

# Check Management, Today

## in USA Grocery Industry

A recent article in *Bank Technology News* stated, “Bad checks are the single greatest source of losses at the retail point of sale.” Research by the University of Florida suggests the average merchant sees 1,365 bad checks for every \$100 million in sales. According to *Nilson Report*, USA merchants lost \$15.56 billion to check fraud in 1994.

*Contrary to conventional wisdom, grocers can reduce their true cost of handling checks 82% by switching to the industry’s “best practice” check management methods.*

**Web of mutual self interest.** Retailers, banks, and recovery firms share mutual self interest in cooperating on the complex challenge of check management. The challenge presents dramatic financial opportunities for each of these “partners.” The average grocer, for example, can increase net income 20% by adopting the industry’s “best practice” check management methods.

*The average chain can increase its bottom line by 20%.*

**Best practice methods facilitate rapid coordination** among partners, stores within a chain — and, ideally, among competing chains in a market area. These *best practice* methods, and grocery store needs and opportunities, can best be viewed against a national backdrop.

**Nationally, the scale of check usage is immense.** Sixty-one billion checks, totaling \$40.9 trillion, were written in the USA during 1994 by individuals, companies, and governments. Personal checks accounted for 57% of the total number of checks written, yet comprised only 7% of the total dollar value — approximately 35 billion personal checks, totaling \$2.9 trillion. This includes 18 billion personal checks, totaling \$636 billion, written at retail point-of-sale and 11.8 billion, totaling \$1.6 trillion, written to pay bills.

The number of checks written is projected to increase through the year 2005<sup>1</sup> — but at progressively slower rates. Checks, as one of the twelve consumer payment systems used in the USA, lost four percentage points of market share over the

<sup>1</sup> Corporations and consumers are in no rush to eliminate checks because of float. Neither are financial institutions which earned \$12 billion in fees on bounced checks during 1994.

past five years and the trend is projected to accelerate over the next ten years.

**Grocery is the Eight Ton Gorilla.** Three segments of the \$2.2 trillion USA retail market — grocery, pharmacy, home centers — accounted for 45% of the 18 billion of checks written for point-of-sale purchases in 1994. The three segments totaled \$240 billion in check usage, of which one segment — grocery — made up \$165 billion.

*“... bad check databases are largely ineffective against organized fraud.”*

Grocers intuitively prefer check verification functions to be integrated into their register systems. However, few register systems, other than MicroNEX’s CRISP™ brand — which uses sophisticated *pattern recognition* to suppress fraud — offer more than passive database look-up. Since bad check databases are largely ineffective against organized fraud, stand-alone verification systems are therefore widely used to augment existing register systems.

*"Grocers without verification average a 1.8% bad check rate."*

**Grocery stores cash more payroll checks than banks.** Grocers are motivated to cash payroll checks by a potential for increased food sales resulting from higher customer traffic ("fresh funds") as well as by the check-cashing fee. Payroll checks are typically cashed at customer service desks by supervisory clerical personnel. The nature of payroll check cashing makes it a target for organized fraud, whereby "runners" are used to pass many bad checks before stores can react.

*"Few stores have check procedures adequate to measure their performance"*

**Check losses are growing.** Bad checks, presented at point-of-sale ("POS") increased from 1.1% to 1.25% over the last five years. Approximately 225 million personal checks written for POS purchases in 1994 were returned. Fraud is also increasing on checks written for POS purchases — currently running 0.14 percent.

Grocers without verification average 1.8% in returns. Grocers using verification market leaders, such as SCAN, experience average returns of 1%. Best practice rates, provided by systems such as the MicroNEX® brand, average 50-75% better — ranging from 0.25% to 0.5%. Paradoxically, low return check rates are not best practice rates if valid customers are turned away. Best practice targets fraud to cut losses without hurting sales.

**Check recovery companies are booming.** The literature consensus for local agency growth rate is 30 percent per year — which suggests strong market acceptance for services that minimize repetitive labor and accelerate the linking of adds/deletes to central databases.

*"Retailers are turning away from internal recovery and verification"*

Merchants and check recovery companies charge return fees on bad checks. Most States establish a maximum fee, typically \$25.00. In addition, check recovery companies charge merchants a percentage of the face value of bounced checks which require more than minimal effort to collect. If restitution is not made within prescribed time limits, bad check writers are subject to additional fees, court costs, and criminal penalties.

**Verification Companies**

rank	company name	checks (millions)		outlets
		\$ value	number	number
1	ETC/ SCAN	118,405	2,127.6	59,439
2	TeleCheck Services	17,188	368.9	36,730
3	CheckRite	8,134	153.0	40,693
4	Computer Cheque	6,357	128.5	3,875
5	NPC CheckServices	5,275	125.0	75,949
6	Concord EFS	4,356	112.5	2,500
7	National Check	3,770	82.0	3,600
8	Comdata	2,998	63.5	3,651
9	CCV	2,196	35.4	7,314
10	CFData Corp.	2,083	33.3	4,950
11	Capital Recovery	2,050	40.1	46,500
12	CrossCheck	1,705	24.7	1,715
13	CheckCare	896	27.3	5,688
14	Equifax	837	11.5	4,000
15	Checktronic	685	13.0	5,700
<b>16</b>	<b>MicroNEX</b>	<b>476</b>	<b>9.4</b>	<b>230</b>
17	AMV Payment	348	3.9	23,200
18	Vali-Check	275	5.1	2,000
19	CheckStop	236	3.1	390
20	TransCheck	51	0.7	220
21	CheckNet	17	0.4	1,000
22	VeriCheck	16	0.1	365

**More than 6,000 companies offer check recovery and verification services.**

Check recovery companies earned \$65 million on revenues of \$1.3 billion from check recovery activities in 1994. Merchants expended \$2.1 billion on expenses allocated to internal check recovery plus tens of millions more in unallocated costs. Merchants spend an estimated \$950 million annually on check verification and guarantee services. In addition, merchants shoulder \$660 million of the \$12 billion in bounced check fees charged by financial institutions.

*"Fraud reduction represents the single greatest potential for savings."*

Growth of credit/debit cards arguably makes check collections harder by taking away best customers. Retailers are increasingly turning away from internal recovery and verification. This suggests an increased awareness among retailers that such traditional fraud prevention tools as positive and negative databases, by themselves, have little impact on fraud in relation to their cost.

**No one really knows how big check fraud is.** Few chains have check management reporting procedures adequate to measure their performance or compare it to their peers. Government studies show \$615 million loss to banks. Check verifiers with broader direct account knowledge claim up to \$15 billion! Commerce Department data suggests the total is closer to \$8 billion. With total Grocery sales at \$410 billion, a 1.25% bad check rate on 40% of transactions value produces a gross of \$2.05 billion in bad checks.

**Fraud reduction represents the single greatest potential for savings.** In addition to eliminating direct losses, fraud reduction cuts check recovery costs more than would first be perceived. Three times as much cost is expended in the vain effort to recover each fraudulent check as on each non-fraudulent check. This is because the full gamut of collection effort is used on fraudulent checks, while many non-fraudulent checks are collected with a single phone call.

Reducing fraud losses from the industry average to industry “best practice” levels, is the key to obtaining the results shown in the table below.

**Fully Costed Economics**  
revenue \$10.5 million; check tender \$4.2 million

supermarket factor	check management	
	average practice <sup>1</sup>	best practice
gross check returns	\$55,674	\$13,919
recovery proceeds	(28,641)	(10,024)
true recovery cost	18,322	489
fraud & prevent cost	3,300	3,267
<b>total check management cost</b>	<b>\$48,655</b>	<b>\$7,650</b>

**Leading check recovery companies offer guarantee and verification services,** sometimes as a loss leader, to acquire the more profitable recovery business. Some also perform general collection services. Since recovery, not verification, is the cash cow their verification processes are largely outdated.

Although market leader verification services are able to cut bad checks rates to 1%, they have little impact on overall losses because they do not appreciably cut the number of fraudulent (uncollectible) checks accepted. Worse, traditional systems reduce sales by turning down valid customers.

**“... best practice systems such as the MicroNEX® brand are able to cut check returns to 0.25%; fraud by 80%; operational costs by 82%; and, direct losses by 89% .... all without hurting sales.”**

In contrast, best practice systems such as the MicroNEX® brand are able to cut check returns to 0.25%; fraud by 80%; operating costs by 82%; and, direct losses by 89%. Most importantly, best practice systems achieve these results without losing sales. The improvements add-up to a 20% increase in the average grocer’s bottom line.

**Most merchant self recovery efforts are marginal at best.** Often sub-optimized on a small portion of the problem, they average 50% recovery versus professional recovery rates of more than 70%. Internal recovery turf is too often zealously guarded, sometimes to the point of denying problems exist. Over \$5.5 billion of “written-off” bad checks are *not* turned over to outside recovery!

**The myth of \$25 fee income.** Merchants usually manage check tender, verification, recovery and collection separately, without a comprehensive P&L.

The result? Each piece looks good, but the *overall* program loses money.

Sub-optimizing in one area may cause losses in another area. Over reliance on bad check data bases, for example, leads to higher fraud losses<sup>2</sup> and lower sales. Internal recovery produces check fee ‘income’ — at the cost of diverting personnel from the merchant’s core business and increasing postage costs, court fees and write-offs.

<sup>2</sup> Only *realtime pattern recognition* can suppress fraud — 95% of all scams are perpetrated in 12-36 hours.

Resubmitting returned checks, for a “second bounce,” reduces bad check rates — at the cost of doubling bank charges and driving up losses from uncollectible checks.

**MicroNEX provides a core discipline** that cuts across all check management activities to help managers impose overall systematic control. These processes and technology simplify the life cycle administration of work steps required to accept paper checks. In addition to improving efficiency, the technology cuts losses from fraudulent checks by more than 80% when properly used.

The savings are well documented in the operations of numerous accounts. MicroNEX databases and technology are used as the industry best practice standard for check management in the retail industry by a major management consulting company.

The results are achieved by giving merchants, recovery firms and collection companies tools to work together, as partners, — with the goal of providing full service check management at the lowest overall cost. MicroNEX “tools” include: advanced check validation products, fulfillment, recovery, collection, and management advisory services.

Merchants have flexibility to use the mix of in-house and outsourcing resources most effective for their particular stores. Centralized and decentralized operations are both accommodated.

*"Merchants may select up to ten levels of protection."*

**MicroNEX verification products include VPay™ and VCheck™**

Both use sophisticated software that operate on terminals in merchants' stores. Advanced pattern recognition techniques help detect and block fraudulent checks from entering merchants' systems. Merchants may select up to ten levels of protection. The overriding objective is to reduce overall bad check losses, without losing sales; and, cut resources wasted on processing uncollectible checks. The preferred terminal has a small footprint, display screen, and keypad — and, scans both check MICR numbers and presenters' mag-stripe driver license numbers.

VPay protects against fraudulent payroll checks presented for cashing. VCheck protects against fraudulent checks presented for payments. VCheck options include NoTenderID™ to speed-up checkout by eliminating the need for shoppers to present an ID — and Val'ID™ to help validate age and ID for tobacco and liquor sales.

**RecoveryPlus™ automates return checks administration.** Also called R+™, it is Windows based software used by collectors, merchants, and MicroNEX check collection affiliates. R+ tracks return check data, payments, transfers of bad checks among collection agencies, law firms, and data centers. It facilitates bad check data entry by cross referencing ID information — DL, for example — with DMV records, prior bad check history, and other files to reduce data entry labor, improve accuracy, and build bad check issuer profiles.

R+ features include "clairvoyant" recovery, enabling recovery personnel to focus on the most easily collected checks. R+ provides extensive management reporting and prints collection letters and affidavits.

**Management reports are an important ingredient.** Key balances and processing figures bring reassurance and pinpoint potential security breaches. Comparison of internal merchant processes, and contracted processes, to national norms and best practices help merchants focus on areas offering the most opportunity for improvement.

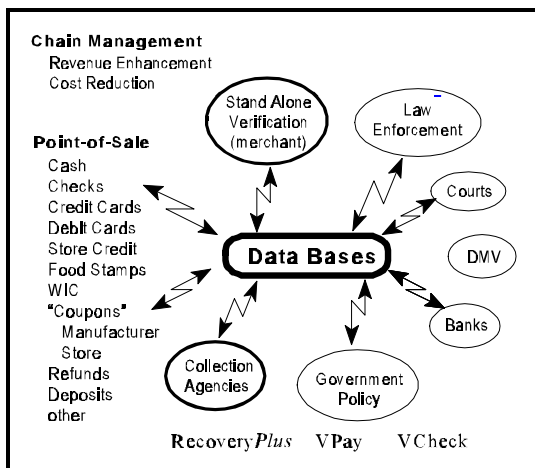
**MicroNEX's check fulfillment center receives more than 50,000 original bad checks a month** from banks, merchants and collectors for data entry. Additional bad check data is received in a variety of electronic formats. Pre-approved form letters, certified notices, and affidavits are automatically generated, batched for folding and insertion equipment, and mailed on schedules specified by merchants. Postage saving techniques are tailored to each store.

**Advisory services help merchants interpret and use reports to streamline internal procedures.**

Assistance is also available from major management consulting firms and certified fraud examiners. MicroNEX supports such projects as best practice reviews. Its *real-time* "scam alert" and "scam profiles" are key ingredients in helping community task forces comprised of local merchants and police systematically apprehend and prosecute organized fraud rings.

**Converting to best practice techniques produces impressive bottom-line results.**

A recent case study by LogisTech — a major packaged goods management consulting firm — suggests Kroger's 1996 net income would have increased 19%, from \$347 million to \$412 million, if "MicroNEX-like" best practices had been used throughout the chain.



**MicroNEX's data center maintains national and regional realtime databases** at MicroNEX facilities — and in merchants' stores.

In-store databases keep verification response times under one second and ensure service is available if phone lines are down.

Check usage patterns are analyzed in *realtime* to limit exposure to newly hatched scams.

Call FMI at (561) 747-9450 for a "best practices" return-on-investment analysis of your store.

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