

---

## The Next Payments Frontier

### ***Electronic Payment Acceptance and the Small Business Market***

Karen L. Webster\*

May 2008

---

#### Introduction and Survey Overview

*Small business is described as the lifeblood of the U.S. economy – and for good reason. In 2005, the last time the data were updated, it was reported that there were approximately 26.8 million small businesses in the U.S., representing roughly 99.9 percent of all business there.<sup>1</sup> These businesses account for half of all private sector employment and output.<sup>2</sup>*

Market Platform Dynamics (MPD) completed a survey of 545 small businesses in April 2008 to better understand the state of electronic payment acceptance in the small business market.<sup>3</sup> For the purposes of this survey, small business is defined as those with annual revenues between \$100,000 and \$5,000,000.

The survey was designed to test several key hypotheses related to the small business market and electronic payment acceptance<sup>4</sup>:

- Payment collection is a matter of great importance to small businesses.
- Small businesses' transactions are predominately paper check-based and paper checks are the preferred method of payment.

---

<sup>1</sup> Small business in this case is defined as those with fewer than 500 employees. 97 percent of all firms in the U.S. have fewer than twenty employees.

<sup>2</sup> SBA Office of Advocacy; The Small Business Economy for Data Year 2006.

<sup>3</sup> MPD is grateful to PaySimple that provided funding for this project.

<sup>4</sup> The survey was conducted online and included 30 questions covering six topics: respondent demographics, banking relationships, payment methods (past, present and future), payment card acceptance, payments mix and receivables management.

\* Karen L. Webster is President of the strategic management consulting firm, Market Platform Dynamics. These survey results were first presented at NACHA's Payments 2008 Conference in Las Vegas on May 20, 2008. Questions about republication or comments on this paper should be directed to the author at [karen.webster@marketplatforms.com](mailto:karen.webster@marketplatforms.com).

- Small businesses that accept electronic payments have fewer problems with payment collection and tend to have shorter receivables cycles.
- There is a positive correlation between small businesses that use online banking and other web-based financial services and electronic payment acceptance.
- There is a correlation between transaction size and electronic payment acceptance: the larger the transaction size, the less likely it is via an electronic payment method.
- Small businesses look to their bankers to help them evaluate their options related to electronic payments and are satisfied with the services received in this area.

This report will provide an overview of the survey results and is organized around 5 key insights gleaned as a result of analyzing our survey data.

## Key Findings

*Collecting payments matters to small business – and why shouldn't it? It is literally the one thing that small business cannot live without. To prove this point, and with a sense of humor, we asked our survey respondents whether they would give up coffee for a week in exchange for a solution that made it faster and more efficient for them to manage payments collection. More than half – 52 percent – said they would. And, more than half of those said they would switch service providers to get a better and more efficient solution.*

We have devised 5 key top line findings from our work, which shed new light on several of our original hypotheses.

***Collecting payments is a matter of strategic priority regardless of the size of the small business.***

The size of a business' bank account or its annual revenue has no bearing on the relative importance of payments collection. Larger businesses in our sample (those with annual revenues of between \$2.5 and \$5 million) may be more sophisticated users of electronic invoicing and other web-based financial services including online banking, but they are kindred spirits with their smaller business brethren when it comes to a desire to collect payments faster and more efficiently.

***Small business lags the general U.S. economy in the adoption of electronic payments.*** As the Federal Reserve reports a significant decline in the use of paper checks, small businesses still report checks as their dominant payment method. Only about 48 percent of our survey sample accepts electronic payments. There is some slight variability among size and type of company, and even size of transaction, but more don't than do. For those that accept electronic forms of payment, sales over the web and phone amount to less than 20 percent of their total revenue today.

***Acceptance is driven by their customer's needs for more payment options.*** The adoption of electronic payments is driven primarily by their customer's preference for payment method. Fees play little part in the decision by the small business owner to accept or not accept electronic payments. As we've seen elsewhere in the payments industry, fees are an acceptable tradeoff for sales lift. Our survey respondents reveal that if their customers want to pay using electronic payment methods, then they will comply and implement a solution that allows them to do that.

***Familiarity breeds satisfaction – and dissatisfaction.*** Small businesses that have implemented electronic payments see its value and state that they prefer it as a payment option. By and large, these small businesses seem dissatisfied with their current solution – and have stated that they will move to a service provider that offers them a better one. Interestingly, more than 60 percent of survey respondents report having the same banking relationship for over 5 years and being very satisfied with it. It seems that in the case of payment collections, loyalty only goes so far.

***Small businesses anticipate a move towards electronic payments in the next two years.*** Even though less than half of our survey respondents accept electronic payments today, nearly 90 percent of our sample expects that electronic payments could account for as much as 25 percent of their transactions within the next two years.

## The Survey Respondents

***The survey respondents reflect a diverse group who have been in business for a very long time. More than two-thirds have operated their businesses for more than 10 years and 65 percent employ between two and 10 employees.***

Most of the companies in our survey are concentrated in consulting/legal accounting, retail, healthcare and construction fields. If legal and accounting services were included with consulting services, it would represent the largest industry concentration overall within our sample.<sup>5</sup> Most of the businesses in our sample are not sole proprietorships.

Eighty-nine percent have annual revenues of less than \$2.5 million and 74 percent report annual revenues of less than \$1 million. Fifty-five percent of the businesses in the survey report a typical transaction size of more than \$500. Most say that their customers transact with them on a monthly basis.



**Figure 1.0: Industry Concentration of Firms in Sample**

Most of the businesses in our survey report that they do business with the end consumer, so operate a B2C enterprise. This, as you will see, has important implications with respect to electronic payment acceptance.

<sup>5</sup> Other, as an industry segment, is concentrated in domestic services and other one-off businesses.

**Key Insight: Collecting payments is a key strategic priority.**

*Collecting payments is noted as a top business challenge, despite the fact that most of our respondents report no serious delays in collecting payments. Somewhat surprisingly, payment collection issues seem to plague those who already accept electronic forms of payment, e.g. credit and debit cards, more frequently than those who do not.*

Collecting payments was identified as a top priority about one-third of the time – tied with staffing as a clear number four. At first blush, this might not sound significant, but closer examination shows that the first three priorities - cost increases, competition and sales – are universal concerns for all businesses and seem quite logical in their sequencing: you have to beat your competitor and get sales before worrying about collecting payments.



**Figure 1.1: MPD Survey Respondent Top Business Challenges**

Forty-nine percent of those in our survey who accept electronic payments report “moderate” delays in payment collection as compared to 36 percent of those who do not accept electronic payments. Some explanations for this might include the industry in which the business operates and payment method used (e.g. no available card, payment by check and check not clearing).

Conversely, those that operate B2B enterprises and who transact business with their customers on a regular basis, may treat slight delays as a concession to keeping the overall business relationship.

More than half report a payment cycle of less than 45 days, with many in the retail and health care sectors and even some service sectors receiving payment upon completion of the service/transaction. Delay and collection issues, it seems, is in the eye of the beholder.

**Key Insight: Small business lags in adopting electronic payments.**

*Small businesses that accept electronic payments prefer that method of payment. That notwithstanding, less than half of all companies in our sample view electronic payments as their most preferred payment method.*

Slightly more than half of our sample, 52 percent, does not accept electronic payments for any transaction. And, although most of the businesses in this survey operate web sites, only 25 percent of those have the capability of accepting payments via that web site. Even fewer, about 13 percent, say that they use electronic means to generate and send invoices to their customers. Only about 25 percent say they generate an invoice at all.

Paper check remains the preferred method of payment: roughly 48 percent of our sample prefers checks to cash. Although there is some variability by industry, none was found by size of company. Interestingly, electronic payment did not trump paper check as the preferred method of payment in any size category; although the gap between those that do and those that do not is greatest in those businesses that transact with other businesses, e.g. B2B enterprises.

There seems to be a correlation between acceptance and typical transaction value. Those businesses that do not accept electronic payments are more likely to have a higher overall transaction value. Sixty-six percent of businesses that report a transaction size of over \$500 say they do not accept electronic transactions – and cater primarily to a B2B customer who pays by check.

**Table 1: Transaction Size and Electronic Payment Acceptance**

Transaction Size	B2B		B2C		Overall
	Accept	Not Accept	Accept	Not Accept	
<\$75	12%	5%	47%	27%	24%
\$76 - \$500	44%	18%	38%	25%	32%
>\$500	44%	77%	15%	48%	44%

That observation shifts significantly when one looks at just the businesses that accept electronic payments today: they overwhelmingly prefer electronic payments.

**Table 2: Use of Electronic Payments and Preferred Payment Method by Those Who Accept Electronic Payments**

Type	% Accepted
Cash	27.90%
Paper Check	31.80%
Electronic Payments	40.70%

Similarly, those that are “online savvy” (e.g. use online banking services, generate electronic invoices) are more likely to accept electronic payments.

**Table 3: Use of Online Banking / eInvoicing & Acceptance of Electronic Payments**

	eInvoicing		Online Banking	
	Accept	Not Accept	Accept	Not Accept
Use	57%	43%	50%	50%
Don't Use	43%	57%	39%	61%

Now, contrast that to what is happening outside of the small business sector. The most recent Federal Reserve Survey<sup>6</sup> states that about two-thirds of non-cash payments are electronic and that non-cash payments have increased nearly 5 percent per year since 2003. Driving that growth is the sharp increase in ACH debit card usage. And of course, larger businesses are increasingly taking payments electronically via debit and credit cards from consumers and using wire transfer for payments to transact with other businesses.

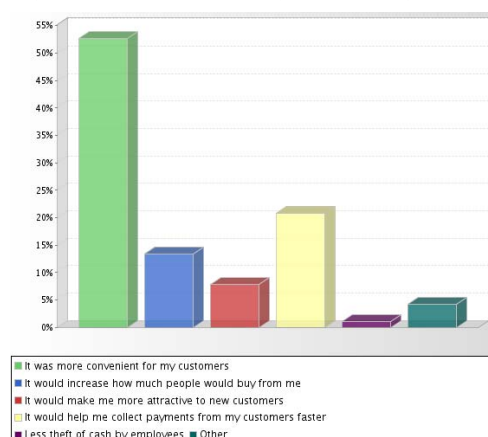
<sup>6</sup> The 2007 Federal Reserve Payments Study: Noncash Payment Trends in the United States: 2003-2006.

**Table 4: Federal Reserve Survey: Number of Non-Cash Transactions across U.S. Small Businesses**

Type	2003	2006	CAGR
Checks	81.4	93.3	-6.40%
Debit	15.6	25.31	17.50%
Credit	19	21.7	4.60%
ACH	8.8	14.6	18.60%
EBT	0.8	1.1	10%
<b>TOTAL</b>	<b>81.4</b>	<b>93.3</b>	

**Key Insight:** Acceptance is driven by the customer's need for additional payment options.

*As customers increasingly demand electronic payment options, adoption by small businesses is also expected to increase.*

**Figure 1.2: Drivers of Payment Acceptance**

Small businesses have always opted into new payment methods when they are convinced that there is a significant group of customers who wish to transact using that particular payment method. In fact, the most successful payment systems over time have been driven by customer preference for merchant acceptance, although it is obviously essential to have both merchants and customers on board the payment platform for it to ignite.

According to our survey respondents, electronic payments acceptance is less related to fees, interest in technology, fears of theft or, oddly, collecting payments faster. It is

overwhelmingly about responding to customer needs: making it easier for them to complete transactions and even increasing transaction size and frequency. Convenience, cash flow and sales lift – not cost – drive adoption decisions. Cost is cited as an issue only when “there is not enough business to warrant” an electronic payment solution.

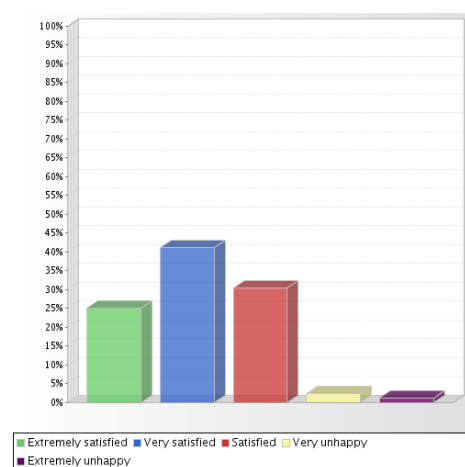
There is a distinction between those enterprises that do business primarily with the end customer and those that transact primarily with other businesses. Most businesses in our survey do business directly with the end consumer, with roughly one-third of those businesses accepting payments electronically and with the profile of that business as having greater than \$1million in sales annually. Fewer than 20 percent of the B2B enterprises report accepting electronic payments, with most of those businesses reporting annual revenue below \$1million annually. We, therefore, observe that electronic payment use, acceptance and interest is a function of who the business' end customer is and whether it is convenient for them to transact using an electronic method of payment. This also supports the previously reported Federal Reserve Data on consumer adoption of debit and credit cards; those consumers that have cards want to, and expect to, use them in a variety of retail locations and B2C businesses have responded accordingly.

**Key Insight: Small businesses that have implemented a payment solution want better solutions with more functionality.**

*We've established that small businesses think that electronic payments are important. Those that have experienced the value of transacting electronically want a better solution and are willing to switch service providers to get it.*

According to our survey respondents, small businesses look to their banks to help them find solutions that make it easier for them to bill and collect payments from their customers. This is increasingly in the form of enabling electronic payments – and even enabling electronic invoicing and/or integrating these solutions into existing accounting packages. Small businesses don't have the resources, the time or perhaps even the expertise to find and coordinate the variety of vendors to help with this aspect of their business. That is why they turn to their banker for help and report having had the assistance of their banker in implementing their current electronic payment solution.

**Figure 1.3: Small Business Satisfaction with Bank**



As reported earlier, survey respondents report a long standing and satisfactory relationship with their banker, with only three percent stating that they are unhappy. However, these relationships seem expendable: survey respondents that already accept electronic payments and who receive help from their banker in this area report being much more interested in switching banks for a better set of services than those who don't accept electronic payments today.

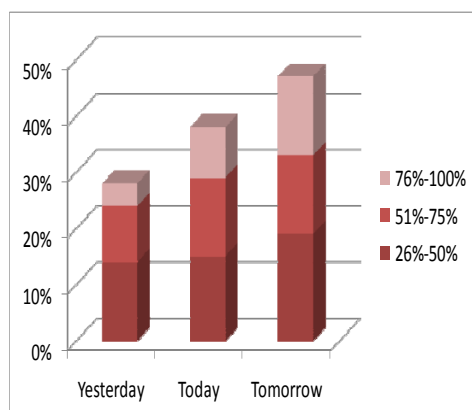
Wanting more from their payment solution might be a function of the services that are provided as part of their current electronic payments portfolio. Most report little else than credit card processing; for example, more than 85 percent of our survey respondents are unable to process ACH payments or debit payments.

**Table 5: Payment Solution Capabilities as Reported by Survey Sample**

Featured Payment Solution Capabilities	Respondents (%)
Recurring Billing	26.60%
Web / Telephone Payments	17.40%
EFT and Direct Deposits	24.70%
E-Check Processing	13.10%
Business Software / Shopping Cart Integration	9.70%
Email Invoicing	13.10%
ACH / Direct Debit	14.70%
Credit Card Processing	62.90%
Check Conversion	5.40%

## Key Insight: Electronic payments are an eventuality.

*Today, less than half of our survey respondents view electronic payments as their most preferred method. In fact, a paper check represents the most common form of payment accepted, and for 66 percent of the businesses surveyed, it is also the primary method of payment.*



Moving forward, that is expected to change. Many of those that don't accept cards today say that they will two years from now. In fact, about 90 percent of the sample says that they will have at least one fourth of their transactions processed electronically by the end of 2011.

**Figure 1.4: Expected Change in Electronic Payment Acceptance**

There is another driving factor behind the move toward electronic payments. Technology is connecting small business with new markets and new customers as never before. Electronic payment acceptance will extend the reach of small business and spur new areas of growth and profit. Further, the

changing "face" of small business will pull through the adoption of electronic payment methods. It is projected that by 2017, Generation Y will become the largest cohort of small business entrepreneurs. As the most technology-enabled generation, it seems logical that both customers and merchants will pull through the demand for electronic payment acceptance.<sup>7</sup>

**Table 6: Preferred Mix of Payments as Reported by Survey Sample**

Desired Payment Mix	B2B		B2C	
	Accept	Not Accept	Accept	Not Accept
Cash	12%	7%	39%	28%
Check	44%	73%	23%	56%
Credit Card	19%	15%	29%	2%
Debit Card	3%	0%	4%	0%
E-Check	9%	8%	1%	8%
Money Order	2%	0%	0%	1%
Wire Transfer	9%	8%	1%	2%
PayPal / Google	2%	1%	2%	1%

## Conclusion

So, who are the businesses that accept electronic transactions today and those that do not? By and large, those that accept deal with the end consumer in the health care and retail fields with a typical transaction amount in the sub-\$200 range, on average. They also tend to be slightly larger in terms of number of employees and reported annual revenue. These businesses also report a higher than average delay in

<sup>7</sup> Intuit Study Foresees Profiles of Small Business as Radically Different in 2017, January, 24, 2007.

collecting payments and returned checks. They see the value of electronic payments but want more from their current solution.

Those that don't accept electronic payments tend toward the B2B space and are heavily concentrated in the professional services fields. They tend to have more frequent interactions with customers and transactions run higher on average. Although they complain little about payment delays, they report the highest failure to pay rate of any in our sample. They have not felt compelled to seek out electronic payments, perhaps because they are not being pushed by their customers to adopt them, and therefore do not perceive any sense of urgency to move quickly in that direction.

**Table 7: Characteristics of Small Businesses That Accept/Do Not Accept Electronic Payments**

Characteristics of Small Businesses...	
That Accept Electronic Payments	That Do Not Accept Electronic Payments
Predominantly in the healthcare and retail fields.	Predominantly in the consulting, services and construction fields.
Multiple employees and annual revenues of >\$1M.	Small/sole proprietorships with revenues of <\$1M.
Primarily B2C with lower typical transaction amounts (<\$200).	Primarily B2B with high typical transaction amounts (>\$500).
Report delays in payments and a higher rate of bounced checks.	Report a higher overall failure to pay rate.
More interested in evaluating alternatives to electronic payment services providers.	Do not transact over the web.

Based on examining this profile and the data made available as part of this survey, we conclude with five key takeaways:

- **Customers rule the roost:** They pull through the demand for electronic payments. Small businesses seek out electronic payment solutions when their customers ask for it and/or they perceive that there is enough demand from their customers to implement a change.
- **Fees don't matter (much):** A faster, better, cheaper solution is appealing to everyone for just about everything. But, when it comes to electronic payments, small businesses seem to say that they will take "better" for now.
- **Loyalty only goes so far:** Small businesses are quite satisfied with their banking relationships but would switch to find a solution that improves their current electronic payment solutions.
- **Believers believe and want more:** Overall, those who accept electronic payments prefer that method of payment. B2C enterprises are nearly three times as emphatic about accepting electronic payments as those who deal primarily with the business customer.
- **Non-believers don't see the value:** Those who don't accept electronic payments don't see the value today, in part because their customers don't demand that they change the way they do business. As a result, they don't see how it will improve their business efficiency and feel no need to jump in.

## Final Thoughts

Described as the lifeblood of the U.S. economy, small business output is just as important on the global stage as it is here in the U.S. The recent joint meeting of the U.S. Chamber of Commerce and the Organization for Economic Cooperation and Development (OECD), held in May 2008, underscores the importance of what they describe as the “entrepreneurial economy” driven by small business. The conclusions drawn from that meeting were that the entrepreneurship created by small business develops new markets, creates new jobs and essentially transforms economies into entrepreneurial engines that drive overall economic growth worldwide.

Fueling this growth both in the U.S. and around the world will be the ability to enable frictionless transactions with customers, regardless of their location. In spite of how small businesses lag the overall adoption of electronic payments today, it is clear that as solutions improve, the number of small businesses that will embrace these solutions will increase. More than 90 percent of those surveyed report that electronic payments will account for as much as 25 percent of their business within the next two years. Based on how small businesses see the future of electronic payments evolving here in the U.S., it is clear that they will play a key role in helping the transformation of markets worldwide into “entrepreneurial engines” of economic growth.