

Expedited payments: The next frontier in US online financial services

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ABSTRACT

This paper explores the factors behind the growing consumer demand for expedited online bill payments and how US-based financial institutions and service providers are responding to the trend. While creating a new fee income stream is a factor for financial institutions, the income potential is outweighed by the increased consumer loyalty and the associated deposit growth. Various models for conducting expedited payments are evaluated.

Keywords: expedited payments, online bill payment, online banking, electronic payments

INTRODUCTION

The growth in the use of expedited payment services is making them the next 'must have' feature for online banking. In fact, according to research from Aite Group, expedited bill payment via online banking is the top product development priority for financial institutions over the next 24 months. Fully 65 per cent of financial institutions expect to offer the service within two years, compared with only about 9 per cent currently offering expedited payments.¹

First, this paper defines what is meant by 'expedited payments'. It defines an expedited payment as an electronic bill payment initiated by a consumer that is guaranteed to arrive at the biller and be posted either the same day it is requested or the next day. In either case, the expedited delivery date should be sooner than that available under standard delivery timeframes and is typically only available to the consumer for a premium service fee.

Use of online bill payment services in general continues to grow, with Online Resources Corporation witnessing year on year increases of around 20 per cent. The US Postal Service Household Diary Study found that 32 per cent of bills in 2007 were paid electronically — either through direct debit or online bill



payment — an increase from 19 per cent in 2003. Still, with the early adopters already on board, and with many financial institutions now providing free online banking and bill payment, the pace of growth has tempered.

Expedited payments could provide the impetus to drive more users to online bill payment, while also helping to return online bill payment into a fee generator. Research backs this up. In the first half of 2008, the company surveyed 14,000 online banking customers and found that 67 per cent of those who do not currently use online bill payment would be more inclined to with the availability of expedited payments. As more financial institutions understand that offering free bill payment reaps longer-term benefits of higher account balances and deeper consumer relationships, the perceived value of ancillary products driving adoption of online bill payment will continue to grow.

Financial institutions now have an opportunity to capture a larger share of expedited payments from billers, providing one-stop convenience for their customers and engendering a higher degree of loyalty to the institution.

MOVING FROM BILLER TO FINANCIAL INSTITUTION

For several years, a variety of billers, such as utility companies, telecommunication service providers, credit card issuers and mortgage lenders, have made expedited or same-day posting services available directly to their customers. Payments to credit card companies continue to be the most common use of expedited payments, but there is growing use for mortgage and utility payments as well.

With these biller-direct expedited payments, consumers who have forgotten to pay their bill or are having cash-flow issues

can log on to a biller's website and schedule a payment for immediate or next day posting and thus avoid a late fee. In fact, a recent survey found that 'avoiding a late fee and penalties' was the motivation behind 84 per cent of people who made an expedited payment. While the consumer is charged a fee for this convenience, expedited payment fees tend to be in the range of US\$5–10, while late payment penalties are generally in the US\$20–50 range, making this an economically rational choice for the consumer.

For the biller, this not only serves as a convenient payment mechanism for their customers, but also improves their receivables management, as the biller receives its payments more quickly and securely and no longer has to contend with the excuse of 'the cheque is in the mail'. Despite its overall benefits, this model is not necessarily efficient for the consumer, who needs to navigate to numerous biller websites, follow different login and navigation processes, and pay varying fees to use the expedited payment feature to pay their various bills.

Institutions are now entering the next phase of expedited payments. Within the past year, more than 500 of Online Resources Corporation's financial institution clients have begun to offer their customers expedited payments fully integrated into their existing online banking and bill payment service. This is a natural service extension and will soon be the price of entry for financial institutions that want to participate in the bill payment space.

DRIVERS OF CONSUMER USAGE

A consumer's decision to use expedited payment services is driven by one of two scenarios. In the first, the consumer has simply forgotten that a payment was due and wants to avoid a late payment fee.

Remember also that, with some bills — notably for credit cards where use of expedited payments is proving most popular — there is not only the immediate hit of a late payment fee but also potential damage to a credit record and the possible imposition of higher interest rates. In this case, the consumer presumably would make an economically rational decision to pay a fee for an expedited payment as long as that fee was less than the potential late fee.

In the second case, a consumer simply needs the option of making expedited payments to match their own cash-flow needs. These users want to pay their bills on time but often lack the financial means available to do so. The solution, again, rather than being subjected to late payment fees and other consequences, is to accept a fee for the expedited payment service in order to time payments to coincide with their cash flow.

In this situation, users may be paying their bills online, but increasing demand is being seen for ‘walk-up’ payment services at outlets such as cheque-cashing stores. For instance, Online Resources Corporation is providing bill payment services through ACE Cash Express Inc., with 1,800 outlets, and DolEx Dollar Express, Inc., with 785 locations, among others. These users are presumably more comfortable transacting outside the banking system and should be less fee-sensitive.

Interestingly, a 2005 study from TowerGroup shows that 65 per cent of consumers who use expedited payment services make at least five transactions per year.² This finding is backed up by a separate research report from Javelin Strategy & Research, which found that 20 per cent of consumers make at least two expedited payments per month. Nevertheless, Javelin found that still only 29 per cent of consumers have ever made an expedited payment.³

The research company concluded:

‘Due to several factors, including the continuing decrease in the consumer savings rate, Javelin believes that this subsection of the consumer population will continue to use last minute payments as a way to partially manage debt — leveraging time to the fullest in delaying bill payments.’

Of course, the consumer could attempt to send an overnight cheque, but there are many obstacles to ensuring that this tactic would meet the objective of avoiding a late payment. For instance, the consumer generally only has a biller address that includes a post office box, to which overnight payments cannot be mailed. Thus, the consumer must track down a physical address to send the payment. Receipt at this address, even if correct, does not guarantee the payment will be posted on time. Most likely, the cheque will go into some type of exception processing, delaying the posting of the payment.

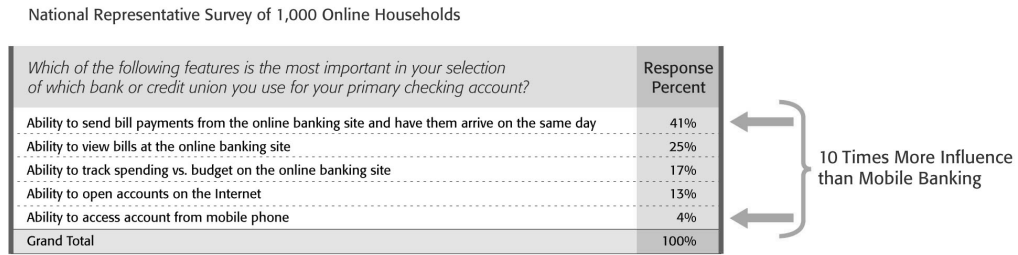
So, for a variety of reasons, a banking-based expedited payments solution meets the needs of both the consumer and the biller. In fact, consumers who have used expedited payment services through their financial institution are quite happy, with 88 per cent saying they were ‘satisfied’ or ‘very satisfied’ with the experience, and 94 per cent planning to use expedited payments in the future.

THE FINANCIAL INSTITUTION PERSPECTIVE

With clear consumer demand for expedited payment services, the question remains: will that demand be met through biller sites or through financial institutions?

Initially, the prospect of additional revenue generation would seem to be the

Figure 1 Same-day payments are a key driver in selecting a primary financial institution



Source: *Online Resources Consumer Preference Survey, 2008*

lure for financial institutions looking to implement expedited payments. But in reality, the potential for revenue generation is only a small part of the value proposition for expedited payments. While reaping additional income from bill payment services with expedited payment fees is enticing, the real benefits are in customer acquisition, retention and deposit growth.

What are the other drivers, then, for financial institutions to implement expedited payments services? The nationally representative consumer survey showed that a strong 41 per cent of consumers said the ability to send same-day bill payments from an online banking site is a key factor in choosing a primary financial institution (see Figure 1). This is an opportunity for financial institutions to use the one-stop shop approach to reclaim some of the payment landscape they have ceded to billers.

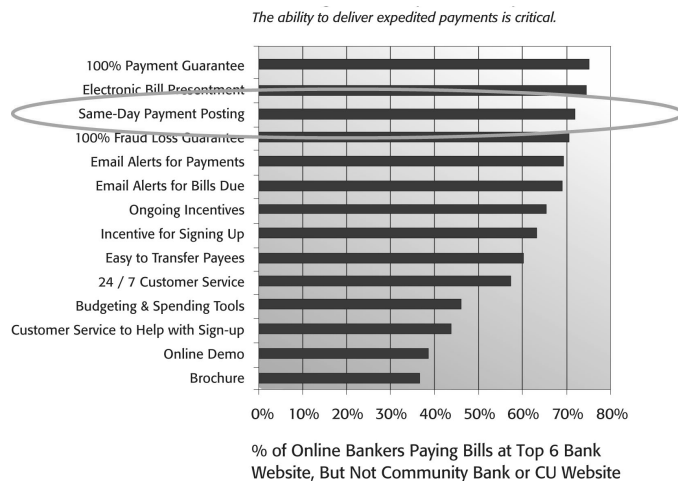
Worth noting here is that, despite all the hype surrounding mobile access, only 4 per cent of respondents to the company survey said that being able to access their account from a mobile phone was important. One might surmise that the money and resources currently being deployed for mobile banking might very well be better allocated to implementing expedited payment solutions that require less of an investment in both financial and technology resources.

The survey data show that expedited payments services can be a key for customer acquisition and retention (see Figure 2). In addition, widely recognised research by Boston Consulting Group and Forrester shows that banking customers who use online bill payment services tend to maintain higher balances.^{4,5} Increased balances, more customers and added customer loyalty are certainly critical factors for a successful web banking offering.

Another benefit to financial institutions is the creation of a new revenue stream. Javelin Strategy and Research forecasts in its February 2007 report⁶ that revenue from expedited payments is growing at a Compound Annual Growth Rate (CAGR) of 11 per cent, from US\$1.3bn in 2006 to an estimated US\$1.7bn in 2009. But at the same time, the mean price for the services is expected to decrease from US\$5.61 per transaction in 2006 to US\$3.14 in 2009. Thus, while fee income is a component of the decision to deploy expedited payments, it is outweighed by the other factors of more customers and enhanced loyalty.

CRITICAL COMPONENTS OF A SUCCESSFUL EXPEDITED PAYMENTS SERVICE

This paper has established the growing consumer demand for expedited payments



Source: Online Resources Consumer Preference Survey, 2008

*Figure 2
Arguments that consumers find convincing for switching from a top six bill payment site*

and demonstrated the advantages for financial institutions in terms of both customer satisfaction and potential added revenue. But what models work best to gain adoption and drive usage?

Following are some key factors to consider when implementing an expedited payments programme.

Measuring the 'network effect'

The network effect refers to the raw number of consumer accounts and biller endpoints that can be connected (see Figure 3). For instance, the Online Resources network has the ability to link approximately 95 per cent of consumer cheque accounts in real time with thousands of commercial billers, credit card issuers and credit service providers across the nation. Without such a network, transactions between banks and billers are in most cases routed through third parties. This network allows for accurate and efficient routing of 'on-us' transactions. On-us transactions also increase payment speeds, therefore enabling a robust expedited payment service. As more billers are linked to the network,

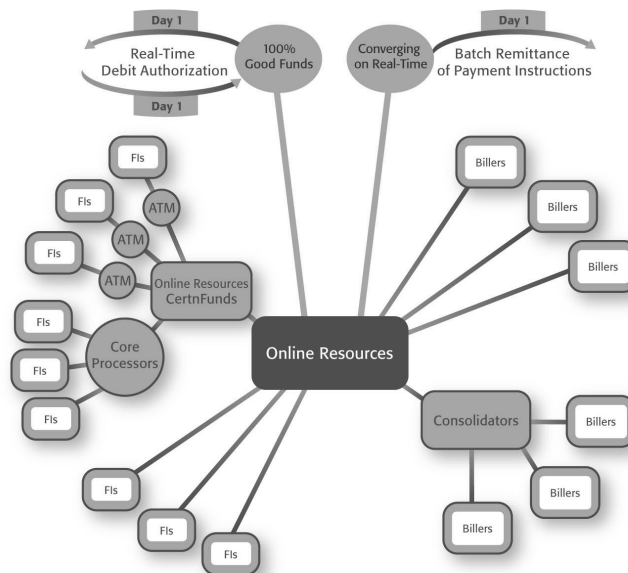
more payments can be enabled for expedited delivery.

An efficient funding model

A secure funds model with real-time debiting provides the quickest, most convenient and consistent payment process. In this model, the consumer requests that a payment be made, the debit is authorised from their account in real time, and it is then directly posted at the biller in a specified timeframe. Every time the consumer attempts to make a payment, they will see the same delivery scheduling options. If the funds are not in the account, the payment is not executed, and thus a non-sufficient funds (NSF) charge is never incurred by the consumer. This method, referred to as a 'guaranteed realtime good funds' model, provides the most efficient and consistent user experience.

Alternatively, some providers incorporate risk scoring into the payment process, where the consumer's risk profile must be assessed according to the payment amount, the account balance and past history of payments at the time of

Figure 3
Guaranteed realtime
good funds



scheduling. Once assessed, the consumer is provided with a payment delivery schedule according to their risk profile. The schedule will provide faster options if the profile is of a certain quality, and slower options if it is not. Instructions for payments are executed regardless of whether funds are in the account, and are processed overnight in batches which at best provide for settlement in 1–2 days via an ACH transaction. This model may provide some marginal benefit to the financial institution, but can result in an unsatisfying and confusing experience for the consumer, who may see changing payment delivery schedules depending on their desired transaction at a specific point in time. This model could not support a consistent consumer experience for an expedited payments service, which as noted previously is used primarily when speed of payment is of utmost importance to the end user.

Guaranteed payment

Critical to consumer adoption of an ex-

pedited payments service is a payment guarantee. Most providers of online bill payment services provide some type of payment guarantee to protect the user from late fees and charges if a payment is not processed properly. Beyond ensuring accuracy, a critical component of the guarantee for an expedited payments service includes assurance that the payment will not only be sent the same day but will also be posted the same day.

Accuracy and efficiency

As many as 85 per cent of electronic bill payment errors are user-generated, such as incorrect entry of an account number. Online Resources uses an application called Real-Time Digital Scanline (RTDS) which validates user-entered data in real time. Specifically, at the time of payment, RTDS checks criteria such as account number masking, validation of prefixes and suffixes, digital algorithms, remittance addresses and special cleaning and adjustment rules.

Fewer errors mean not only more



Source: Online Resources

Figure 4 Same-day payment capabilities create financial institution revenue opportunities

satisfied customers, but also lower customer service costs.

Ease of use drives adoption

Ideally, the expedited payments option is seamlessly integrated into the financial institution's bill payment infrastructure. This can be likened to ordering on amazon.com, where the consumer can simply choose the preferred shipping method when the order is placed. The same process is used whether there is regular or overnight shipping. The same integration should apply to expedited payments, as shown in Figure 4, where consumers simply choose their speed of payment delivery. Non-integrated services require the consumer to use an alternative payment process, sometimes with an additional account sign-in and opening of additional, different windows outside the payment application. This dual process has been found to increase complexity and discourage use. Financial institutions and other bill payment providers, such as walk-up payment providers, who want to integrate expedited payments functionality within their own solution can take advantage of expedited payments processing functionality through a stand-alone API application. This approach will allow them to integrate the consumer experience while still maintaining ownership of the front-end consumer experience.

Marketing and awareness

Marketing to consumers is a critical component of a successful expedited payments service. Creating awareness of the service means that consumers will understand they can rely on it when time is critical. Financial institutions and billing service providers are experimenting with various tactics to increase awareness and drive usage, while minimising consumer intrusion.

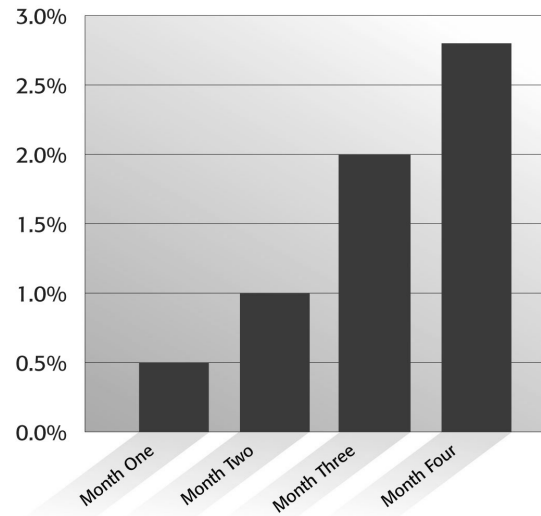
Similarly, financial institutions are experimenting with a variety of price points and fee structures to achieve optimal usage.

A REAL-WORLD EXAMPLE

Silver State Schools Federal Credit Union in Las Vegas, Nevada, implemented Online Resources' Expedited Payments service in February 2008, and their early experience is instructive. Silver State Schools FCU has more than 70,000 members and more than US\$900m in assets. The education-based credit union operates in 21 locations throughout Nevada.

The institution was prompted to institute an expedited payments feature for reasons mentioned above, with the key goal to meet member demand for the service. The credit union also saw this as an opportunity to position itself as the primary financial institution for its mem-

Figure 5 Same-day payments adoption rate



Source: Silver State Schools Federal Credit Union, July 2008

bers' use. Sliver State Schools FCU set a transaction fee at US\$6.95 and launched the service with an aggressive marketing campaign. The service was integrated with the institution's existing functionality and was accompanied by customer service training and tools.

During the first month, approximately 0.5 per cent of online payments were made through expedited payments. But this quickly doubled to 1 per cent in month two, doubled again to 2 per cent in month three and, by the fourth month, 2.8 per cent of bill payments were expedited (see Figure 5).

Not surprisingly, credit card bills were the most frequent payment made. In fact expedited payments accounted for 3 per cent of payments made to one large credit card issuer.

Some other interesting usage trends emerged. Nearly half (47 per cent) of expedited payment requests occurred after the cut-off time for a same-day transaction, demonstrating a strong demand for next-day processing. Within just the first 90 days, 7 per cent of the members using

expedited payments made multiple payments. All this usage was generated with minimal marketing, although the credit union is using some internal banner ads to promote the offering.

Importantly for a service-driven membership organisation such as a credit union, call centre impact was minimal and neutral. To date, there have been no customer claims for missed payments through the expedited channel.

This implementation and launch of the expedited payments service was highly successful, largely because the institution strove to meet its customers' needs and was committed to following the best practices learned to date.

A LOOK INTO THE FUTURE OF EXPEDITED PAYMENTS

Expedited payments currently account for fewer than 1 per cent of all online payments, but this share could increase to between 1.5 per cent and 2 per cent by the end of 2008. With the current pricing structure in place, one can see expedited

payments accounting for approximately 2–3 per cent of all payments in the near term. While this may seem like a limited adoption rate, the fees generated at this usage level would be sufficient to cover the cost of a bank's entire online banking and bill payment service offering, whereas banks currently provide these services primarily as a loss leader.

But as the research suggests, fees are already under pressure, and financial institutions are experimenting with a variety of price points and fee structures. Nevertheless, expedited payments remain an economically rational choice as a method to avoid late payment fees as long as the service fee is less than the penalty.

Ultimately, expedited payments may follow the same path as online bill payment, where the once a fee-for-service model relatively quickly became a free service to drive customer acquisition, support customer retention and enable the financial institution to grab a larger share of the deposit market. A likely intermediate step is that the fees will begin to decline on same-day or next-day expedited payments, while the emergence of real-time expedited payment functionality rises to the top of the premium fee schedule.

On the technology side, the industry is clearly moving toward real-time debiting and posting, which is no doubt what tech-savvy consumers will expect and demand. In the meantime, financial institutions have a window to capture increased wallet share and develop a new revenue stream.

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