

EFT IN ELECTRONIC COMMERCE IN THE USA

BY SIDNEY LIEBERMAN, PRIORITY ONE CORP., USA*

This article relates to the electronic fund transfer system used in the USA and describes procedures that may not be applicable in other countries whose banking systems are different than those in the USA. Electronic fund transfers (EFT) as a process has been around for many years, although it is only lately that its importance in the electronic commerce cycle is being understood.

WHAT IS EFT

EFT is a method for transferring money automatically by computer using the Automated Clearing House (ACH), an independent entity closely associated with the Federal Reserve Bank of the United States. The system provides for transfers within the USA, and in some instances between USA/Mexico and USA/Canada.

Two terms should be defined. EFT is the process by which funds are moved electronically. ACH is the legal entity that moves the funds. What is described herein may not be exactly applicable to systems used in other countries.

NOT THE SAME AS BANK WIRES

EFT is not the same as wire transfers. A wire transfer transfers money outward from the debtor to the creditor, always disbursing the funds of the party initiating the transaction. Wire transfers do not work on an inward direction. One can not send a wire transfer directing the customer's bank to debit their customer and bring the money inward to the bank account of the creditor/vendor. Wire transfers are done from point A to point B relatively promptly and cost perhaps \$15 to \$25 each. By contrast, EFT is done on a delayed batch basis, and transactions must be entered at least 2 days ahead. But cost is very very low perhaps 1% or 2% of the cost of a bank wire. While the system does not accommodate instant transactions, it does permit forward entering of

transactions to be executed from 2 to 30 days ahead.

EFT IS BI-DIRECTIONAL

However, EFT works in both directions. It can be used to transfer money outward to pay bills or to deposit payroll checks. But its most important and overlooked function is its usage to collect money from customers and bring the money into the bank account of the creditor/vendor on the due date.

On the due date is extremely important. The program can make a sweep of all customers who have authorized the process and collect the money on a designated date, usually the due date, and put "cash", not uncollected funds in the creditor's bank account.

TYPICAL USERS

EFT is widely used by the large phone and electric companies to have customers pay their bills by "direct payment" or "auto payment" or a host of other names. But most smaller and midsize companies are not using EFT to collect their receivables or to make their payments because:

- a. they don't understand the process
- b. they don't know who can provide the service

COLLECTING RECEIVABLES BY EFT

EFT is the only system by which a creditor can initiate a transaction to collect money from the bank account of a debtor located anywhere in USA. In all other cash application systems it is the debtor/customer who decides when to write the check.

* Sidney Lieberman
(sidney@juno.com) is chairman of
Priority One Corp., a full service
provider of electronic payment
processing services, based in Rothsville,
Pennsylvania, or see [http://
www.prioritycash.com/](http://www.prioritycash.com/).

EFT requires that the company being debited must authorize the transaction. This is done by the vendor making EFT payment on due date a part of its selling terms or by soliciting the customer to authorize automatic payment in consideration of several possible reasons such as:

1. Cost savings - it saves the nuisance and cost of writing small checks.
2. Offer a small discount to sign up for EFT.
3. Extend the due date slightly for automatic payment on the theory that it is better to get all your money on the 15th than to have a nominal date of the 10th that is really paid 30, 60 or 90 days later.
4. Simply state that is the way you do business.

FLOW CHART OF THE PROCESS

The accompanying diagram indicates the flows of information and funds to make the process work. The process shown provides for the collection of money via EFT and credit cards through the client's credit card bank. A processor, such as our company, Priority One Corp., is the one that issues the computer instructions for all this to happen.

COSTS OF COLLECTING RECEIVABLES

A recent Federal Reserve study states that it costs approximately \$3 - \$4 to collect an account using conventional statements, envelopes, stamps, opening incoming mail and making deposit tickets...and that is based on collecting the money when the customer writes the check, not always on the due date. This figure doesn't take into account the time value of the delayed receipt of funds.

By contrast, receivables can be collected by EFT for less than half the cost of a postage stamp. Using certain automatic processes, the charge ranges from 20 cents a customer to as low as 15 cents a customer, regardless of the dollar volume of the transaction. And the money is collected on the due date, not when the customer remembers to write the check.

Unlike credit card fees which are a percentage of the transaction, EFT is based on the number of transactions, regardless of the dollar size. It costs the same 20 cents to collect a \$20 account or a \$20,000 account.

WHO DOES EFT

Only banks (or companies with bank guarantees) may transmit data directly into the ACH network. All others must transmit data into a bank or authorized processor who in turn transmits into the ACH network. Where the bank does EFT, it usually sells a software package to the client, who has to transfer, into the software package, the data already contained in their accounts receivable file. This involves labor and possibility for error. The banks function is to transmit to the clearinghouse the data manually entered by the client in the required format. Banks normally charge for reports, transactions, etc.

However, non-bank specialists in the automatic collection of funds use proprietary

software programs that make the process completely automatic to the client. There is no software or hardware to buy and no data to be manually entered. Upon obtaining customer authorization the client enters into its receivable file the bank account number and bank routing number of the customer. Periodic downloads of receivable files enables the EFT service provider to reformat the data and transmit it to the ACH clearinghouse. The money ends up in the client's bank on the due date as cash.

EFT AS A COLLECTING MECHANISM

EFT is best suited to businesses that have large numbers of relatively small dollar transactions where credit is never a factor in the purchasing decision. This covers phone companies, pager companies, water/sewer companies, publishing companies, alarm companies etc.

It is most difficult to use where the invoices are big dollar items where the customer wants to control the float and where customers do not want to pre-authorize

an invoice because the inspection and approval process is complicated.

EFT AS A PAYMENT MECHANISM

Use as a payment mechanism is the most common use of EFT in electronic commerce. Buyers use EFT to remit the purchase price of the products or services they have ordered through electronic commerce. Companies use EFT to pay bills, or to deposit payrolls directly into the bank accounts of the employees.

Some companies like multi level marketers that have tens of thousands of sales persons getting commission checks daily or weekly are ideally suited for payment by EFT. Just think of the cost to mail and reconcile such a large volume of paper checks usually for low dollar amounts each.

CREDIT CARDS AS A COLLECTING MECHANISM

Many businesses take credit cards, particularly for recurring monthly transactions where the card is not present to be swiped through a recorder. Such transactions require additional processing by the vendor before they are passed to the credit card company for payment.

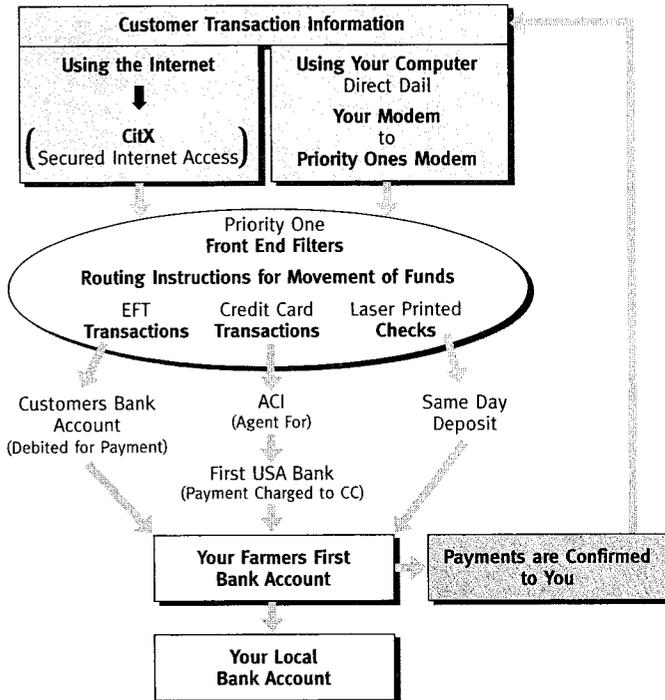
By utilizing EFT, all receivables - those with a bank number going the EFT route and those with a credit card number going to the credit card bank - can be handled very effectively and efficiently, in both events putting the money in the clients bank account on the due date.

THE FUTURE

EFT is an extremely efficient process which will become much more prevalent in the years to come, not only for large companies but also for small and medium size businesses also.

For additional information: the Internet has a great report on how IBM collects using EFT. Look up <http://www.financing.hosting.ibm.com/cashflow>.

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