jewelry sales, will pay higher fees than industries with more favorable risk profiles, such as auto parts retailers or hospitals.

The Financial Advantages of E-checks

The transaction processing fees for fully warranted e-checks are typically less than comparable credit card processing expenses, which include interchange fees, chargeoffs and fraud prevention services. So what are the overall potential bottom-line impacts that could accrue from adding the e-check option? As discussed previously, online merchants can expect a sales increase of 1.5 percent to 4 percent.[21] In addition, for the portion of existing sales converted from bank card payments to e-check payments, the merchant can potentially save money on processing fees, depending on its average interchange rate and the terms of its e-check acceptance service agreement.

Given those assumptions, here is a conservative example of a hypothetical increase in profits and savings in processing costs for a merchant with $500 million in sales and a gross profit of 25 percent.

First, consider incremental profits from a 3 percent increase in sales:

$500,000,000 total annual sales	X	3% incremental sales from e-check	X	25% gross profit	=	**$3,370,000 incremental gross profit**

Now, add hypothetical processing savings from converting credit card transactions to e-check transactions:

$500,000,000 total annual sales	X	2% sales converted to e-check	X	1% lower fees for e-checks *(varies according to interchange rate and e-check acceptance service)*	=	**$100,000 cost savings in processing costs**

Getting Started with E-checks

Most small to mid-sized online merchants are served by eCommerce gateways, such as First Data℠ Global Gateway, Cardinal Commerce, CyberSource, IP Commerce, PayPal or Tempus Payment Gateway. Gateways enable multiple payment services; they can help their online merchant clients to quickly and easily connect to an e-check acceptance service. If no customization is required, the merchant can often be operational with e-check acceptance within a day or so.

Some of the leading e-check acceptance services and gateways have partnerships to streamline implementation and ongoing operations. TeleCheck, for example, has pre-integrated its Internet Check Acceptance service with First Data Global Gateway, Cardinal Commerce, CyberSource and Tempus Payment Gateway. Conversely, a large eCommerce merchant may prefer to create a direct, host-to-host connection to the acceptance service instead of going through a gateway.

As discussed previously, only about 20 percent of online merchants have implemented an e-check payment option, but this is growing, especially amongst savvy Internet retailers with reputations for innovation and customer service. In general, the more payment options that an online merchant offers its Web site visitors, the more likely it is that those visitors will become customers. Retailers are continuously looking for cost-effective ways to retain existing customers and find new customers, and payment choice is an often neglected aspect of their eCommerce strategies that they can no longer afford to overlook. Indeed, a 2009 Javelin report recommends to merchants that "given the growing usage of debit as an online payment method, consider introducing other secure cash-based options for making purchases online."[22] As the trend to offering alternative payment methods accelerates, consumers' awareness of the new options will increase, as will their expectations of eCommerce payment option breadth. Merchants at the forefront of this development will be better positioned to attract and retain customers who value the ability to pay for online purchases with a wide variety of payment types.

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First Data powers the global economy by making it easy, fast and secure for people and businesses around the world to buy goods and services using virtually any form of payment. Serving millions of merchant locations and thousands of card issuers, we have the expertise and insight to help you accelerate your business. Put our intelligence to work for you.

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