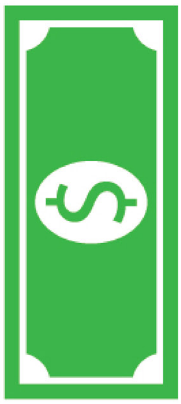
GO BEYOND PAYMENTS

An Executive Whitepaper

May 2014



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Executive Summary

There is an explosion of new, disruptive business models in the marketplace today. These upstarts are challenging the incumbents with a combination of customer intimacy and social, mobile and local technologies - all born in the cloud. What is common to all - Uber, AirBnB, RocketLawyer – and others, is the need to make payments frictionless and capture the mindshare of their customer base.

Most of these companies, however, pay scant attention to the real needs of establishing a scalable foundation in these winner-take-all markets. Lured by low-cost offers from payment processors, they may listen to their developers and make a decision to go with them based only on the price, rather than pause and examine the big picture of growing the business beyond the first six to twelve months.

When one zooms out and takes a strategic view, a very different picture emerges: in fact, payments constitute an important but small part of the overall needs of the business. It's estimated that over 11% of revenue spend is still remaining to be addressed on top of the payments investments in order to build a solid growth foundation.

PAYMENTS	Payments	Accept payments arround the world	» Develop processor relationship per country and currency » Get merchant acts » Set up entities in every country -2.5%	2.5%
PAYMENTS	Smarter Payments	Optimize renewal rates, authorization rates, and conversion rates	» Setup multiple gateways » Develop advanced routing rules » Develor retry logic	2.0%
COMMERCE	Subscription Billing	Calculate recurring revenues, send invoices, modify subscriptions - co-terminations, proratio, extensions and subscription management	» Additional purchase of Billing only vendors, integration costs for payment gateways for 2.5%	2.5%
COMMERCE	eCommerce	Develop product catalog, pricing, promotions for online, shopping cart with multi-country support, advanced marketing tools, cart abandonment, A/B testing, customer payment flows, fulfillment, APIs etc.	» Initial R&D + Ongoing Maintenance -2%	2.0%
OPERATIONS	Business Operations	Reduce fraud File taxes and VAT with local authorities Manage chargebacks and Refounds Handle Customer calls	» Reduce fraud » File taxes and VAT with local authorities » Manage chargebacks and Refounds Handle Customer calls	4.5%

11%

This whitepaper explores these areas in detail, and attempts to illustrate why it's necessary to not sacrifice the long term picture at the altar of payments.

The 'Uber'ization Effect

DONE QUICK QUIZ:
WHAT DO THE FOLLOWING HAVE IN COMMON?

TOWN CAR AND LIMO SERVICES

RIDE-SHARING

LEGAL FORMS AND ADVICE

ELECTRONIC FLEA MARKETS AND AUCTIONS

CONCIERGE AND PERSONAL ASSISTANT SERVICES

NIKE FUEL POINTS

While the above companies have very little in common on the surface, together they are leading the movement to radically change the traditional method of accepting payments.

Since time immemorial, the buyer-to-seller relationship has mostly been conducted on a one-to-one basis, with the seller handling everything, including the processing of payments. Uberization introduces a new, third actor (a service really) into the equation – one whose sole function is to handle the payment part of the transaction. By removing payments from the conversation, Uberization leaves the seller free to focus completely on servicing the individual buyer. With the emphasis now on the ongoing relationship -- and not the transaction -- the seller can concentrate on long-term strategies like adding new features and services that drive sustained revenue streams and consequent profitability.

As illustrated, the Uberization Effect is not just limited to the above-mentioned companies, but also to every industry that provides services to consumers and businesses. All are now on notice and potentially under threat from these emerging players that aim to create a frictionless buying experience.

UBERIZATION

Coined in honor of Uber - the company that disrupt the $10 billion USD taxi and limousine industry, Uber basically places the consumers' credit cards on file, locatest a nearest Uber black cab/limo driver and connects them to the consumer on demand. With Uber, the payment for the transaction is handled before the car even arrives, leaving both passager and drive free to enjoy the ride.

With each transaction, Uber collects a fee – a business model similar to that of a talent agent – in exchange to putting the rider and driver together.

This is a perfect example where payment is subsumed by commerce.

EMERGENCE OF NEW, INTERESTING SERVICES

Fueling this digital growth is also the changing behavior of the buyer – who is demanding new and inventive services that leverage smart technology and design to increase convenience or provide easy and affordable access to goods and services.

This empowerment is also due to the ubiquity and advanced capabilities of today's smartphones, which enable and compel consumers' need to research and comparison shop practically every purchase, no matter the cost or significance 1.

It is therefore no surprise to see these new services emerge in traditional and hidebound services industries. It is here where the introduction of technology holds out the greatest opportunity, both to profit and change the entire landscape of how transactions are conducted.

While the only similarity in these new services may be their use of technology to exploit the weaknesses or inefficiencies of their respective industries, they are all reliant on some form of online payment to grow customers and ensure long-term revenues.

PAYMENTS ARE HOT AGAIN

The demand for services dependent on an online payment mechanism has created a new frothiness within the payments industry. Case in point is the recent, eye-popping $800 million USD acquisition of Braintree by PayPal. That's not to mention the entrance of Wells Fargo into the space with Litle, and the skyrocketing valuations of new arrivals like Stripe, which just received $120 million USD in funding and is now worth over $1 billion USD.

DIGITAL STRATEGY & ONLINE SELLING AS A BOARD-LEVEL TOPIC

Given its explicit tracking, spend traceability and accessibility via marketing techniques, it's no surprise that boardrooms across the globe are demanding digital strategies from both marketing and sales organizations to introduce self-service channels and reduce cost of sales.

The price of digital ignorance can be painful. The landscape has clearly changed, and CEOs can no longer afford to sit back and continue to view commerce as a restricted domain within a department. Instead, they must lead the charge and champion the creation of a culture of commerce, and emphasize – at the company-wide level – projects and actions that align with it.

3Q13 PAYMENTS INDUSTRY ACQUISITIONS

TARGET	ACQUIRER	DATE
DataBill	Pinnacle Data Systems	July 1
NetSpend	TSYS	July 1
ECCO Health	Kareo	July 24
Element Payment Services	Vantiv	July 31
Pay Divvy	Higher One	Aug. 1
ProfitPoint	Clutch	Aug. 5
Perceptech	Acceo Solutions	Aug. 8
Grumbl Media Holding	Cliq Digital	Aug. 16
Skrill Group	CVC Capital Partners	Aug. 19
Charge Payment	US Data Capture	Aug. 20
Fine Trade	NTT Docomo	Aug. 28
PayMetric	Francisco Partners Management	Aug. 28
AS Maksekeskus	AS Eesti Post	Aug. 30
IP Commerce	Evo Payments International	Sept. 3
Simplex GTP	Bottom Line Technologies	Sept. 4
DB Trans S.A.	FleetCor Technologies	Sept. 10
Syncada	U.S. Bancorp	Sept. 10
BluePay	TA Associates	Sept. 11
Centauris Solutions	Intrix Technologies	Sept. 19
PayPartners	TransCard	Sept. 19
AmeriCart	AmeriCommerce	Sept. 20
Merchant Transact	SpringBrook Software	Sept. 25
Braintree Payments Solutions	eBay	Sept. 26
Century Payments	WorldPay US	Sept. 30
Scicom Data Services	Venture Encoding	Oct. 1
PaymentLink	Wirecard AG	Oct. 31
Official Payments Holdings	ACI Worldwide	Nov. 5

*Aquisition closing still pending/not announced. Date denotes when deal was announced.

Hitting the Payments Wall

or Limitations of Traditional Payment Processors

As revenue grows, most online service providers start to realize the shortcomings with payment processors.

SCALING OPERATIONS FOR GROWTH

With growth comes complexity and the need to scale smartly to meet increasing operational and customer demands. You can scale payments to keep up with demand, but if you leave out commerce – which most processors don't even consider – you're most likely going to leave behind other essential business functions like marketing, back-office operations, distribution and customer management.

GEOGRAPHIC COVERAGE

The typical payment processor will only be able to provide coverage for a single country or region. If your plans or your customers take you beyond that, you'll need to source and sign a processor for every region or country for which you intend to sell. The addition of every processor means a new development project to integrate it, and more time and resources spent to maintain it.

TIME-TO-MARKET

The final consequence of this is lost time – to contract management, to the API development necessary to integrate multiple payment processors, to operation debugging and to staffing and training to ensure ongoing maintenance. The effect of all this time spent to shore up payments, paradoxically, is the loss of the core business focus and momentum that put you in the position to expand payments in the first place.

The bottom line is that future growth is now being inhibited by inflexibility and inability to scale. Let's examine some of the issues in detail.

CUSTOMER ACQUISITION ISSUES

For any online seller that experiences success, the issues and questions can start almost immediately. Let's examine the ones that can arise on the acquisition side first.

How are you supporting chargebacks?

There is a strict limit on chargebacks that most card networks such as Visa and MasterCard will tolerate – about 1%. Anything more and the business risks getting banned permanently from these networks.

What about refunds?

Do you have a money-back guarantee? If so, if your call centers can't scale to meet the volume, the negative social response you receive may destroy your brand.

Is mobile part of the plan?

The day where you could get away without a mobile cart and payment strategy are long gone. If you can't handle mobile, take 20% off whatever revenue you expected, and move on.

Can you handle subscriptions?

Subscriptions are the best way to lock-in long-term revenue, but if you are unable to support renewals and recurring bills, you're going to have to table them until you can.

What about risk and anti-fraud?

The strength or weakness of the filters you use to detect risk and fraud have a direct correlation on chargeback rate. How do you know if yours are calibrated correctly?

Are you prepared for multi-state taxation, or to collect internationally?

The U.S. Congress is currently considering legislation to make online taxes a reality for all 50 states. The collection of taxes (such as VAT) is already a reality in Europe and elsewhere in the world. Your ability to calculate, collect and render taxes across multiple states and nations – and keep up with a growing body of regulation -- will have a direct impact on your ability to compete in the U.S. and abroad.

What about your back-office operations?

If you're selling internationally, payments are inevitably going to involve more than one processor. This means somehow reconciling them all with financial applications and accounting for foreign exchange fluctuations.

Affiliate attribution.

Do you have the capability to continually compensate your OPM and affiliates for recurring revenues, or minutely control the payout margins for renewals?

Cart abandonment.

Are you capturing cart abandonments and utilizing retargeting strategies – follow-up marketing messages, integrated emails and discount offers -- to encourage conversions?

RETENTION AND GROWTH ISSUES

While customer acquisition is obviously important, reducing churn is absolutely essential to sustain any type of long-term success.

Customer retention issues can arise just as quickly as those on the acquisition side. And as the sales and customers pile up, so, too, do the questions of how to keep them coming back, or from leaving.

Let's take a closer look at the most common and critical issues for retention.

Dunning management.
Do you have the capability to automatically send and collect recurring invoices?

Automated renewals.
Can you set your customers on an automatically recurring revenue plan and store credit cards for the most frictionless experience?

Grace periods.
Can you set grace periods for subscriptions to give a chance for customers to self-renew, thereby reducing support costs?

Customer notifications.
Can a series of notifications be set up that will periodically ping the customer – seven days in advance, one day in advance, on the day of – to ensure that this trickle feed will ensure churn control?

Secure credit card storage.
Can credit cards be securely stored so that the renewal process can be done with a minimal amount of friction? SK Note: Similar to Automated renewals above – maybe change the end of that one so that credit cards is unique down here.

Automated account updater.
It's estimated that with the recent Target® credit card scam, about 10% of all cards in the US were reissued. That means the impact to your subscription renewal business is almost a given. Can you update all the cards to the latest reissued credentials without having to manually contact every individual consumer?

Coupons and discounts.
Is there a way to integrate coupons and discounting to entice renewals?

Channel partner renewals
Direct renewals are easy, but can you extend the same renewal offers through VARs, distributors and other channel partners?

ROI Benefits of Going Beyond Payments

To successfully sell digital goods and services to global customers requires some combination of integrated smarter payments, commerce and distribution. Companies can choose to buy these pieces separately or try to build them themselves. Whatever the choice, it almost invariably requires an additional integration layer -- all of which requires time and money for R&D, implementation, and ongoing maintenance. A third way, made possible by a solution like Avangate, is to put it all together under a single platform – one that integrates seamlessly with any existing business system.

Let's take a look at the individual pieces and examine the estimated costs and returns of each approach – as a percentage of revenues. It is clear from the figure below that payments represent only 2-3% of the total investment needed for success.

SMARTER PAYMENTS

To put it simply, standard out-of-the-box payments solutions really don't have the capabilities needed for digital commerce. Advanced capabilities let you do things like update your customers' credit card automatically, route transactions intelligently and improve authorization rates globally.

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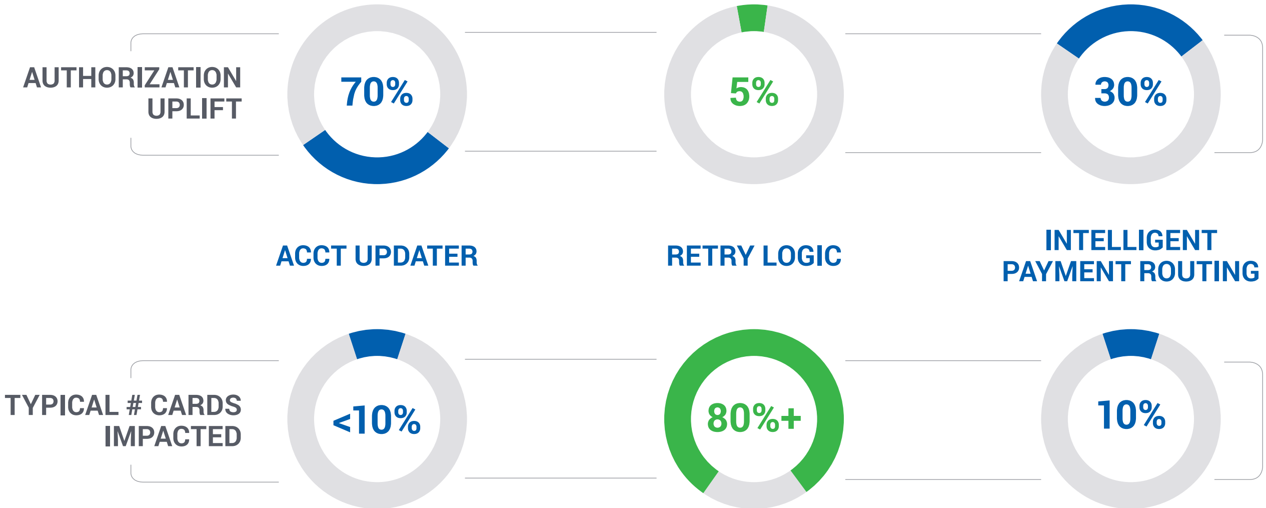

SELL GLOBALLY WITH A SINGLE API

Sell around the world without contracting with multiple processors. Smarter payments use a single API to aggregate payments across processors, integrating them with one platform. This eliminates the need to sign individual contracts on the business side, and enables you to leverage a single connection on the technical side.

INTELLIGENT PAYMENT ROUTING

Smarter payments use Intelligent Payment Routing to route and re-route payments between gateways as a failover mechanism and to increase card authorization rates.

ACCOUNT UPDATER

Ensure recurring billing continuity for active subscriptions with the seamless updating of credit/debit card accounts. Smarter payments enable you to reduce churn and increase authorization rates by automatically updating the customer card expiration date with the issuing bank. Avangate's Account Updater, for example, proactively updates cards for subscription customers seven days prior to expiration – increasing retention 10-40%.

Set for US shoppers for VISA / MasterCard Cards associated to renewals see ~71% authorization success rate on updated cards

RETRY LOGIC

Smarter payments include configurable retry logic that enables you to minimize failures and recover up to 20% of failed transactions.

CHARGEBACK AND REFUNDS MANAGEMENT

Instead of leaving chargebacks and refunds in inexperienced hands or to chance, smarter payments handle them both as discrete services, using advanced tools and expert human intervention to reduce the instance of both and ensure accurate and timely repayments and reconciliation back to financial applications.

Conclusion and Next Steps

In conclusion, online services companies selling digital goods need a better understanding of the intersection of payments, commerce and distribution.

Here are a few next steps with your current payment provider:

1. **Review** your current payment charges and operational costs – including risk/fraud management, taxation compliance and filing, foreign exchange fees, financial reconciliation and others – to get a complete picture.

2. What percent of your transactions are chargebacks and refunds? **Examine** your marketing to ensure that you are not close to the red line of 1%.

3. **Demand** better performance from existing traffic – improved conversions, better authorization rates and more control. It's easier to optimize than to acquire new traffic.

4. **Review** subscription-billing effectiveness and examine the link between the payment processor and billing provider – where the most inefficiencies hide.

5. Can your provider respond to new market opportunities – for e.g. in Brazil, China, Russia? Are all the local payment methods supported? This is a **key growth area** that cannot be ignored.

Before you sign on the dotted line, make sure you understand the big picture. And go beyond payments..

About Avangate

Avangate is the leader in Customer Centric Commerce solutions, helping Software and Cloud services companies increase their online sales across touchpoints and business models, as well as grow their distribution channels to profitably scale and enter new markets. Avangate's solutions include a full-featured, modular and secure Commerce platform, which integrates online eCommerce, subscription billing, global payments, a partner order and revenue management solution, as well as a constantly expanding worldwide affiliate network.

Avangate has received numerous industry accolades such as the CODiEs Award for "Best eCommerce and Billing Solution", the Red Herring Top 100 European Award for Most Innovative Companies and was selected as a Gartner "Cool Vendor in E-Commerce". Avangate powers Commerce for thousands of companies including Abbyy, Bitdefender, FICO, iYogi and Kaspersky.

To learn more about Avangate,
please visit **www.avangate.com**.