

## On Internet, Inroads for Noncard Payments

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As part of their perpetual attempt to lower the cost of accepting payments, Internet retailers are increasingly encouraging consumers to use credit and debit card alternatives, including electronic checks, direct debits, or instant loans.

The merchants - and the payment companies that support them - often cite customer demand as a reason for the changes. They say consumers are eager to avoid the need to put their card numbers online and remember passwords.

That may well be part of the story. But payments executives also point out that Visa U.S.A. and MasterCard International are planning to raise interchange again soon. With or without the rate hike, it is a whole lot cheaper for a merchant to accept an automated clearing house payment than a card-based one, and the dispute rules can be more advantageous for merchants.

To some extent, the same thing is happening in the real world, with retailers trying out point of sale systems that convert checks to ACH payments. But the activity seems most intense and variegated in Internet and telephone sales, which lend themselves more to experimentation.

Merchant processors and acquirers have been busy devising and packaging products that let e-tailers test an array of options, from electronic checks, which let consumers type the information from a paper check directly into an online order form, to instant financing for remote purchases, to systems that let consumers put Web purchases on a phone bill.

For instance, this month First Data Corp. started marketing First Data Encompass, a bundled set of alternative Internet payment offerings. Merchants can now sign up in one swoop for TeleCheck check acceptance services, Verified by Visa, MasterCard SecureCode, and a 2-year-old instant loan product called Bill Me Later.

"We're placing bets here, but part of what we've done is we've lowered the threshold or cost of any one given bet," said Margaret Weichert, a vice president of Internet services for First Data, of Denver.

"I'd say we're probably going to see a good number of solutions tested in the next couple of years, not all of which will succeed," she said. "I'm fairly certain there will be one or two or three alternatives to credit cards."

Meanwhile, Visa and MasterCard have themselves been working on alternatives to traditional cards, such as prepaid products and radio-frequency systems. But since there is still much market share to be won away from cash and checks, neither company says it is worried about future prospects or feels threatened by ACH.

Arthur D. Kranzley, an executive vice president in MasterCard's e-business and emerging technology division, said the percentage of MasterCard transactions made over the Internet or through a remote device has been growing faster than was predicted at the start of the e-commerce boom.

"We projected it would be 3% to 4% by now, but actually over 7% of our transactions are coming over the Internet," Mr. Kranzley said. "By 2008, we project that over a quarter of our transactions will come over the Internet or by remote device."

At Visa, "we're not seeing any falloff in terms of volume to competitive payment systems - the growth is there," and more than 90% of e-commerce transactions take place on card products, said Jim McCarthy, the senior vice president for emerging products.

The consumer protections and perks Visa offers - including zero liability, Verified by Visa, and the Visa Extras reward program - can't be matched by alternative payment options, Mr. McCarthy said. With Verified by Visa, merchants get a payment guarantee and a 5-basis point interchange discount.

With electronic checks and ACH programs, merchants face a bigger risk of repudiation, and investments in anti-fraud guarantee services drive up costs, Mr. McCarthy said. Also, consumers have to input a lot of personal information and don't necessarily get real-time authorization, he said.

He pointed to the failure of Project Action, a Nacha initiative that would have used a push-credit model to create an ACH-based payment alternative. "What they were in essence trying to build was a replication of the Visa authentication system."

Nobody is predicting that noncard payment methods will topple credit and debit on the Internet anytime soon, but industry experts say the much-lower price of ACH payments for merchants suggests some rebalancing is in order.

"Merchant preference is the primary driver to new payment forms, not consumer behavior," said Charles Marc Abbey, a partner at First Annapolis Consulting, a Linthicum, Md., payments consultancy. "Visa and MasterCard don't have the most advantageous dispute rules from the merchant perspective, and they are more expensive" than ACH-based transactions.

"ACH has its own problems in terms of the returns that are generated off of Web-initiated ACH, but it is a vastly different price point for ACH and for credit cards," he said.

Speaking more generally about the prospects for some of the newer alternatives, Mr. Abbey observed that, historically, the payments business has been "supply-driven, not demand-driven."

Nevertheless, just as there have been throughout the recent history of the Internet, there continue to be people who say consumer preference will drive the move to alternative payment methods, and who set up business models based on that belief.

For instance, for the last three years PaymentOne Corp. of San Jose has let people charge Internet purchases to a phone bill, among other things. It says it is targeting people who still fear using their credit card over the Internet, as well as the nearly 40% of U.S. households that do not have a credit card.

PaymentOne, whose customers include major Internet service providers such as America Online Inc., says it can facilitate payments by credit and debit card, ACH, phone bill, or direct paper invoice.

Each option has its plusses and minuses, said Don Teague, PaymentOne's vice president of sales and marketing. In the credit card realm, "you've got credit card expiration issues, credit limit issues," he said. "In the ACH world, you'll have issues with insufficient funds, and then we have some other, rather obvious issues with folks using debit cards.."

For two years, I4Commerce Inc. of Timonium, Md., has offered Bill Me Later, which offers instant loans to people buying items at any of 20 merchants, either on their Web sites or by telephone. The participating merchants include 1-800-Flowers.com, Kbtoys.com and Hotels.com.

The underwriting is all done in real time, and people can pay off the loan either within a few weeks at no interest or over time at a 17.99% rate.

Mark Lavelle, I4Commerce's vice president of business development, said the merchant gets paid right away, and I4Commerce assumes the risk. For the consumer, it is "simpler and more convenient," because "all the information you need to make your purchase is basically in your head." Users enter only their date of birth and the last four digits of their Social Security number. They must also agree to certain terms and conditions.

Ms. Weichert of First Data said Bill Me Later, which is part of the Encompass platform First Data has been touting, is one of the many things First Data supports to see what winds up sticking.

"Our goal is to try to help create a market for these alternative payments, and to that end we're really trying to address all of the challenges that have previously prevented those markets from taking off," she said.

Individual merchants can decide which of Encompass' payment services to offer. Some merchants, like Crayola.com and Match.com, offer the TeleCheck direct debit option, which mimics a paper check. Some are using Verified by Visa and MasterCard SecureCode, which prompt consumers to enter a password connected to their card account.

For the time being, "what we will see is a lot of things getting tested, and solutions like ours that lower the cost of testing should increase the general market's willingness to try these things," Ms. Weichert said.

"Something has to give here. The branded debit offering on the Internet is still priced in an area that is fairly expensive for merchants," she said. "The new Visa and MasterCard rates that came out at the end of January are still pretty high. For larger merchants that know their customers [and] that have pretty low fraud rates, they absolutely are going to look at other alternatives."

Bruce Frymire, a spokesman for CyberSource Corp. of Mountain View, Calif., said the increasing globalization of e-commerce is also driving demand for alternative payment options. His "gateway" company connects merchants to the card associations and payment processors.

With more U.S. e-tailers serving customers from other countries, "many of our merchants are now finding that they need to offer more than just the standard credit card options for payments," he said. For example, in Germany, one of the largest markets for e-commerce, "credit cards are not even the preferred payment mechanism," Mr. Frymire said.

Over all, he said, there is a strong demand for electronic checks - which represent up to 15% of the online volume at a small number of merchants - and for person-to-person payments through eBay Inc.'s PayPal, which CyberSource also supports. It also facilitates Bill Me Later, which Mr. Frymire said has had some success in the online flower-selling business.