[FEATURE]

Alternative payments daz

Cool initiatives on a small scale give ISOs and acquirers time to adjust to a shifting consumer-driven landscape

By Richard H. Gamble

KEY NOTES

- To become players in the mobile commerce world, ISOs need to adapt offerings to virtual or Web-based POS systems and ally with mobile marketing, sales, and merchant acquiring service providers.
- SVP, which allows people to shop online and then be routed to their banks' online banking platform to authorize the payment, is attracting niche verticals like universities.
- PayPal becomes more influential with the acquisition of Bill Me Later and with plans to open its platform to third-party developers next month, paving the way for mobile payments.
- While talk about e-money abounds, most systems still ride the current rails, resulting in a charge to a credit card or a debit to a bank account.

Bill Nelson walks through the parking garage to his car after a long meeting. He takes his smartphone from his pocket and searches for Chinese restaurants within 12 blocks that offer takeout. He finds three, and one of them offers a 10 percent off coupon good for the next hour. He enters the address in his GPS and drives off. Four minutes later, he pulls up to the takeout window and hands the phone to the employee so that she can quickly pass it by a scanner to register the coupon and pick up his credit card number from the radio-frequency signal emitted by the chip-embedded sticker he has attached to the phone. Then she hands him his phone and sack of food and he drives away. Nelson is riding the wave of revolutionary change in alternative commerce.

But for the Chinese restaurant, one more credit card transaction has been rung up in its five-year-old POS system, aided by year-old readers for the coupon and chip. And the ISO that has helped the restaurant accept card payments for 12 years earns a few pennies of revenue.

This hypothetical example shows how the world of alternative payments is evolving—a dramatically different shopping experience for the consumer often rides on a totally traditional payment infrastructure.

Fueling Critical Mass

There's no denying the dazzle. For a niche player capitalizing on smartphone technology, consider RideCharge, which specializes in making it easy to book and pay for automotive transport by Web or mobile handset. With "Taxi Magic" software built for the iPhone, Blackberry, and Windows Mobile smartphones, RideCharge has built volume for ground transportation providers in

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major U.S. cities, says George Peabody, director of the emerging technologies advisory service at Mercator Advisory Group in Maynard, Massachusetts.

To use the service, the riders first set up an account with RideCharge and provide card numbers and a billing address. Then, when they need a ride, their phone knows their present location within a few blocks and shows them local transportation options. Riders pick the taxi company they want, enter their pick-up location, and hop in when the ride shows up. At the destination, the driver tells the passenger the charges and the passenger, using the smartphone, picks the card to be used, adds any tip, and authorizes the payment through RideCharge, according to Peabody's published case study. The driver gets confirmation through the company's dispatch system, an inexpensive way to enable electronic payments, and the passenger gets a PDF receipt by e-mail later. RideCharge has to be PCI compliant but the cab and limo companies do not.

If dazzle is just one sign of success, critical mass is quite another. "A lot of these experiments are marginal, one-off stuff," observes consultant Paul Martaus, president of Martaus and Associates in Mountain Home, Arkansas. "They're imaginative, but it will take them years to reach critical mass. You can't get there without attracting both a large group of merchants who want to accept an alternative payment and a massive group of consumers who want to use that alternative payment, and that's hard to do."

"We hear a lot of noise [about e-money schemes] but we don't see much real activity," adds Keith Kallquist, vice president for strategic business development in the treasury services division of Bank of New York Mellon. "At the end of the day, it almost always results in a charge to a credit card or a debit to a bank account. Most e-money systems have built access features on top of existing payment systems."

Services like PayPal, BillMeLater, eBillMe, and Google Checkout offer settlement mechanisms, but they're all "different flavors of vanilla," asserts Kallquist. You can set up intermediate accounts and make or receive payments

ACH Payment Volumes

	2008	2007	% change
ARC	2,679 million	2,666 million	+ 0.49
BOC	78.4 million	4.2 million	+ 1,773
POP	479 million	463 million	+ 3.46
Telephone	347 million	334 million	+ 3.8
Web	2,078 million	1,737 million	+ 19.65

ARC, BOC, and POP are all check conversion transactions: ARC for retail lockbox conversions, BOC for back-office conversions, and POP for point of purchase conversions. "Telephone" is for ACH payments authorized by phone and "Web" is for Internet transactions settled by ACH.

SOURCE: NACHA

through those accounts, but a buyer has to fund them by writing a check, charging an amount to a card, or authorizing an ACH transfer from a bank account, he maintains. The merchant typically moves funds that accumulate in an alternative account into a traditional account to get full use of the funds.

There has been some growth in e-money that is tied not to credit cards or bank accounts but to telephone accounts, Kallquist reports. There is a group of providers—Bill to Phone, Bill2Phone, mPayy—that let you pay through your account with a telecommunications provider, but that phenomenon is neither new nor large, he says. "Phone companies have exposed their billing to third-party providers for years, but at the end of the month, you pay for what you bought, along with your phone bill, in a traditional way."

Another size limiter is that most e-money schemes "only work in an online environment," Kallquist observes. "Some day you might be able to use your Google Checkout Account to pay at Wal-Mart or your PayPal account to buy stuff at Target, but there's no way to do that today. There's still a clear line between online and off-line commerce."

Making Money on Money

While selling alternative payments to consumers means emphasizing convenience, security, and privacy, an economic driver for the providers is something economists call "seniorage," Kallquist says. You take real money and give it to someone else who promises to make it conveniently available to you at a later time, he explains. Meanwhile, they hold the real money and can earn interest on it. In this respect, many of the alternative payment schemes are like American Express travelers checks. "Diverting real money to the providers of alternative payments may be a huge motivation for many of these enterprises," he notes.

Prepaid cards, which reward issuers with both seniorage and spoilage, have grown significantly, with $13.6 billion in closed-loop gift cards, $5 billion in open-loop gift cards, $23.6 billion in payroll cards, $3.9 billion in employee incentives, $2.8 billion in consumer incentives, and $2.2 billion in general purpose reloadable cards, according to Mercator data from 2007, the most recent available.

But tickling consumers' fancy is also an important driver. For example, blooms® grocery store provides shoppers a UPC scanner. Pick up some pickles, soup, and cereal, and scan your items as you load your cart to reduce check-out times. A shopper can even set up a prepaid account at blooms® and just walk past the register and out of the store. "That's not so much an alternative payment as an improved shopping experience enabled by an alternative payment scheme," Kallquist observes.

So why do some merchants favor e-money schemes over MasterCard or Visa when they have to pay roughly the same discount rate and when money goes into a less accessible account? Part of the answer may lie in the cost of meeting the card network merchant stipulations, including PCI compliance. E-money schemes usually keep the merchant from touching the consumer's credit or debit card number or bank account information.

Cornering the Online Market

The clearest example of an alternative payments system that is reaching critical mass, Martaus says, is PayPal. The smashing success of eBay as an online marketplace with PayPal as the settlement component has propelled PayPal to mainstream numbers and recognition. "eBay bought PayPal and applied dramatic imagination," he says. "It's the settlement mechanism for the most popular online auction site, and it has spread beyond eBay transactions. I can buy an airplane ticket online and pay for it from a PayPal account."

San Jose, California-based PayPal, a global closed-loop network, holds 75 million active registered accounts. In addition, 3 million merchants globally offer PayPal as a payment option, according to Anuj Nayar, director of communications. The buyer and seller engaged in online commerce both must have PayPal accounts. The buyer funds the paying account, typically by charging the funds to a credit card, using a debit card, authorizing an ACH funds transfer, or using

Prepaid Card Issuance (2007 numbers)

Closed-loop gift cards	$66.0 billion
Open-loop gift cards	$5 billion
Payroll cards	$13.6 billion
Employee incentives	$3.8 billion
Consumer incentives	$2.8 billion
General purpose reloadable	$2.2 billion

SOURCE: Mercator Advisory Group

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a balance that's already in the account. When the purchase is finalized, PayPal moves the funds from the buyer's account to the seller's. Anyone can earn interest on balances in their PayPal account if they sign up for a money market fund, Nayar adds.

The value of payments made through PayPal in 2008 came to $60 billion, Nayar says. On average, PayPal holds about $3 billion at any one time in account balances, he adds. "We bridge the Internet and the financial services world," he claims. "We're the only truly global online payment platform. We connect to 27 financial networks and 15,000 local banks. It took us 10 years to get here. We have no plans to enter the off-line world," he explains.

Two major initiatives will change the way PayPal operates. With the acquisition by PayPal of Bill Me Later, buyers will soon be able to buy now and pay later, drawing on "transactional" credit that will work much like a credit card except without a committed credit limit, Nayar explains.

The other change is that PayPal will open its platform in November to third-party developers, paving the way for PayPal to be built into mobile device platforms as a settlement option, Nayar reports. PayPal already has worked with RIM to enable BlackBerry users to download applications through the BlackBerry App World and pay for those that carry a price tag through their PayPal accounts, he explains.

While PayPal is not usually sold to merchants through acquiring banks and ISOs, they could be eligible to sign up merchants and earn a share in the revenue, Nayar says.

Ushering in ACH's Next Iteration

While versatile technology and diverse needs are driving a proliferation of alternative payment ventures, "there's no need to reinvent the payment rails," notes Jan Estep, president and CEO of the National Automated Clearinghouse Association (NACHA), which oversees operations of the ACH, one popular set of old rails.

While the ACH is a traditional payment system long used for such things as direct deposit of payroll, it is a growing commercial payment alternative, both online and in the brick-and-mortar world, thanks to three successful check conversion programs. Online merchants who started by taking credit card payments are actively promoting the less expensive use of ACH transfers from bank accounts. In the process, they are denting the revenue of card issuers and merchant acquirers. NACHA statistics show that Web-based ACH payments topped 2 billion in 2008, an almost 20 percent increase from 2007. (See Table on ACH payment volumes.)

Check conversion has grown into a big business. More than 3.2 billion checks were converted to ACH debits in 2008, up 103 million from 2007, no doubt helping checks survive as a viable alternative to card payments. While the highest volume of conversions occurs in lockboxes, the fastest growth—more than 1,700 percent—is in back-office conversion, the newest conversion option. Conversion at the point of sale is up a modest 3.46 percent. (See Table on ACH payment volumes.)

NACHA's latest alternative payment, now in the early rollout phase, is called secure vault payments or SVP, explains Samantha Carrier, senior director for advanced payment solutions. SVP allows people to shop online and load a shopping cart, but at checkout, they can choose the SVP pay option and be routed to their banks' online banking platform to a page that only allows authorization of that particular payment. The account holder is dealing only with his or her bank at this point. "It's an elegant loop, fast and seamless," Carrier says. "There are virtually no data to enter." It's highly secure, and merchants like it because, once authorized, payment is assured. "There are no charge-backs for 'I didn't do this transaction,'" she says.

SVP is attracting interest from niche verticals like universities, Carrier reports. The University of Georgia went live in April, and more than 50 colleges and universities have signed up for the service. Both the online merchant and the buyer's bank have to be participants in this closed-loop network for it to work, she explains. The merchant's bank pays the shopper's bank an authorization fee, set by NAHCA, for the transaction. The SVP service could be sold to merchants through acquiring banks and ISOs, she adds.

Tracking a Smartphone Revolution

Smartphones are increasingly driving how consumers interact with merchants, Peabody reports. "No fundamentally new payments infrastructure has emerged, but the broader commercial ecosystem is changing radically as elements of the point of sale move into the mobile hand set. The POS hardware manufacturers and the ISOs that support traditional merchants are facing a big change. More and more, we'll see payments embedded in the purchasing experience."

How card data is captured is taking a new twist. Peabody notes a shift in momentum from near-field communication (NFC) to card-not-present mobile payments. "While card brands, issuers, and behemoths in the mobile ecosystem struggle to make NFC a reality, opportunistic payment service providers and merchants are capitalizing on smartphones to grow transaction volume through information-rich interfaces, account access, and even card not present payments," he writes in the report *Remote Payments on the iPhone: Account Access, Card Not Present, and a Seamless Payment Experience*.

The telecommunications providers that are so deeply involved in mobile commerce don't want to see payments made as charges to a phone bill, Peabody says, but they do want to earn something, and so far, that hasn't happened. "The mobile providers are looking for a share of the revenue, but banks don't want to share, and the current model doesn't accommodate sharing." Billing a purchase to a mobile phone account only works for the sale of digital goods, and then the mobile providers take 25-50 percent of the transaction, not an attractive proposition for most merchants, he adds.

ISOs aren't necessarily shut out of the mobile commerce world, Peabody says, but to become players, they need to adapt their offerings to virtual or Web-based POS systems and ally themselves with mobile marketing, sales, and merchant acquiring service providers. ***TT***

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