



eB2B at the Tipping Point?

Why Checks May Finally Be On Their Way Out
November 2007

One of the reasons I went to the AFP (Association for Finance Professionals) conference in Boston in October 2007 was to get updated on the progress of the migration of business to business (B2B) payments from checks to electronics. As a general statement, progress on this has been very slow. But recent acquisitions (**Xign** by **JPMorgan Chase**, **Harbor** by **Amex**) and product announcements (most recently, the **MasterCard Payment Gateway**) seemed to signal a change in pace. So off to Boston I went, asking myself the question: *are there developments that will change the pace of conversion to electronics?* My answer is “yes” – read on!

The Problems

The stubborn persistence of check usage in B2B payments has been a continuing problem – despite overwhelming evidence of the benefits of electronic payments, and years of work towards that goal by banks, corporations, and payments providers. Through the years, I’ve come up with my own theory of the biggest problems in accelerating adoption of B2B electronic payments.

The first problem is signing up the supplier. Basically, check payments are just too simple, and everything else has been too complex in this regard. A corporate buyer doesn’t have to do anything to pay by check, except read the supplier’s invoice, print a check, and mail it to the invoice address. Any other system requires the buyer (or the buyer’s agent) to “sign up” the supplier. This is fine if your supplier is highly dependent on you (and will jump through any hoops to please you), but most large enterprises deal with many, many suppliers, not all of whom fit this profile. And a supplier who wants to be paid electronically, don’t forget, needs to sign up with every customer they supply. Many payments providers chasing after this problem have touted the idea of a “supplier network” – but the base of such networks has been pathetically low – often in the thousands or tens of thousands, while big corporations can have hundreds of thousands of companies in their A/P (or A/R) files.

The second killer problem is the handling of remittance data. How does the buyer tell the supplier what they are paying for? (In the B2B world, this is often an amount different than what is requested on the invoice, so simply referencing the invoice number is not enough). Again, there have been multiple solutions but no cohesion – so buyers and suppliers dealing with multiple counterparties (in other words, everyone) had no standardized way of receiving or sending the data.

Where We Are The conference started with AFP's announcement of market research showing that progress was, in fact being made: the typical organization is now making 74% of its payments by check, compared to 81% in 2004. Well, gee. On the whole, very big companies (revenues over \$1 billion) did better than smaller enterprises, but both, in my opinion, are still doing poorly. A slightly more optimistic picture is shown when enterprises were asked about their plans: 43% of enterprises thought it likely that they would convert the majority of their big suppliers to electronic payments within three years, and 33% of their other suppliers. This good but not great news is also reflected in statistics about ACH based B2B payments: these grew 9.7% in Q2 2007 vs. the same quarter the last year.

So I found all of this discouraging: it sounded like more of the same (slow but steady progress). Where were the events that could give that growth curve a nice, hockey-stick shape? **I found four new forces at work that I believe are significant.**

- 1) Card payments for A/P purchases** – this is by far the biggest news. Purchasing or procurement cards were introduced years ago – first for incidental corporate purchases and then for an expanding set of non-accounts payable purchases: in other words, purchases that did not fit into the standard financial supply chain. Now these cards are being aggressively pitched as an alternative to checks or ACH for A/P purchases. What does this mean? A corporation receives an invoice, approves it for payment, and then, rather than cutting a check or ACH, authorizes their supplier to submit a purchasing card transaction for the invoiced amount. (There are some interesting variations to this flow, but that's a longer story.) There's some real juice in this transaction: the supplier gets their money right away (instead of waiting 30 to 60 days), but pays a discount fee (lots of movement here, but for sake of argument let's say it is 1% to 2% of the purchase amount). The buyer pays the card issuer in 30 days and gets a "rebate" (a share of the discount fee which flows back through the issuer to the buyer). ***This is the consumer "rewards program" retooled for corporations – and it is proving to be just as big an incentive for businesses as it has been for consumers.***

Conventional wisdom has held that the discount rate is too costly for this mechanism to be used for purchases larger than a certain amount – many people would toss \$2,000 around as an example. What I heard in Boston is that **this is not the case** – that for many suppliers, the benefits of card acceptance (faster funds + ease of use + guaranteed payment + good remittance data handling) outweigh the cost of the discount fee – even for much larger amounts. Two enthusiastic corporate A/P presenters on session panels talked about getting over 50% adoption by vendors approached. One banker I spoke with said that “every customer is asking about this”.

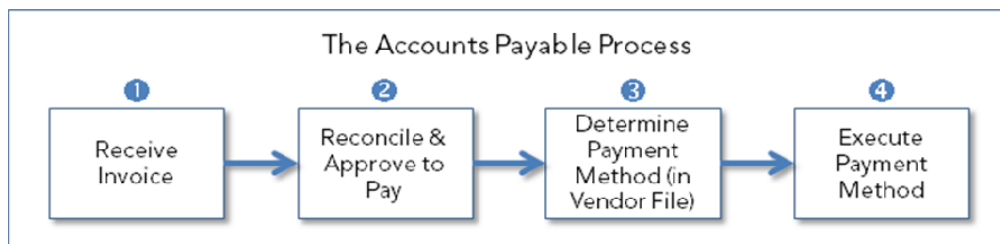
The rebate program is giving the corporate buyer the **energy needed to deal with the supplier sign-up problem**. One of the sessions I attended was called “**Making the Business of Payables Pay**”. The basic message was that moving payments to the card networks not only was cheaper than checks, but, with the rebate, become money-earning transactions. Now, if you are a corporate treasurer, your reaction to your A/P department becoming a profit center will be tempered by an understanding of what might be happening in your A/R department – but still, this is big news, and I the conference sessions were full of earnest A/P managers, taking careful note. One banker did caution me that adoption will be very different depending on the industry – but in industries with decent margins, he expects the conversion to card based A/P payments to move very quickly.

A Note on Payments Economics

*At Glenbrook, we spend a lot of time mulling over some of the more philosophical aspects of the payment industry. One take on this development (the use of cards for A/P purchases) is that it is yet another example of the movement of payments economics to a world of “**he who is paid, pays**”. Thirty years ago, retail department stores and restaurants did not pay a percent of their transaction for the privilege of being paid – now, they routinely do. Looks like A/P purchases are going the same way. Is this a problem? Not really – the seller of goods sees that the benefits of the improved payment mechanism compensate for the cost.*

What’s next? Consumer bill payment?

- 2) **A new attitude towards accounts payable outsourcing** - suddenly, the term “Outsourcing Accounts Payable” seems to come tripping off of many tongues, without stumbling – it’s beginning to sound like the obvious, right thing to do. What does it mean? Different things to different people. Take a look at a simple value chain:



Banks for many years have been offering to outsource #4 (“give me your approved payments file, I’ll cut checks and send ACH’s for you”). That has been of some utility and has had some adoption. But now, with the integration of card payments into the “methods” portfolio, the value is increasing and more corporate customers are demanding full outsourcing of function #4. Banks like **Wachovia** are seeing this as a standard component in A/P outsourcing RFP’s from customers. Several providers are backing up to earlier stages of the value chain, and offering to manage the “determine payment method” function, the “reconcile and approve to pay” function, and the “receive invoice” function. The value of providing each of these earlier functions varies by market segment and corporate size, and it’s probably too early to predict how well they will be adopted. The hidden jewel in here, however, is function #3, which is leading to....

- 3) **A new life for the supplier network concept** – remember when we said above that supplier sign-up was one of the core problems? Although several smaller players were chasing “network nirvana” (Xign, Clareon, OBX....) none were really big enough to rock the boat. Now, this idea is coming around again – with players like **American Express, MasterCard,** and **JPMorganChase** leading the way. (Expect **Visa, Citibank,** and possibly some other major cash management banks to be in close pursuit.). The proposition? Any supplier who signs up with the network to receive payments from one buyer can easily expand that to multiple buyers. This is enabled by something as simple as easy-to-use supplier portals, where a supplier can make choices (I want ACH payments from these buyers; I’ll accept card payments these buyers, etc.)

The power, of course, is the network effect: rather than each buyer's A/P system keeping track of each supplier's preferences, the network does the work. Now, this implies that the supplier will still have to register/sign up at each network: but how much better to do this than to sign up individually with each buyer. **This is such a great idea that it is hard to hold back the enthusiasm of its advocates.** One banker did warn me "we're still not there yet" and corporations are predictably nervous about losing control of this aspect of their vendor files. But, for the first time, I see the shape of a future market, where a limited set of supplier networks (maybe 3 to 6?) are active and enable a corporate payer to reach most of its suppliers electronically without going through an individual sign-up exercise. (This implies a network-to-network "gateway" function – but hey, payments networks know how to do that.)

The Holy Grail?

Jump starting a supplier network requires an easy way to get tens or hundreds of thousands of suppliers registered on the network. The purchasing card networks already have huge bases of card accepting suppliers – think about what it could mean if they could "wave a wand" and enable these suppliers to be on an A/P supplier network. Similarly, a bank with a really large base of small and medium size business customers could be in a position to feed – or even to become – a supplier network.

*Other companies with large bases of enterprise customers are potential providers or partners. It didn't surprise me to see **ADP** with a quiet but well thought out Accounts Payable Outsourcing product. Other players could include **D&B, Experian, or Intuit.***

- 4) The final factor is the least exciting, but possibly the most significant – **new progress on remittance data standards.** You'll recall that remittance data handling was the second of the two "killer problems" we identified at the beginning. There are two aspects to this problem. One is how the data is physically delivered (with the payment, such as ACH CTX, or otherwise). The other is the format of the data delivered electronically. The ANSI/EDI councils addressed this early on with the "820" EDI format. The problem was its very flexibility – an 820 could be tailored in so many different ways, for so many different verticals, that the concept of standardization was lost.

The **EPNSTP820** initiative, driven by **The Clearing House Payments Company**, is a significant step forward. It defines a short subset of key remittance data elements that can be the default format for “most” remittance data. They are working hard to see that this format can be handled by suppliers’ accounting systems – critically by QuickBooks (for small businesses) – but others as well. Some people have been concerned about a potential standards war between this approach and a more XML based approach being used in Europe – but I’m convinced, after talking about it with the project sponsors, that flexibility to deal with future standards changes and/or convergence is sufficiently “baked in” to the current approach. Even better, **CHIPS** (the large value payment system which is also a part of The Clearing House Payments Company) and the **Fed** (in its role as operator of the Fedwire) are also cooperating in this effort, so as their efforts (and those of other country’s large value payment systems) to become a more accepted option for B2B trade payments progress, we won’t have to re-invent the remittance data solution.

A few other factors were interesting, but seemed less significant to the overall progress of B2B payments

Invoice Flipping continues to generate some interest. This is a concept that allows a company to send out an electronic invoice (which, by the way, is probably the biggest single cost save a company can implement in automating the financial supply chain) which the receiving company can “click to pay” – thereby “flipping” the invoice to a payment. **American Express** and a number of other vendors offer this. It is clearly a good solution for some small business payers – but less so for large corporate A/P operations, who want standardized methods for dealing with suppliers

UPIC (Universal Payment Identification Code) remains my favorite idea that is still, unfortunately, going nowhere fast. This is a simple dummy account number scheme, that allows a supplier to provide a UPIC rather than their “real” bank account information to a buyer. The UPIC can be used only for money-in payments, meaning that a corporation is protected against unauthorized account debits and other undesirable uses of their bank account number. Furthermore, it would let a supplier register a UPIC with, say, a supplier network – and not have to change that in the future if the underlying bank account number (or bank!) changed. The problem? UPICs are issued by banks – which are understandably reluctant to enable bank switching. So they are glacially slow in adopting this. **U.S. Bank** is a notable exception – and we hope we will see other banks following the course.

In summary, here's what I expect to see over the next few years for B2B payments:

- A dramatic shift in volume from check (and sometimes, from ACH) to card based A/P payments
- The formation of three to six major supplier networks. Who? Definitely MasterCard, American Express, and Visa – and possibly some direct bank or third party providers. These networks will keep supplier payment preference data and route transactions based on preference
- An acceleration of suppliers' willingness to be paid driven by the ability of accounting software to accept and integrate more standardized remittance data

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