WHITE PAPER SERIES: FINANCIAL INSTITUTIONS PERSPECTIVES

# Commercial Payments

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mastercard

RFi Consulting

# About This Series

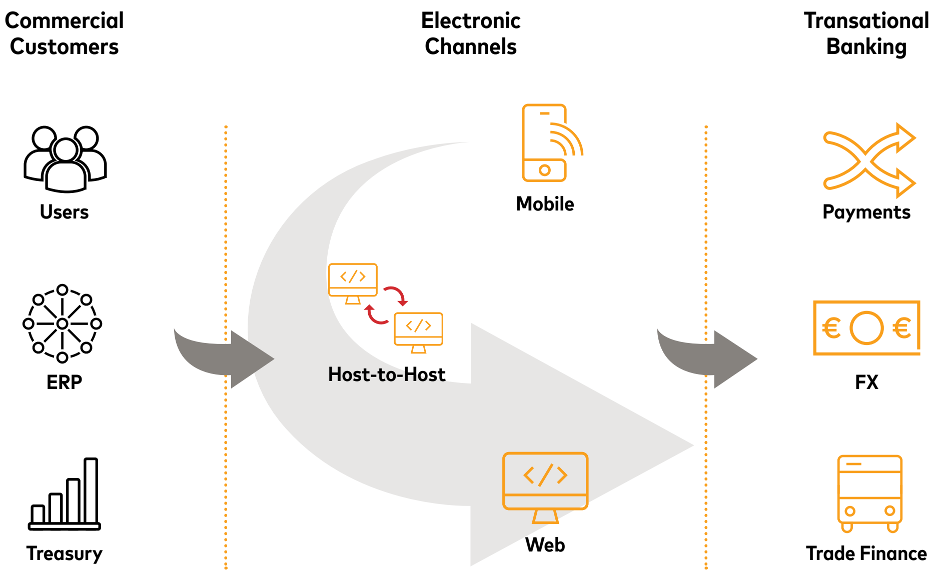
Through this series of papers, we examine the dynamic and growing commercial payments sector in Australia. This paper investigates the payment perspectives of banks and financial institutions, primarily focused on domestic payments, channels, account management and pricing. Mastercard has partnered on this series with RFi Consulting (RFi), an independent consulting firm focused on the financial services sector and with a strong specialisation in the payments industry.

# Overview

Banking respondents indicated that they believe that business enterprises in Australia are well served for their commercial payment needs, particularly in comparison to many other countries. The ease of use of the Direct Entry system and the ubiquity of online banking for businesses have been key in achieving this. However, the desire to link data/information with a commercial payment has been noted as an unmet need for many years. In Australia, the New Payments Platform (NPP; due to go live at the end of 2017) is trying to solve for this gap in service.

Other areas where companies have requested innovation include –

- Additional data elements accompanying payment;
- Faster, real-time payments;
- Transfers outside of business hours, including weekends;
- Lower cost;
- Consistent messaging and file formats;
- Ubiquity (ability to pay to, and receive from all).



# Domestic Payments

Larger corporations want more back-end integration with their ERP systems, TMS and other procure-to-pay systems to enable more "payables and receivables automation." To some extent, this requires ERP providers to work more closely with the banks on file formats and linkages. However, as one moves down in company size to mid-market and SME businesses, these enterprises become less served in terms of the integration of their payment systems, giving rise to issues. They tend not to have the right systems and do not have the time or resources to invest in solutions.

Hence, ease of payment origination, integration with accounting systems and improved reporting remain opportunities amongst SMEs. Both Xero and MYOB, accounting platforms favoured by the SME sector, have actively enhanced and promoted their integration of payments to improve efficiency for their users/customers.

Of interest, respondents noted a continued reliance on cash amongst many businesses in the SME segment. Businesses that receive cash use it to pay suppliers, such as paying route trade deliveries and bills over the counter to Australia Post with cash. The receipt of cash into these businesses is, however, itself being reduced by consumers' use of electronic payments, particularly contactless cards and the move to e-commerce.

E-commerce has seen significant growth, but in terms of payments-related revenue to the bank, it has shown a heavy skew to large corporates. The table below provides an indicative division of payments-related revenue from merchants to the bank between physical point of sale and e- commerce.

### Estimated Division of Bank Revenue, POS vs eCommerce

| Segment | Turnover of the Business | Division of Bank Revenue from POS payments | Division of Bank Revenue from eCommerce payments |
|---|---|---|---|
| Institutional | $500+m | 20% | 80% |
| Corporate | $50-500m | 25% | 20% |
| Business | $5-50m | 25% | - |
| Micro | Below $5m | 30% | - |
| Total | | 100% | 100% |

The e-commerce revenue split is interesting because it is inverse to the number of online merchants by size, with a small number of institutional merchants contributing the vast majority of turnover, albeit at low margins. Furthermore, research undertaken by RFi indicates that 90% of the approximately 100,000 online merchants in Australia sell less than $1m per year online. Please note that these numbers include MOTO merchants.

Banking respondents claim that it is hard to make money from payments alone, which are a required service in order to gain a business account, and that it is necessary to generate revenue from the broader client relationship.

It was noted that **loans**, **float** on transaction account balances and **fees for other services** probably generate up to **eight times** as much **revenue** for the bank as payments alone.

There appears to be increasing interest in the opportunity to innovate in the commercial payments arena using existing payment methods, for example through the use of virtual cards. Large corporates appear to be investigating the use of Purchasing Cards (P-Cards), particularly in virtual format, to replace certain Direct Entry payments, and B2B card acceptance is growing (albeit slowly) to accommodate this. For example, JB Hi-Fi and one of its major suppliers have recently changed their payments interaction, with the supplier set up with an eCommerce facility and JB Hi-Fi provisioned with a virtual P-Card; a significant value of payments has moved from Direct Entry to card, with all parties benefiting: the supplier is happy to receive earlier payment, JB Hi-Fi is pleased with the improved efficiency and integration, and the bank sees an uplift in revenue. However, engineering such changes in a payment regime between multiple parties and departments takes a significant effort.

# Electronic Channels

As noted by one bank respondent "What you see in your private life, you want in your company life", and nowhere is this clearer than in the user interface (UI) and experience that companies desire in online transactional banking, with simplicity and reliability. Although the values are significantly higher, and with them an expectation of more security, people expect to be able to make commercial payments in a similar manner to that of retail payments.

An example is the growing trend for commercial payment transactions to be initiated via file upload on a PC/computer system, and then authorized on a mobile device. Another is a collective change from batch processing to the real-time processing of individual transactions, in line with the rising expectations of users.

In the commercial payment space accessed online –

Integration with the ERP system (SAP/Oracle/etc.) and/ or Treasury Management System has become more important in order to capture efficiencies, gain speed and immediately "know your position";

- Management of working capital has more focus;
- Security needs to be controlled within the organisation as to "who is allowed to see and do what", ideally managed by an Administrator via a "dashboard";
- The threat of cyberattack is a growing issue, but most large corporates have good processes and systems in place to defend themselves;
- Increasing alignment of corporate personnel against specific activities undertaken by the bank, e.g. some corporates now have hundreds of people interfacing with the bank versus a limited few in the past.

Although there is a higher level of security against external attack in the commercial sector, internal fraud is still an ongoing challenge. This becomes more problematic as payments move into the real- time digital space, as desired by the customer, and companies probably need to be prepared for some inconvenience for the sake of security.

There has been strong growth in cross-border transactions being conducted/initiated online, with straight-through processing and validation to the end point recipient. The average size of business sourcing inputs from overseas suppliers is decreasing, driven by digital access to providers located offshore. Smaller businesses have been attracted to the online channel due to its ease (and familiarity) in making these overseas payments.

Larger corporates tend to pick different banks for individual specialty services, but usually only one bank gets the transaction banking "mandate," as then only one integration into the ERP system and one online interface (with which the team can get familiar and can master) are required. Banks are often willing to take the corporate payment message in whatever format is provided by the company's ERP systems, and then transform it into the relevant format for the bank to process. For example, Qvalent (owned by Westpac) has several thousand plug-ins available for such file transformations.

Transactional banking usually goes out to RFP for the large corporates, but selection is not all about price. Normally "pitches" will include demonstrations of the bank's online, mobile and other user interfaces, with comparisons made to the competition. In addition, service, integration and innovation are important. Corporates want to know that they are not going to be left behind, so the payments providers need to show that they will be on a pathway and services will continue to evolve - particularly in their digital offerings.

Another selection criteria can be data access: that is, there has been increasing interest in the use of payments data by commercial enterprises, focused on the concept of "big data" and how this information can be used for competitive advantage in the marketplace and/or to improve efficiencies in the business. Indeed management reporting is very important to the corporate customers, with their Treasury functions needing information for effective management of working capital and cashflow. Companies want access to this information via online "portals" and customised links/interfaces.

As noted above, businesses also want to send and receive data along with the payment, and the NPP will hopefully deliver this capability via the online interface. Additionally, ISO standards are helping to make this possible both domestically and internationally.

# Account Management and Pricing

Large corporates[1] do not tend to be priced at the transaction or at an account level, but rather at the "relationship level," with bundled "all in" pricing. However, this relationship pricing can be difficult as the bank does not always have sufficient transparency of the requirements, especially with a "new to bank" client, and may not be the only FI involved. In addition, Multi-National Corporations headquartered overseas tend to already have multi-country banking representation, but Australian banks can be sub-contracted to provide local services on behalf of the main incumbent.

The account management teams at the banks handling these customers draw on resources from many other areas in the bank, servicing the customer's needs for domestic and cross-border payment transactions, working capital management, correspondent banking and technical input (e.g. for ERP integrations).

The income streams available to the providers of commercial payments include:

- Transaction fees (varying by payment method, e.g. Direct Entry, BPAY, cheque, etc. and which are under competitive pricing pressure in the market);
- Merchant Service Fees (which will be impacted by the new RBA card regulations);
- Foreign Exchange margins;
- Monthly or Subscription fees (e.g. under "all you can eat" or "fee cap" arrangements);
- Establishment fees (for new facilities, e.g. LOC);
- Failed transaction fees (e.g. for rejected direct debit transactions).

Pricing pressure is also coming from corporate procurement teams, who want everything in "unit pricing" and want it to be priced lower. Procurement tends to disregard the back office costs of the corporation (on which they do not normally get measured) and therefore the efficiencies that integration and straight-through processing can bring to the overall enterprise. For example, BPAY can solve significant payment reconciliation issues for some enterprises, but this tends to be ignored in pricing discussions, as "businesses seem to lose sight of the end-to-end cost of payments."

[1] ASX500 entities, Multi-National Corporations, Government and other large enterprises.

In conclusion, commercial enterprises are showing considerably more interest in payments today than in the past, driven primarily by their customers - especially if they deal with consumers. Payment methods were previously seen as a utility, but are now viewed as a way to capture additional revenue. For example, merchants expanding their card acceptance to include UnionPay in order to capture Chinese tourism spend. There is a focus on payment systems being "always on" 24x7, with real-time access to information – including at weekends. Businesses have "no room for failure" and need reliability from their payments provider(s).

The cost of providing payment services tends to be about the complexity of the payment flows rather than their quantum, with some commercial payments being very simple and others highly complicated, for example:

- In project finance, multiple banks may be involved with different tranches of payment due against varying milestones;
- For commodity exporters, a trade facility may be attached which involves a LOC, with payments made into and between different foreign currency accounts held onshore;
- In the government sector, different agencies tend to do things differently, as each has separate and different legacy systems; despite a push for simplification, sometimes specific legislative changes are required due to the current statutes dictating that particular procedures must be followed;
- The "end of day sweeping" of a company's various accounts into a central treasury account does still occur, but instead some corporates opt for pooling and offset, allowing the money to remain in the separate accounts; however this can also be complicated by any joint venture investments of the enterprise, which may dictate that separate and distinct accounts be maintained.

The account management team at the payments provider needs to price its services appropriately for complexity, because these types of transaction require more resources and expose the bank to more risk. But, the customers involved in such transactions are usually sophisticated, highly educated and tend to drive a hard bargain.