DIGITAL PAYMENTS: IS THIS REALLY GOODBYE TO CASH?

AN ANALYSIS OF BUSINESS AND CONSUMER TRENDS

ACCUITY

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EXECUTIVE SUMMARY

Digital payments transaction value is growing exponentially and is expected to climb to USD 8.7 trillion worldwide by 2025[1]. Driving this acceleration are factors such as new technology, consumer demand, fintech disruption, regulatory initiatives like the EU Payment Services Directives, and now the global pandemic.

Boosted by the internet and universal use of smartphones, currently estimated at 3.5 billion users worldwide, these factors are transforming how businesses and consumers pay for goods and services. They have also brought to light a new set of priorities. Speed, user experience, and operational efficiency have become primary concerns for corporates and financial institutions, including banks, PSPs, and other fintech companies facilitating digital payments.

While many organisations are hurrying to assemble the digital tools needed to compete in this dynamic landscape, some are already well positioned to embrace digital transformation. Overall, the most significant gap is between the consumer and business-to-business (B2B) markets.

In many ways, the consumer market is light years ahead of the B2B financial services and corporate sector. Consumers already have at their disposal numerous digital payment channels, including online banking, peer-to-peer networks, e-wallets and other cashless electronic options.

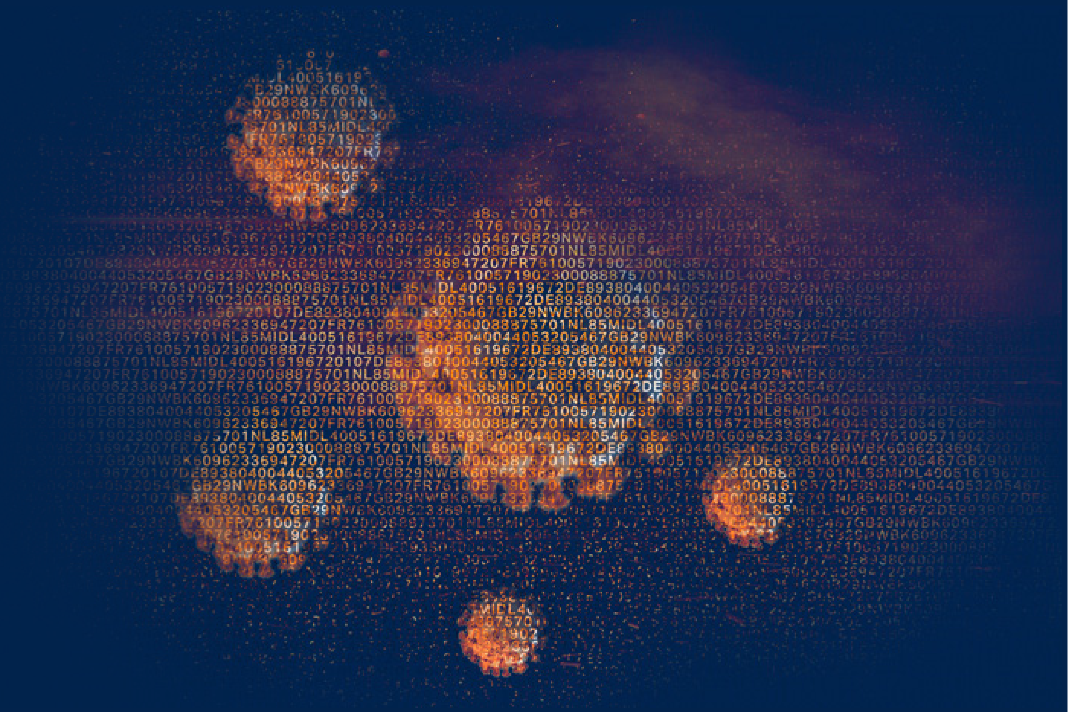
The pandemic has only accelerated the rise in ecommerce and corresponding digital payment volume. Fintech companies offering seamless digital payments built on modern technology have multiplied to capture the growing consumer market and take advantage of pockets of opportunity in the B2B sector. In doing so, these fintech disrupters also stand as competition to traditional financial institutions, compelling them to seek out innovation to remain relevant.

As a result, financial institutions and corporates are more ready than ever to embrace significant changes to operational processes and structure to establish the straight-through processing (STP) needed for fast, frictionless and efficient payments. Whether through partnerships with fintech companies, sandbox initiatives or Application Programming Interfaces (APIs), the transformation has begun.

Adopting automated, electronic processes minimises errors and will enable payments to go through the first time, every time, without manual intervention. What financial institutions and corporates have begun to realise is that the automation of processes brings more benefits than anticipated – benefits that will continue beyond the temporary virtual working environment foisted upon the world by the pandemic. As commercial payment flows become fully digitised, it is unlikely that organisations will revert to legacy processes even after the pandemic is nothing more than a dark spot in the history books.

This whitepaper from Accuity was developed based on our experience working with over 2,000 bank customers and many of the leading corporates and non-bank financial institutions around the world. It will explore the payments transformation across various sectors and the factors shaping the payments trajectory.

THE EVOLUTION OF PAYMENTS DIGITISATION



Digital payments represent the exchange of electronic (non-physical) payments over digital channels, such as over the internet or through mobile computing. Although the digitisation of payments has been advancing for some time across all industries, geographies and markets, the pandemic has increased the urgency, and hence the volumes of digital payments. What was once a far-reaching initiative has become more crucial and in fact, mission critical.

Adoption of digital payments is shaped by many factors, from regulatory initiatives and consumer expectations to new technology and fintech disruption. But there is no consistent path. Different industries and different geographies are often at very different stages of adoption.

Here we take a closer look at the consumer and B2B markets with a deeper dive into corporates, financial institutions and fintech companies.

CONSUMER MARKET

It is not unusual for consumers to be early adopters of new trends or technology and subsequently drive change across the slower moving financial sector. In fact, much of what is happening today in terms of payments digitisation began on the consumer side.

Consumers across the world are increasingly shifting away from cash to mobile and internet-based payments. Peer-to-peer (P2P) payment systems are a good example of this shift. In the U.S., more than 30% of the population uses P2P payment systems, such as Venmo and Zelle, the two largest such systems. eMarketer predicts that P2P mobile transactions will grow from an anticipated $396 billion in 2020 to more than $612 billion by 2023. However, consumer-level adoption of digital payments is not confined to the U.S. In China, arguably the biggest market in the world in digital payments, transaction value reached $1,596 billion in 2019.[2]

Mobile payments offer a lifeline to the estimated two billion unbanked and underbanked individuals in the world today. These are people who do not have a bank account or who have an account but rely primarily on money orders, check cashing services and other outlets for their financial services needs. Along with e-wallets, mobile payments help this underserved market by providing a fast, secure and inexpensive way for someone like a gig worker to receive funds, make payments, and move money to obtain whatever is needed in both their work and personal lives.

BUSINESS-TO-BUSINESS MARKET

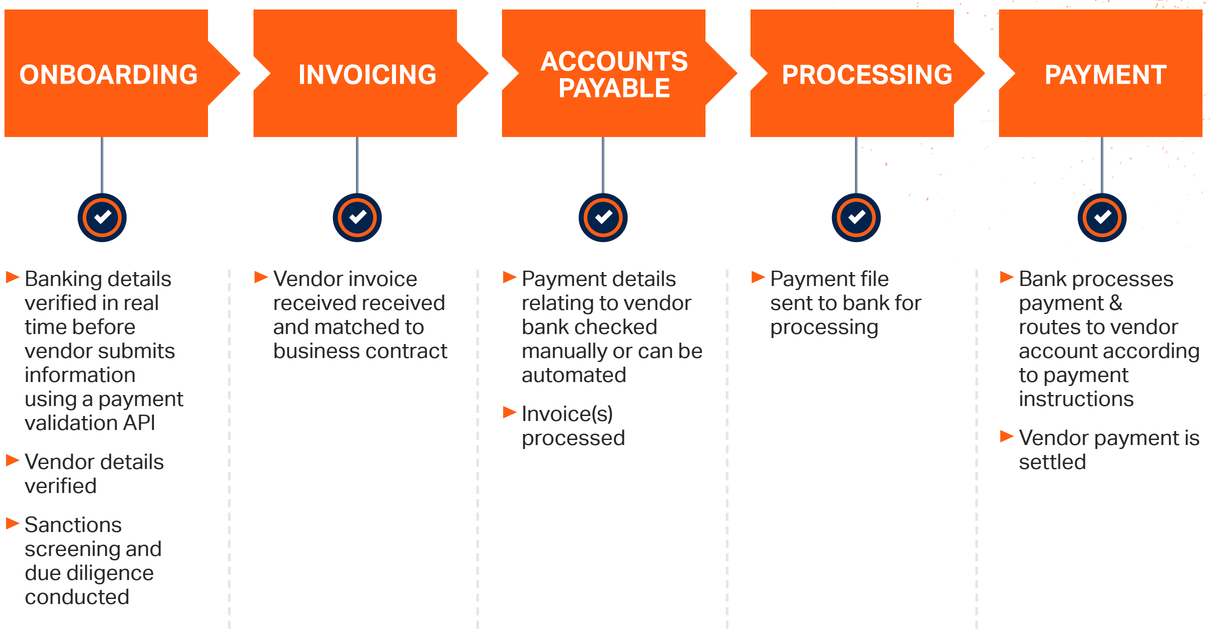
The fast, frictionless transactions a consumer experiences with payments are influencing user expectations in the B2B sector. Those expectations are driving a rise in payments digitisation across the entire continuum from retail to commercial. Based on an analysis of payment flows, Mastercard estimates the B2B payments market is approximately $120 trillion dollars globally and $25 trillion per year in the U.S. Yet, cheques still represent more than 50% of the overall transaction value.[3]

As payments become increasingly electronic in B2B, organisations can amplify the benefits of the transformation by updating overall processes to remove friction, increase speed, lower costs, and improve efficiency. This requires a holistic approach that starts at onboarding and continues through payments processing and reconciliation. (see Fig. 1)

The pandemic has brought into clear relief the need for companies to move modernisation of processes from a back-burner project to a critical element of business operations in order to remain relevant and competitive.

To grasp the full impact of digital transformation, it is helpful to understand how it affects key B2B sectors: corporates, including small- and medium-sized enterprises (SMEs); financial institutions; and fintech companies.

Fig1: Best practice workflow for onboarding vendors through digital portals and setting up their payments



CORPORATES

Consider the transformation across the corporate sector, including both SMEs and multinational corporations. Primarily as a result of the pandemic, companies must now maintain business continuity for accounts payable and other day-to-day processes in an essentially virtual environment. But payments transformation is at different stages of adoption across different companies. As a result, some organisations were able to transition seamlessly to remote operations while others hit roadblocks along the way.

The adoption of digital payments technology varies considerably across geography as well. In India, for example, cash represents approximately 96 percent of total payment transaction volume.[4] Other jurisdictions in Asia-Pacific (APAC) have also been slow to adopt digital payments in the corporate sector, which stands in stark contrast to the well-developed consumer use of digital technologies in most APAC countries. China is one exception – it is a leader in digital payments in both the consumer and B2B markets. Online bank transfers are the main B2B payments method in China, while electronic bill payment is popular with B2B companies that have accounts receivable financing needs.

In the U.S., B2B payments are already considerably electronic. Although check usage continues to decline, cheques still account for slightly more than 40 percent of B2B transactions, according to a survey by the Association of Financial Professionals (AFP). But that is half of what it was in 2014, when cheques represented more that 80 percent of B2B transactions.

A HOLISTIC APPROACH TO PAYMENTS

Establishing the processes around payments is a challenge many SMEs have to overcome in order to grow. For example, something as seemingly simple as bringing together disparate pieces of information to take advantage of early payment discounts can be hindered by departmental silos and legacy systems that do not communicate with each other. Digital transformation can help remove barriers that cause friction in payment flows, reducing risk and ensuring timeliness of payments to sustain these businesses and their relationships.

Payment execution, however, is not the only area getting attention. Corporates are looking at every point of the buyer-supplier process to see what can be automated so they can gain the greatest benefit from digital transformation. This includes improvements in onboarding, KYC, and payment reconciliation, to name a few. In other words, digital transformation is driving companies to rethink and reengineer processes to gain efficiencies and visibility across the enterprise.

ACROSS-THE-BOARD BENEFITS

A direct outgrowth of payments transformation is that companies now expect more services from their banks. The frictionless process and numerous options available to consumers are tangible proof of the possibilities in payments on the B2B side. Consumers have multiple choices, whether paying by card ACH, wire, or cheque, they are not limited to just one payment product or one approach.

Corporates are coming to expect the same level of choice. That means more payment products and payment options across a broader swath of geographies, plus quicker settlement times and lower fees. Corporates also want intelligence based on data analysis to determine the best payment method for a particular situation.

Financing decisions, which are based on harnessing and integrating various pieces of information from the supplier, for example, can come into play as well. The payments industry is stepping up to meet this demand. There has been a considerable number of mergers and acquisitions as well as partnerships formed with card companies, fintech companies and others to address the lending, trade finance, bill paying and other corporate business needs – underscoring the importance of these functions. Deutsche Bank's investment in Traxpay, a provider of supply chain financing, dynamic discounting and other services to corporate customers is one such example. Traxpay will enable the bank to expand its supply chain finance offering and offer more flexible payment terms to customers.

By removing barriers, digital transformation within the corporate space will bring with it more visibility and predictability in the payments process, which is critical given how quickly money moves. Corporates will gain greater insight into the inbound and outbound payment flows within the company. This knowledge provides a more accurate picture of liquidity for better risk management and more efficient use of capital. A report by Goldman Sachs believes these improvements can lead to a $950 billion global opportunity across invoice processing, AP payment processing, working capital management, factoring and cross-border payment optimisation.[5]

FINANCIAL INSTITUTIONS

For years, U.S. financial institutions (FIs) have been looking for ways to speed the adoption of electronic payments. Although the industry has made great strides and is moving in the right direction, the shift to digitisation of these payments has not been as fast as some would like. The reality is that cheques still work and are a mature and trusted payment instrument.

According to the National Automated Clearing House Association (Nacha), 26.8 billion payments were made on the ACH Network in 2020, which was an increase of 8.2% over 2019. Over the same year ACH payments initiated by paper cheque fell 21%, and now accounts for less than 4% of all ACH payments.[6] As electronic payment methods continue to increase their share of these accounts payable payments, consumers, organisations and FIs all stand to benefit.

In Europe, open banking initiatives have completely changed the landscape for financial institutions, driving up competition from challenger banks and other innovative payments providers. To embrace transformation, FIs must be able to deliver solutions and processes that can scale and that can evolve quickly. This level of agility and flexibility is not at the core of how traditional institutions operate, which has compelled FIs to work more closely with fintech companies and PSPs to fill the gap.

WHAT HAPPENS TO CASH?

It may be tempting to think that the pandemic will hasten the transformation of some markets into cashless societies. Perhaps this may be true for some of the Nordic countries that were already far along in that journey before the pandemic arose. Cash accounted for just 1% of the total value of all payments in Sweden as far back as 2016, and the Bank of Finland predicted that the use of banknotes would end by 2029.

What is interesting is that while electronic payments are more hygienic when compared to cash, it remains to be seen whether cash will disappear so quickly. Many countries are still incredibly reliant on cash and people tend to hoard paper money in times of crisis. Although the volume of cash usage is decreasing, it is unlikely – at least in the short term – to expect cash to go the way of the dinosaur. The key to a truly cashless society is trust. People will be more willing to transition entirely to digital payments if they trust the banks and fintech companies behind the payment processes.

FINTECH COMPANIES

Once the go-to providers of nearly all payments services, banks are losing ground both on the consumer and corporate side to newer competitors. Fintechs, digital banks, PSPs and other non-traditional financial service providers are eroding banks' grasp on payment services. These newer players, which include companies (and products) such as PayPal (Venmo), Monzo Bank, and Ant Group (Alipay), can deliver services faster, cheaper and with less friction than traditional banks. Even in tightly regulated markets like China where approximately 90 percent of B2B payments are processed by banks, digital competitors are seeping in.

Turning to fintech companies for payments services can certainly enhance the capabilities of a company by increasing its payment options. But it is important to optimise the relationship by considering the various factors associated with suppliers globally. That is, payment options will vary for suppliers based on value of the payment, geography, prevalent behaviours related to the market in question (is it more card, cheque or ACH oriented), and other factors.

As newer competitors continue to leverage local clearing networks for facilitating payments, companies must be knowledgeable about these payment systems in order to benefit from the options offered. Very simply, the ability to handle global payment flows rests on a company's ability to understand local payment systems. Financial institutions need to understand the systems as well in order to partner with providers that can best meet the needs of the bank's customers.

The increased use of local clearing systems for real-time low value payments is gaining traction, leading to more and more countries promoting real-time payments rails. There are currently more than 50 countries live with real-time payment systems around the world with more coming on board every year. The challenge will be to ensure that the most suitable payment network is always chosen and that all payment details that are required by each unique network are correctly included in the payment instructions to prevent payments from failure. Further enhancements in technology and adoption of standards that harmonise processes across these clearing systems will continue to drive greater use of real-time payments around the world.

WHAT HAPPENS TO BRICK AND MORTAR BANKING?

It is also tempting to think that the number of physical bank branches will decrease significantly as a result of digital transformation. After all, the pandemic has shown that it is possible to do business with fewer branches in general and certainly fewer full-service branches.

While the number of bank branches is definitely decreasing – HSBC, for example, recently announced the closing of 82 branches in the UK – the pandemic only accelerated this trend, which started several years ago. The bigger change will be how branches operate. Simple transactions that might have been done in a branch will be moved online. Full-service branches will be reserved more for those processes that are not done easily online, such as obtaining a mortgage. It is important to note, however, that physical presence is an intangible asset in terms of gaining the trust of the consumer. While there will be continued growth of challenger and virtual banks, the importance of a physical presence to the customer will not completely disappear.

THE ROLE OF TECHNOLOGY

Technology makes it possible to consider multiple factors in tandem in order to present various payment options. It helps remove friction in legacy and new processes alike. However, organisations must have the right infrastructure to support new technology, which often requires a re-engineering and a different way of thinking about workflow, processes and payments.

Without proper planning to understand how new technology integrates into an existing ecosystem, unintended issues may arise. The last thing a company wants or needs is to resolve one set of issues only to have to tackle a new set of problems.

The pandemic has added fuel to the fire in accelerating digital transformation. It has exposed the inefficiencies and the risks of not using technology to its fullest extent in supporting operations. With a holistic approach to technology, organisations can overcome logistical barriers that exist in their payment processes and more readily support growth.

APIs have become one of most efficient ways to incorporate new technology into an existing ecosystem. They allow different systems to share information and easily connect to each other without having to reinvent the wheel. APIs enable companies to quickly expand service offerings, fast-track delivery, improve customer engagement, and drive new revenue opportunities.

THE ROLE OF STANDARDS

In addition to technical advancements, standards and regulatory initiatives continue to play an important role in bringing about transformation in the industry.

In Europe in particular, the digital transformation push owes much to the first Payment Services Directive (PSD1), which was introduced to boost competition, protect consumers and improve service. It was instrumental in ushering in open banking by allowing third parties (e.g., fintechs and non-banks) to carry out financial transactions that were once controlled solely by banks.

The Second Payment Services Directive (PSD2) went even further by creating new payment services that offered users wider access to accounts and more choices for initiating payments. With new non-bank players competing head on with traditional financial services providers, FIs have had to innovate to remain competitive.

As regulatory forces continue to drive open banking in Europe, market pressure and consumer demand for modernisation of payments systems are already leading to changes in the U.S. and the rest of the world. The pandemic has only increased the urgency of digital transformation. In addition to the more prevalent use of APIs, whose adoption owes much to open banking initiatives, other advancements in technology and networking such as the adoption of ISO 20022 and SWIFT gpi are also driving change.

THE ADDED VALUE OF DATA

A core benefit of digital transformation in payments are the new ways in which the industry can harness data for greater insight. ISO 20022 is one such example.

This payments messaging standard offers a flexible infrastructure that harmonises payments language to facilitate information exchange. It brings with it the ability to capture not only more information, but more meaningful, referential information with more context. As such, ISO 20022 allows for greater insight and scrutiny of payments to ensure accuracy, speed processing, reduce risk and improve compliance. Corporates and FIs continue to embrace ISO 20022 as the leading messaging standard for payment types around the world.

The value of data is not only apparent in ISO 20022 messaging standards, but applies across the spectrum where it is further enabled by a digital presence. Mobile payments, for example, provide companies with insight into customer behaviour that can be used to uncover opportunities and tailor products and services to a particular audience to drive revenue.

When used properly, data provides companies with a feedback loop to continually enhance the customer experience. Data insight leads to more targeted products and services, which in turn drives customer satisfaction resulting in greater engagement, which closes the loop by providing more data.

LOOKING AHEAD

A perfect storm of new technology, consumer demand, regulatory initiatives and fintech disruption was already brewing when the global pandemic provided the accelerant to propel digital transformation forward.

Like a stone that gathers speed as it rolls down a hill, payments digitisation shows all signs of picking up even more momentum. As an increasing number of alternative payments providers enter the fray and as more corporates and banks jump on the bandwagon, more will follow. No organisation can afford to be left behind in the digital transformation that is revolutionising a once staid industry. Simply put, the benefits are too compelling to ignore. They include:

- Faster, more accurate payments transactions
- Reduced exposure and lower costs
- More efficient accounts payable
- Better liquidity management to optimise use of working capital
- Wider choice of services for increased customer satisfaction

APIs will continue to play an important role in bringing about transformation, particularly for organisations trying to ease the stranglehold of legacy systems. They offer the fastest, easiest way to expand services and deliver the frictionless customer experience needed to survive in an increasingly competitive environment.

There is no turning back from the payments digitisation journey. Even in cases where legacy processes worked without issue, the pandemic and other market forces are compelling organisations to revisit their operational processes to ensure business continuity in an increasingly digital world.

HOW ACCUITY CAN HELP

Accurate reference data is essential for organisations that set up, route, and process payments.

Accuity provides instant access to payments validation and routing data covering financial institutions worldwide. With its comprehensive source of truth wherever you need it within your payments flow, Accuity enables you to eliminate failed payment costs, improve your customers' experience, and maximise your straight-through processing rates.

This comprehensive information is available through Bankers Almanac API solutions, which easily integrate into workflows within a digital payment ecosystem. The Bankers Almanac APIs deliver complete data and automation for faster, more accurate domestic and cross-border payments. They facilitate an improved customer experience at the point of payment initiation while driving routing and payments efficiency in your back office.

TO LEARN MORE ABOUT STRAIGHT-THROUGH PROCESSING FOR PAYMENTS CLICK HERE.

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