PAYMENTS INNOVATION



hat is the biggest change about to hit the world of the corporate treasurer? Do not be surprised when, not so long from now, the bread and butter of transaction processing emerges from its humble backroom to become a central and critical part of your firm's IT strategy and banking relationship.

It's not so surprising. The application of computer systems to payments processing offers substantial economic gains, both in terms of cost reductions for banks and companies and in greater speed and reliability of payments flows, so reducing operational and credit risks.

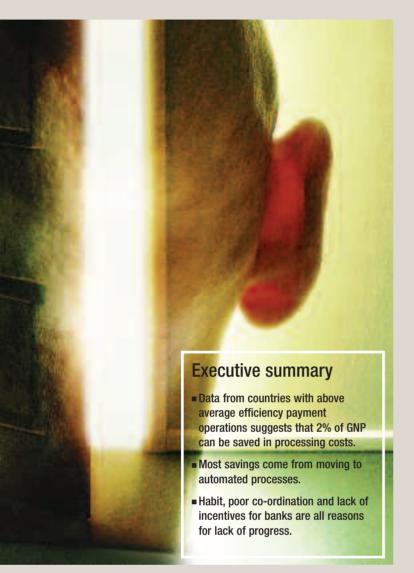
Good quantitative research is lacking, but broad comparison of those countries with more efficient payment operations, such as Norway, to those of average efficiency, such as the UK or Germany, suggests that savings in processing costs alone can be of the order of 2% of GNP. Most of these savings come from moving from manual to automated processes.

These benefits can be stated more vividly: a significant part of the labour force that will be required to support ageing populations in Europe – more nurses, home-helps, and care-home workers – can be found by freeing up labour currently engaged in processing cheques and invoices. This has to be worthwhile.

SLOW TO ABANDON FAMILIAR WAYS The potential gains are large but banks and companies in most countries have been slow to abandon familiar ways of paying and receiving money. Partly this is custom and habit – placing invoices on the spike is a more reassuring process than tracking payments on a computer screen. Partly it is a problem of co-ordination – banks and companies are reluctant to be first movers and take on costs unless they are sure others will follow. And partly it is a problem of incentives – banks gain little or no competitive advantage from improved systems for passing payments to and from other banks. The result is that only in a few smaller countries, where a limited number of far-sighted bank executives have sufficient influence to lead the process of change, has payment processing been significantly rationalised. This is why the most efficient systems for payment processing are found in countries such as New Zealand, Finland, and Norway.

The current efforts to create SEPA (Eurospeak for a Single Euro Payments Area) are proving to be a catalyst for change, opening up a new world of possibilities for payment processing across Europe. The gears are grinding, and the introduction of the European directive on payments will eventually remove most of the legal obstacles to pan-European payment processing.

More important still are the efforts of the European Commission



together with the representative body for banks and other credit institutions, the European Payment Council, to create choice in payments. Whereas payment processing has typically been conducted through monopoly silos, such as the UK's BACS (now operated by Voca), increasingly there will be an open market for payment services, offering corporates and other customers new choices in how their payments are processed.

TRANSACTION MANAGEMENT Equally far-reaching is the gradual emergence of European and global processing and messaging standards that will cover the entire process of transaction management through the supply chain, from order, through invoicing/billing, to final payment. This will work in much the same way as on the internet. Winning buyers in eBay auctions can almost instantaneously complete their transaction just by clicking on a PayPal logo, entering a password, and effecting a payment to the seller. But the difference is that, unlike PayPal (which operates by levying hefty merchant charges and is therefore expensive), the new arrangements for intercorporate payments will be cheap as well as efficient.

The cost savings will be particularly dramatic for smaller and medium-sized enterprises, where the costs of processing invoices and payments can amount to several percentages of total revenue, and

where automated systems can dramatically improve monitoring and collection of payments. Automated cross-border payments will also be a catalyst for cross-border competition by smaller enterprises, currently a preserve of the largest enterprises.

GREATEST IMPACT SEPA is primarily a euro zone initiative (seeking to achieve seamless payment processing across the euro zone by 2008), but within the EU the developments in corporate payments will have as great an impact on the UK and other non-euro member states as they will on the euro-members. UK, Swedish, and Danish banks are mostly extremely good at managing IT and providing IT-based services. They will be highly effective competitors for corporate cash management services, both in and outside the euro zone.

Once these processes are fully automated, the foreign exchange leg $-\pounds$ to \in , Danish krone to Swedish krona, and so on – becomes simply another low-cost processing step. Exchange rates will remain uncertain but the speed and reliability of payments can be as good between currencies and within the euro zone. The SEPA initiative is giving banks across the EU the incentive to harmonise, so most of the economic benefits will be felt both inside and outside the euro zone.

Other aspects of SEPA will be harmonised on a somewhat slower timetable than corporate-to-corporate payments processing. Direct debits are a key instrument for household to corporate payments but for legal and institutional reasons will remain fragmented across the European Union for some time yet. Harmonisation of credit transfers – both household to corporate and household to household – can adopt much of the framework used for intercorporate payments, and so follow them relatively quickly. Point-of-sale and online cards depend on national verification systems, and substantial investments are required to make these truly pan-European, but on a practical level it will be possible to achieve universal card acceptability, even if underlying processing remains fragmented. But these are lesser issues: demand for cross-border payments by households is less than the demand by small and large corporates, so it is the corporate world that will be in the vanguard of change.

STRENGTHENING BUSINESS CASE These issues can be expected to cross the desks of corporate treasurers with greater regularity. The business case for overhauling transaction processing will strengthen dramatically in the next two to three years, as possibilities for big cost reductions open up. The main issue here is how quickly to move and in what direction. Much can be learnt from the Scandinavian experience. Finland, for example, has gone a long way in developing low-cost decentralised processing of invoices and payments through the supply chain. The new processing standards will be consistent with these early initiatives, so there is no need for companies in the UK or elsewhere to be guinea-pigs. The path of change has been trodden already – all that is needed is to take a look and then follow.

Benefits can also be expected from the reduced burden of trade credit outstanding – at least from smaller customers who can be much more easily tracked and chased. The large customer may still be in a position to bully suppliers up to the last legal limit of late payment, even when payment systems are lightning-fast. But payment automation will also facilitate the introduction, at last, of systems for crediting interest penalties on late payments, so even here there will be eventual benefits.

Alistair Milne is Senior Lecturer at the Faculty of Finance at Cass Business School.

A.K.L.Milne@city.ac.uk

www.cass.city.ac.uk/faculty/a.milne/index.html