

A SOLUTION WHITE PAPER

Beyond Payment – E-Commerce Trends and Payment Challenges for Online Merchants Expanding E-Commerce Operations Internationally



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EXECUTIVE SUMMARY

This paper is written with e-commerce finance professionals in mind and focuses on e-commerce payment back-office operations as the central theme. Anyone interested in expanding their e-commerce operations internationally can benefit from the insights and recommendations presented.

Payment is a basic activity for any commercial transaction. It encompasses the exchange of payment information, funds, goods and services between multiple parties. In the context of e-commerce, it also forms an implicit agreement involving delivery of goods or services, post-sales support and financial liabilities and risks.

To enable international e-commerce, online merchants need to look beyond the web front-end and consider additional factors like back-office operations, banking infrastructure and indirect taxation. Such an approach will better enable merchants to deliver the seamless online shopping experience consumers expect. For this reason, we have subtitled the report “Beyond Payment.”

Global online sales are projected to reach 1.09 trillion dollars by 2017, at a compound annual growth rate of 16.2%¹, outpacing growth in traditional retail. By that same time, it is projected that 46% of online transactions will be made outside the currently developed markets in North America and Western Europe.¹ Online merchants in search of new revenue streams are thus driven to expand e-commerce channels.

Accompanying the opportunities that international e-commerce presents are challenges introduced by differences in the payment behaviors of regional consumers and tax/VAT regulations in new markets. The result is increased complexities in payment mix and the associated impact on back-office processes. This is further compounded by the emergence of alternative payment methods, mobile proliferation and ever-changing tax policies.

In the start-up phase, setting up the multiple acquirer and banking relationships required for international e-commerce can result in additional costs and slower than expected time-to-market. On the operational side, the same complexities can indirectly impact customer satisfaction, as processing accuracy decreases and lead-time to delivery and query handling time increases.

The on-going changing landscape of e-commerce indirect taxation further aggravates the situation as online merchants have to continually monitor rules, change processes and update IT systems to stay compliant with new regulations.

¹ Source: Euromonitor International, 2013

The selection of an experienced payment partner can help offload some of these complexities. Leveraging a partner's established payment, customer support and fulfillment processes, as well as their organizational experience with international regulatory compliance, banking and system infrastructure, can greatly simplify the online merchant's international e-commerce expansion.

PART I: GLOBAL TRENDS AND DEVELOPMENTS

In Part I, we highlight the trends relevant to international e-commerce and the payment landscape. We also provide an introductory explanation of key concepts and operating models. In providing an overview of developments within the e-commerce landscape, we hope you can better appreciate the opportunities, challenges and complexities facing online merchants.

E-Commerce: An Increasingly Important Sales Channel

Global online sales are expected to continue a growth trajectory from US\$234 billion in 2007 to US\$1.09 trillion by 2017, a compound annual growth rate (CAGR) of 16.2%.¹ E-Commerce is expected to take a growing share of total retail sales as more consumers shift to shopping online. Various figures over the last 10 years show e-commerce growing at a significantly faster rate than traditional retail sales. In fact, even in years with declining retail sales, e-commerce has still shown modest growth. This suggests that adding e-commerce into the channel mix can act as a hedge against recessionary economic decline. And for online merchants, this channel popularity will increase competition and the need for innovation and differentiation, especially as new entering players in the market can be expected.

Growth Opportunities Through International Expansion

While developed markets continue to command a significant share of global online retail sales, these markets are showing signs of maturity in comparison to the developing parts of the world.

Between 2007 and 2012, the Asia Pacific region contributed the highest growth share at US\$102 billion, overtaking North America and Western Europe. During the same period, North America and Western Europe grew at 11.6% and 16.9% respectively, both below the global average CAGR of 17.1%.¹

Further analysis based on market research from provider Euromonitor International shows that by 2017, almost 46% of global online retail sales will be transacted outside North

America and Western Europe (figure 1). To find new growth avenues, online merchants should clearly consider looking beyond domestic and developed markets.

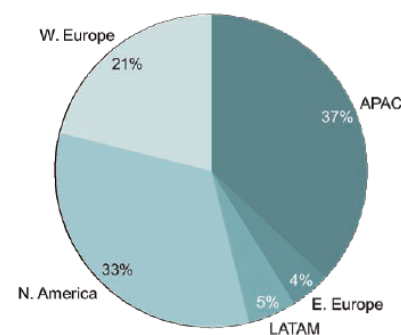


Fig. 1 2017 Global online retail share by regions. Source: 2013 ModusLink analysis based on Euromonitor International data

Yet while there are obvious growth opportunities through international expansion, challenges can obstruct market entry, resulting in varying degrees of success. Figure 2 below shows selected online global brands with varying levels of penetration at the regional level.

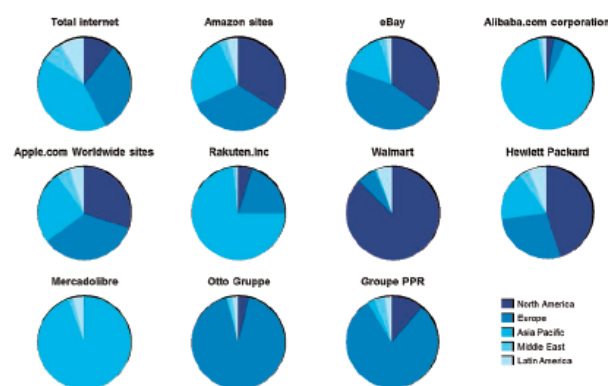


Fig. 2 Composition of regional visitors to select retail and auction sites. Source: "How to Reduce the Complexity Payment Service Providers Face in a Global Ecommerce Market" 2012, Payvision + Innopay

Innovations in the Payment Space

Along with the growth in e-commerce, the payment industry has been developing new products and services to capture a share in this growing space. This development provides consumers with more convenience and security when making online purchases. The choice of payment options is a key consideration for online merchants in order to reduce shopping cart abandonment. Offering payment options that are confusing to consumers, that they do not trust or that are simply not in accordance with their banking needs can significantly impact the success of the sales channel.

¹ Source: Euromonitor International, 2013

In this section, we introduce some key developments in non-traditional payment methods, their implications and how they differ from traditional payment options.

Electronic wallets (e-wallets) – These are Internet-based application layers built on top of traditional payment options like card payments and bank transfers. Leaders in this area are Internet giants such as PayPal, Google Wallet and Checkout By Amazon®.

E-Wallets center on consumer accounts that have been pre-registered with these providers. These accounts store payment details based on consumers' preferred funding source. Common sources include traditional payment options like credit or debit cards, bank accounts or direct bank transfers. After accounts are funded, consumers can shop online and make payments to associated merchants simply by logging into their e-wallet.

These e-wallet providers act as a trusted intermediary—trusted by consumers and merchants alike— for storing payment information and facilitating ease of checkout between buyers and sellers. In recent years, these providers are also transiting into the mobile wallet market for offline payments at POS terminals.

There are two primary models under which e-wallets operate:

1. Payment processing e-wallets – Under this model (figure 3), the provider acts as a payment processor. Based on the consumer's preferred funding source, they collect money from the consumer. The collected funds are then deposited into the merchant's accounts registered with the same provider. Online merchants then go online into their seller accounts to transfer deposited funds into their own bank accounts.

PayPal and Checkout By Amazon also examples of this model, whereby online merchants do not need to establish merchant relationships with acquiring banks, but still need to provide their own bank accounts for withdrawing funds. Registration for seller accounts can be done online and is usually a simple process.

This model is currently limited by the geographic coverage of the e-wallet provider. As of this writing, Checkout By Amazon is only available for U.S.-based merchants. However, it is generally expected that as these players extend their international presence, we will likely see more countries supported.

In addition to geography, cost is another factor of consideration, as this model is essentially an additional layer built on top of traditional card payments. E-Wallet providers' fees are also typically higher than card interchange fees. Online merchants should also note any costs associated with the aforementioned underlying banking infrastructure that are required to facilitate flow of funds.

2. Non-payment processing e-wallet – The key difference for this model is that the provider does not process the payment (figure 4). Instead, online merchants, as part of the sign-up process, provide an existing payment processor. Google Wallet is an example operating under this model.

During the checkout process, the provider retrieves the consumer's payment details stored in their accounts, and initiates processing directly with merchants' payment processor. Funds are deposited directly into the merchant's' bank account, just like any credit/debit card payment.

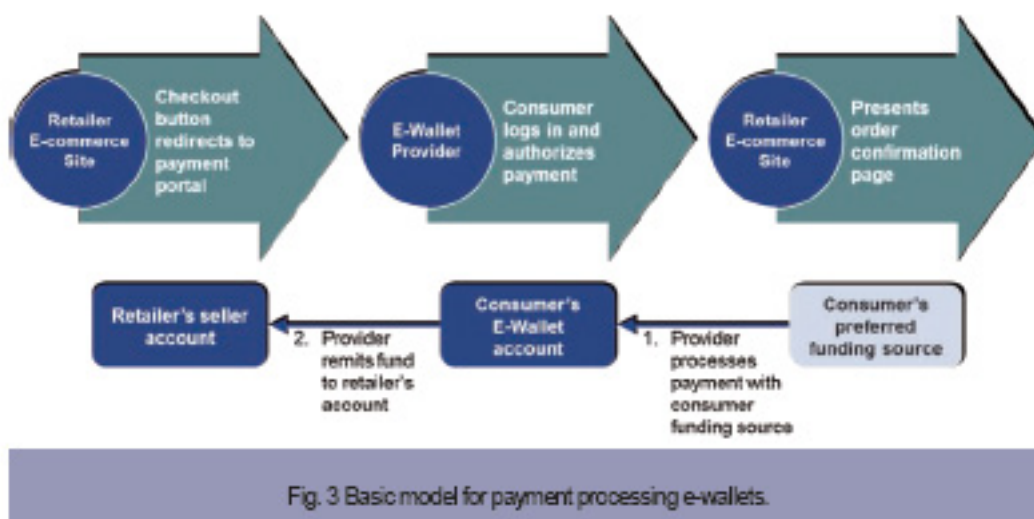
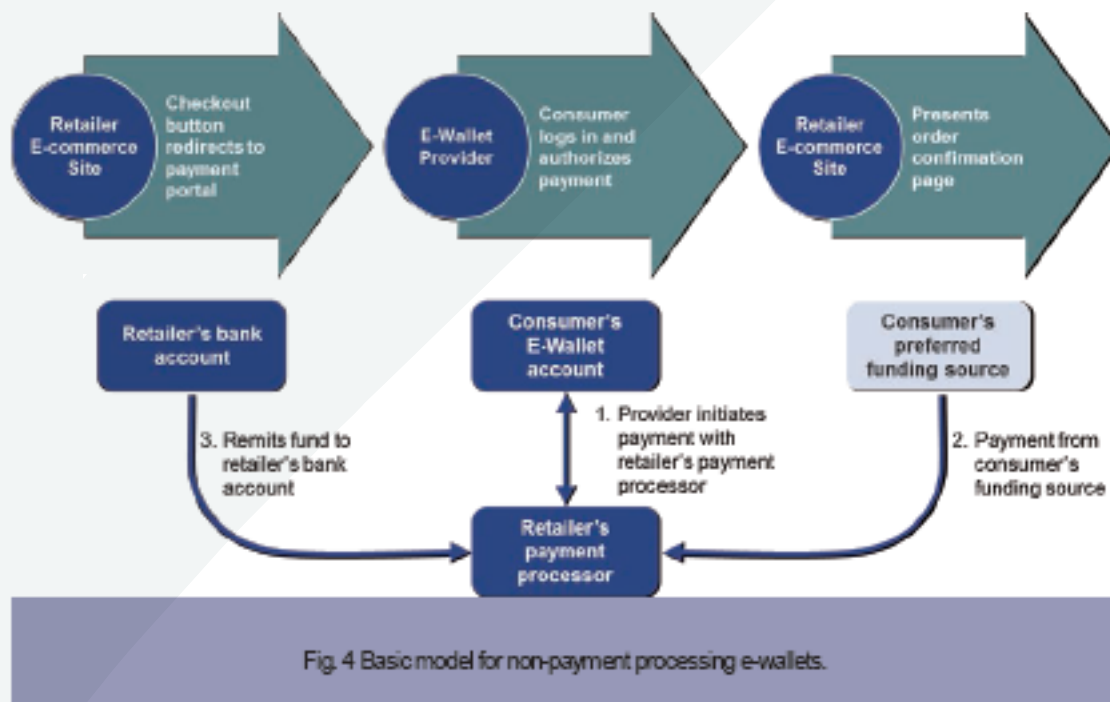


Fig. 3 Basic model for payment processing e-wallets.



For consumers, both types of e-wallets provide convenience and ease of payment. Keying in a login ID and password is easier when compared to filling in a typical payment details page for traditional payment options. The “brand trust” of these established Internet giants may in some cases provide additional assurance to consumers, as they do not have to share sensitive personal and payment information with unknown sellers. This is particularly useful for online merchants entering new markets where their brands may not be as established compared to their home market.

For online merchants, offering these e-wallets as payment options provides an easy way of extending reach to the vast global consumer base of these Internet brands. As of Sep 2013, PayPal reported 100 million accounts with coverage in 190 countries², Checkout By Amazon reported hundreds of millions of accounts³ with coverage for 27 countries⁴, and Google Wallet offers coverage in 161 countries⁵.

There are additional value-added benefits with these options, such as deferred payment schemes (e.g. Bill-Me-Later by PayPal and Klarna.com). These deferred payments are funded by the providers working in partnership with a financing bank, allowing online merchants to capture full sales revenue without incurring the risk of credit management.

Mobile payments – In line with the proliferation of mobile devices, payment providers have taken note and the established players are already leading the charge to bring mobile payment innovations to the market and encourage adoption. There are two main types of mobile payments:

1. Mobile wallets – These are extensions of the e-wallets as discussed previously, with mobile-specific features and services. Due to their input and interface simplicity, e-wallets are a good fit for mobile checkouts. PayPal and Google Wallet offer mobile versions in the form of apps and plugins for mobile-optimized e-commerce sites. These payment options allow consumers to manage their e- wallet while on the move and also allow consumers equipped with near field communication-capable (NFC) smartphones to make payments with their mobile device at brick-and-mortar POS terminals. Coming full circle, this mobile payment innovation is enabling secure cashless transactions in the offline domain.

Traditional payment players have also entered the mobile wallet space. Visa has introduced V.me, a cross-channel digital wallet with customized mobile payment services. The V.me mobile wallet stores both Visa and non-Visa payment accounts and supports NFC smartphones using the PayWave application.

² <https://www.paypal.com/webapps/mpp/compare-business-products>

³ <https://payments.amazon.com/business>

⁴ <https://payments.amazon.com/help/Checkout-by-Amazon/Checkout-by-Amazon-FAQ>

⁵ <https://support.google.com/wallet/answer/2604797?hl=en>

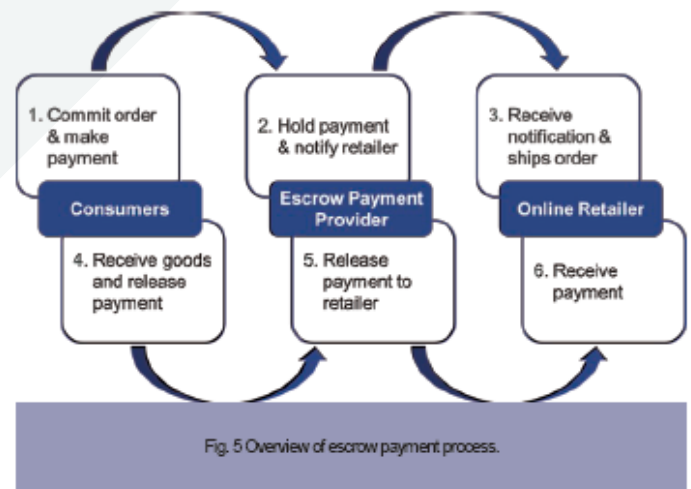
2. Mobile network operators (MNOs) billing – Another form of mobile payment has an MNO act as the payment intermediary. The value of the purchase is added to the consumer's telco bill in each billing cycle. This provides consumers with the same convenience in mobile purchases as mobile wallets. In developing markets, telco billing plays a critical role in reaching unbanked consumers who otherwise would have limited options to make online payments.

Escrow payments – In developing markets like China, where e-commerce is relatively young, escrow payments play a critical role in encouraging e-commerce transactions and can be a viable alternative to cash-based transactions like COD, which can be costly for the seller. In this developing market environment, consumers typically have lower trust for remote selling and buying. Making a payment prior to seeing the goods can be seen as risky, where in many cases, consumers have little to no avenues of recourse should the goods' quality turn out to be under expectations or not delivered. For this reason, the prevailing payment option in these markets is cash-on-delivery.

As an alternative, escrow payment providers act as a trusted intermediary and provide consumers in this segment assurance and risk mitigation, while for online merchants, they offer a lower transaction cost relative to COD. and there is no fraud risk, as payment is held by the escrow provider prior to delivery. Figure 5 on the following page shows an overview of how escrow payment works.

The escrow payment provider accepts payment from the consumer as part of the checkout process. Once payment is received, the payment provider notifies (typically through electronic integration) the relevant online merchant of fund receipt, while holding on to the funds. Upon notification, the online merchant processes the order and delivers the goods. Once consumers take delivery of the goods and signal acceptance, the escrow payment provider proceeds to remit the said funds of the transaction to the online merchant. Through this intermediary process, online merchants can bridge the risk perception for remote purchases.

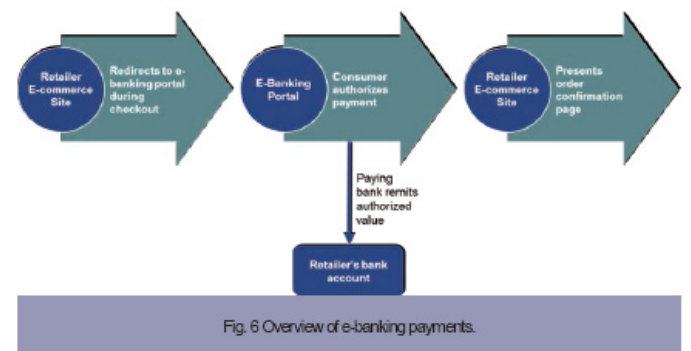
A particularly successful provider in this space is AliPay by the Alibaba group. AliPay commands 50% market share of all China e-commerce transactions and with 550 million registered users⁶, offers a testimony of the benefits discussed above.



E-Banking and multi-bank networks – E-Banking is particularly well accepted in many parts of Europe, where card and credit payments are less popular. In recent years, as banks have moved to offer traditional banking services via the Internet, they have also enabled direct payments for online purchases via online banking portals and multi-bank networks. Examples of this are Giropay in Germany, iDEAL in the Netherlands and eNets in Singapore.

In this payment scenario, consumers are automatically redirected from the merchant's checkout page to a banking portal, where consumers need to provide their e-banking login details. Once logged in, consumers are then presented with order information including order value and merchant details. Consumers can then authorize the payment from the bank, who will in turn remit the authorized funds to the online merchant. Once the payment is completed, the consumer is redirected back to the merchant's site for an order confirmation page. The entire process is done electronically, which means online merchants can process shipments immediately upon order confirmation.

Figure 6 below shows generic flow of how e-banking payment works.



⁶ <http://market.alipay.com/ospay/aboutAlipay/marketShare.html>

For the consumers, this option alleviates trust concerns as they are logging directly into their bank's portal, which is a trusted party and presents a familiar experience as consumers do their online banking via the same portal.

For online merchants, e-banking offers reduced fraud risk. Once payments are authorized, they cannot be repudiated by the paying banks. The liabilities related to authenticating consumers' ability to pay lies with the banks through their own banking portals. Another potential benefit for both parties is cost. Unlike credit cards with percentage-based fee structures and interest rates, it is not uncommon to find e-banking payment options with fixed fees per transaction for the sellers and often no fees at all for the customer. For merchants offering high value product, this option reduces costs.

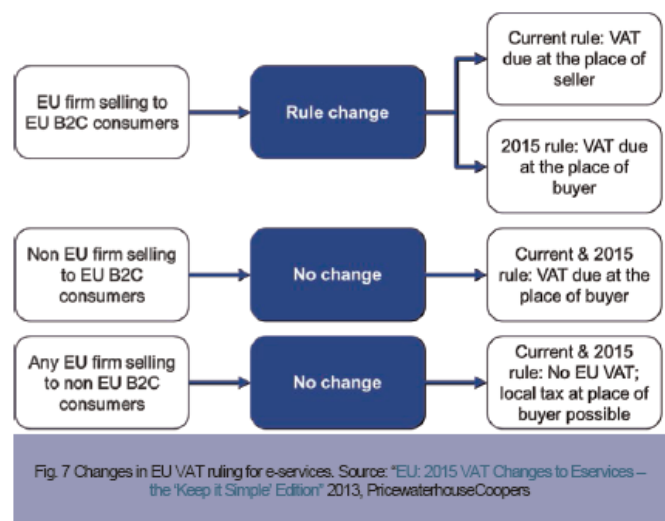
Conversely, e-banking payment options are usually domestically oriented. This means online merchants have to look at individual market preferences, many times country by country and establish connections to multiple banks and their e-banking portals. Often this burden of connectivity can be outsourced to a payment service provider.

Depending on target markets, online merchants need to fully understand consumers' payment preferences, their risk attitude and the maturity of the existing payment infrastructure in order to select the appropriate payment options for each market. Merchants should also note that each payment option can require a different process within the value-chain. By adding new payment options, complexity is introduced.

E-Commerce Indirect Tax: Upcoming Changes and Implications

Since the advent of the Internet and e-commerce, governments have struggled to agree on tax treatment for cross-border online transactions. Unlike offline transactions, where the location of the buyers and sellers can be clearly and easily identified within a single geographic location and as such, an applicable tax rate applied, the nature of cross-border transactions mean that there is not one clear, single, over-arching tax jurisdiction and applicable rules. For years, there have been discussions and some developments, but debates have been ongoing. With tight economic conditions, coupled with burgeoning budget deficits, governments have stepped up efforts to recapture lost tax revenues and balance the playing field as increasing transaction volume continues to move online. Following are two important upcoming developments which will impact online merchants.

2015 EU VAT changes to e-services⁷ – In 2015, a new legislation impacting indirect taxation of B2C telecoms and electronically supplied services⁸ will take effect in the European Union. Under this change, both EU and non-EU merchants providing e-services will have to collect an applicable VAT rate based on the consumer's country of residence. Currently, only non-EU merchants selling to EU consumers follow this ruling and for EU-based merchants, the applicable VAT rate is based on the seller's country of residence. This current situation gives an advantage to certain EU-based merchants when selling across borders. For example, the applicable standard VAT rate in Germany is 17%, compared to 21% in the Netherlands. Assuming pricing for e-services are the same in both countries, Dutch consumers have higher incentive to buy from an online merchant based in Germany due to the VAT differences. See Figure 7 below for an overview of the changes.



By 2015, not only will the playing field will be leveled for e-services merchants, there are additional implications for selling into multiple EU countries:

1. Additional VAT registrations – Currently, merchants are only required to register for VAT in their respective EU country if their annual transaction value within that country exceeds a certain threshold limit. This new ruling can potentially mean more VAT registrations for EU countries where a merchant is currently selling.

2. Differentiation between B2C and B2B customers – Merchants must charge the prevailing VAT rate when selling to B2C consumers, but for B2B customers, the current zero-rated VAT and reverse charge mechanism still applies.

⁷ EU: B2C 2015 VAT Changes - New Proposal for an Implementing Regulation

⁸ For more information on the definition of e-services see <http://ebiz.pwc.com/2012/10/eu-what-are-eservices/>

3. Identification of country of residence for B2C consumers

– In order to charge the correct applicable VAT rate, online merchants need to identify and document a buyer's resident country.

4. Reporting and payment of VAT to each respective EU country.

*Changes to U.S. Internet sales tax treatment*⁹ – Currently, online sales within the U.S. are taxable only in states where the online merchant has a recognized sales tax nexus (or permanent establishment). For years, this tax ruling has given online merchants an advantage for out-of-state sales, which do not require online merchants to collect sales tax. The bill undergoing U.S. Congressional review will require all online transactions to collect sales tax based on the buyer's residence state, regardless of merchant's tax nexus.

This pending bill, if passed, will level the playing field between offline and online merchants within the U.S. In addition, similar implications will apply in terms of accurate sales tax calculation and collection at the point of order capture, based on the state of residence of the buyer and reporting and payment of sales tax to each respective state authorities.

E-Commerce taxation is clearly a complex and dynamic field, as governments evolve tax regulations to fit changing public policy needs. In the context of international e-commerce, this complexity is compounded as online merchants have to deal with the differing tax treatments of multiple countries. For online merchants, the risk of non-compliance can be direct penalty costs, as well as indirect cost in terms of damage to reputation.

PART II: CHALLENGES WHEN EXPANDING INTERNATIONAL E-COMMERCE OPERATIONS

When evaluating the opportunities that emerging international markets present, online merchants should not underestimate the challenges accompanying international expansion.

Studies show that online merchants operate in a buyers' market (figure 8) and have to offer relevant payment options to reduce basket abandonment. While credit and debit card payments remain a relevant and viable payment option for the established online channel, merchants who choose to offer only card payments for the sake of simplicity risk isolating significant parts of the global market and large consumer segments that do not have access to credit cards or are averse to card payments.

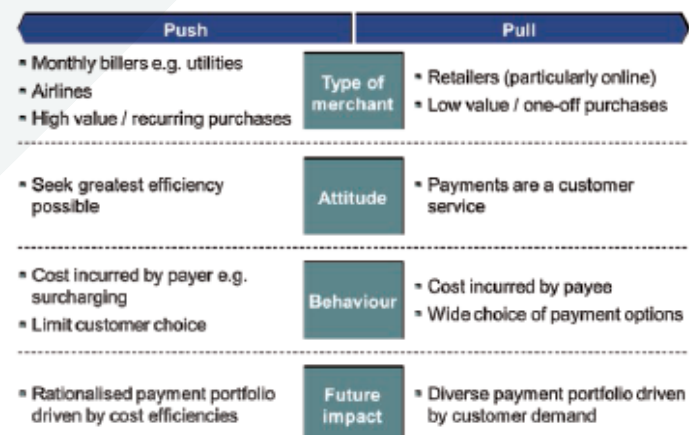


Fig. 8 Analysis of merchant attitudes towards payment. Source: Value Partners

As a result, handling foreign currencies, offering local payment options and managing differences in tax and regulatory frameworks are commonly cited challenges to international expansion.

In Part II, we discuss the common challenges and complexities in back-office operations as a result of expanding into new countries and adding payment options:

- Banking infrastructure to support local payment options.
- Handling increased back-office complexity.
- Indirect taxation, treasury and cash management.

We also propose ideas as to how online merchants can possibly respond and more importantly, adopt a more holistic approach towards payment strategy, one that includes a total view of your value chain when planning your international expansion.

Banking Infrastructure to Support Local Payment Options

After an online merchant has identified the payment options relevant to targeted countries, there must be an examination of the banking infrastructure and currencies supported for movement of funds.

Deciding on banking infrastructure – Enabling local transactions will typically involve multiple accounts depending on the number of countries, payment options offered and currencies the merchant has chosen to support. The choice of bank accounts will influence the ability for consumers to transact in a local manner when buying from an overseas seller.

⁹ Marketplace Fairness Act of 2013 <http://www.gpo.gov/fdsys/pkg/BILLS-113s743es/pdf/BILLS-113s743es.pdf>

There are generally three approaches:

1. Single account in the merchants' home country and currency

- This is the simplest approach for online merchants. However, this choice means that consumers will have to remit funds or transact only in the online merchant's home currency. In the case of bank transfer, consumers will have to bear the cost of foreign exchange and additional bank fees for overseas remittance. For example in Germany and Japan, when money is transferred from a resident account to foreign account, the sending bank may impose "lifting charges," which are charges on top of the amount transferred. While this is a simple approach, it provides the least convenience and imposes additional cost for consumers outside the online merchant's home market. This approach can be very limiting to market expansion and business growth.

2. Offshore accounts with foreign banks offering local currencies

- In countries with open currency market and banking regulations, it may be possible to establish offshore bank accounts in the country of the targeted consumers without the need for establishing a local business entity. Taking this approach allows online merchants to transact in local currency using a local bank account, providing more convenience to customers compared to overseas transactions. The downside is that such an option is not available for every country, and even in countries where this is available, such accounts are subjected to tighter restrictions in terms of cash repatriation and transfer caps.

3. Multiple local banking relationships with local currency

- This approach provides the highest level of convenience for consumers with the fewest banking restrictions. With this setup, consumers are transacting domestically with the online merchant in the local market. The major downside for this approach is that a local business entity is required for setting up a local bank account (see section on e-commerce taxation and cash management). In some countries, most notably emerging markets such as India, China and Russia, this may be the only option available as their currencies are not freely traded on the international foreign exchanges.

Registering merchant accounts - Merchant accounts are contracts between the merchants and the payment providers which allow online merchants to accept payments from the consumers. The application process varies according to the type of payment options, countries and banks. Here, we cover two main areas online merchants typically have to deal with:

1. Credit and debit card payments – This typically includes global card brands like Visa (credit/debit), MasterCard and American Express. To accept card payments, online merchants need to establish merchant accounts with an acquiring bank, which is a line of credit offered by the bank to the online merchant. Through the acquiring bank, online merchants get access to the relevant card network and installed base of card holders.

2. Non-traditional payment options – This includes e-wallets, mobile and escrow payments mentioned in Part I. Application process varies according to types and countries.

In most cases, an acquiring bank can support multiple authorization currencies and a subset of settlement currencies. This allows online merchants to transact in the local currency of the consumer and have the acquiring bank pay the online merchant in the same local currency, or to have it converted to the online merchant's home currency based on prevailing foreign exchange rates. In some cases, a local merchant account is required due to local regulations, or to enjoy a lower interchange fees charged by the card networks.

In planning a payment mix, online merchants need to consider the overall cost and time that is needed to complete these set-up steps. The complexity is compounded if online merchants are targeting multiple countries with differing banking and/or acquiring requirements. While setting up a local banking relationship provides the maximum consumer convenience, it needs to be balanced with the risks and capital requirements required to establish local business entities, the lead time needed to apply for local bank accounts and the technical integrations cost required for adding a payment option.

In most cases, using a payment service provider, or "PSP," can be a more viable option to add payment methods. PSPs act as an aggregating intermediary (figure 9) with established acquiring relationships which can be leveraged to provide the expected level of consumer convenience. Payment service providers also typically offer gateways with pre-built connections to supported payment options. By one single connection between an e-commerce site to the PSP's payment gateway, online merchants can immediately and easily gain access to multiple payment options, reducing the number of integration points.

When taking this approach, online merchants need to look at existing banking infrastructure, the set of targeted markets and then select a payment service provider with offerings closely

matching current and future target market needs. Payment options can then be enabled in a shorter lead-time and potentially speed up an expansion schedule.

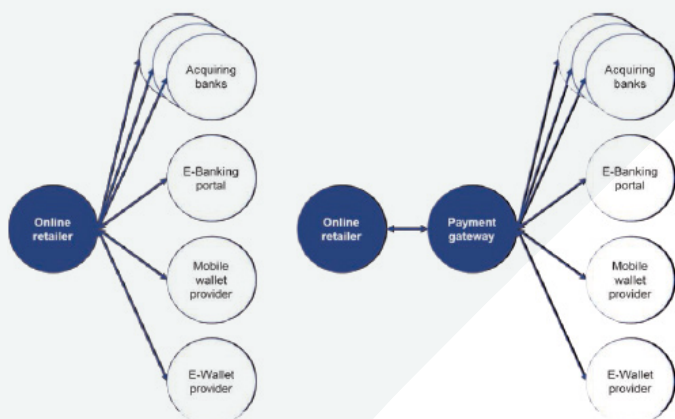


Fig. 9 How a payment service provider can simplify payment complexity.

Handling Increased Back-office Complexity

When planning international expansion, online merchants should consider how payment options will fit within the existing value-chain, specifically in areas of customer service, finance and logistics. The challenge is to balance 15 consumer preferences and purchase experiences against the cost of handling increased complexity in back-office operations.

Figure 10 below shows the expanded set of payment-related activities in a merchant's typical value-chain.

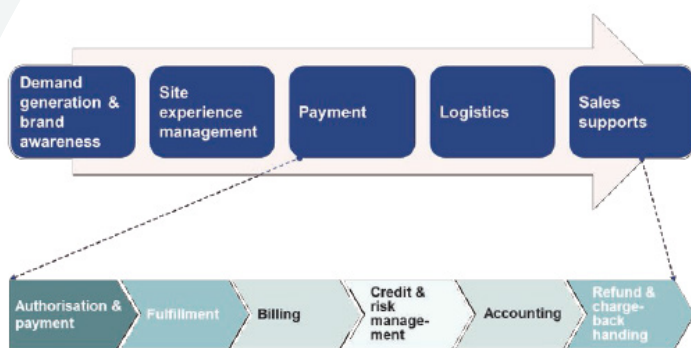


Fig. 10 Order processing in the case of bank transfer payments.

For consumers, an optimal online shopping experience extends after the purchase and typically entails the following basic elements:

- Accurate and timely delivery after payment is made.
- For subscriptions and installment payments, accurate and timely billing and deductions.
- In cases of returns, visible tracking of returns and prompt refunds.

Concurrently, online merchants have to balance these expectations against business risks:

- Accurate reconciliation of fund receipts against deliveries made.
- Credit risk of consumers (e.g. installment payments) and of buying firms (e.g. selling on credit terms).
- Receipt of returns prior to disbursing refunds.

To deliver an optimal consumer experience while balancing against business risk, online merchants need to coordinate activities across different function groups. In a high volume context, IT system integration and automation is required between the e-commerce platform, Customer Relationship Management (CRM) system and ERP (finance and logistics) to provide the relevant order and payment visibility required by each function to operate in a coordinated manner.

Using four example scenarios below, we will highlight how payment relates to back-office activities and the coordination that is required.

Order processing in the case of bank transfer payments -

Unlike orders committed online through card payments, a bank transfer order does not guarantee fund receipt at the point of capturing the order. The typical process (figure 11) involves an order created online, with a lapse in time whereby the consumer has to make a remittance offline. Then, once the funds are received in the merchants' bank account, the order processing continues and delivery is triggered. There will be instances where funds are not received within a given time period. In such cases, online merchants can opt to cancel the order or to send a reminder to the consumer. In either case, follow-up activities are required. This approach helps online merchants mitigate the risk of non-payment. However, it introduces complexity into the value-chain as variation in operational process is introduced. Coordination is also required between finance, logistics and customer service to enable the process.

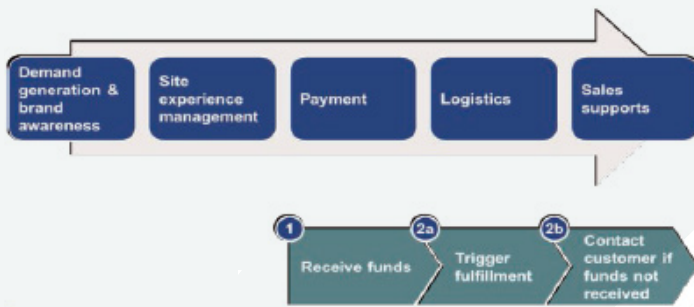


Fig. 11: Order processing in the case of bank transfer payments.

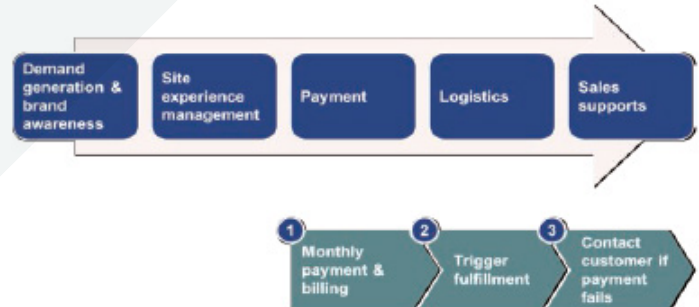


Fig. 13: Order processing for subscriptions.

Order processing in the case of cash-on-delivery payments

- Cash-on-delivery ("COD") payments introduce a different set of processing and coordination requirements. In this case, delivery takes place before funds are received. Acceptance and payment may not take place on the first delivery attempt. Customer service is required to follow-up with the consumer to arrange a second attempt. After successful delivery, finance then books the cash receipt, revenue and closes the order.

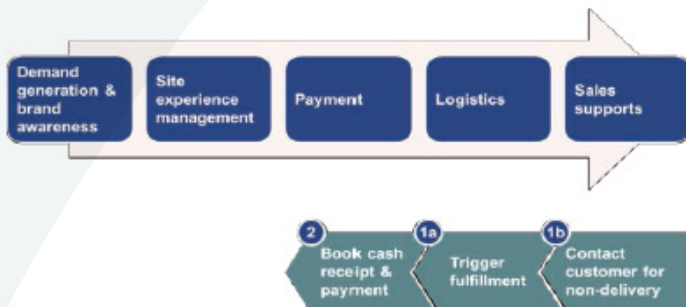


Fig. 12: Order processing in the case of cash-on-delivery payments.

Order processing for subscriptions - A subscription is an agreement to a series of payments and deliveries over a defined period of time. Payment can be either made upfront at the start of the subscription period or on a periodic basis with periodic delivery. Delivery needs to be withheld if the periodic deduction is unsuccessful and requires follow-up by customer service. This introduces a new set of processing rules as system automation is necessary to trigger periodic billing, order creation and processing, especially if subscription rules vary by products and contracts (figure 13).

Returns processing and refunds - Accepting returns alleviates risk for consumers and encourages sales conversion. As such, it is a common practice among online merchants. However, returns is one of the most complex yet critical components of e-commerce, as there are many possible variations in a returns scenario, guided by differing consumer protection rules and local market practices and expectations around the world. Poor returns handling creates consumer dissatisfaction and has been known to damage an online retailer's brand reputation.

Returns are typically triggered by consumers to the customer service department, where a returns management authorization (RMA) is logged. The process then goes into a time lapse as consumers have to ship their returns offline. After the logistics department receives the physical return, it is validated according to online merchant's returns policy, which may vary by country. If everything conforms to policy, finance triggers a refund and the cash outflow needs to be reconciled against the original sale as a credit note (figure 14).

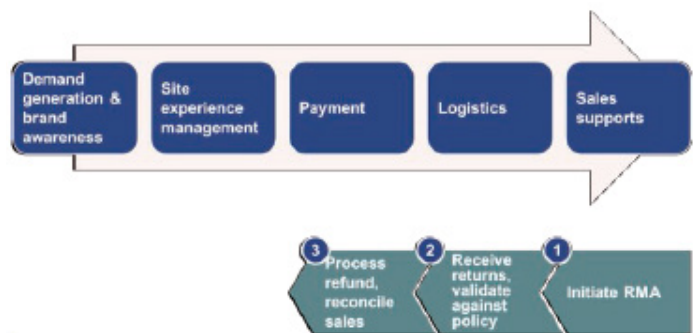
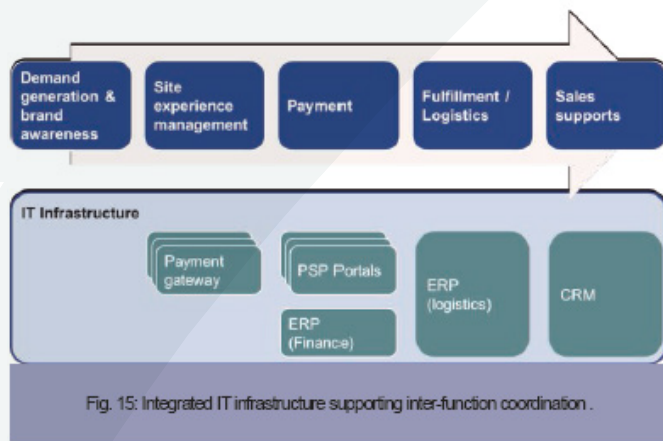


Fig. 14: Returns Processing.

As mentioned, selection of payment options is driven by the consumer preferences in a particular geographic market. Increasing back-office complexity should not deter online merchants from offering payment options relevant to new markets. Online merchants should take a holistic view in planning and have the coordinated processes mapped out and communicated. The information needs of each supporting function, such as order and payment visibility, must be analyzed and where necessary, IT systems need to be integrated (figure 15). This will automate information flow, business rules enforcement and provide the coordination necessary between functions.



The three common areas of cross-functional coordination and related IT integrations are:

1. Customer Relationship Management (CRM) System

supporting customer service centers - Customer service agents need clear and immediate visibility to service queries on delivery, payment and returns status. For every order captured by the web store and each payment processed by the payment gateway, information needs to be propagated to CRM to provide visibility. As orders are processed dynamically, statuses are constantly changing and these changes must be updated in a timely manner to the CRM and the web store.

Customer service centers are one of the most common consumer touch points for initiating an RMA. CRM must be integrated with returns logistics functions to communicate RMA requests to the returns collection points.

2. ERP supporting logistics operations - Depending on the type of payment and order, the point of order capture does not necessarily trigger a delivery immediately. Bank transfer orders and pre-orders are two examples, as these deliveries must

be put on hold until payment is actually received, or inventory is available for shipment. ERP automation and integration with payment ensures that only eligible orders are processed and sent to the warehouse for picking and delivery. Likewise, subscription-based orders are automated to generate pick orders in the warehouse based on delivery schedules triggered by the relevant logistics operations. For RMA, physical receipt at returns collection points must trigger an update in CRM so that agents have up-to-date information.

3. ERP supporting finance operations - Integration with financial modules in ERP will automate revenue booking and reconciliation against deliveries and returns. As shipments move out of warehouses, the changes in inventory must be reconciled against web store orders and revenue booked.

Depending on the order type, revenue recognition rules vary. For example, an annual subscription with upfront payment needs to have revenue recognized over the months of subscription period.

Online merchants can outsource order and payment processing to a complete solution e-commerce service provider. These providers can provide customer support, payment and logistics services under a single vendor relationship. With integrated IT infrastructure and order processing, these one-stop solutions can greatly simplify your back-office complexity and potentially reduce costs, improve customer satisfaction and improve both expansion timeframes and revenue outcomes.

Indirect Tax Compliance and Cash Management

For some merchants, one of the major deterrents from offering local transactions may be indirect tax. Based on the current tax/VAT rulings in the U.S. and E.U. respectively, certain groups of online merchants can leverage a pricing advantage by not having to charge sales tax/VAT for out-of-state and/or international sales. As mentioned, this is dependent on the rules regarding country of merchant establishment and a customer's country of residence.

Setting up an offshore bank account typically entails some form of business registration in the foreign market which involves capital investments and lead-time needed for business registrations. It also implies the requirement to charge sales tax/VAT to consumers, which may negate the pricing advantages.

With recent developments in e-commerce sales tax/VAT rulings, the trend is moving in the direction of a leveled playing field in terms of tax treatments. Online merchants need to review

their strategy in this new environment. Markets which were unfavorable because competitors previously had a pricing advantage may now become favorable.

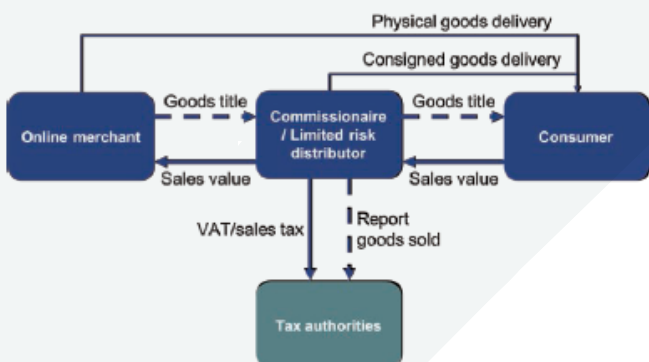


Fig. 16: Overview of Commissionaire/Limited Risk Distributor structure.

Payment strategies using local bank accounts which were previously unfavorable can now be considered to satisfy consumer preference. The variable to consider here in the context of taxation is that cash repatriation may be restricted for offshore accounts or may be deterred by withholding tax. For example, Taiwan levies a 40% withholding tax against merchants for overseas transfers from offshore accounts.

To overcome these tax complexity challenges, online merchants can consider working with a third party provider offering the Commissionaire or Limited Risk Distributor (LRD) Structure (figure 16) to address markets gaps and transact locally at the same time.

Commissionaire is a VAT structure applicable to distant selling in Europe, while the Limited Risk Distributor (LRD) structure applies to North America and the Asia/Pacific region. While they are different in legal construction, we present a simplified overview to help online merchants understand the benefits.

A Commissionaire/LRD will take over the goods title ownership at the point of sales transaction—this is called “flash ownership”— and will then act as the seller on behalf on the principle online merchant.

From an indirect tax perspective, VAT/tax reporting and remittance is the seller’s responsibility. Therefore, the Commissionaire effectively becomes the final seller of goods and services to the consumer and becomes the seller of record. This structure allows the Commissionaire/LRD to take over VAT/tax reporting and compliance for online merchants.

The physical goods can be consigned with the Commissionaire/ LRD and delivered to the consumer. Alternatively, they can be delivered directly by the online merchant when a sales transaction is performed by the Commissionaire/LRD. In this case, a message needs to be electronically triggered to the merchant’s warehouse for delivery.

In terms of money flow, consumers will pay the sales value, including VAT/tax to the Commissionaire/LRD. On receipt of the funds, the Commissionaire/LRD separates the VAT/tax component of funds and remits to the relevant tax authorities. The remaining fund representing the sales value is reported and remitted back to the online merchant.

Commissionaires/LRDs offer the following advantages for international e-commerce expansion:

- 1. Leverage of Commissionaire's VAT/tax structure** - Allows merchants to sell locally without having to setup entities within target countries.
- 2. Offload VAT/tax compliance** - Due to the nature of Commissionaire/LRD selling on their behalf, merchants can offload VAT/tax compliance to the Commissionaire/LRD.
- 3. Leverage of Commissionaire/LRDs banking infrastructure** - With typically broad operating bank accounts and acquiring relationships in multiple countries, online merchants can transact in a local manner without having to establish their own bank accounts and acquiring relationships.
- 4. Cash management** - Transactions and funds flow through the Commissionaire/LRD’s bank accounts, allowing merchants to outsource some elements of cash management, such as reconciliation.
- 5. Cash repatriation** - Merchants who are challenged with funds held in foreign countries can use a Commissionaire/LRD’s non-restricted bank accounts and intermediary service to receive funds. When necessary, the Commissionaire/LRD can even remit funds in a merchant’s chosen currency, with the merchant bearing the forex difference, allowing merchants to bypass restrictions in foreign bank accounts and transfer funds back to the home country.

A Commissionaire/LRD is clearly a different model from establishing a local agent or distributor as typically seen in indirect sales. Online merchants maintain the consumer relationship, control over product pricing and inventory management. The Commissionaire/LRD's purpose is only to enable local transactions. As such, it does not take over product support and inventory risk, which distributors do. By retaining product and inventory control, the online merchant retains the benefits of a direct channel. Table 1 below shows the differences between selling indirectly via distributors and agents, against using a Commissionaire/LRD for direct sales.

	Indirect sales using distributors/agents	Direct sales using Commissionaire/Limited Risk Distributor
Seller of record	Distributor is seller-of-record	Commissionaire/LRD is seller-of-record
Merchant of record	Not applicable	Commissionaire/LRD is merchant of record
Indirect VAT/tax compliance	Not applicable	Principle outsourced to commissionaire/LRD
Inventory ownership	<ul style="list-style-type: none"> Distributors owns inventory once purchases from Principle. Inventory risk lies with distributors 	<ul style="list-style-type: none"> Principle maintains ownership of inventory Flash title ownership—title transfer at point of transaction
Product pricing	Decided by distributor subjected to Principle's recommended retail price (where applicable)	Decided by Principle
Product support	Consumer approach distributor as first point for support	Consumer approach Principle as first point for support
Marketing & promotions	Distributor's decision. May bundle or provide promotions, subjected to contractual limitations with Principle	Principle decides on marketing and promotions where necessary to generate demand or push products

Table 1: Differences between selling via distributors and Commissionaire/LRDs.

CONCLUSION

The addition of payment methods and the increasing back-office complexities that are naturally driven by international e-commerce expansion are often misunderstood or underestimated. Further, these complexities have significant impact on both the consumer's buying experience and the merchant's business model. Merchants must understand that their customer's online shopping experience is driven by both regionally-expected payment options and the resulting buying experience after the payment. Both of these elements require a well-running back office operation in order to drive customer satisfaction. It should be clear how this back office operation is of critical importance to the success of the merchant's expansion plans.

Functions including payment, finance, customer service support and logistics all need to coordinate coherently to deliver an optimal customer experience. This coordination needs to be

supported by an integrated IT infrastructure—one that facilitates timely and accurate information flow to all of the relevant actors within the value-chain. When evaluating a payment processing partner, merchants should also consider the more granular areas of financial reconciliation, indirect taxation, cash repatriation and regulatory compliance. A plan to focus on the core business activities of product and channel development and marketing, while leveraging a partner's banking, payment and VAT/tax infrastructure support, can be a far simpler, faster and more successful means of expanding into valuable new e-commerce markets.

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ABOUT THE AUTHORS

Lawrence Cheok is a trusted e-business consultant, advising Fortune 500 clients in strategy, planning and execution. His specific expertise lies in helping firms understand the cross-functional challenges between e-commerce and back office processes and helping them navigate the complexities in global e-commerce legislative regulations, indirect taxation, import/export rules and data privacy. Cheok has more than 10 years experience in B2B and B2C e-business and its underlying technology, product management and product marketing. His interest lies in understanding consumer online behavior and applying that knowledge to platforms, payment methods and CRM.

Wim Huiskamp is global vendor service manager at ModusLink, where he is responsible for end-to-end contract and supplier relationship management for the Company's Financial Management Solution. He maintains and controls the compliance portion of the FMS organization in relation to indirect tax, PCI, KYC and payment industry standards. He brings more than 10 years of financial management experience to his role.

Andre Malinowski is the director of ModusLink's Financial Management Solution and in that role, advises multiple large, global online merchants on the complexities of global e-business ecosystems and developing long-term financial management and payment strategies to enable growth. Prior to ModusLink, Malinowski held various positions with enterprises specializing in online transactions.

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