

# A thousand possibilities

**NEIL BURTON** LOOKS AT THE MYRIAD OF NEW PAYMENTS OPTIONS FOR CORPORATES AND SMALLER BUSINESSES.

It is frequently said that there is little innovation in payment services, yet more than a thousand new payments providers have become regulated in Europe since 2009. Smaller firms in particular, which may lack the negotiating power to get what they want from their banks, should consider the new options rather than put up with costly and outdated services.

**THREE CHEERS FOR THE EC** The European Commission's Payment Services Directive came into force across Europe in November 2009, imposing requirements on providers of services to protect their customers. For example, client funds must be held in accounts entirely separate from the provider's own funds.

Currently, there are 159 authorised and about 770 registered payments institutions (the new term for regulated payments providers) in the UK alone. Authorised firms have been vetted by their national regulator – in the UK, the FSA – while small providers need only register. Around 90% of all newly regulated providers are in the UK.

Many of these so-called non-bank new entrants result in wider choice for corporates. "Non-bank" may be misleading since most if not all of the new entrants rely on banks and the banking system, albeit using a model different from that of the banks themselves. And few are new entrants as such. The effect of the directive is to impose rules and behaviours appropriate to handling someone else's money. It also levels the playing field; authorised payment institutions have the same rights of access to payments schemes (Faster Payments, BACS, CHAPS in the UK) as banks. SWIFT treats authorised payment institutions as "supervised financial institutions" – ie. the same as a bank.

**CHANGING MARKETS DEMAND NEW SERVICES** A fast-changing market and mass adoption of new technology have been putting pressure on long-established business models for years. The current model for automation of correspondent banking has its roots in the 1970s, when SWIFT was first established. Yet banks themselves have repeatedly complained that correspondent banking is not fit for purpose for low-value payments. Indeed, at Sibos (SWIFT's annual conference) in 2004, a senior banker posed the following questions:

- Why are bank products so complex and difficult to use?
- How do we expect to help our customers become more efficient when we are not efficient ourselves?
- Why is it that so many of the successful innovations in our industry are pioneered by non-banks?
- If the internet is ubiquitous and free, why should we pay SWIFT for messaging?

In parallel, over a similar timeframe, the internet has opened up international trade to anyone with a computer, which in turn results in many more payments of relatively low value. And most such transfers are done on open account; where sophisticated financial instruments lubricate large value flows in supply chains, letters of credit and factoring are typically not cost-effective, nor simple enough, to facilitate the import of a container-load of consumer goods from a provider in South-East Asia, say.

**SMALL BUSINESSES NEED HELP** Small and medium-size enterprises (SMEs – companies with no more than 250 employees and a maximum turnover of €50m) are the backbone of the European economy, accounting for 99% of EU businesses and three-quarters of all private sector jobs. They are an important factor in most multinationals' supply chains, yet their needs are rarely considered in supply chain solutions.

A survey carried out by the European Commission (EC)

in summer 2010 found that about 70% of companies considered that problems recovering debt in another country constituted an obstacle to cross-border trade. The EC estimates that debt written off by EU businesses amounts to €55bn a year and that 63% of cross-border debt is not recovered. A significant proportion of this liability probably grew as a result of trading on open account, which for smaller businesses is the only widely understood cost-effective option.

A 2010 survey of more than 100 UK SMEs also found that the cost of making and receiving international payments was the biggest frustration (cited by 41%), after fluctuations in exchange rates.

Midcaps and large corporates also suffer; indirectly, because SMEs are inevitably part of their commercial ecosystems; and directly because bulk cross-border disbursements such as expense runs, payroll and pension payments are often inefficient, leading to customer dissatisfaction as well as cost issues.

Recent research by consultancy Glenbrook Partners found that reliability and security were the biggest cross-border payment challenges (see Figure 1). Other surveys have shown that finality of clearance is more important than timeliness, especially for lower-value transfers that don't materially affect overall liquidity. Reconciling receivables with invoices has been another big challenge for automation in the back office. New payments models offer great potential for solving some of these long-term challenges, which correspondent banking was never designed to address.

And lifting charges – the charges which a bank in the beneficiary's country may apply to a correspondent banking transfer – have long been a source of pain. Though largely eliminated in the euro zone as a result of the Single European Payments Area (SEPA), they continue elsewhere. The amount can be substantial as a percentage of a low-value transaction, but the impact of the uncertainty can be just as great. Transfers made and received across a local account do not incur these charges.

Although fees and charges are frequently assumed to be the most important issue for users of corporate payments, the Glenbrook survey found that other characteristics have a higher priority (see Figure 2).

**ONE NEW MODEL** One group of payments institutions – which were themselves corporates prior to the Payment Services Directive – have adapted the corporates' own internal model to provide a best-of-breed service to others. Corporate treasurers typically hold currency accounts in the countries where their business operations are based. They collect and disburse large and small sums across these accounts with ease, paying transaction fees appropriate to local transactions. Positions are pooled, swept and netted. Balances on these accounts can be viewed online, and drawn down or topped up as necessary. Such services are often used for bulk low-value transactions, especially cross-border, such as expense disbursement, payroll and pensions; and for low-value open account credit transfers such as trade payments.

There are benefits to focusing solely on payments. Where banks must allocate valuable development resource across a broad suite of offerings, a payments services provider can –

**Figure 1:** Biggest cross-border payments challenges

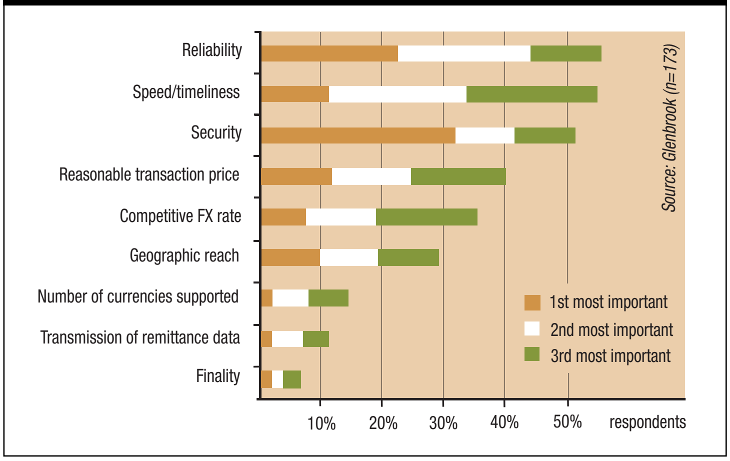
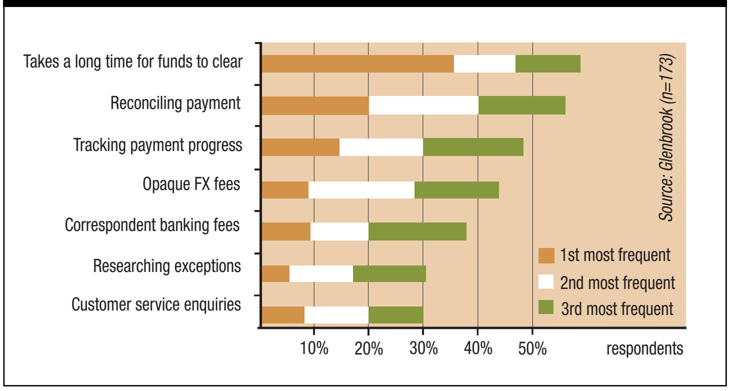



**Figure 2:** Biggest issues for users of corporate payments




and must – focus on the basics: global reach, quality of service, transparency, efficiency, speed and cost. New payment institutions have a reach and metrics comparable with the biggest global bank.

**MORE CHOICE** The long established and widely used correspondent banking model relies on sending messages between trading counterparties. But at its simplest, moving money from one place to another is an accounting problem. Unencumbered with the economics of sustaining an old model, new payment institutions offer a far broader range of choices.

Most industry conferences are geared to the traditional payments models, such as correspondent banking. Corporates and payment institutions need to find each other directly. While anyone can (and should) check that a firm is on the FSA list of regulated payment institutions, there is not currently a simple way to access the entire list, nor even to see the groups and types of different business models available. If corporates wish to help support innovation, and challenge outdated models, raising this topic at conferences, and at future ACT events, would be welcomed.

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