



Improving Small Business Payments Processing

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Topics

- Federal Reserve: Overview & Payments Role
- Payments Basics
- Small Biz Payments Facts & Needs
- Challenges of Reconciling Payments & Remittance Data
- Case for Participating in Remittance Coalition

Federal Reserve Overview

- Federal Reserve System's main responsibilities:
 - Establish & execute U.S. monetary policy
 - Promote a stable financial system
 - Supervise & regulate financial institutions (FIs)
 - Provide financial services to FIs & U.S. Government



Federal Reserve's Role in Payments

Federal Reserve Banks are “banker’s banks”

- Provide financial services to about 15,000 FIs:
 - Currency/coin ordering & depositing - **FedCash[®]**
 - Check clearing - **FedForward[®] & FedReturn[®]**
 - ACH (Automated Clearing House) - **FedACH[®]**
 - Funds & Securities transfers - **Fedwire[®]**
 - Electronic Access - **FedLine[®]**

Fed is also U.S. Government's bank

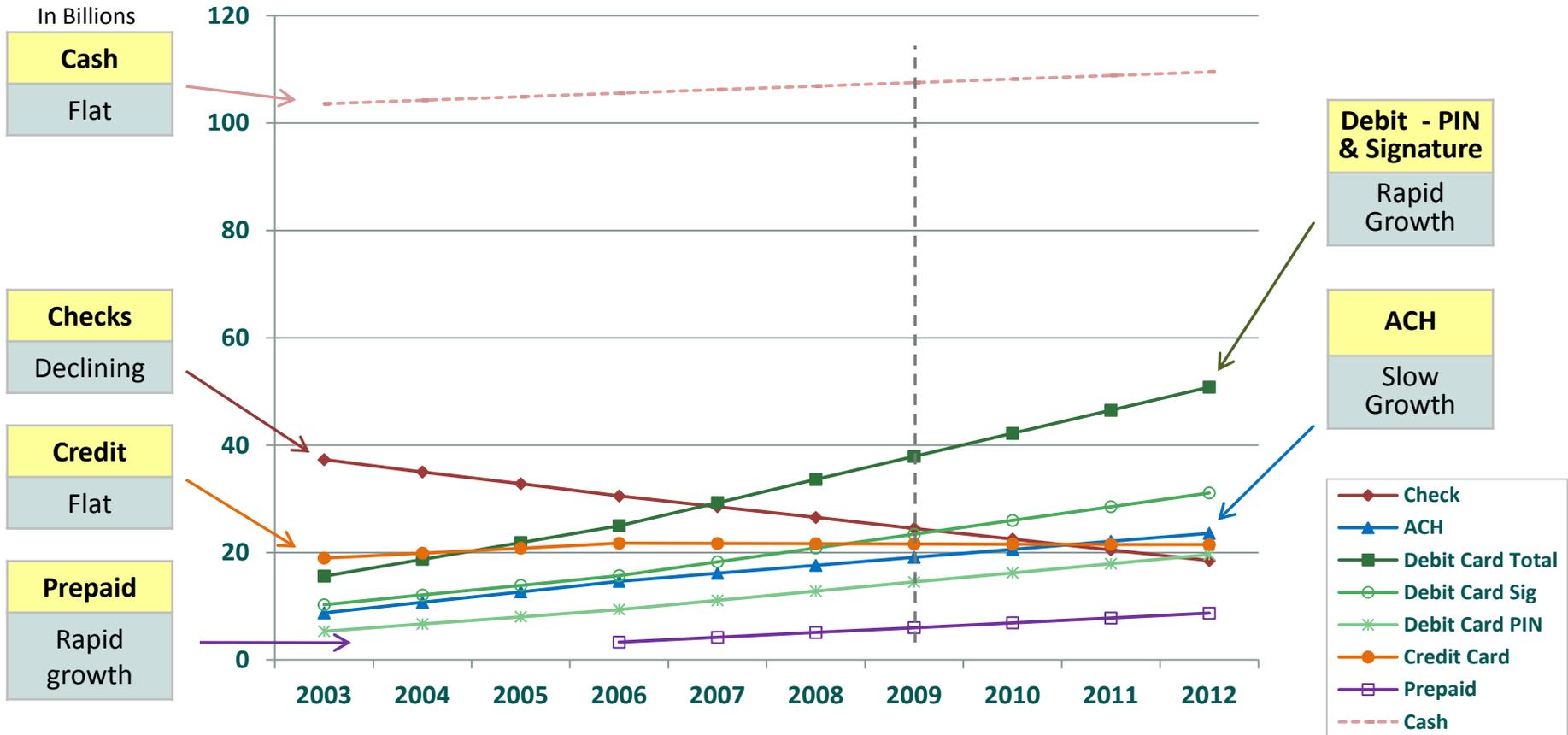
- Services include Savings Bonds & Treasury Auctions

Fed works with diverse stakeholders to improve efficiency & effectiveness of U.S. payment system

Payments Basics

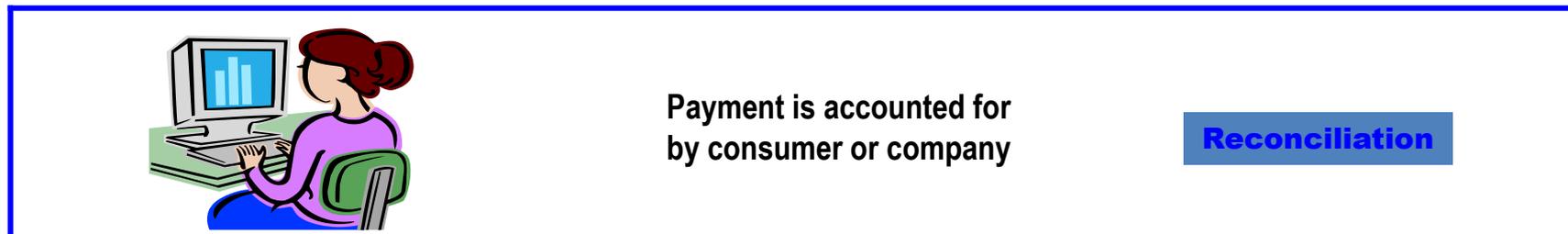
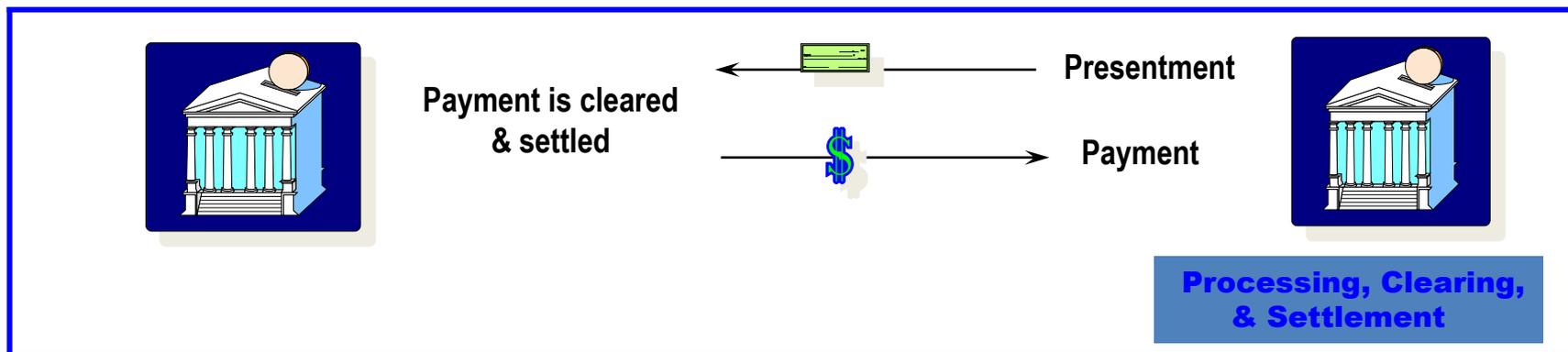
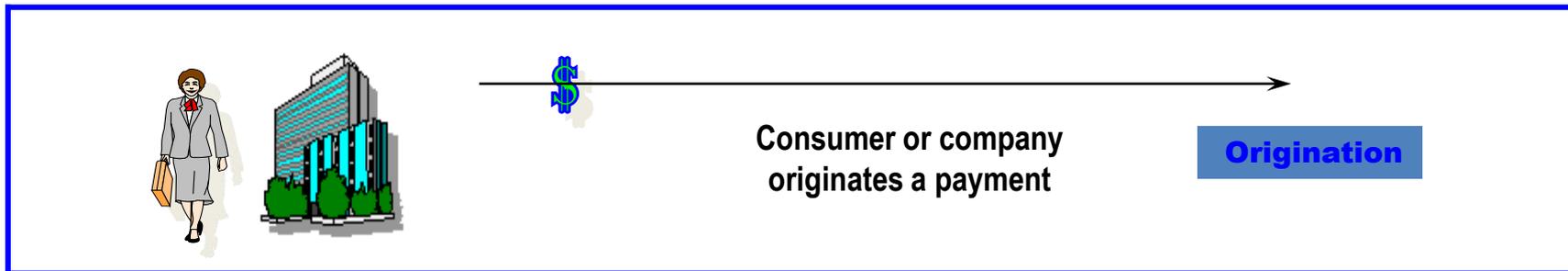
Biz Payments Are Mainly ACH, Cards, Cash, Checks & Wire Transfers

Estimated Total Number of Transactions by Payment Type



Source: Noncash data points for 2003, 2006, & 2009 from Federal Reserve Payment Studies. Cash based on McKinsey estimate for 2009 & forecast for 2014.

Businesses Care How Payments Integrate with End-to-End Process



Businesses Participate in 3 Payment Categories

Consumer to Business (C2B)

- Point-of-Sale (POS) purchases
- Bill payments
- On-line, E-commerce payments
- Loan payments
- Tax payments

Business to Consumer (B2C)

- Employee payments (payroll, expenses, pensions)
- Investment payments (interest & dividends)
- Consumer refunds

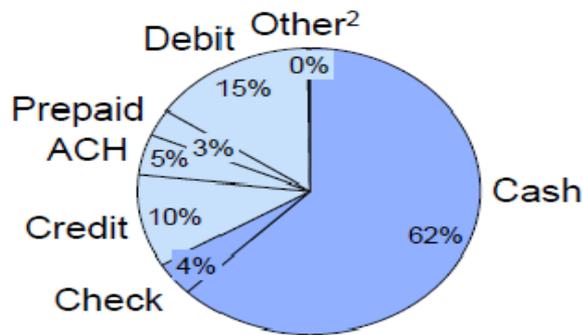
Business to Business/Gov't (B2B)

- Corporate cash management
- Purchasing programs
- Vendor payments
- Online payments
- Trade financing
- Intra-org. transfers
- Business tax payments

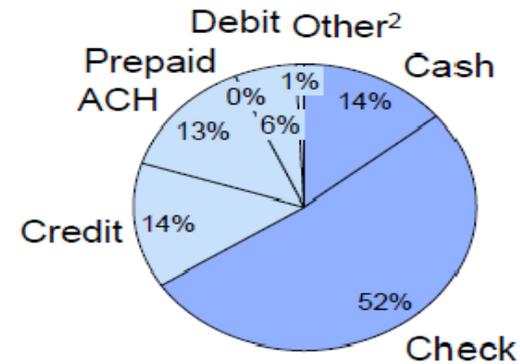
Payment Types Favored Vary by Category

Percent of 2008 transactions ¹

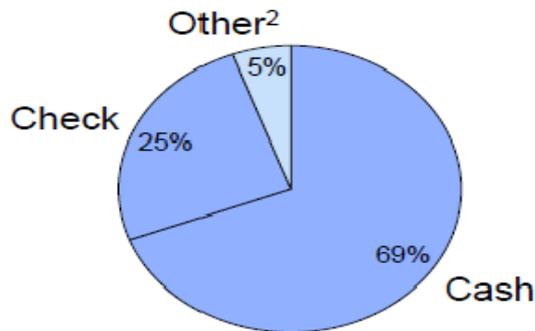
C2B 100% = 207 billion



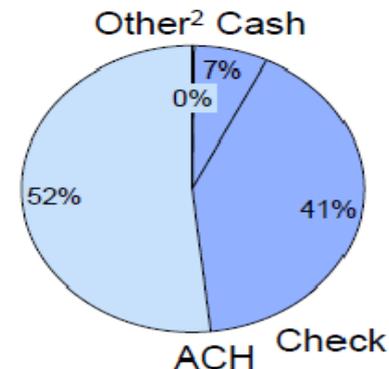
B2B 100% = 22 billion



C2C (P2P) 100% = 9 billion



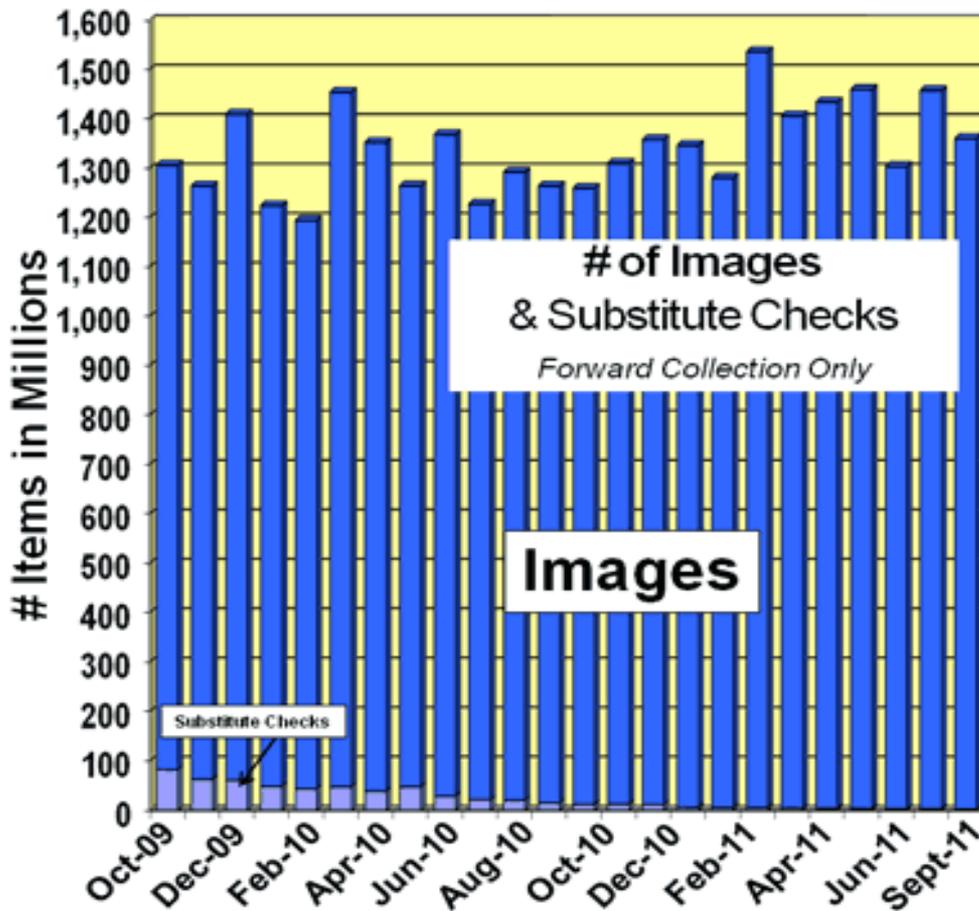
B2C 100% = 10 billion



Source: McKinsey US Payments Map, 2008 - 2013

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Most Checks Clear Electronically



- Annual check image volume is 14.8 billion – over 99% of all checks deposited
- Image clearing has speeded settlement – sometimes same day
- Using imaging, some businesses “deposit” their checks for collection with their FI remotely

Source: Check Image Collaborative, September 2011

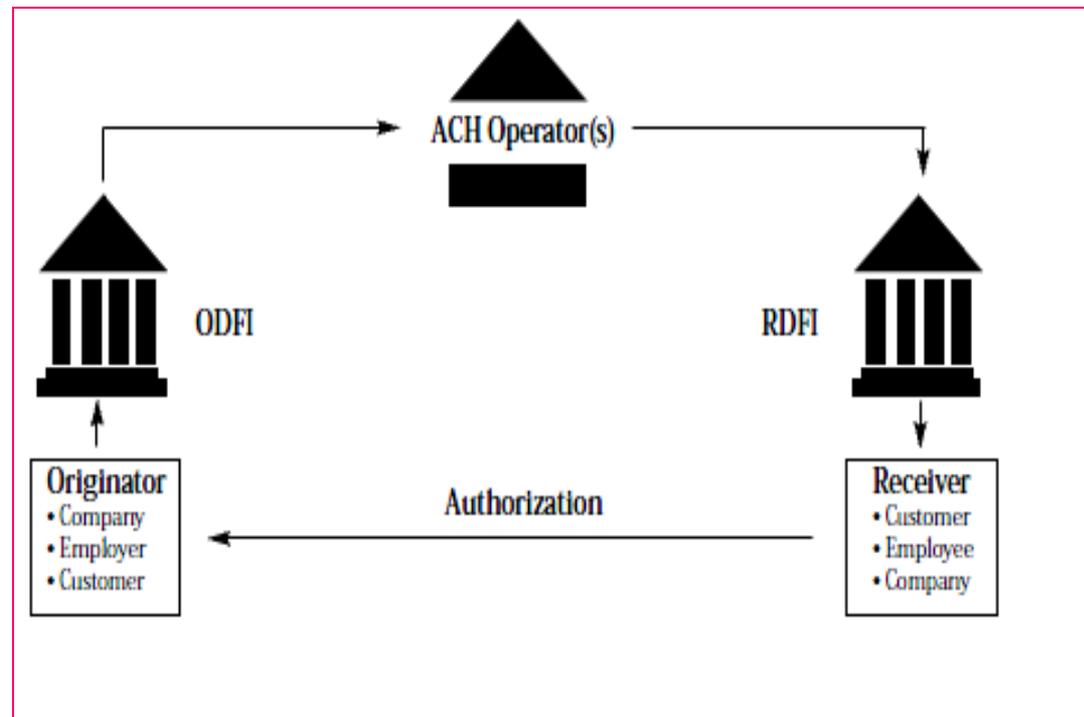
Automated Clearing House (ACH)

ACH is an electronic, batch processing payment system used for consumer & business transactions.

FIs (ODFIs) receive ACH payment instructions from businesses; FIs group ACH payments into batches & transmit them to ACH operator (e.g., Fed); operator distributes ACH payments to receiving FIs (RDFI). FIs apply ACH payments to appropriate accounts.

Types of ACH Payments

- “Direct deposit” —e.g., payroll & social security
- Preauthorized debits—e.g., monthly mortgage, utility bills
- ACH “E-Check” - check to ACH conversion
- Business-to-business



Cards Dominate

Electronic Payments Volumes

Value & Volume

- U.S. card payments totaled 65.5 billion transactions valued at \$3.5 trillion in 2009

Consumer Adoption

- Almost all U.S. households have some type of payment card – i.e., credit card (78%), debit card (80%), prepaid cards (17%)

Usage Trends

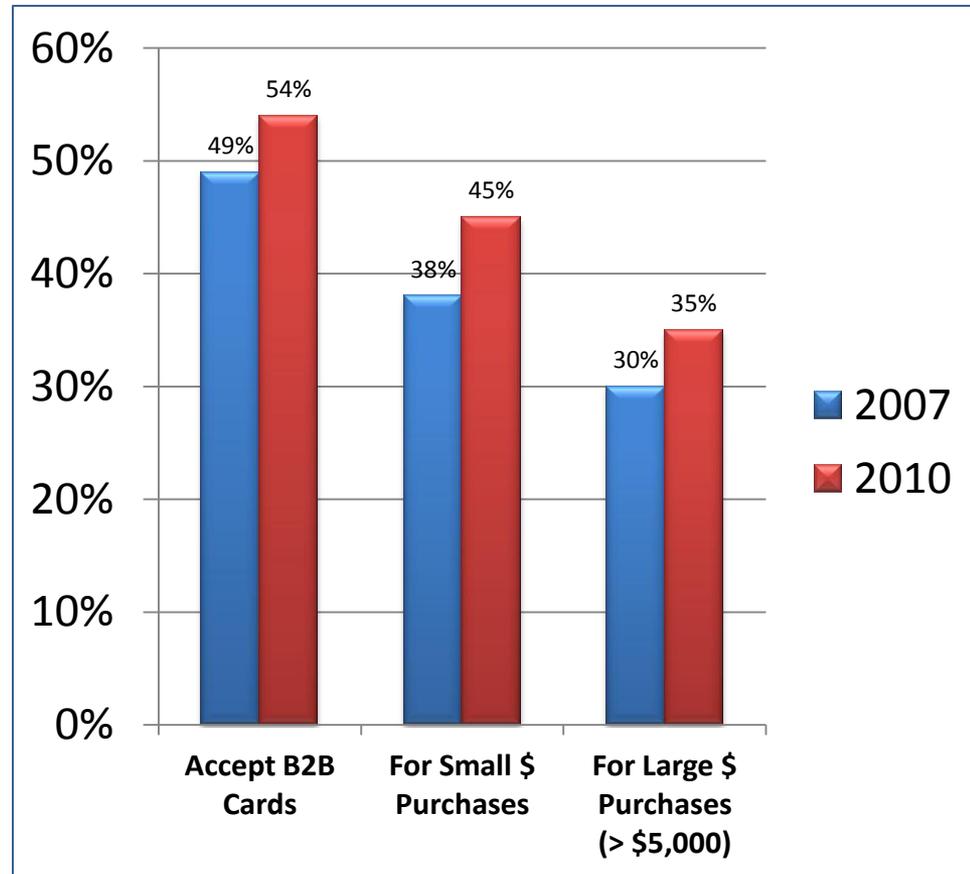
- Consumer use of cards shifting from credit to debit
- Business use of cards expanding from T&E to purchasing cards for B2B payments

Growth Forecast

- By 2012, prepaid cards expected to reach \$526 billion in value, up from \$140 billion in 2009
- By 2015, debit & credit cards projected to grow to 97 billion transactions; a 9% increase per year

Purchasing Card Use Growing

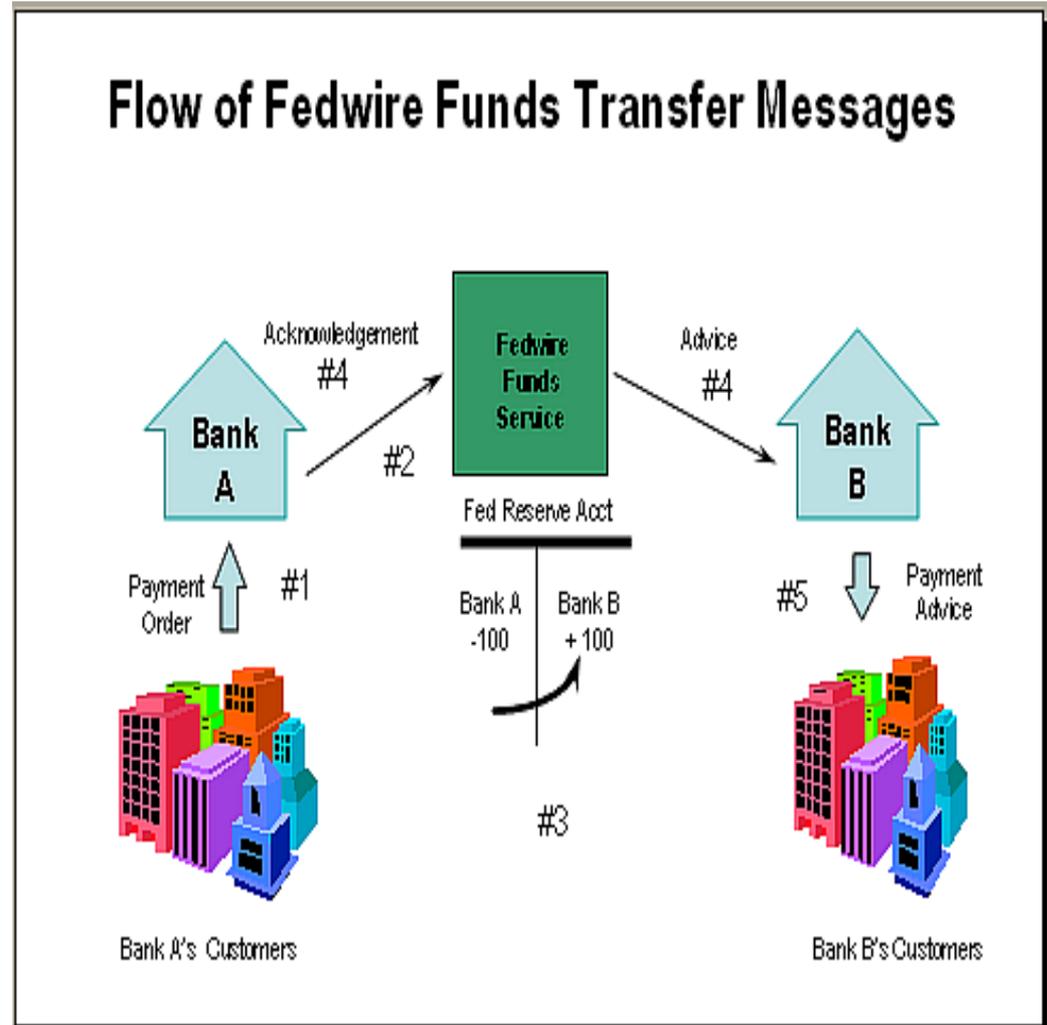
- Fastest growing B2B electronic payment – VISA estimates 25% annual growth
- Originally targeted for low value purchases (less than \$1,000); now used for some higher value purchases
- Adoption success due to:
 - Financial incentives to payer
 - Improved efficiency
 - Reporting & risk management tools



Source: National Association of Purchasing Card Professionals

Wire Transfers

- Real-Time Gross Settlement System
 - Individual wire transfers processed immediately
- Primarily used for time-critical &/or large-value payments
- Once posted or acknowledged, transactions are final & irrevocable

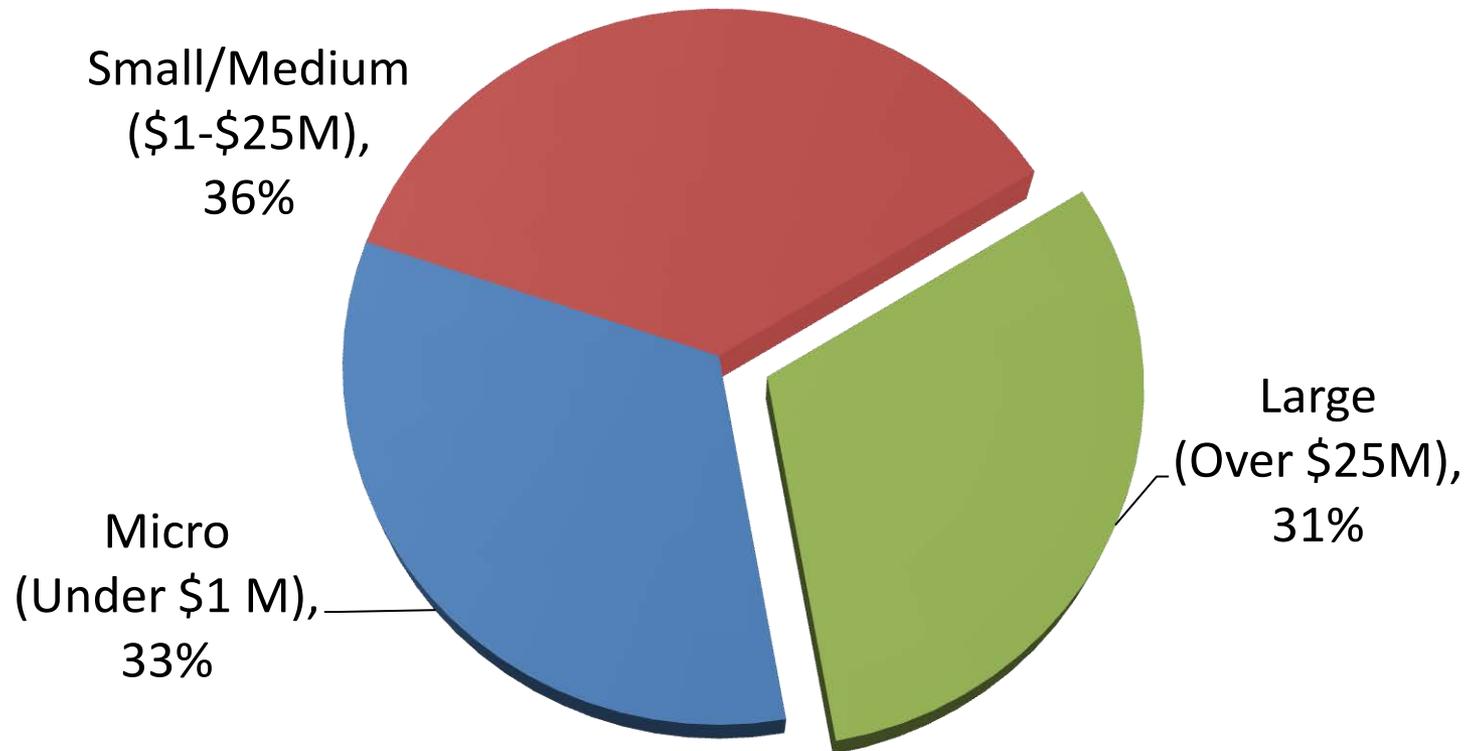


Small Biz & Payments

Small Biz Touches 7 out of 10 U.S. Payments

% of Total Payments by Business Size

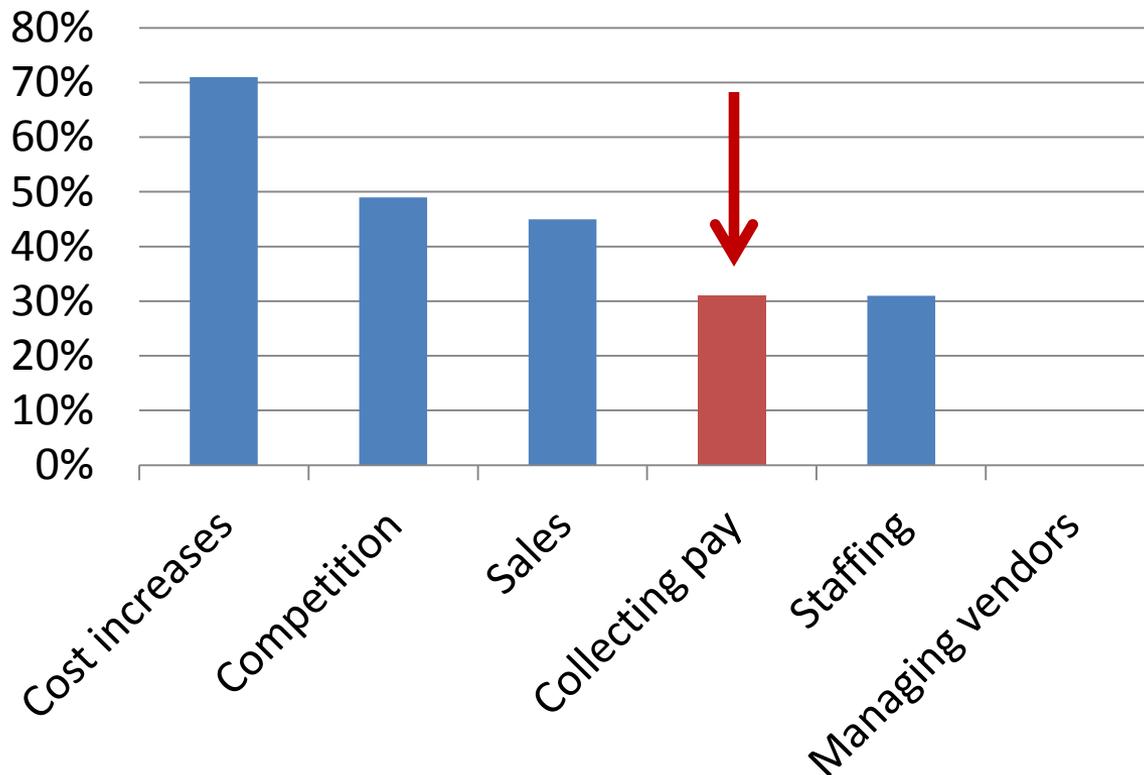
Based on 19.5 billion payments totaling \$24 trillion in 2006



Source: Cited in BAI's Small Business Payments in 2006 report distributed at its TransPay Conference May, 2006

Collecting Payments is Small Biz Priority

% of Small Biz Ranking This as Top Priority

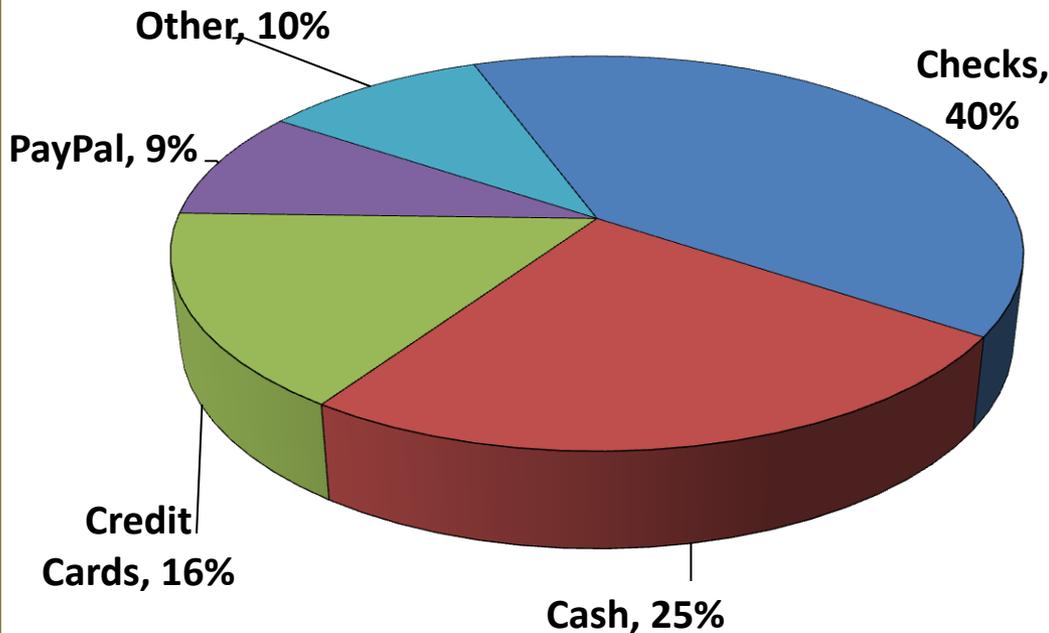


- About 1/3 of small businesses say collecting payments is their top business challenge

Source: The Next Payments Frontier: Electronic Payment Acceptance & the Small Business Market, May 2008

Small Biz Accepts Mainly Checks & Cash, Followed by Cards

Checks & Cash Account for 2/3 of Receivables (Average of 259 payments per month)

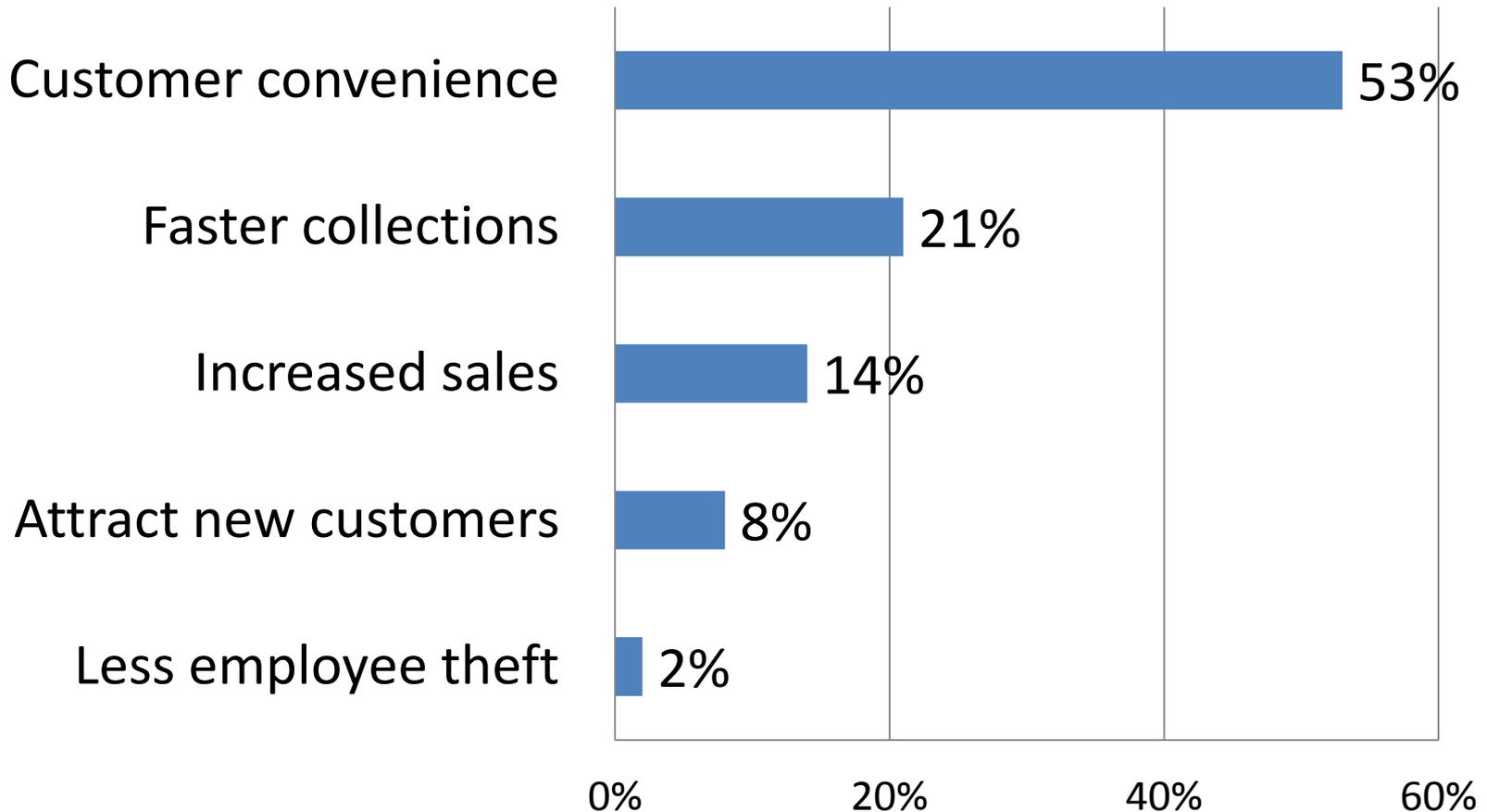


Accepted by Small Biz:

- 88% of small biz accept check & cash payments
- 54% of small biz accept credit & debit card payments
- Only 1/4 of small biz with websites can accept payments over the web

Source: 2006/2007 Study of Small Business Payment Preferences by Dove Consulting/Hitachi Consulting; Small Business Payables & Receivables Survey, Cash Edge/Fiserv, January 2011

Small Biz Reasons for Accepting Payment Methods



Source: The Next Payments Frontier: Electronic Payment Acceptance & the Small Business Market, May 2008

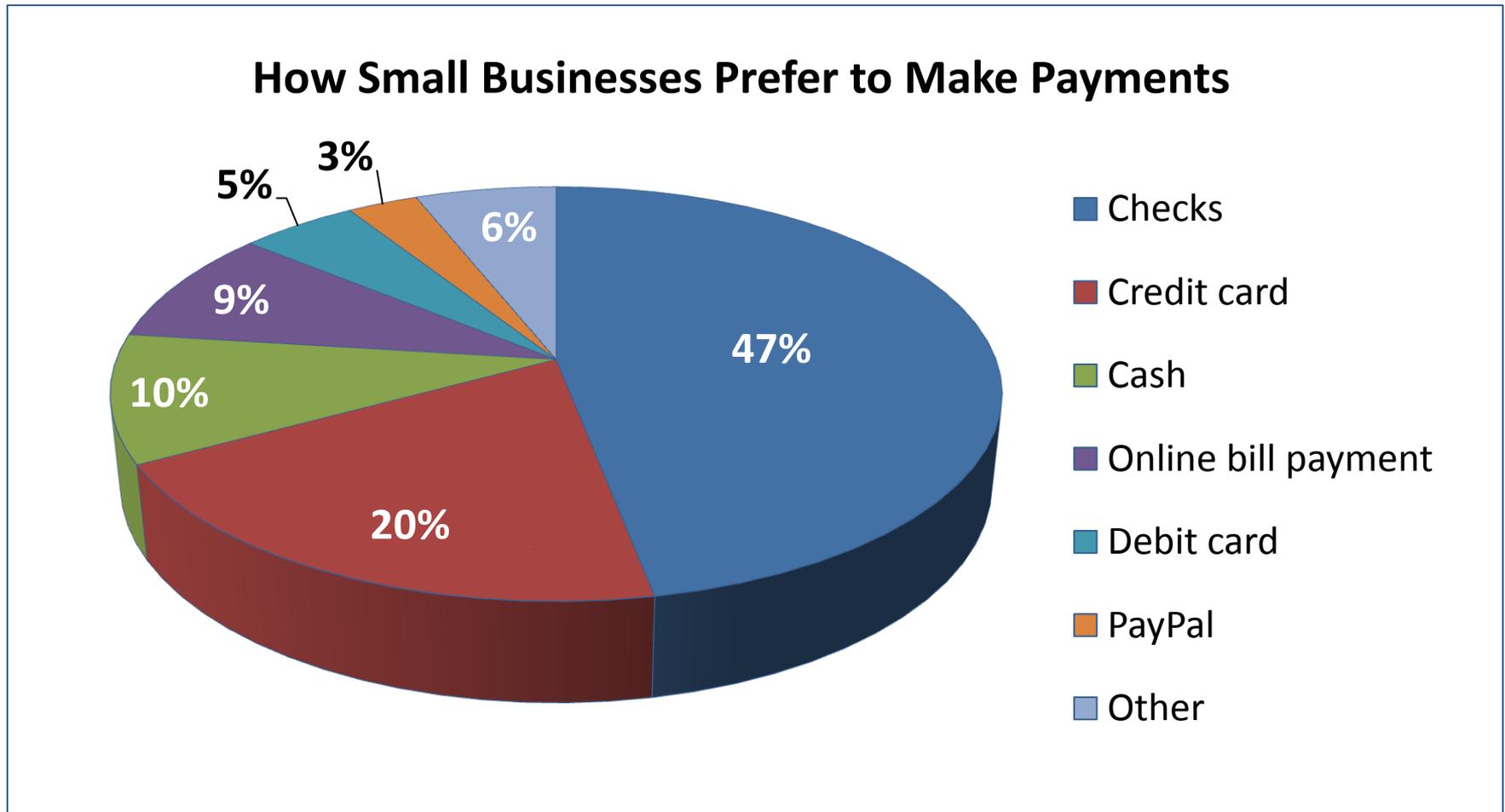
Which Small Biz Accept Electronic Payments?

Characteristics of Small Businesses...

| That Accept Electronic Payments | That <u>Do Not</u> Accept Electronic Payments |
|--|---|
| <ul style="list-style-type: none"> • Mainly in healthcare & retail | <ul style="list-style-type: none"> • Mainly in consulting, services & construction |
| <ul style="list-style-type: none"> • Multiple employees & annual revenues of >\$1M | <ul style="list-style-type: none"> • Small/sole proprietorships with revenues of <\$1M |
| <ul style="list-style-type: none"> • Primarily B2B with low typical transaction amounts (<\$200) | <ul style="list-style-type: none"> • Primarily B2B with high typical transaction amounts (>\$500) |
| <ul style="list-style-type: none"> • Report delays in payments & higher rate of bounced checks | <ul style="list-style-type: none"> • Report higher overall failure to pay rate |
| <ul style="list-style-type: none"> • Transact over web | <ul style="list-style-type: none"> • Do not transact over web |

Source: The Next Payments Frontier: Electronic Payment Acceptance & the Small Business Market, May 2008

Payment Methods Preferred by Small Biz



Source: 2006/2007 Study of Small Business Payment Preferences by Dove Consulting/Hitachi Consulting

Barriers to Implementing Electronic Payments



Source: U.S. Bank, Electronic Payments – Trends in Accounts Payable, Winter, 2010

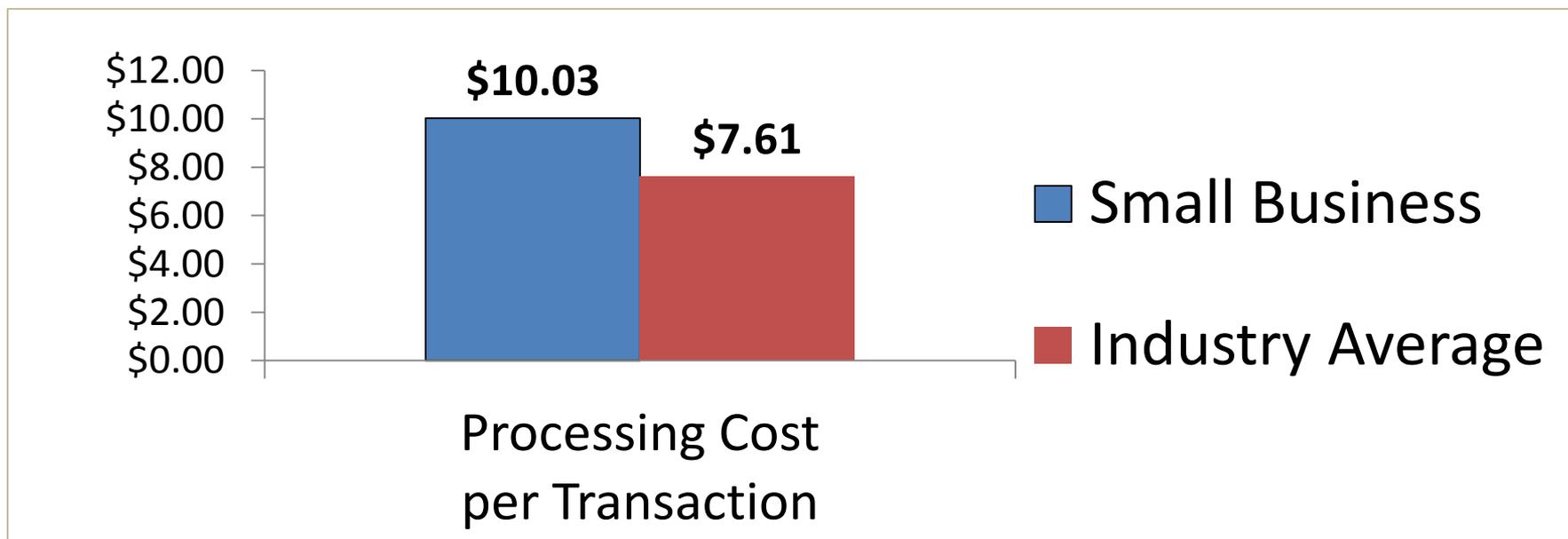
Check Fraud Hits Small Biz Hard

- Checks are dominant payment form targeted by fraudsters & check-related fraud continues to rise
- Paper checks account for as many as 10 times the fraud incidents as electronic payments
- Small businesses are vulnerable to check fraud & abuse: the average scheme in a small business causes \$127,500 in losses

Source: Nilson Report, Association of Financial Professions Payment Fraud Survey , 2007 StopCheckFraud of APA Technology; U.S. Bank Electronic Payments – Trends in Accounts Payable, Winter 2010

Payments Processing Is Costly for Small Biz

The cost of processing payments is higher for small businesses compared to the industry average:



Using electronic payments & remittance information, the cost could be reduced by 71-77%, or \$3.08 to \$3.30 per payment.

Source: 2006/2007 Study of Small Business Payment Preferences by Dove Consulting/Hitachi Consulting. Aberdeen Group, SMB: High Costs Aren't the Only Problem, September 2008; Small Business Payables & Receivables Survey, Cash Edge/Fiserv, January 2011

Small Biz Identify Unmet Payment Service Needs

| Payment/Banking Services that Small Businesses <u>Want</u> | % of Small Biz |
|--|----------------|
| Straight-through processing of payments from business to bank | 70% |
| Identity-management platform that safeguards business identity & protects accounts when conducting business electronically | 70% |
| Electronic payments package integrating accounts payables, accounts receivables, & expense tracking | 65% |
| Bank services that are easily integrated into payroll & HR systems | 60% |
| Live intraday financial position information | 55% |
| Automated card-based, expense-processing system that ties in key partners | 50% |

Source: BAI Study, 2006

Challenges of Reconciling Payments & Remittance Data

Remittance Data Defined

Remittance Data Definition: Information shared between a seller & buyer that provides a detailed accounting regarding the provisioning of goods &/or services relative to a payment.

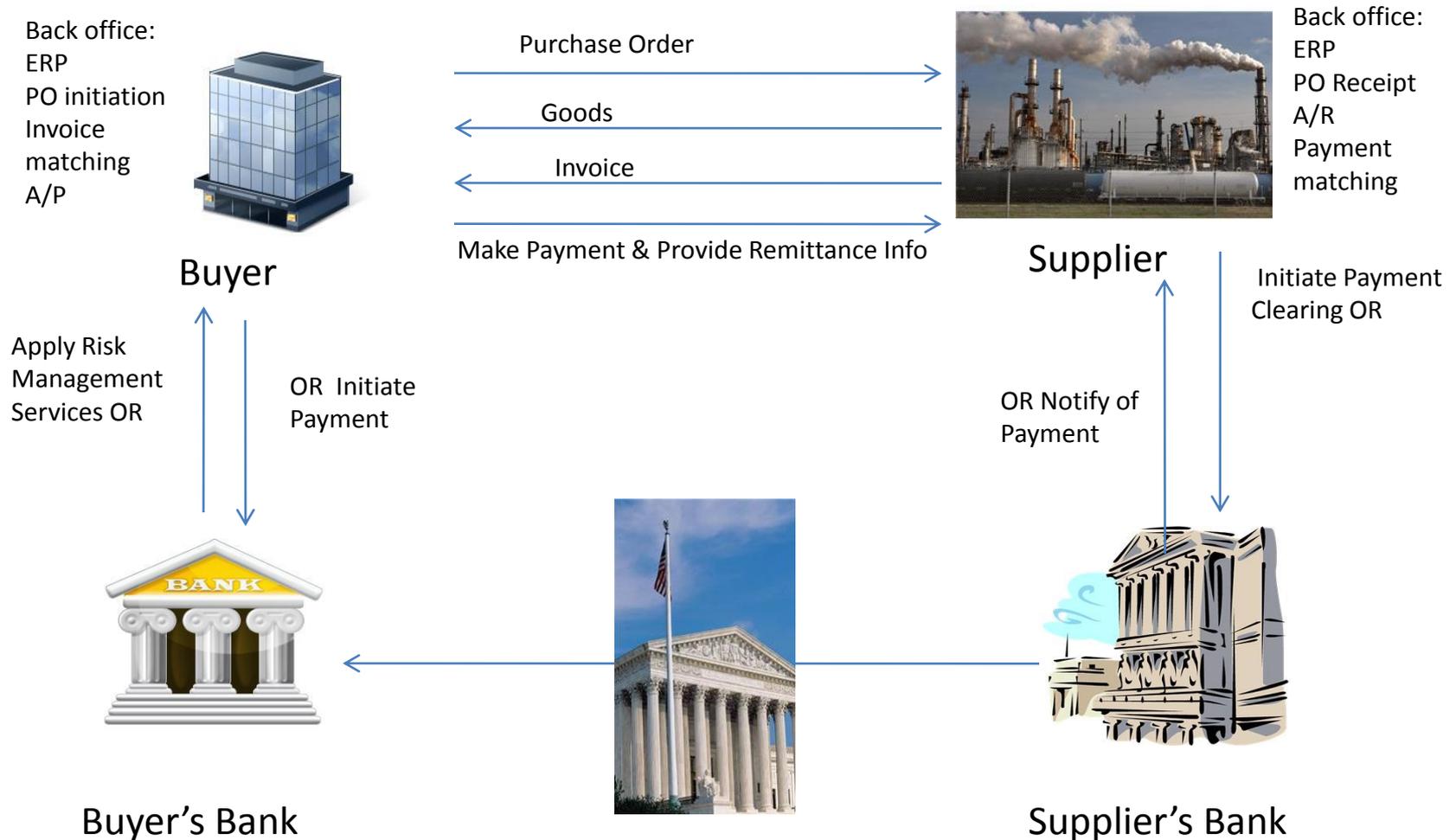
Remittance data is initiated by a buyer to notify seller of a payment.

Seller uses remittance data to:

- Close an open accounts receivable entry
- Acknowledge that payment was received
- Determine other liabilities (e.g., adjustments, rebates, promotional efforts, special pricing, etc.)



Remittance Exchange



How Remittance Data is Exchanged on ACH Payments

| Method for Exchanging Remittance | When Sending ACH | When Receiving ACH |
|----------------------------------|------------------|--------------------|
| Email | 63% | 62% |
| EDI/CTX transmission | 39% | 42% |
| Mail | 18% | 22% |
| Fax | 16% | 22% |
| Customer website | 6% | 14% |
| 3 rd Party website | 6% | 10% |
| Own organization's website | 6% | 7% |

Source: 2010 AFP Payments Survey

Common Problems Reconciling Payments & Remittance Data Efficiently

- Complete remittance data isn't provided
- Remittance formats aren't standard
- Matching payments to remittances may be difficult when received separately
- Discrepancies are difficult to resolve
- Payments & accounting systems aren't integrated
- Remittance data needs to be re-keyed, causing errors, delays & costs

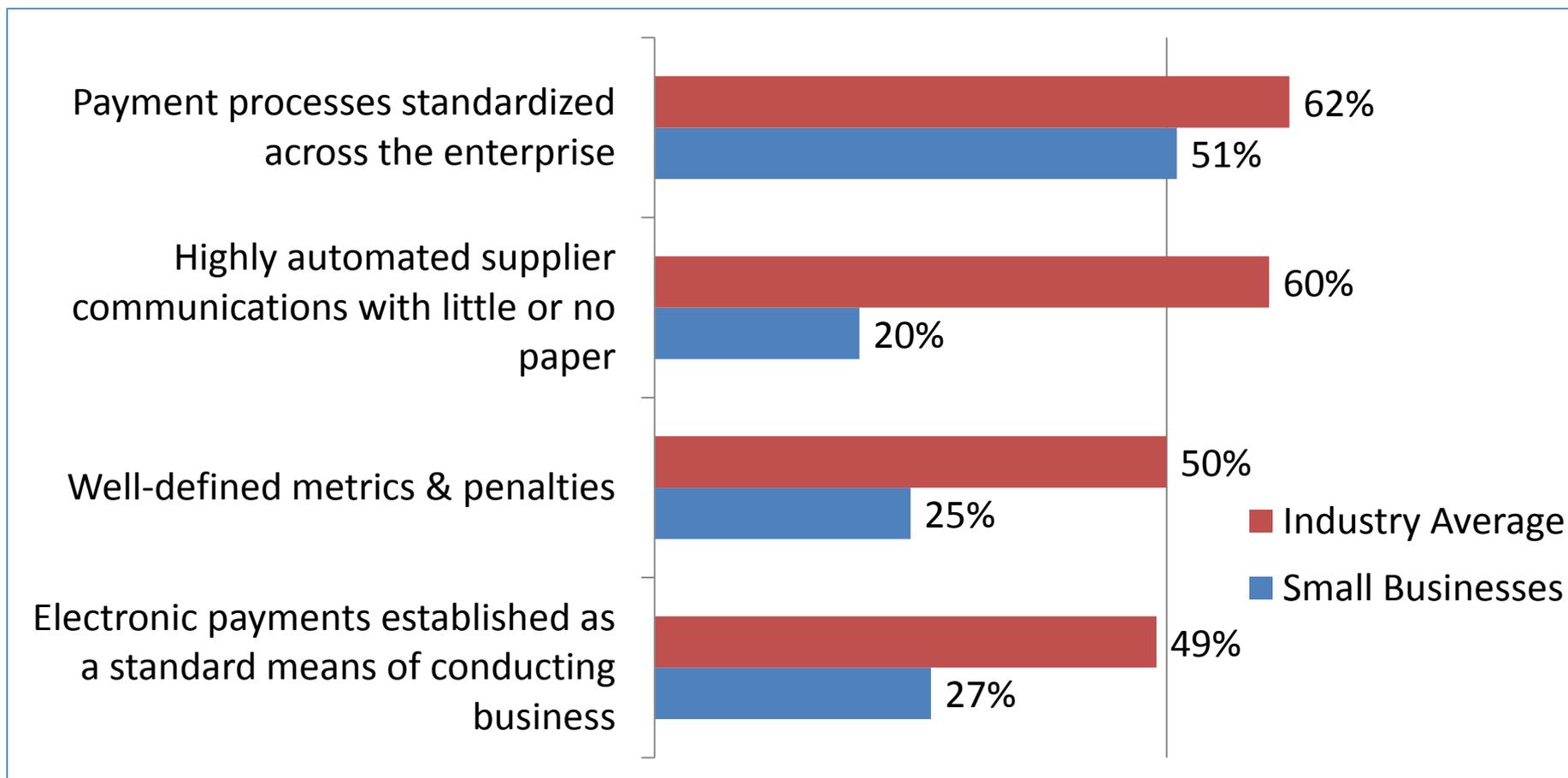


Small Biz Payments & Remittance Integration Needs Not Addressed

- Existing banking & vendor solutions don't address small biz needs adequately
 - E.g., Intuit's "QuickBooks" doesn't integrate readily with NACHA ACH format
- Information & education for small biz is insufficient about existing solutions &/or new initiatives
 - Banks do not educate small biz customers effectively about their services



Small Biz E-Payables Capabilities Lag Industry Average

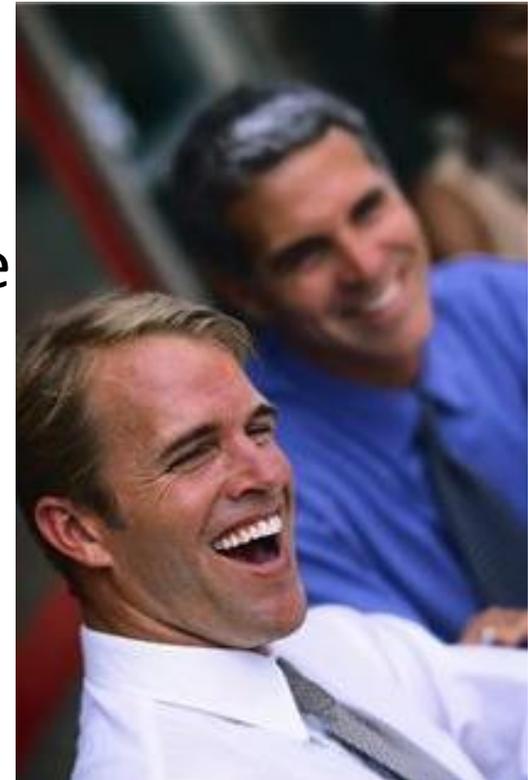


Source: Aberdeen Group, SMB: High Costs Aren't the Only Problem, September 2008

Why Automate Remittance Data?

Benefits of automating processing of payments & remittance information:

- Enable more efficient automated reconciliation of payments & remittance data
- Identify & resolve discrepancies faster
- Achieve cost savings
- Maximize rebates & incentives
- Reduce fraud risk



Benefits to Small Biz of Processing Receivables Electronically

Benefits cited by small biz after switching to electronic payments & processing of receivables:

- Eliminate/reduce past due payments
- Get paid faster
- Save time on billing
- Look more professional
- Gain & keep more customers
- Increase average sales from customers

Source: PaySimple, Electronic Payment Processing– How to Find the Best Solution, October 20, 2011

Case for Participating in Remittance Coalition

Addressing Remittance Problems Requires Working Together

In June 2011, a group of payment system stakeholders (Federal Reserve, standards developers, bankers, business representatives, software vendors & others) decided to form a voluntary “Remittance Coalition” to find ways to make it easier for businesses in all industries to process payments & remittance data more efficiently & effectively.

Coalition members agreed that outreach to small biz would be a priority, as this community is under-served.



Remittance Coalition Plans

Efforts underway by Remittance Coalition:

- Educate businesses on using electronic payments effectively & best practices for reconciliation
- Work with software vendors to support common remittance formats & electronic payments
- **Conduct a survey of business practitioners on remittance processing problems & solutions needed; ensure small businesses are included**
 - **Identify & implement additional actions based on survey results**

Electronic Payments & Remittance Processing Solutions Survey

- Online survey asks about:
 - Business views on barriers to electronic payment adoption
 - Pain points for remittance exchange & reconciliation
 - Evaluation of proposed solutions
- Survey to be distributed by organizations representing businesses – Association for Financial Professionals, Credit Research Foundation, Institute of Financial Operations, National Association of Purchasing Card Professionals
- Launch of survey in late May, concluding by early July, 2012



Small Business Perspective Needed

- **How can we best invite small businesses to participate?**
 - Small Business Development Centers (ASBDC) websites?
 - Online distribution to small business contacts
 - Other opportunities?



Small Business Payments: Educational Opportunities

- Work with ASBDC to address payment & remittance processing issues of small businesses
 - **Presentation** at ASBDC Annual Conference in September on results of Remittance Coalition survey
 - **Educational materials** for use by counselors to assist clients in choosing best options for making & receiving payments, exchanging info about payments & reconciling payments
 - **Webinars** on payment & remittance topics



A blue-tinted photograph of a classroom or meeting. In the foreground, many hands are raised, indicating an interactive session. In the background, a person in a suit stands at the front, possibly a teacher or speaker. The overall scene suggests a Q&A or discussion period.

**Questions &
Comments?**

Contact Information



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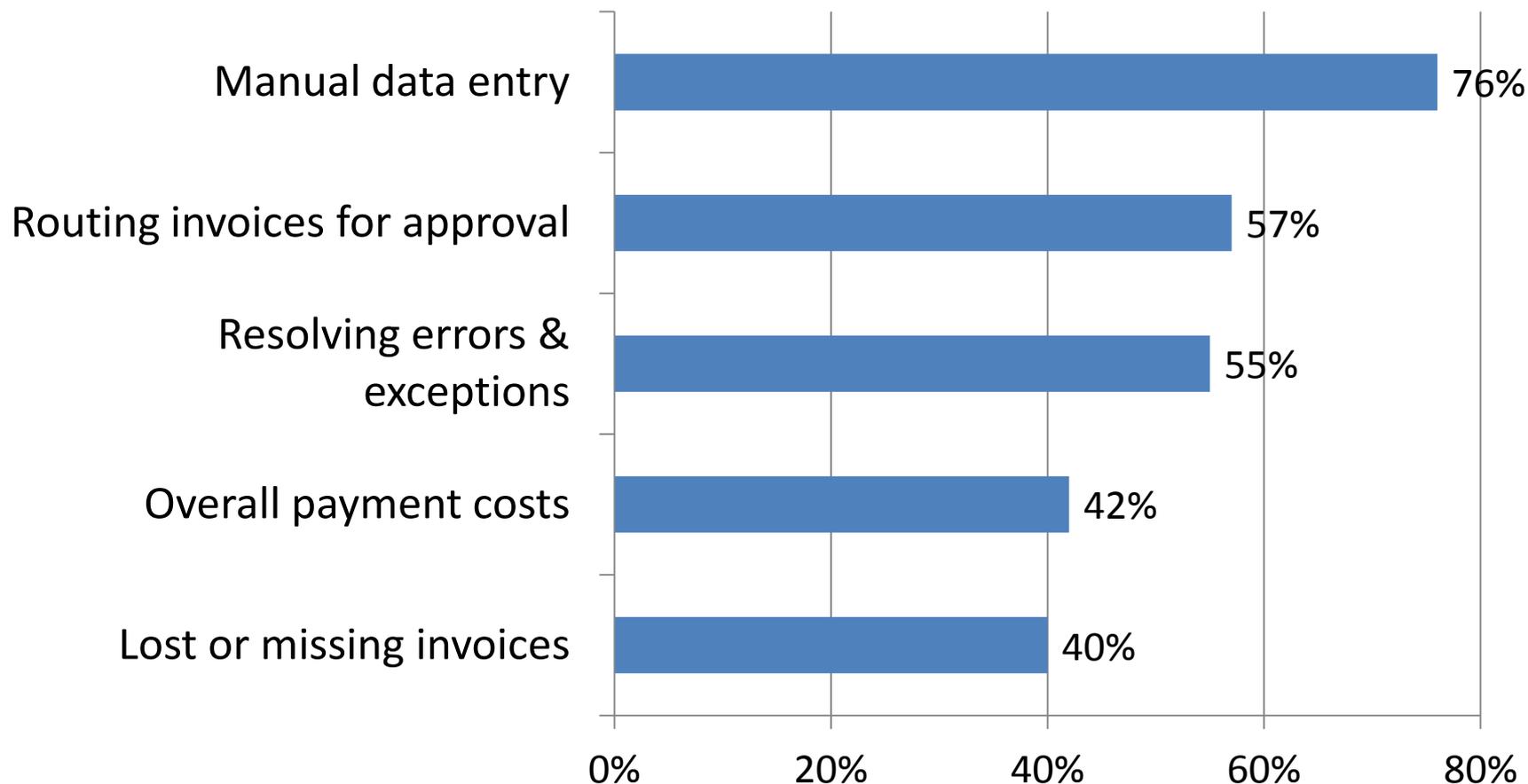
APPENDIX

Barriers to Electronic Payment Adoption

| ACH | Cards | Wires |
|--|---|--|
| <ul style="list-style-type: none"> • Hard to implement; complex rules & technology | <ul style="list-style-type: none"> • Costly to receive due to high interchange fees | <ul style="list-style-type: none"> • Transactions costs relatively high |
| <ul style="list-style-type: none"> • Costly to implement, especially EDI | <ul style="list-style-type: none"> • Not accepted by many trading partners | <ul style="list-style-type: none"> • Hard to reconcile |
| <ul style="list-style-type: none"> • Complex capabilities needed to integrate payments & remittance | <ul style="list-style-type: none"> • Some effort & cost to implement | |
| <ul style="list-style-type: none"> • Solutions lacking to address needs of small companies & banks | <ul style="list-style-type: none"> • Integration of payments & remittance data limited | |

Common Challenges of Processing B2B Bill Payments

Survey Found Same Pain Points for All Business Sizes

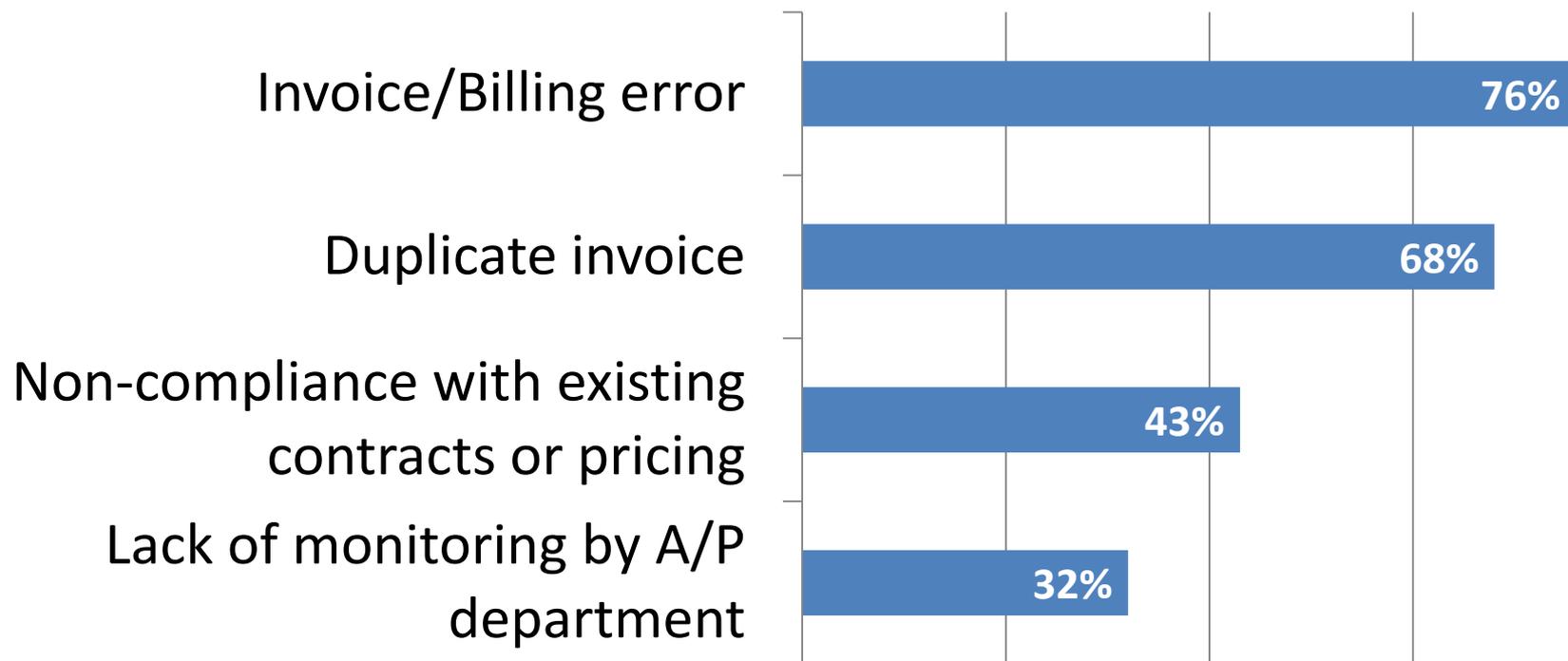


Source: U.S. Bank, Electronic Payments – Trends in Accounts Payable, Winter, 2010

Small Biz Plagued by Improper Payments

Over half of small businesses have had financial losses due to “improper payments.” About 8% of all outgoing payments are improper.

Types of Improper Payments Common in Small Biz



Source: Aberdeen Group, SMB: High Costs Aren't the Only Problem, September 2008