Call for a change in the payment process

Bob Lyddon explains why he believes the time is right for a different approach to be taken towards international payment methods.

Boston Consulting Group (BCG) predicts an annual reduction in price of more than 30% for cross-border payments within Europe, to reach domestic levels by 2007. Current prices inhibit trading internationally and must fall if e-business is to truly take off and include small and medium-sized businesses. However, such a price fall within today's banking structure could backfire:

- consolidation of providers and increased dependency;
- social exclusion from international services for companies whose financing is provided by domestic banks; and
- an increase in price once the market has consolidated.

Nevertheless, corporations are embarking on initiatives to streamline European financial processes beyond the centralisation of the Treasury function itself. There is an assumption implicit in these initiatives that the BCG price predictions will be fulfilled. But circuits do not exist to permit such a price fall and this implies a higher all-in cost for payments after streamlining.

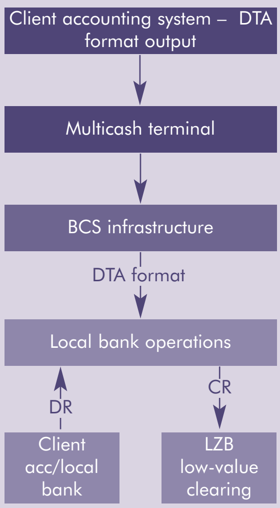
Benefits of the current process model

This next round of streamlining will affect day-to-day payments, which are managed by local finance functions within a model whereby each country runs every process, but to small scale.

From a regional level, this model looks duplicative and inefficient, but the banking systems service it cheaply and efficiently. An example set-up in Germany is shown in *Figure 1*.

FIGURE 1

Typical domestic end-to-end structure for commercial payment



The benefits of such a set up are:

- the accounting system outputs the clearing format, which accommodates rich remittance information and detailed transaction coding;
- the BCS infrastructure is inexpensive; and
- follow-up messages from the clearing are processed.

Corporate initiatives

Example initiatives that change the payment process model are:

- implementing an ERP system where payments for all countries are initiated centrally;
- outsourcing financial processes to process-specific service providers – meaning that there may be one provider per process in the region; and
- establishing a regional shared service centre for the finance function.

What happens if the current process model is changed?

The benefits case made for any of the above often contains the assumption that the payments equation is neutral.

In Figure 1 the external cost per item could be DEM0.02, with 30 banks capable of handling this, and internal and communications costs are low. Take this to a regional level, though, and there may be as few as four banks that can offer the required multi-domestic service. The external cost can rise to DEM0.35, and internal and communications costs are higher too.

A client targetting savings of DEM20 each on 300.000 invoices a year may incur extra costs of DEM2 per payment, thereby reducing the benefit by 10%.

The difference between meeting a regional treasury service requirement and a multi-domestic one

The required multi-domestic service differs from the service that exists now, which is a regional treasury service. The 'big six' banks are able to support this by having branches in each country, access to local high-value clearing, and foreign exchange/money market capabilities.

Broadly, these banks need to have a presence in all countries, but do not necessarily need to be able to carry out everything in each one. The client uses them as an 'overlay', with one or more local banks forming the underlay for local transactions.

A multi-domestic service requires comprehensive access to local transactions. While the big six banks can front a multi-domestic service, the actual clearing interface is often via a local partner – see *Figure 2*.

However, this is more complex and costly. The big six banks offer more where the country is their home country or where they have made local acquisitions.

However, in countries where the big six banks are not represented at all, the local partner carries out everything. In fact, as the geographical scope increases, the client may end up using a preponderance of partners.

An alternative is to take the 'club' approach. These consist entirely of partners and address regional treasury requirements, but with one important difference – each partner has scale in its own country and can offer comprehensive local payment services.

But the clubs have not yet leveraged this advantage. Being based on SWIFT, they encounter problems, such as:

- high costs in the banks' SWIFT processing infrastructure compared to their local infrastructure;
- SWIFT formats being less rich than local formats for remittance information;
- SWIFT messages not readily corresponding to the messages received back from the clearing; and
- the SWIFT service embraces the standards for its messages, the security around them and their transmission – but the security and communications components could be bought cheaper.

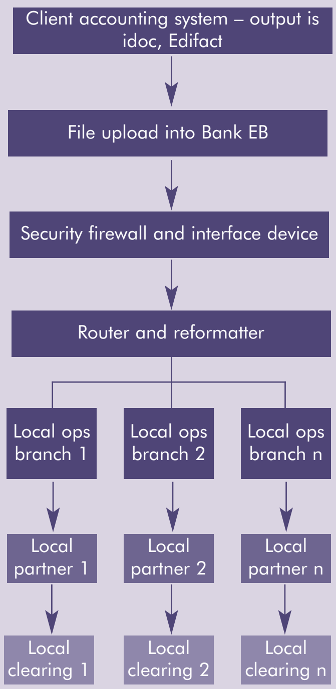
Is a new organisation the answer?

There is space for a new organisation whose aim would be to offer pricing much nearer to domestic levels and a smoother route from the company to the clearing. The service components of such an organisation would be:

- access from the user's choice of IT platform using the platform's output and input formats;
- interfaces to e-marketplaces and EBPP models and to Application Service Providers (ASPs) operating for corporations;
- access to bank accounts in several countries and to several banks per country;
- the ability to pay in and out of the accounts using whatever payment instruments, to and from local and international counterparties;
- receipt of a full set of clearing messages for each operation, and full remittance information;
- liquidity management services on the account balances (balance information, pooling, sweeping, interest-bearing investments); and
- the facility to check billing and analyse bank performance and income.

FIGURE 2

Multi-domestic clearing via a Big six bank, where low-value clearing access is through local partners



Where will a solution come from?

The banks themselves have a full agenda:

- gaining or retaining management focus on and investment in this type of business;
- integrating acquisitions/mergers; and
- dealing with the anticipated impact of e-business.

So while banks would undoubtedly want to link into a solution and can see the advantages, they are not in a position to drive it. SWIFT will not lead the charge since it is guided by the banks, and its initiatives are directed at high-value business across product domains – in payments (CLS, RTGS), trade (Bolero) and securities (GSTPA). Instead, the new organisation could be triggered by the business community expressing its needs to a sponsor that in turn links to banks and technology providers.

A business plan and service specification exists now for the organisation, and it has the key differentiating factor in that it is not sponsored by a party with vested interests.

Arm's length funding can be attracted on the basis of the support of the business community and an expression of willingness by a few banks to be used. Thereafter, the amount of money needed and the complexity of the undertaking is not so great because there is no re-engineering of existing systems and because inputs and outputs are discernible.

Benefits for the corporation

The advantages for corporations from the existence of such an organisation would be significant, as follows:

- all banking services under one roof at near-to-domestic pricing;
- single payment and information process to support e-trading, ASP usage and traditional trading;
- reduced dependency on individual banks; and
- ability to substitute banks without unravelling internal processes.

There is pent-up demand for such an organisation, and unlocking access to the start-up capital would require the following:

- up to five corporations validate that the business community needs such an organisation;
- one or two banks express a willingness to service these corporations through the organisation;
- the corporations work with the sponsors to confirm the organisation's processes and specifications; and
- they all undertake to pilot the service and use it when it goes live.

Any feedback on this concept from members of the Association would be most gratefully received. ■

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