

The Rising Use of Electronic Payments by Small Businesses

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Prepared for:

deluxe®

INTRODUCTION

As the needs of small-business customers evolve, bank product portfolios and processes must also evolve to keep up. Further, a growing comfort with technology and financial applications within their personal lives is driving small-business expectations for similar user experiences and capabilities to power their business banking. One such expectation is for faster and more digitized payments. While the COVID-19 pandemic has increased the need for digitalization in all aspects of banking, the gradual shift away from paper checks to digital payments began long before the onset of the pandemic. That is not to say that small businesses no longer need or use paper checks. For many, checks remain a critical component of their overall payment strategy. However, the desire and usage of other payment types is rising among small businesses. Financial institutions must ensure that they are not only offering these customers the right options, but are also making their transition to digital as seamless as possible. Offering multiple payment options along with technology-supported processes is critical to banks' successfully reducing obstacles to adoption, improving usability, and creating efficiencies for businesses.

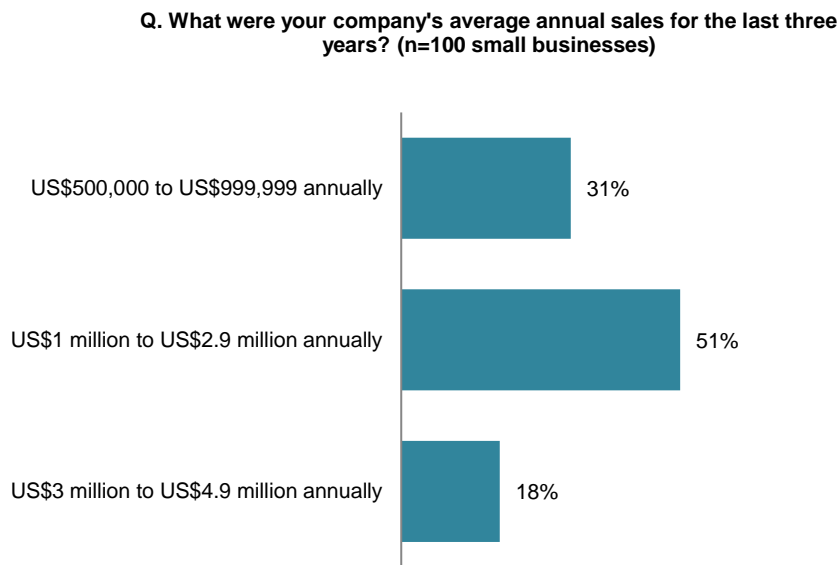
This white paper explores small businesses' growing shift toward digital payments and the key drivers for doing so. It examines their perceived benefits and hurdles for change, as well as what banks should do to assist in their transition. Finally, it highlights the importance of both checks and digital payments to small businesses and how it is important for banks to implement a strategy that enables small businesses to initiate and receive both effectively and efficiently.

METHODOLOGY

This white paper, which was commissioned by Deluxe and produced by Aite Group, is based primarily on the results of a February 2021 Aite Group online survey of 100 U.S.-based small businesses generating between US\$500,000 and US\$4.9 million in annual revenue with less than 20 employees. This paper's content also leverages Aite Group research of banks' small-business offerings and strategies and the author's extensive knowledge of the market.

The data have a margin of error of 8 points at the 95% level of confidence; statistical tests of significance between groups were conducted at the 90% level of confidence.

Figure 1 breaks down survey participants by their annual revenue.

Figure 1: Breakdown of Survey Participants by Annual Company Revenue

Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

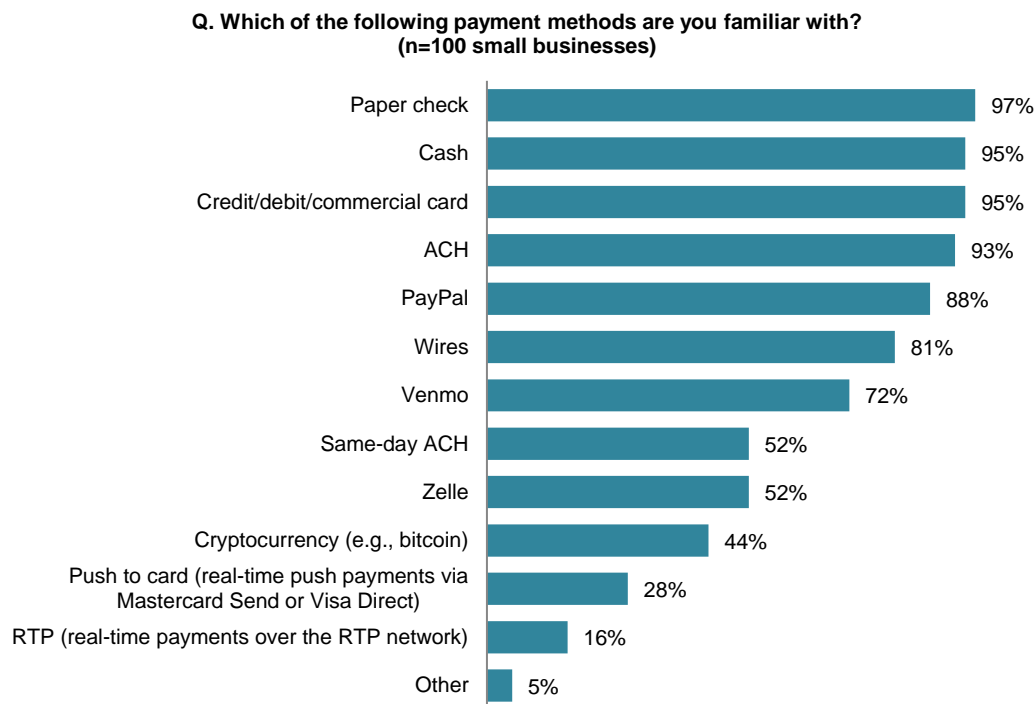
Survey participants represent a range of industry groups. Fifty-four percent of respondents are from companies within professional services, financial services, and retail. Qualification to participate in the survey required the participant to work in a payment or finance-related role with decision-making authority and knowledge of their company's payment methods and processes.

THE SMALL-BUSINESS PAYMENTS LANDSCAPE

The payments landscape is exploding with new payment options available through both banks and nonbanks alike. As small businesses have become a key target market for many of these offerings, it is not surprising that their awareness of many of them is quite high. While they are most aware of the more traditional payment types, their personal experiences have also brought their attention to newer methods such as Venmo and Zelle (Figure 2).

Overall awareness is growing across the segment, often with little difference across revenue size. Some products, like ACH, Zelle, and cryptocurrency, have greater awareness among businesses with more than US\$1 million in annual revenue than smaller micro businesses.

Figure 2: Small-Business Awareness of Different Payment Options

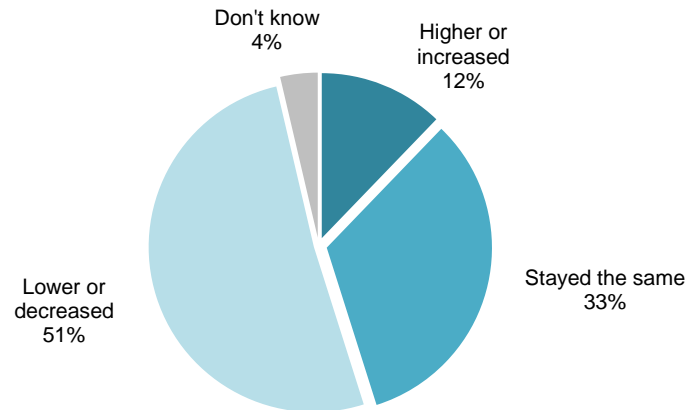


Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

Small businesses are not only aware of different payment types but are also using them. Thus, a bank's ability to offer options is important. Aite Group estimates that more than 75% of small businesses consider flexible payment options to be an important consideration when selecting a new bank partner. While paper checks continue to be viewed as a vital component of their overall payment strategy and still represent a large share of small businesses' monthly overall payments (37% of small businesses pay more than 50% of their monthly payments via paper check), a clear shift to digital payments is happening. As such, 51% of small businesses state that the number of paper checks disbursed by their company in 2020 was lower than that in 2018 (Figure 3).

Figure 3: The Decline of Paper Checks

Q. How does the number of paper checks disbursed/sent by your company in 2020 compare with the number in 2018? (n=83 small businesses that disbursed paper check(s) in 2020 or do so in current disbursements process)

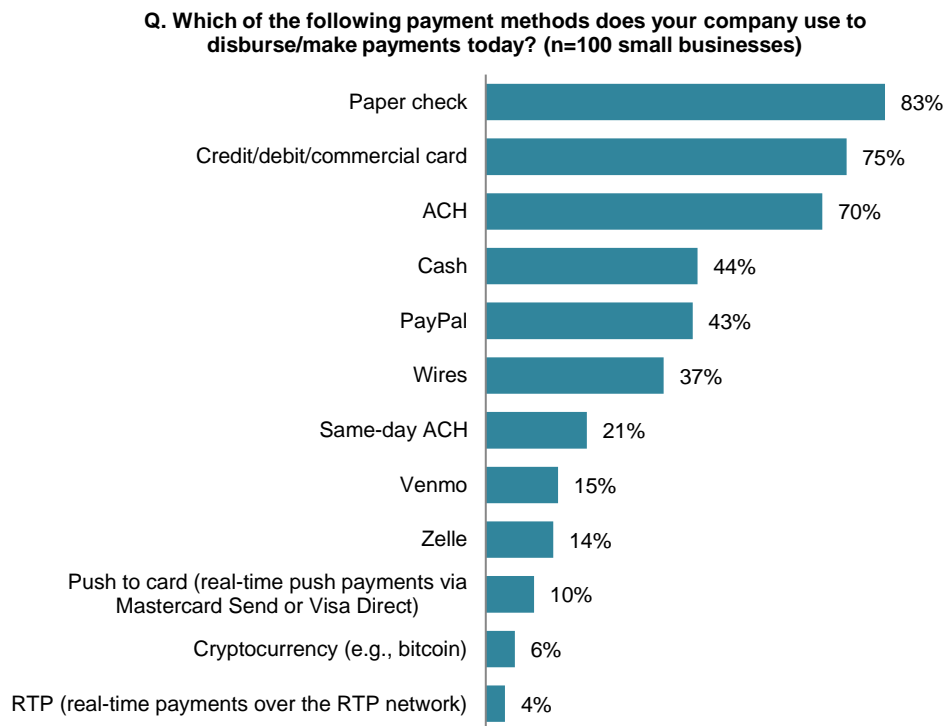


Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

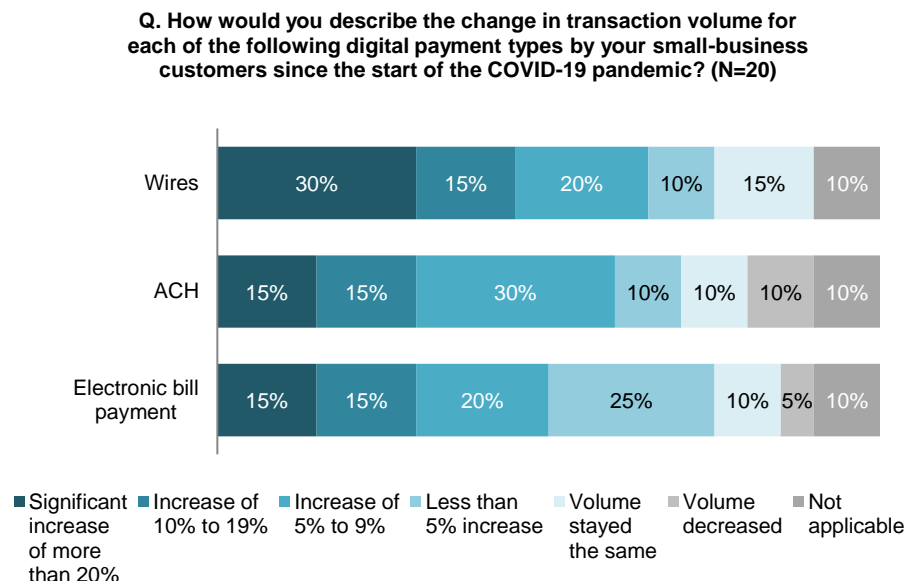
Digital payment options are appealing as businesses seek out faster, more efficient alternatives to pay customers, vendors, and bills. Thus, ACH is now used by approximately 70% of small businesses (Figure 4). Many begin using ACH once they reach US\$1 million in annual revenue (77% of businesses with greater than US\$1 million in annual revenue use it versus 55% of micro businesses).

Other digital payment options have also experienced growth over the last few years. In fact, a February 2021 Aite Group survey¹ of U.S. banks found that more than half have seen at least a 5% percent increase in digital payment volume for electronic bill payment, ACH, and wires since the onset of the COVID-19 pandemic (Figure 5).

1. See Aite Group's report *The Pandemic's Effect on Small Businesses' Digital Transactions and Banks' IT Priorities*, March 2021.

Figure 4: Payment Methods Used by Small Businesses

Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

Figure 5: Digital Payment Transaction Volume Growth Since COVID-19

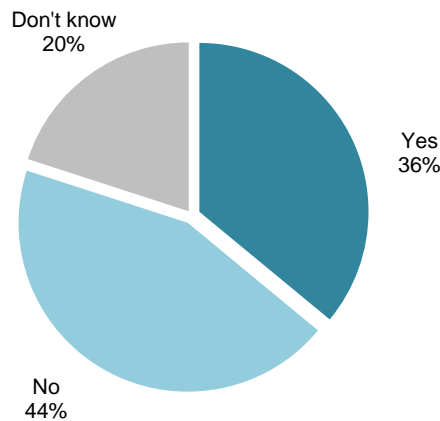
Source: Aite Group small-business bank survey, February 2021

Other newer digital payment types such as real-time payments that do not currently have large adoption rates are also showing great promise among this customer segment. More than one-

third of small businesses see clear use cases for real-time payments (Figure 6). Thus, one can infer that real-time payments usage will grow among small businesses once it is more widely available to them. Of businesses surveyed, 79% believe real-time payments will have a positive impact on consumer customer satisfaction.

Figure 6: Small-Business Belief in Use Case for Real-Time Payments

Q. Do you believe that your company has use cases or situations that are better suited for immediate or real-time payments than for other payment methods? (n=100 small businesses)

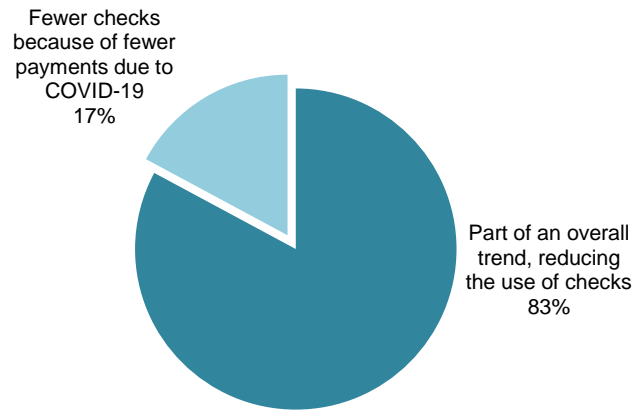


Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

Interestingly, while COVID-19 has had an impact on creating a greater need to shift to digital payments, most small businesses state that their transition started long before the onset of the pandemic. For those businesses, the fact that they are now writing fewer checks is part of an overall trend rather than a direct result of the pandemic (Figure 7). This trend is largely being driven by a greater overall comfort with technology, improved technology ease-of-use, and changing demographics. The last driver will become a greater factor in time as millennials, who have grown up with technology and digital payments, comprise a larger share of the workforce. Thus, the shift toward digital will continue long after the pandemic is behind us.

Figure 7: The Trend Toward Lowering Check Usage

Q. Is the lower number of paper checks disbursed/sent in 2020 primarily due to your company making fewer overall payments related to the impact of COVID-19, or is it an overall trend in reduction of check usage that you expect to continue?
(n=35 small businesses that disbursed fewer paper checks in 2020 than in 2018)

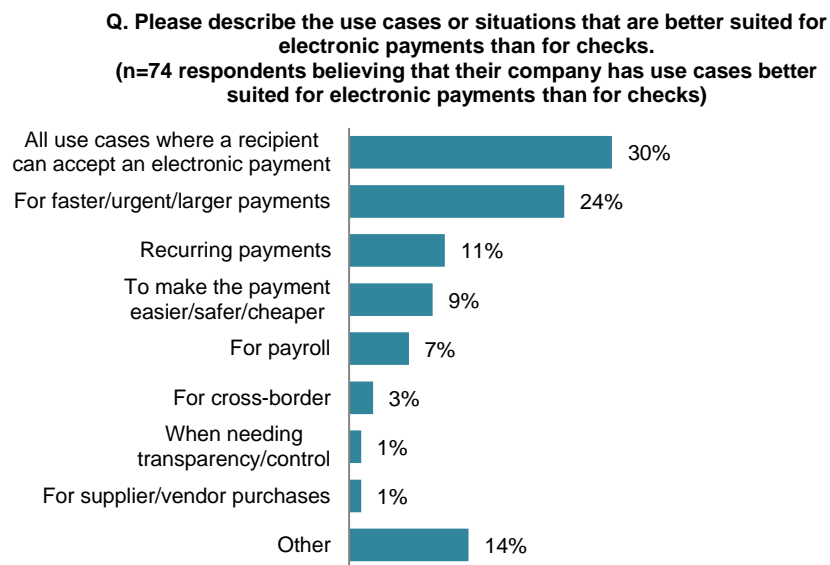


Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

THE SMALL-BUSINESS TRANSITION TO ELECTRONIC PAYMENTS

While the familiarity and comfort associated with using paper checks cannot be denied, businesses are increasingly recognizing the benefits of digital payments and the ideal use cases for them. Beyond simply sending digital payments when they know the recipient can accept them, many small businesses also believe they are ideal for urgent payments where greater speed is needed and for recurring ones to eliminate the manual processes associated with paper checks (Figure 8).

Figure 8: Ideal Use Cases for Digital Payments



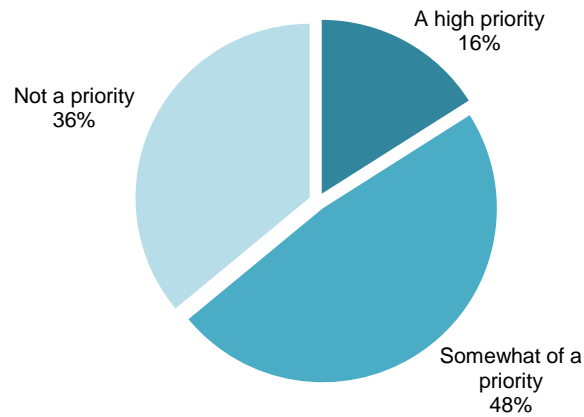
Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

DIGITAL AS A PRIORITY

As the benefits of digital payments become more widely realized, transitioning more payments to a digital environment is becoming a higher priority for many small businesses. Among those surveyed, 16% consider improving the payments process to be a high priority, while it is somewhat of a priority for an additional 48% (Figure 9).

Figure 9: Improving Payment Processes as a Priority

Q. How much of a priority is it to improve the payables payments process?
(n=100 small businesses)



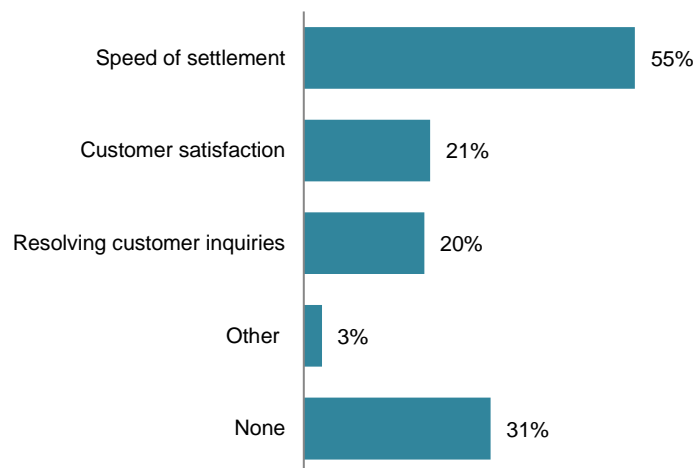
Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

THE DESIRE FOR GREATER SPEED

Fifty-five percent of small businesses see speed of settlement as the biggest gap in their current payments process strategy. Shifting more payments to a digital environment will address this. Digital payments eliminate manual processes and are not reliant on the U.S. Postal Service, which can experience delays. They are also more predictable, as the sender can determine the exact date of receipt, with the option to pay more for faster delivery (Figure 10).

Figure 10: Perceived Gaps in Payment Process/Strategy

Q. What do you believe are the biggest gaps in your company's payments process/strategy? (Select all that apply; n=100 small businesses)



Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

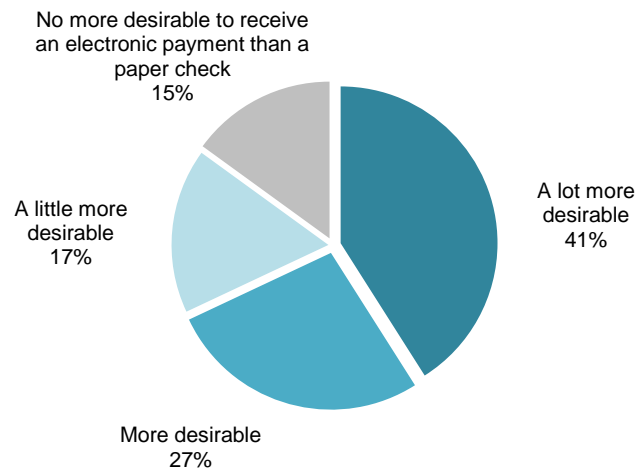
OTHER FACTORS DRIVING TRANSITION

While speed and control are important, they are not the only factors driving small businesses to transition to digital payments. There are several factors small businesses consider when selecting their payment methods. Digital payments score well in many of these areas.

- **Cost:** Small businesses have limited budgets and are often price sensitive. Thus, it is not surprising that cost is a primary determinant when selecting a payment type. Digital payments eliminate not only costs associated with manual processes but also those due to postage, envelopes, and printing, often faced when sending paper checks.
- **Reducing vulnerability to fraud:** While all businesses, regardless of size, are concerned with fraud, the ramifications for a small business can be especially great if they fall victim to it. Digital payments have several fraud prevention capabilities aligned with them, such as alerts that quickly flag unusual activity, which could be payments that are either originating from a new user or are for an amount larger than usual. They also eliminate the risk of mail fraud.
- **Improving cash flow/decreasing payment lifecycle:** Small businesses are looking for speed on both the payables and receivables sides. When making payments, faster speed allows them to hold onto their funds longer. On the receivables side, it grants them faster access to funds owed to them. The predictable nature of digital payments enables businesses to manage cash flow in a more automated way.
- **Improved customer/supplier experience:** Providing a good client experience is critical to maintaining business. Despite that, 21% of small businesses view customer satisfaction as a gap in their current payment process/strategy (Figure 10). As more businesses and consumers accept digital payments, it has become a preferred method by many. Digital payments offer more automated reconciliation for the recipient, while also enabling them to more quickly resolve customer inquiries with easier digital access to information and greater transparency. Further, as recipients of checks themselves, small businesses understand the greater ease associated with receiving electronic payments over payer checks. They want to offer that better experience to their customers. Sixty-eight percent of small businesses state that receiving electronic payments are more (27%) or a lot more (41%) desirable than receiving paper checks (Figure 11).

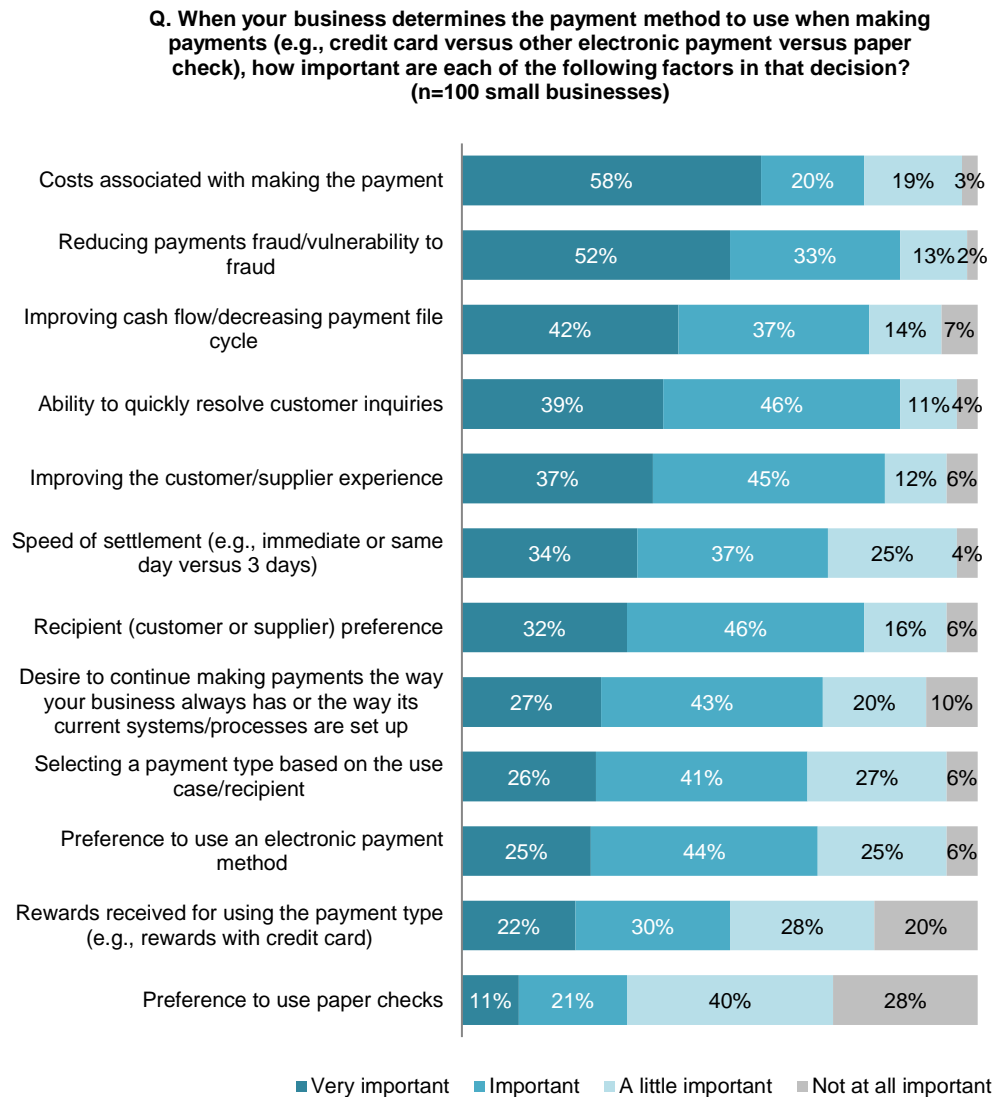
Figure 11: The Greater Desirability of Electronic Payments

Q. How much more desirable is it to receive an electronic payment than a paper check? (n=100 small businesses)



Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

It is important to note that while paper checks remain an important part of small-business payment strategies, the preference for paper checks ranked lowest among factors considered in payment-type decisions (Figure 12).

Figure 12: Determinants of Payment-Type Decisions

Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

BANKS MUST ASSIST SMALL BUSINESSES WITH THEIR TRANSITION

The transition to digital payments has created opportunities for banks. Those with the right product portfolios and strategies can leverage digital payments to cross-sell additional products, deepen relationships, and become more of a partner or advisor.

OFFER MORE TOOLS AND EDUCATION TO ASSIST SMALL BUSINESSES WITH DIGITAL PAYMENTS

Digital platforms are more user-friendly than ever before, but many small businesses continue to struggle with all the options available to them. While they are increasingly making more types of payments, Aite Group estimates that only 40% of small businesses are confident they are choosing the right one. Banks must focus greater attention on customer education to ensure they are making the best payment decisions among the growing number of options being presented. Payment wizards/rules-based engines to guide them through the process may also be made available. Such initiatives will grow small-business confidence, as well as their likelihood to continue to grow their digital payment volume and adoption.

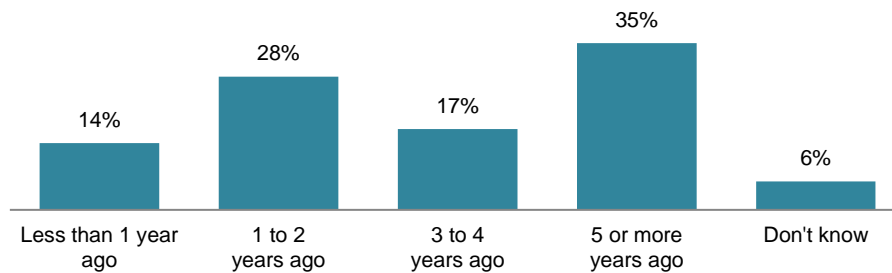
HELP THEM OVERCOME KEY OBSTACLES SLOWING DOWN THEIR TRANSITION

Small businesses see benefits in transitioning to digital and many know change to their payment processes is needed (64% consider it a high priority or at least somewhat of a priority), but change is not always easy. More than half of small businesses (52%) have not made a major update or improvement to their payables process in over three years (

Figure 13).

Figure 13: Improvements to Payment Processes Are Long Overdue

Q. When was the last time your company made a major update or improvement to its payables payments process?
(n=100 small businesses)

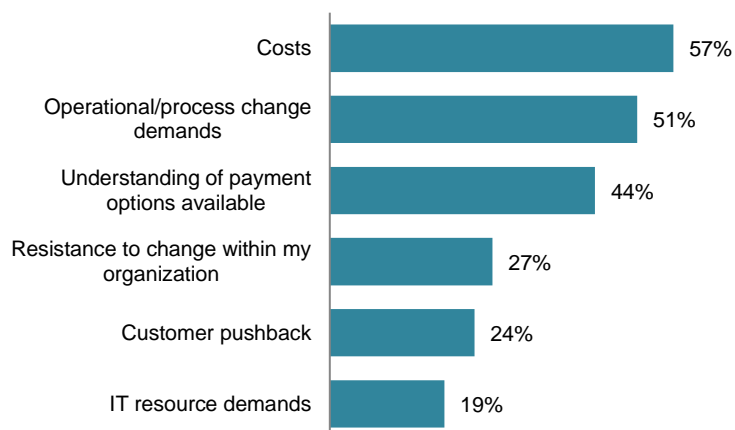


Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

Many are being held back by concerns about cost (57%), operational/process change demands (51%), and a lack of understanding of payment options available (44%) (Figure 14).

Figure 14: Hurdles to Change

Q. If your company wanted to make changes to methods or processes used in disbursements/payments it makes, what are the biggest hurdles in changing the payment methods or processes?
(Select all that apply; n=100 small businesses)



Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

Banks can help them by instead stressing the key benefits that change will bring such as reduced manual processes, improved operations and cash flow, and reduced costs. As mentioned previously, it will also improve their ability to better address greater client preference for digital payments and, thus, enhance customer satisfaction. These benefits far outweigh the challenges they need to overcome.

LEVERAGE NEW MARKET OPPORTUNITIES

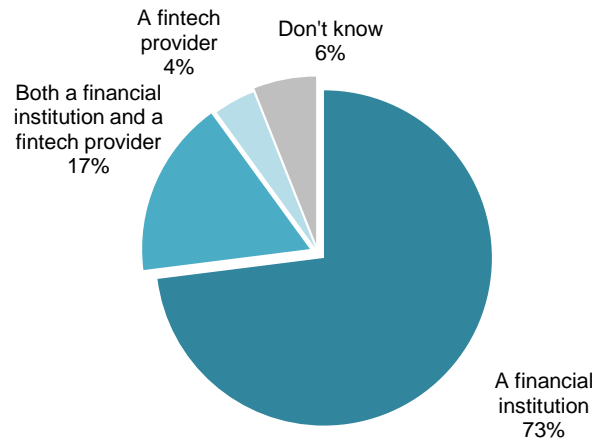
While COVID-19 has not been the main driver for small-businesses transition to digital payments that began long before its onset, it has been an accelerator. Many businesses, especially those run by baby boomers and traditionalists that once hesitated to leverage digital channels for payments have been forced due to work from home orders to give it a try. Many banks have seen success by taking a step back and targeting these new users of digital payments and guiding them through the process. As a result, many more businesses are now comfortable interacting with their banks digitally and appreciate its convenience. Banks should leverage this opportunity to continue to encourage them to leverage new digital capabilities.

ADOPT FINTECH COMPANY BEST PRACTICES

Of businesses surveyed, 21% of small businesses use a fintech provider to make payments. Banks must do what is necessary to keep their business. Key factors driving them to fintech providers include ease of submitting a payment file (52%), better reporting and analytics capabilities (38%), and a failure by financial institutions to offer the right capabilities (29%). Banks must learn from these companies and replicate some of their best practices, especially from an ease of use standpoint. Fintech companies have done a great job of identifying gaps in bank portfolios. As they increasingly look more and more like banks and offer more bank products, those banks not expanding their capabilities and/or partnering with these companies risk disintermediation and losing their business to them (Figure 15).

Figure 15: Small-Business Usage of Fintech Companies to Make Payments

Q. Does your company make disbursements/payments through your financial institution or a fintech provider?
(n=100 small businesses)



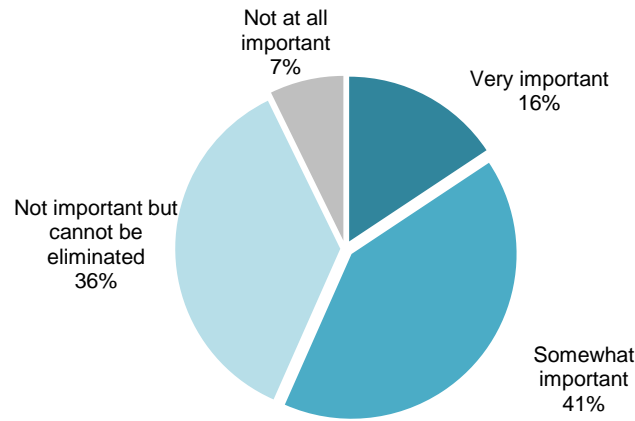
Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

RECOGNIZE THE NEED FOR BOTH CHECK AND ELECTRONIC PAYMENTS SIDE BY SIDE

The decision to offer check and digital payment options does not have to be an either-or scenario. Checks and electronic payments can be offered side by side, as there are use cases for both. There is no denying that checks are still widely used by small businesses and as mentioned previously, still comprise a large share of their monthly payments. They are easy to use, don't require changes to operations and processes, and businesses have been using them for a while and, thus, are comfortable with them. There are instances where using checks makes sense. As such, 57% of small businesses consider paper checks to be important or somewhat important to their overall strategy. An additional 36% believe that while they aren't important, they can't be eliminated (Figure 16). While there is a clear shift toward digital payments, paper checks are not going away in the foreseeable future.

Figure 16: The Continued Importance of Checks

Q. How important do you consider checks to be to your overall payment strategy? (n=83 small businesses that disbursed paper check(s) in 2020 or do so in current disbursements process)



Source: Aite Group's survey of 100 U.S.-based small businesses, February 2021

Nevertheless, there is no denying that paper checks have longer payment life cycles, are more vulnerable to delays, and are more costly than digital ones. Of businesses surveyed, 60% recognize those higher costs. Most of them associate the higher costs with postage (86%), printing (71%), and time (71%). However, 65% of small businesses estimate paper checks costs to be no more than 10% higher than those associated with digital payments. Given their often-low payment volume, this small cost variance is rarely high enough to force change. Thus, in cases where paper checks are still used, banks should consider helping their small-business customers digitize their processes with electronic checks (e-checks). E-checks, such as those offered by Deluxe and others, offer several benefits over paper checks with minimal disruption to their back-end systems and operation processes. Some of the benefits of e-checks include:

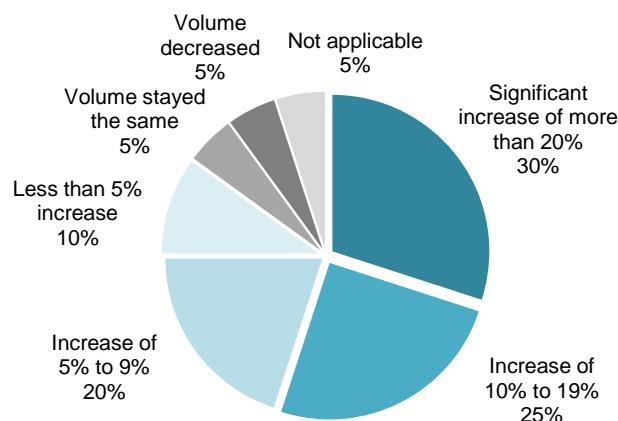
- Reduced manual processes
- Lower cost as the need to purchase stamps and envelopes is eliminated
- Increased speed of payment
- Ease of use as only a recipient's email address is needed
- Ability to include remittance information with each payment
- Options for recipients regarding how they receive their payment (i.e., paper check, direct deposit, or a deposit to a credit card or PayPal account)
- Integrates seamlessly with current accounts payable processes

HELP SMALL BUSINESSES AUTOMATE THEIR RECEIVABLES

Finally, while this paper has focused primarily on the shift to digital payments, banks cannot view payments in a vacuum. As their small-business customers send payments, they also simultaneously receive them. Similar to the outbound side, small businesses are also showing growing interest in receiving electronic payments, especially those generating at least US\$1 million in annual revenue. Despite that, 89% of small businesses continue to also receive paper checks from payees. Just as greater availability of digital payment options will enable them to automate outgoing payments, banks should also be helping small businesses automate their receivables with products, such as lockbox and remote deposit capture. While some small businesses with higher receivables volume are taking advantage of lockbox offerings (approximately 17%), their use of remote deposit capture is taking off, especially through its mobile form-mobile capture. Approximately 48% of small businesses use remote deposit capture and/or mobile capture with an additional 20% stating they plan to. Aite Group forecasts that percentage to continue to grow as business-specific mobile capture is currently viewed by most banks as one of the fastest growing mobile banking capabilities. In fact, 55% of banks have seen an increase in mobile capture transaction volume of at least 10% since the onset of the COVID-19 pandemic (Figure 17). Focusing attention on delivering more automated services to small businesses on both the payables and receivables side will be vital to banks continuing to see success with small businesses going forward.

Figure 17: Increase in Mobile Capture Transaction Volume Since the Onset of COVID-19

Q. How would you describe the change in transaction volume for mobile capture performed by your small-business customers since the start of the COVID-19 pandemic? (N=20)



Source: Aite Group small-business bank survey, February 2021

CONCLUSION

- Small-business payment preferences continue to evolve. While digital payment volume is on the rise, often at the expense of paper check usage, the two remain vital components to most small-business payment strategies. Thus, banks must find ways for the two to live side by side and continue investing in both technologies to ensure processes are as efficient as possible, regardless of the payment type selected.
- A greater focus on education is important as banks help small businesses grow more comfortable with electronic payments and willing to try new options. Doing so will enable businesses to enjoy the benefits digital payments offer, such as speed and efficiency, two factors especially important to small businesses that are often strapped for time. Less time spent making payments and managing their finances leaves them more time to focus on growing their business.
- Banks must offer payment options that are easy to use with minimal disruption to small-business processes. Recipients of those payments must also have options to enhance customer experience.
- Payment technology continues to evolve and advance. While paper checks will likely continue to play a role in small-business payment strategies for the foreseeable future, those banks offering small businesses more efficient and easy-to-use options will stand out in the market.
- Customer needs are evolving, and banks of all sizes must keep pace. Any bank not yet doing so risks being at a competitive disadvantage in the near term against more forward-looking institutions, thereby lowering its chances for new customer acquisition and retention.

ABOUT DELUXE

Deluxe, a Trusted Payments & Business Technology™ company, champions business so communities thrive. Our solutions help businesses pay, get paid, optimize and grow. For more than 100 years, Deluxe customers have relied on our solutions and platforms at all stages of their lifecycle, from start-up to maturity. Our powerful scale supports millions of small businesses, thousands of vital financial institutions and hundreds of the world's largest consumer brands, while processing more than \$2.8 trillion in annual payment volume. Our reach, scale and distribution channels position Deluxe to be our customers' most trusted business partner. To learn how we can help your business, visit us at www.deluxe.com, www.facebook.com/deluxe, www.linkedin.com/company/deluxe, or www.twitter.com/deluxe.

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