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Beyond Business as Usual

New Industry Index Aims to Quantify
The Progress of Corporate Payments

Companies still make most of their payments with paper checks, but new VICOR-commissioned research suggests a major change is afoot. Restless bankers are more than ready.

Corporate payments are on the cusp of a major evolution, one that will prompt that part of the business to finally join its retail brethren in the electronic world.

For many sources, the progress is long overdue. While most industry observers expected the shift to electronic corporate payments to occur several years ago—retail payments made the leap five to seven years ago—a lack of aggregate data illustrating trends in the space has stymied efforts to spur greater adoption among banks.

But new research released this month by VICOR, a Richmond, CA-based payments-processing company recently acquired by Metavante, aims to quantify the progress made in the corporate-payments business with an annual industry index, the VICOR CPPI, an acronym for the Corporate Payments Progress Index. In addition to examining the state of the industry in 2006, it also projects where it is headed in the next 24 months. The foundation of the index is based on research conducted in conjunction with Celent. *U.S. Banker* received an advance preview of the CPPI findings.

The CPPI was created because no single metric or index existed to track the state, progress and overall direction of the corporate-payments industry, according to VICOR. The CPPI, measured on a scale of 0-100, is a consolidation of three equally weighted sub-indices. These sub-indices were identified by payments executives as the three most critical industry drivers: cost per transaction (the cost index), investment in payment processing and support systems (the ePayment index) and overall satisfaction (the satisfaction index). Each of the three sub-indices is calculated on a weighted average of the market share percentages of the four major corporate-payment methods: ACH, check, purchasing card and wire transfer.

To obtain the underlying data for the CPPI, Celent developed and administered an online survey to 4,000 corporate payment executives, of which 220 qualified responses were received. Survey respondents came from a broad spectrum of industries: 15 percent were from financial services; six percent from healthcare/pharmaceutical services; 17 percent from manufacturing; eight percent from retail trade services; 17 percent from other services; six percent from technology; three percent from telecommunications and media; three percent from wholesale and distribution services; four percent from energy/petroleum and transportation services; four percent

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from construction/construction supply and 16 percent were labeled as "other." The majority of respondents—52 percent—had company revenues of between $100 million and $499 million, while 24 percent had revenues of between $1 million and $10 million; nine percent had revenues of between $500 million and $999 million; nine percent had revenues greater than $20 billion; and six percent had revenues of between $11 billion and $20 billion.

While there is still much ground to cover to reach straight-through processing of corporate payments, VICOR estimates that about 40 percent of payments already are made electronically, dispelling the prevailing notion of an "80/20 rule," which holds that the level of electronic payments is only 20 percent, says Bob Murphy, svp of marketing at VICOR. "The overriding message [of the research] is to give banks a clear picture of where we are and how long it will take to reach STP," Murphy says. However, he estimates that the market is still six to nine years away from that day.

Although some initial steps have been taken, corporate payments are still dominated by paper checks. There are several reasons that bankers and analysts cite as to why, even as most developed countries have made bold moves into electronic payments.

Mainly, paper checks work well. With no government mandate requiring a move into electronic payments, the industry has relied on the free market to make the push. And, says Murphy, the free market is fairly content with old ways for now.

Indeed, the main obstacle in corporate payments that emerged in VICOR's research is the lack of investment made by corporations. While costs and satisfaction scored relatively high in the VICOR CPPI, investment by corporations is still low, Murphy says, keeping the overall score at 55 out of a possible 100.

A separate component to the research is a gauge of what percentage of corporate payments are actually made electronically, which currently notched 40 percent.

When presented graphically, that puts the current market about in the middle of a nine-box grid, or what Murphy labels a "mixed payments/transition phase." In 2008, Murphy projects that the CPPI measure will be at 65, with an e-payments percentage at 55 percent, which is still in that same middle square.

Murphy estimates that it will be three to four years before the industry shifts into the next stage on the evolutionary payments cycle, into a stage he calls the "mixed payment/stepping stone." That stepping stone, of course, is the last stop before full STP, he says.

Bankers agree with the sentiment that corporate payments are in the initial stages of a major leap forward, but differ on just what has held them back.

Len Heckwolf is head of Bank of America's payments and receipts product management group within in global treasury services division and former chairman of NACHA, the Electronic Payments Association. He says the biggest constraint in electronic business-to-business payments is the lack of convenience. "We haven't made them easy," he says.

With so many options for consumer electronic payments, he says the end game has largely been achieved, while the corporate side has lingered. "But that's about to change," he maintains.

On the consumer side, there were clear benefits for large billers to shift customers to electronic-payments methods, he says, with no real downside to the consumers. But many corporations expect an equivalent change would be costly because of changing IT systems.

He says that does not have to be true, as some available banking products make it easier to do than commonly perceived. Still, the perception continues.

Indeed, Rob Abele, president of the corporate payments systems division at U.S. Bancorp, says cost is a major concern. Not only does a corporation need to have a system to handle STP, but it also needs to have all its suppliers on the same system, which is a major challenge since many of those suppliers are small businesses worried more about day-to-day survival than the latest payments technology. Still, he says large companies today are very interested in a higher level of detail on their expenses to better "manage their supply chain," he says.

Layered on top of that is the segmented problem of silos within an organization, he says. Departments like accounting, procurement or IT all have different agendas that often not aligned with each other. "It's like the wild, wild West out there right now," he says.

As a barometer, he looks at the skyrocketing adoption trend of purchasing cards, usually used for small purchases like office supplies. "Today, probably two-thirds, maybe 75 percent, of the Fortune 500 use [purchasing cards]," he says. "Fifteen years ago, it was a dozen."

One of the biggest challenges to the advancement of electronic corporate payments is the lack of standards on remittance, says Alenka Grealish, manager of the banking group at Celent. Unlike consumer payments, which are usually straightforward, corporate payments can come with 30 pages of instructions when one check covers various payments. Ultimately, Grealish expects a standard template to be formulated for all companies and banks, instead of the differing proprietary systems now used for payments.

But even before that, she says there are things that banks could be doing, especially for their small-business customers, to promote more electronic payments. While the consumer side is more advanced, she says it's through no inherent feeling on the part of consumers.

Consumers don't particularly care which method they use to make payments, but they are rewarded for using electronic methods, she says. And banks could use that same approach for small businesses by adding rewards for the use of debit cards. "There's a lot of room to grow...but banks are not quick to change," she says.

One of the challenges in shifting away from paper checks comes, ironically, from rules meant to make them more efficient in an electronic world. Check 21 rules will give the paper check a longer life than before the law, Murphy says, because the new rules make the paper-based system easier and more efficient. "Without Check 21, we would have seen the deterioration of checks faster than we really saw," he says.

The number of companies using ACH payments has increased more than 1,000 percent in the past 10 years, to 6.3 million companies in 2005 from 500,000 in 1995, according to NACHA. The total number of business-to-business ACH payments grew to two billion in 2005, up 11.3 percent over 2004, according to NACHA.

While all sources say that STP is the ultimate goal, and all believe it would be achieved in a matter of years and not decades, they also agree that the paper check will probably never be eliminated. Heckwolf says one of his favorite quotes is from Rich Oliver, the Federal Reserve's product manager for retail payments, who once said: "'Checks will decline forever.'"

—Lee Conrad