



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®**

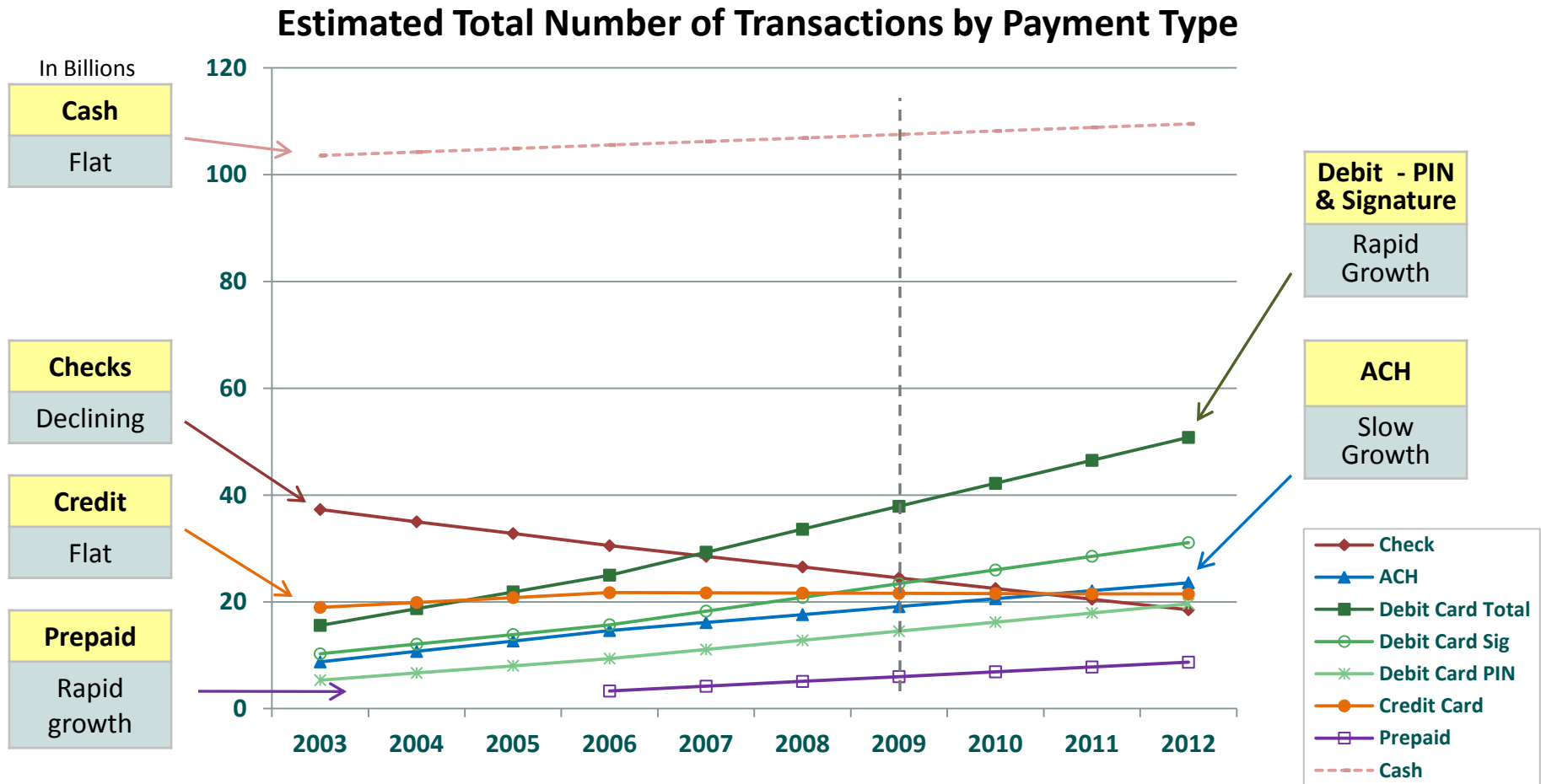
Fed is also U.S. Government's bank

- Services include Savings Bonds & Treasury Auctions

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

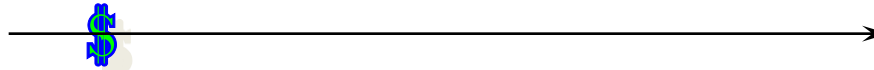
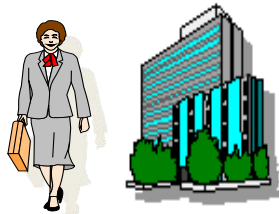
Payments Basics

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



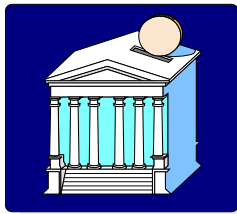
Source: Noncash data points for 2003, 2006, & 2009 from Federal Reserve Payment Studies. Cash based on McKinsey estimate for 2009 & forecast for 2014.

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

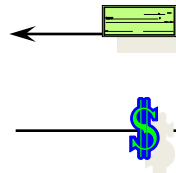


Consumer or company
originates a payment

Origination

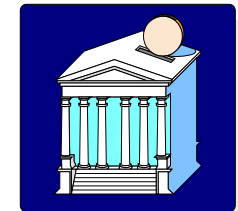


Payment is cleared
& settled



Presentment

Payment



**Processing, Clearing,
& Settlement**



Payment is accounted for
by consumer or company

Reconciliation

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

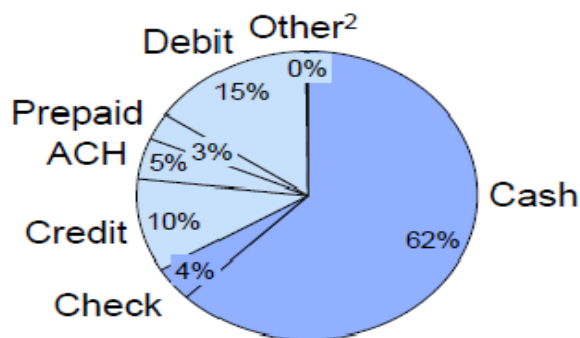
Business to Business/Gov't (B2B)

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

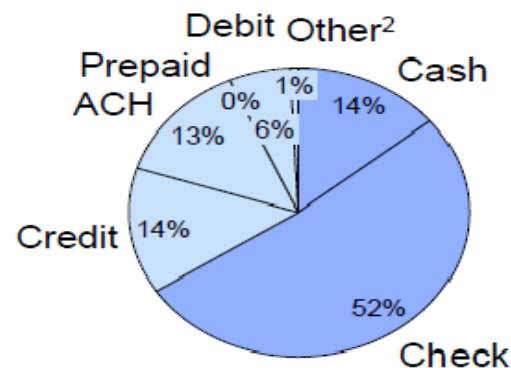
Payment Types Favored Vary by Category

Percent of 2008 transactions ¹

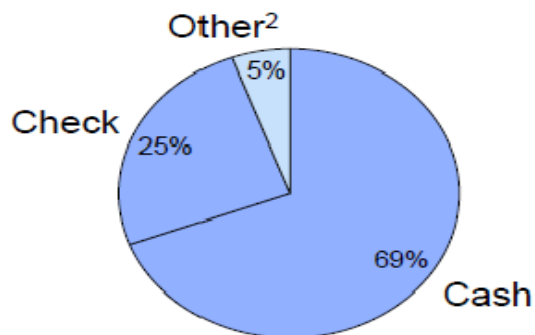
C2B 100% = 207 billion



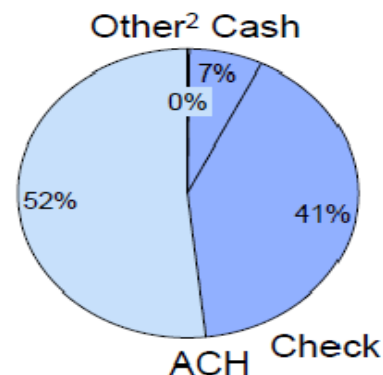
B2B 100% = 22 billion



C2C (P2P) 100% = 9 billion



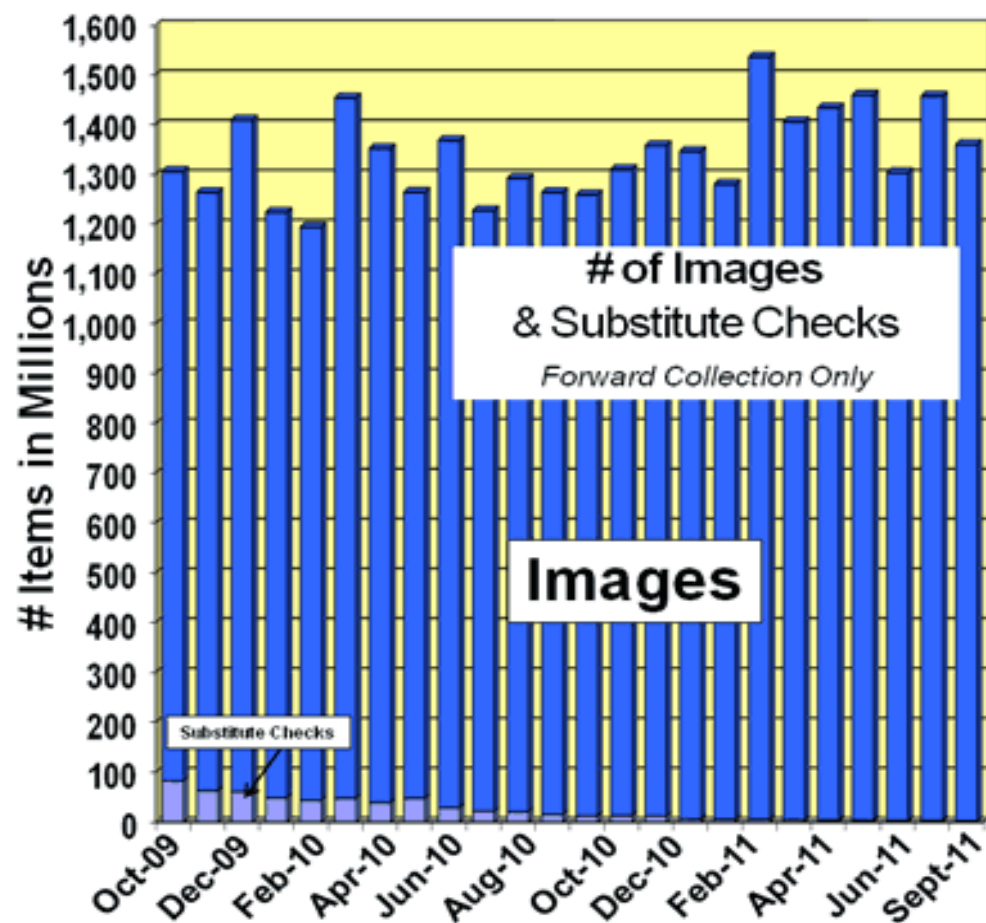
B2C 100% = 10 billion



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

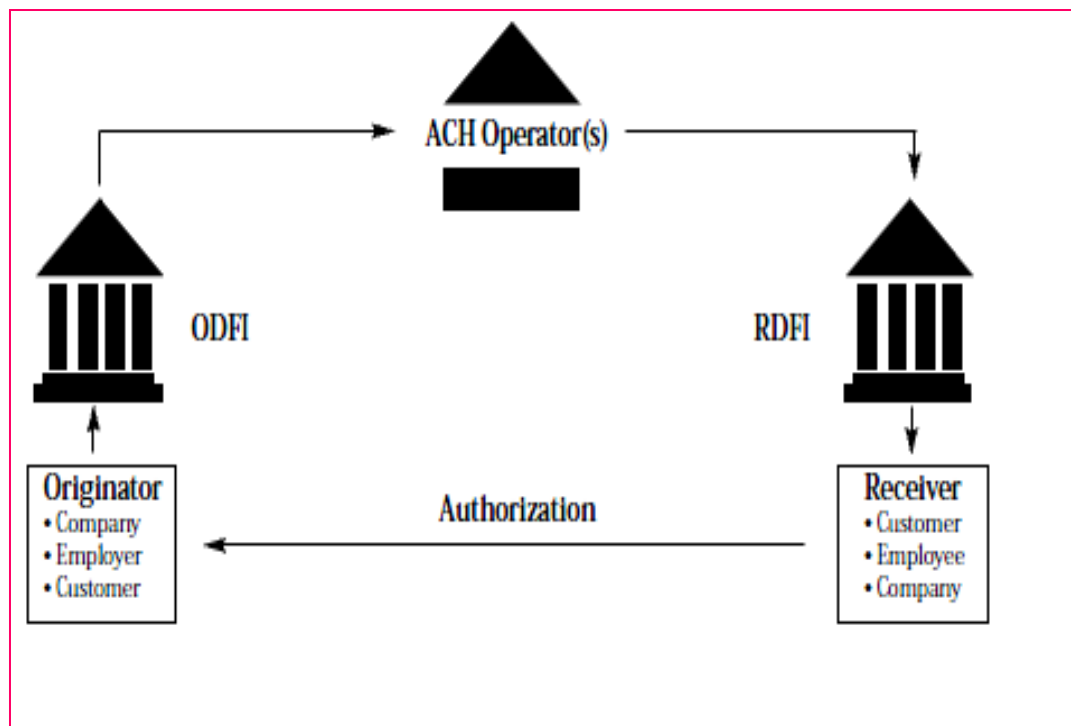
Automated Clearing House (ACH)

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

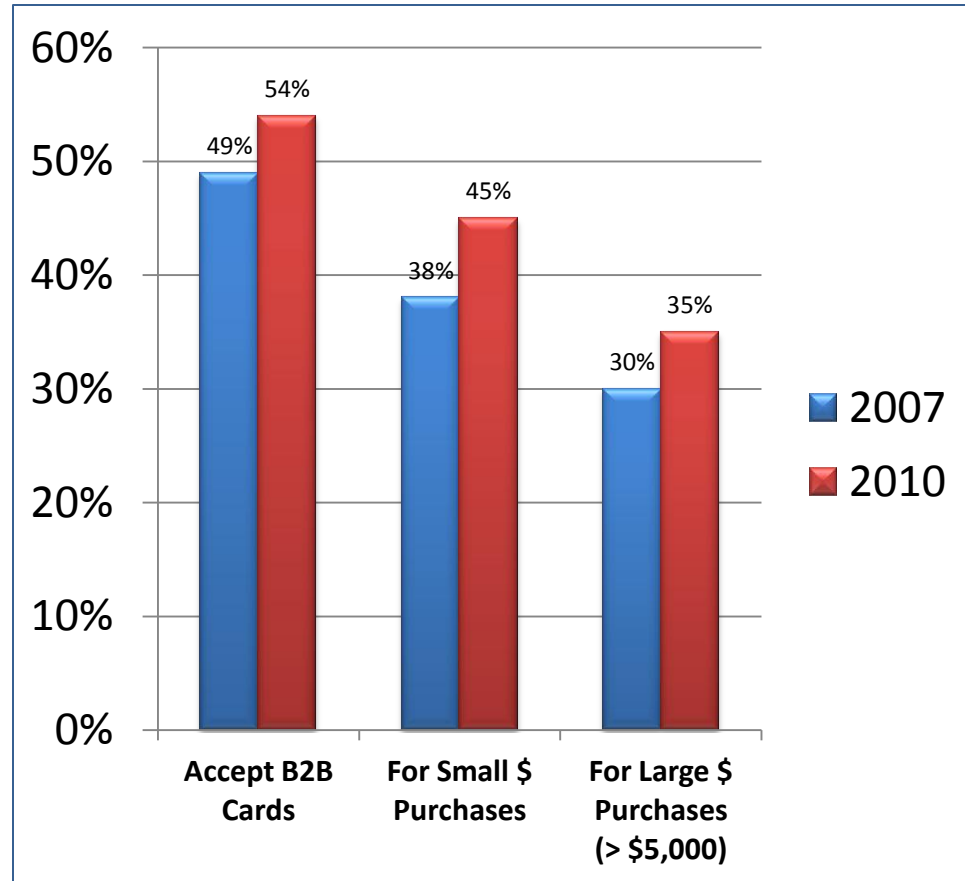
- Consumer use of cards shifting from credit to debit
- Business use of cards expanding from T&E to purchasing cards for B2B payments

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

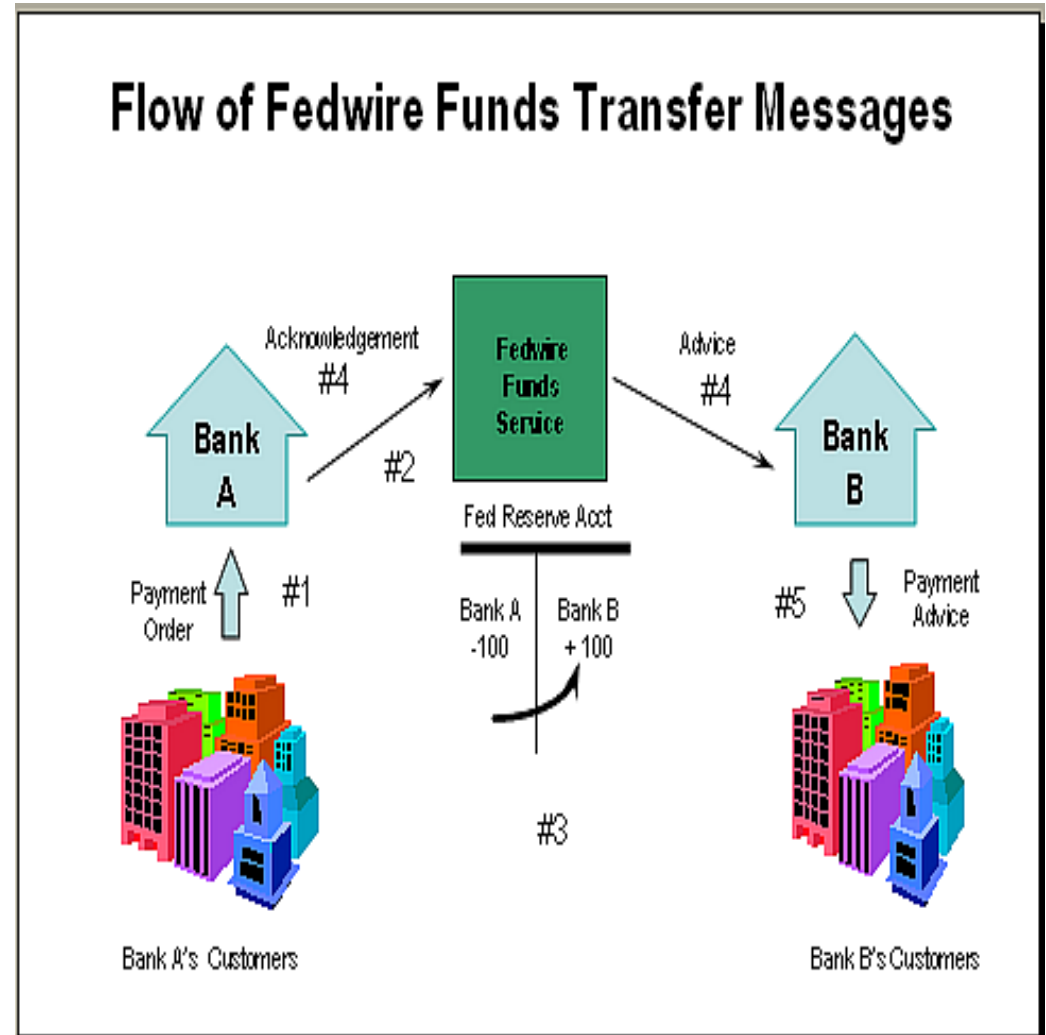
- Fastest growing B2B electronic payment – VISA estimates 25% annual growth
- Originally targeted for low value purchases (less than \$1,000); now used for some higher value purchases
- Adoption success due to:
 - Financial incentives to payer
 - Improved efficiency
 - Reporting & risk management tools



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

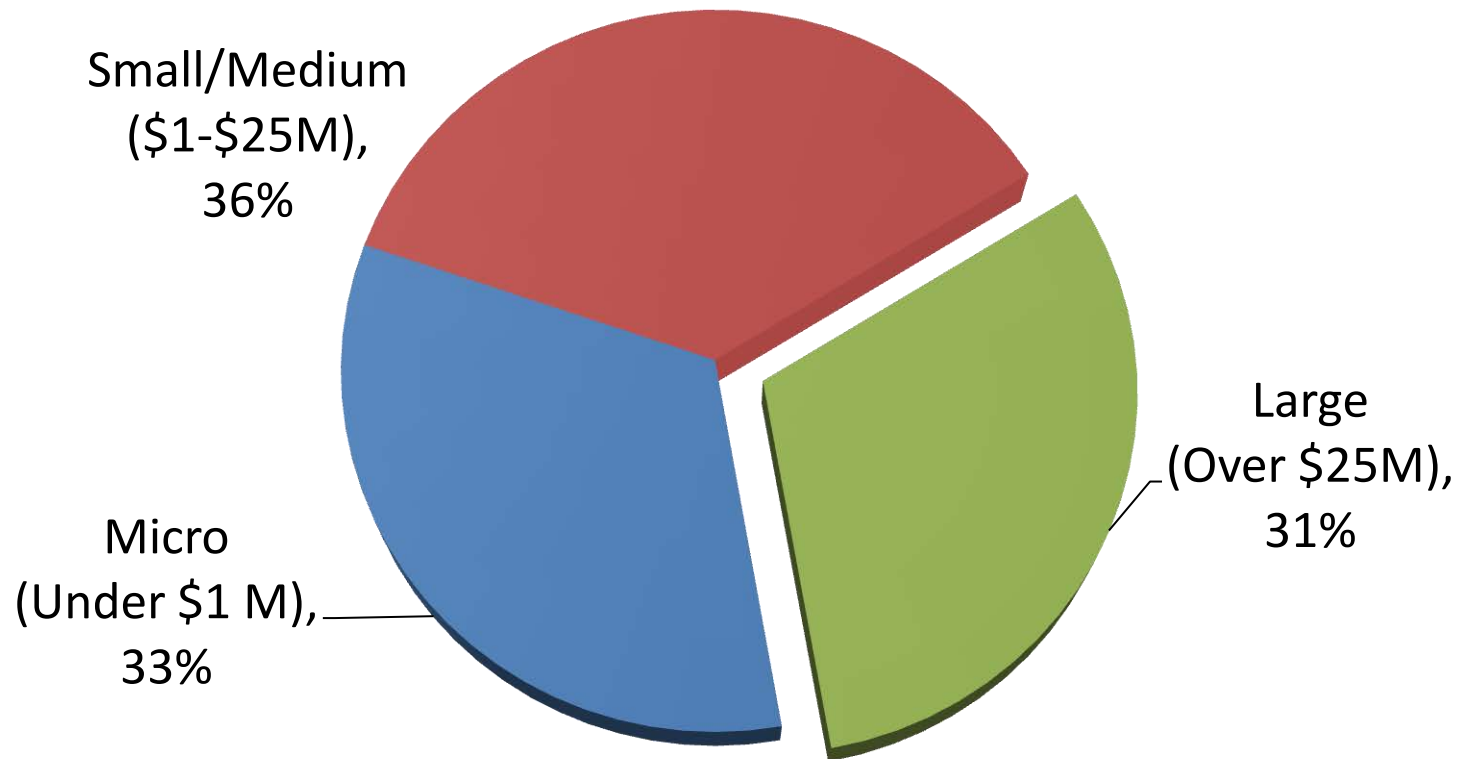


Small Biz & Payments

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

% of Total Payments by Business Size

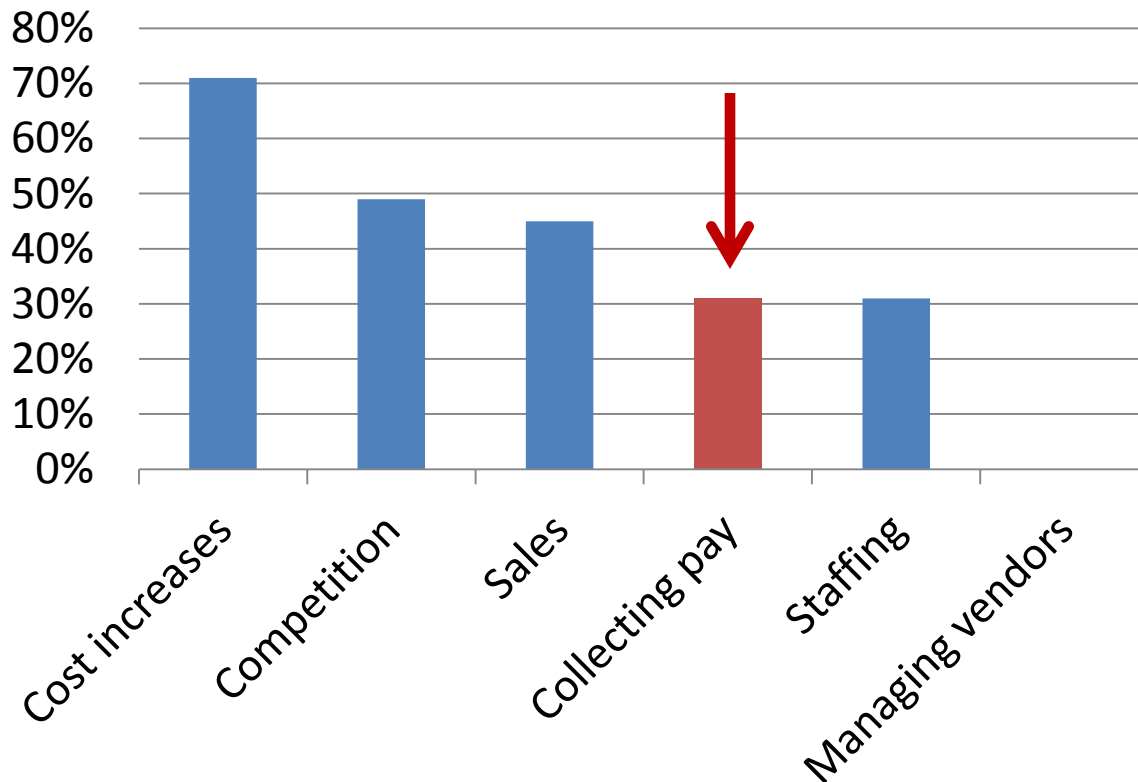
Based on 19.5 billion payments totaling \$24 trillion in 2006



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

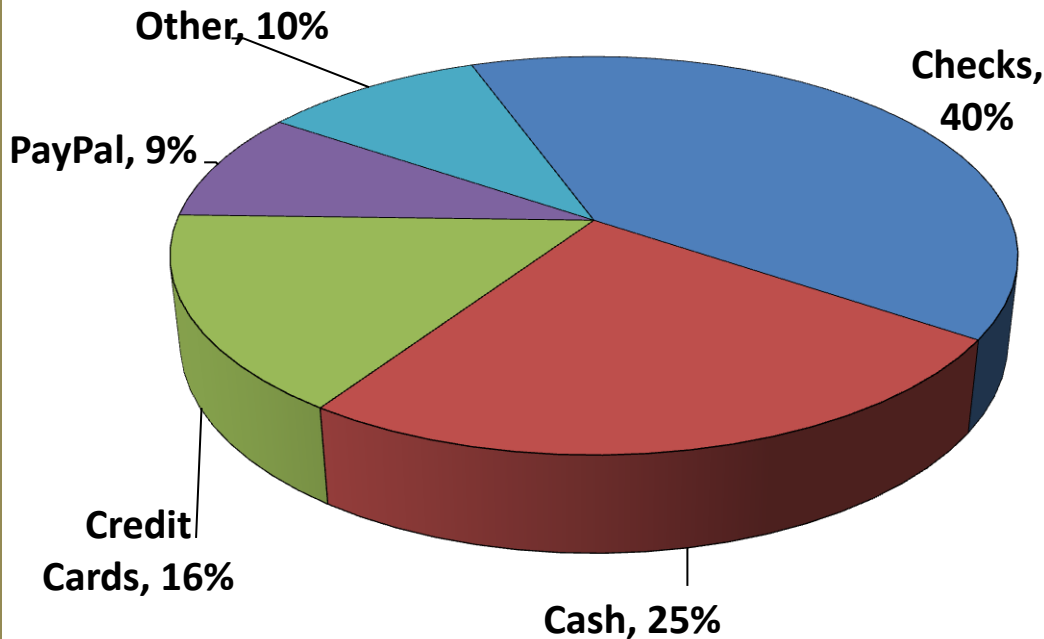


- About 1/3 of small businesses say collecting payments is their top business challenge

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)

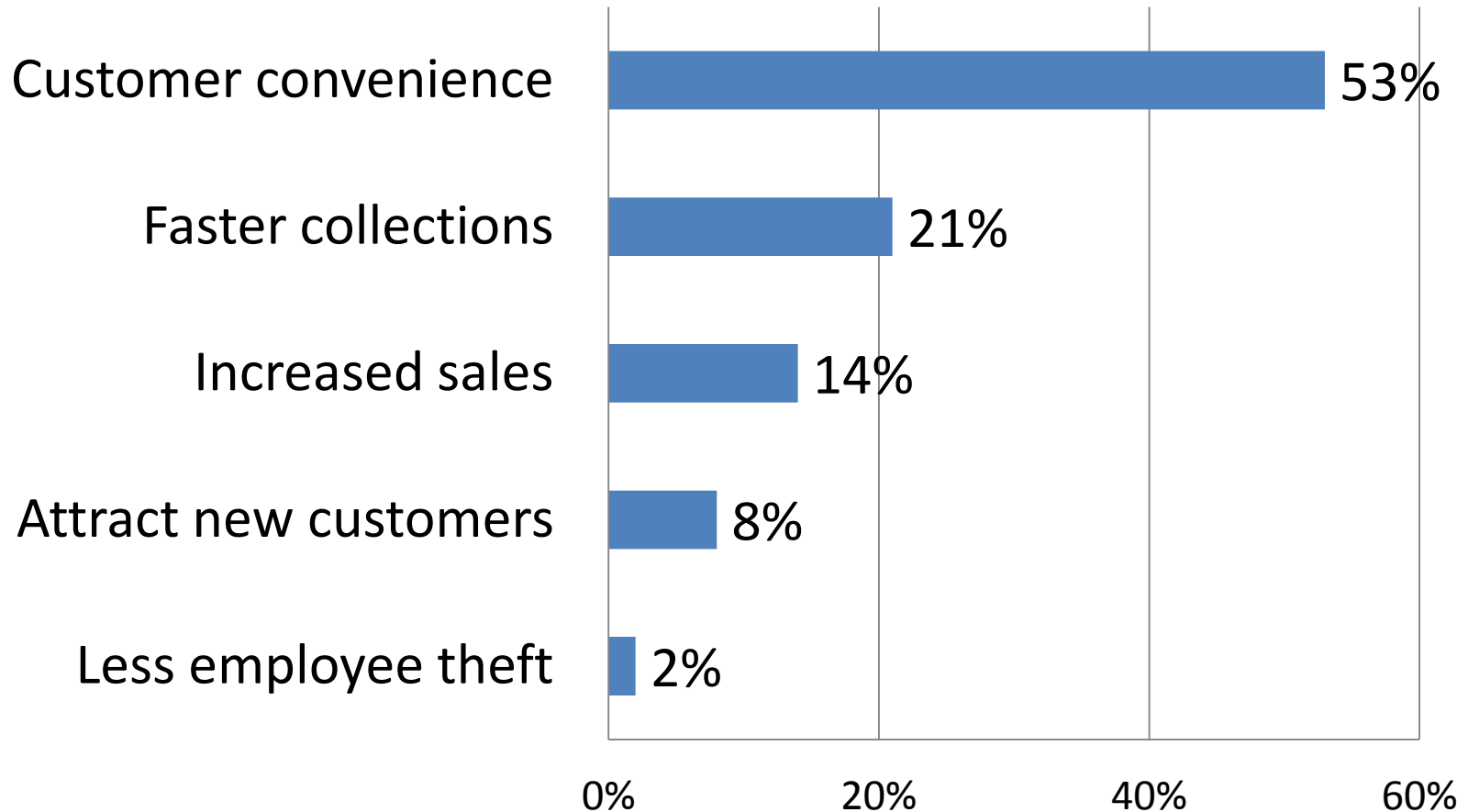


Accepted by Small Biz:

- 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



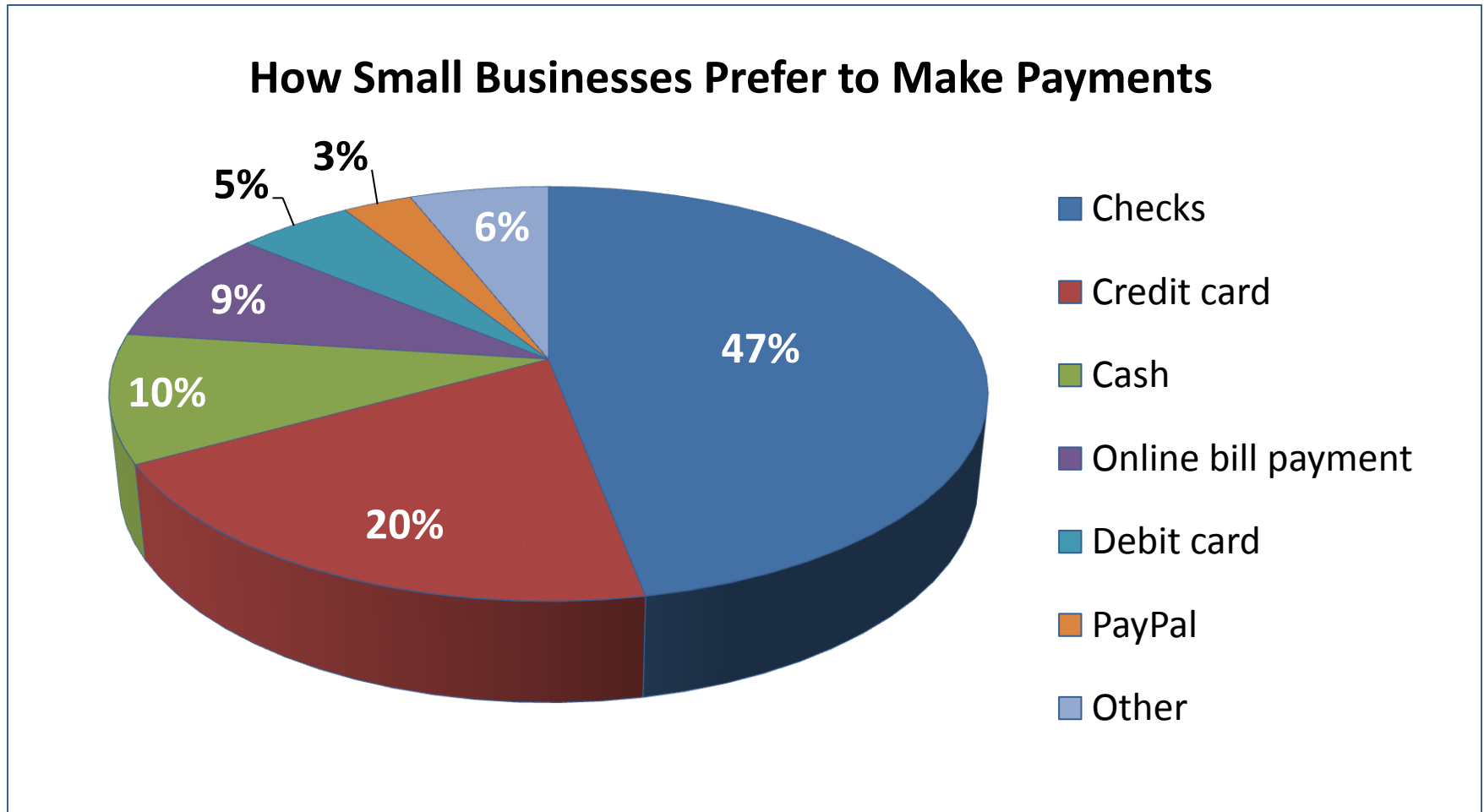
Source: The Next Payments Frontier: Electronic Payment Acceptance & the Small Business Market, May 2008

Which Small Biz Accept Electronic Payments?

Characteristics of Small Businesses...	
That Accept Electronic Payments	That <u>Do Not</u> Accept Electronic Payments
• Mainly in healthcare & retail	• Mainly in consulting, services & construction
• Multiple employees & annual revenues of >\$1M	• Small/sole proprietorships with revenues of <\$1M
• Primarily B2B with low typical transaction amounts (<\$200)	• Primarily B2B with high typical transaction amounts (>\$500)
• Report delays in payments & higher rate of bounced checks	• Report higher overall failure to pay rate
• Transact over web	• 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

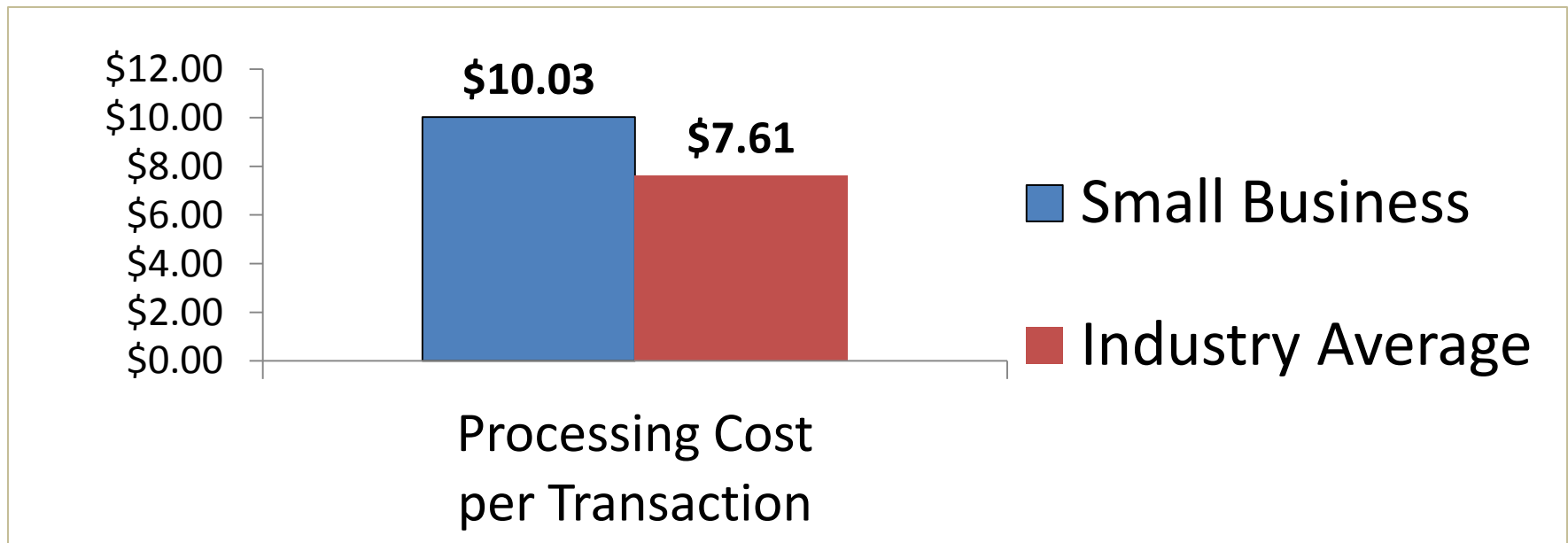
Check Fraud Hits Small Biz Hard

- 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.

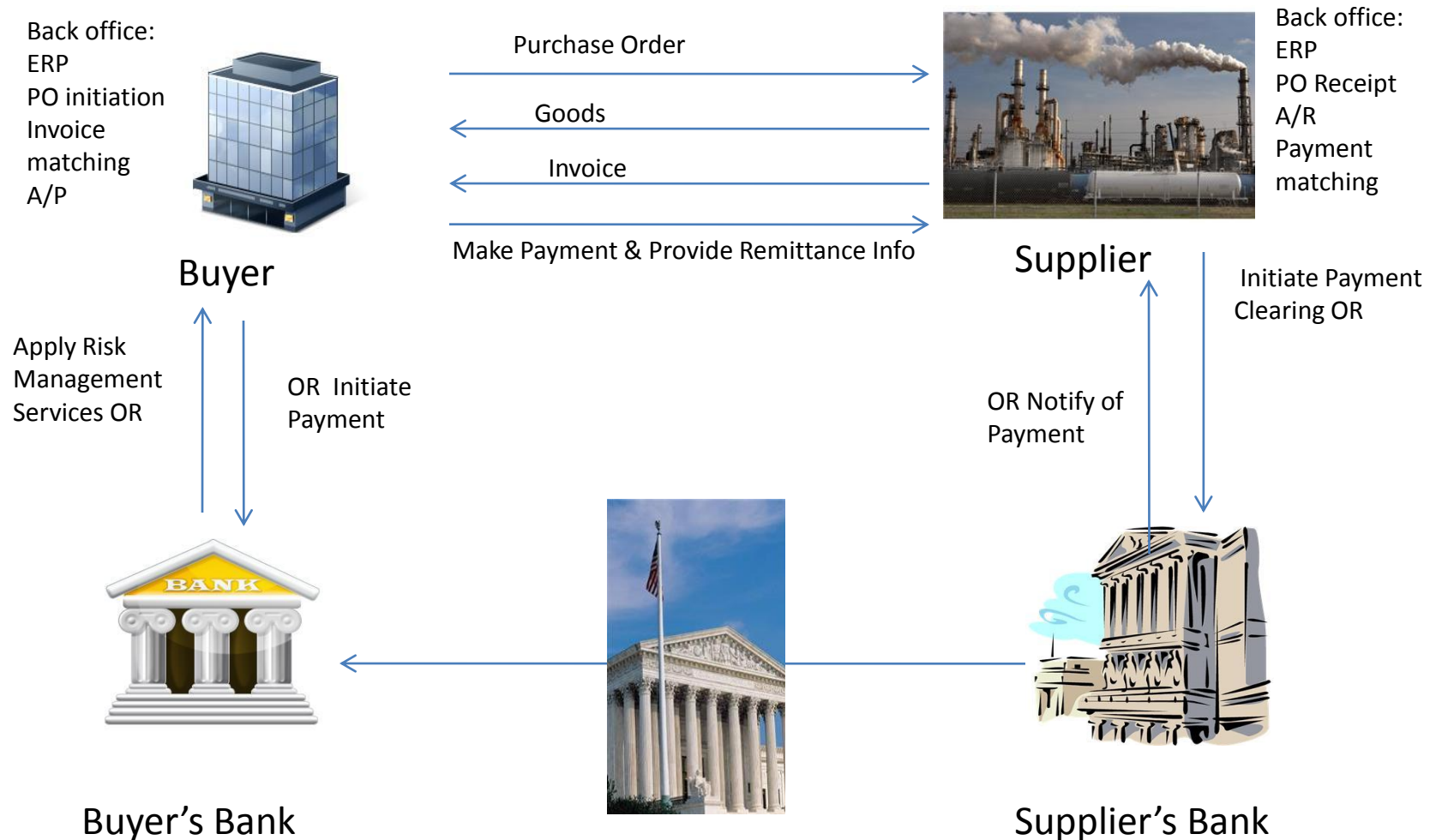
Remittance data is initiated by a buyer to notify seller of a payment.

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

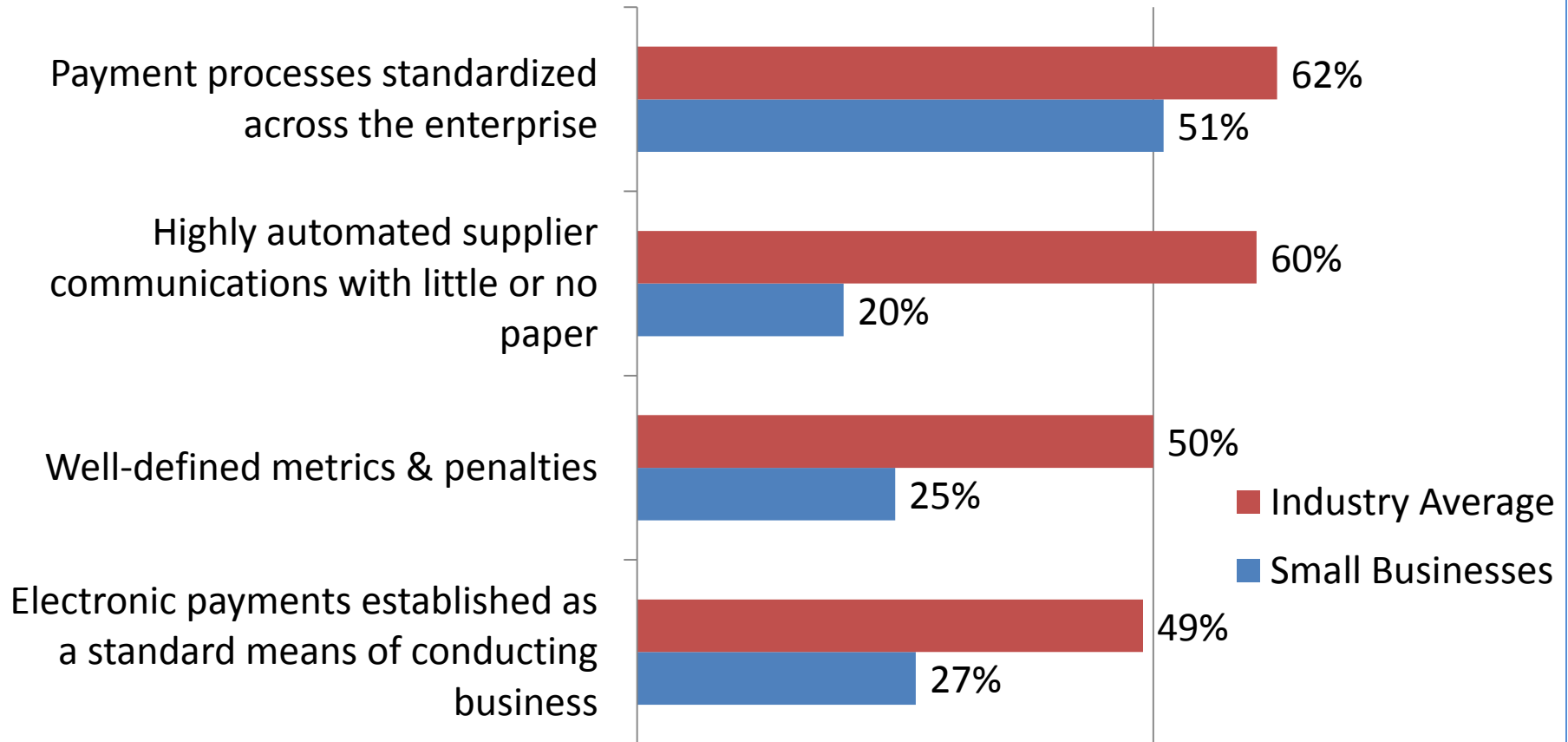


Small Biz Payments & Remittance Integration Needs Not Addressed

- 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





Questions & Comments?

Contact Information



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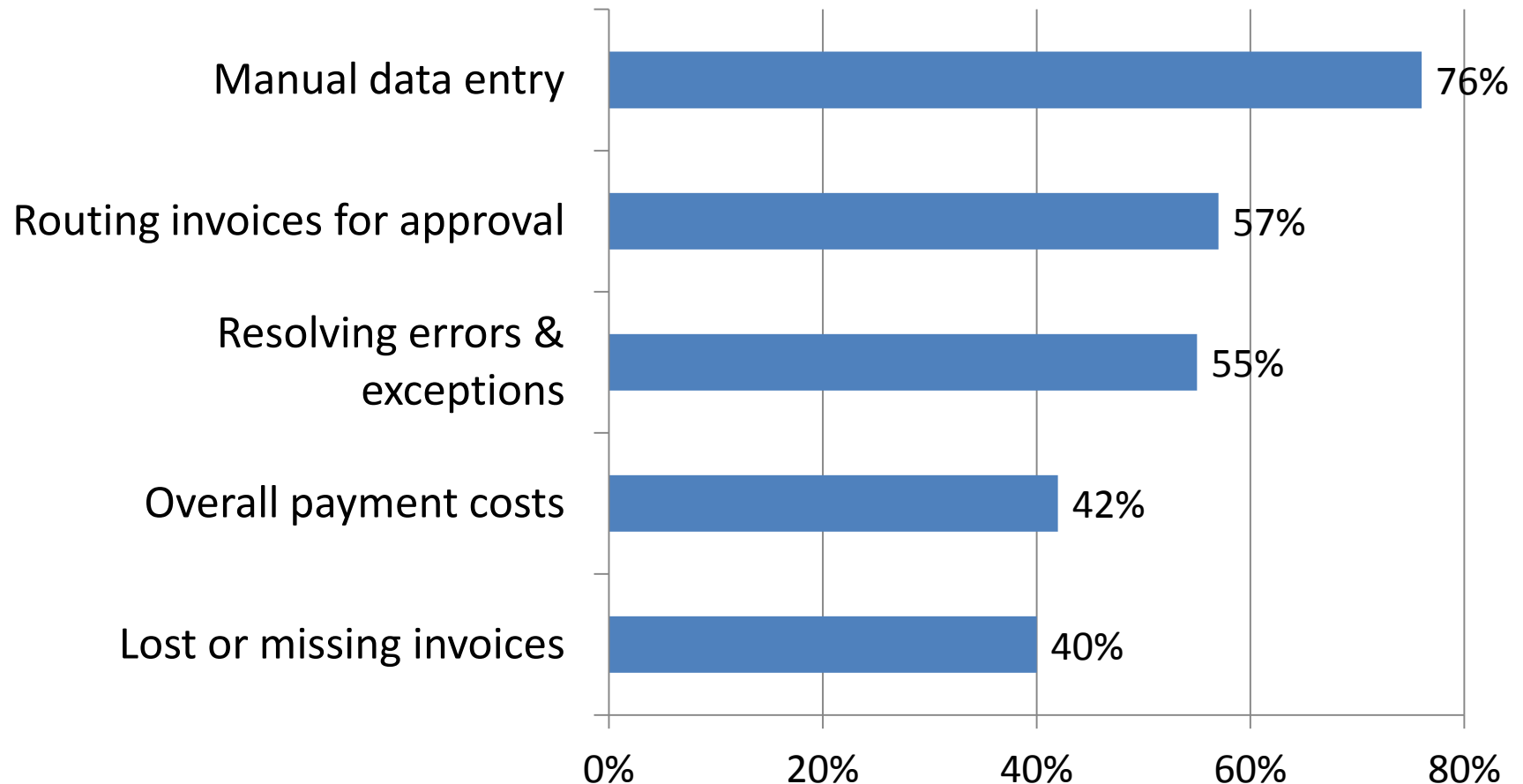
APPENDIX

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

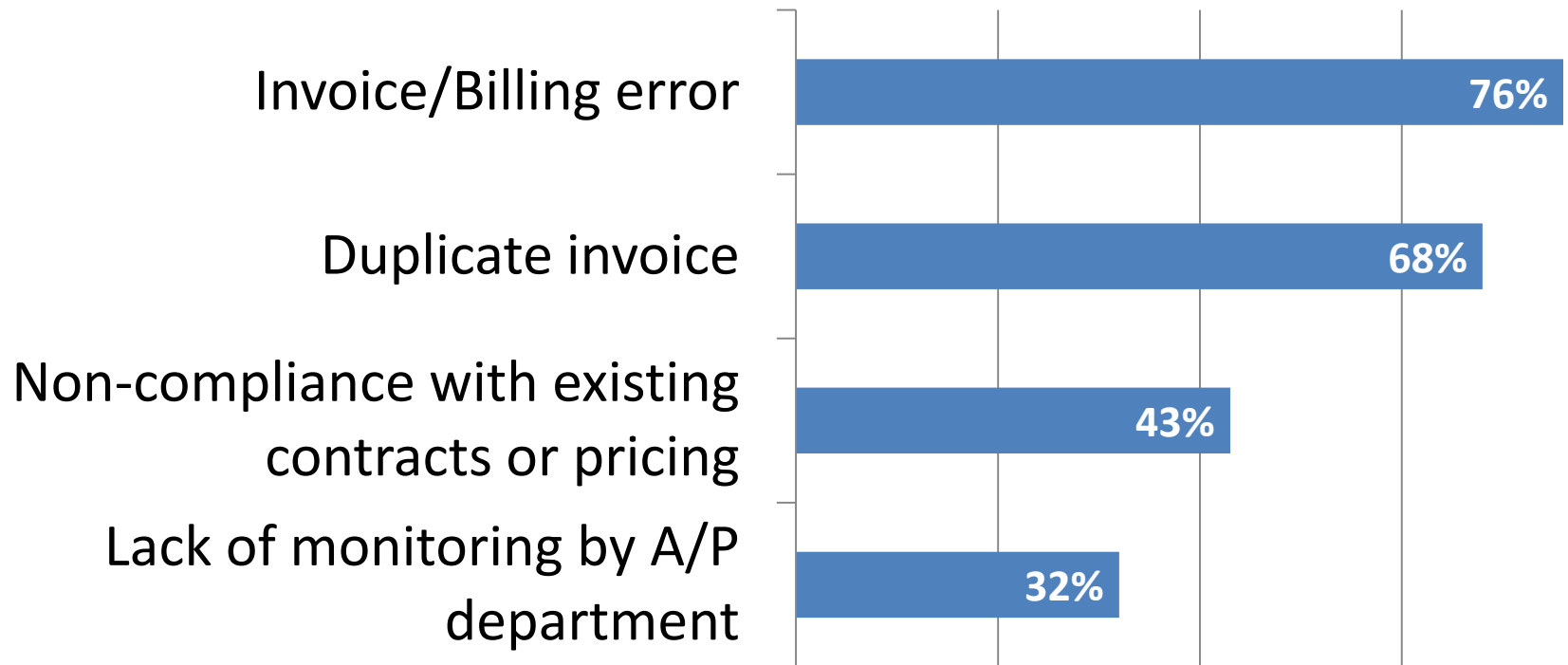


Source: U.S. Bank, Electronic Payments – Trends in Accounts Payable, Winter, 2010

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