The State of B2B Payment Transformation

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Conducted by: MasterCard Advisors
Sponsored by: U.S. Bank Corporate Payment Systems
Over the last decade the U.S. Payment System, including both consumer and business payments, has undergone significant transformation from a paper-based check dominated payment system to an electronic payment system (cards, ACH, wires). This has happened in resounding fashion for consumer payments and is underway, albeit more slowly, for business-to-business payments (B2B).

To illustrate the dimensions of this B2B transformation, four recent payment studies from a cross-section of highly credible industry groups were analyzed, as was a survey fielded by MasterCard\(^*\) that was specifically designed for this white paper (Figure 1.0). The survey and industry data is reviewed in this white paper including payment vehicle mix/use, volume trends, payment preferences, key factors affecting the transformation (e.g. technology, customer, regulatory, global), barriers to change and expectations for the future.

Today, the U.S. payment world is still dominated by checks; however, the number is on a downward trend. The typical organization makes 74% of its payments by check versus 81% in 2004.

The forces of change are building immense pressure on the “status quo” and businesses are accelerating their efforts to reengineer procurement and payment operations. The transformation to a world dominated by purchasing cards, ACH and wires has begun and a significant shift to electronic straight-through-processing is anticipated in the next three years. A change is clearly happening in the B2B payments arena.

Several important conclusions can be drawn:

First, the primary change forces that are driving the “electronification” of business payments include:

- Improving business process efficiency
- Increasing working capital optimization
- Investing significantly in Enterprise Resource Planning (ERP) systems
- Monitoring strict adherence to Sarbanes-Oxley requirements

Second, significant results have already been achieved by a number of U.S. businesses, resulting in the following important benefits:

- Greater operational savings
- Increased early payment discounts
- Reduced risk
- Improved supplier satisfaction

Finally, more businesses are planning to adopt electronic payments over the next three years. In particular, commercial cards are continuing to have high levels of adoption due to recent enhancements. In addition to the above benefits, these solutions have increased control, simplified integration, expanded spend visibility and improved cash float. The continued migration to electronic payment solutions will further advance the overall B2B payment transformation.
2. Overview of Recent Studies

The primary sources selected for this white paper were all published in the last year (October 2007 – June 2008) and provide significant new data on the U.S. payment landscape (Figure 2.0).

Figure 2.0

<table>
<thead>
<tr>
<th>Study Name</th>
<th>Publication Date</th>
<th>Summary Description</th>
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| 1. AFP Electronic Payments Study                     | October 2007           | • The Association of Financial Professionals (AFP) conducts surveys periodically of corporate practitioner members and potential members (job titles for survey include: cash manager, director, analyst, assistant treasurer).  
• The 2007 mail survey was fielded September 2007 and 493 completed surveys were gathered for the final report. |
• The most recent study was implemented in three parts with the first two parts (surveys of both financial institutions and payment networks) published in December 2007 and part three published in March 2008. |
| 3. PayStream Advisors Automation Study, (eProcurement, Web Invoicing) | December 2007           | • PayStream Advisors is a leading consulting firm that focuses on business automation.  
• The December 2007 reports are part of their ongoing series of industry research. |
| 4. TowerGroup Corporate Payment Presentation         | May 2008                | • TowerGroup is a leading industry research group.  
• The May presentation was prepared by Susan Feinberg, Research Director of Wholesale Banking. |
| 5. MasterCard Financial Professional Survey          | May 2008                | • MasterCard fielded a special survey for this white paper.  
• The May survey was fielded on the internet with corporate financial executives. |
3. U.S. Payment Transformation

The new millennium has seen an electronification of the U.S. payment system, as measured by the periodic payment studies of the Federal Reserve. The U.S. payment system includes both consumer and business payments and between 2000 and 2006 the percent of check transactions has decreased from 58% to 33%. If you factor into the Federal Reserve Study a forecast that TowerGroup Research recently developed, market share for check transactions in 2009 is forecasted to be 18%. Conversely, electronic transactions (including cards, ACH, wires) are forecasted to be 82% in 2009, up from 42% in 2000 (Figure 3.0).

3.1 State of Business Payments

In the U.S. B2B payments world, checks still are the dominant payment vehicle. But the October 2007 study by the Association for Financial Professionals (AFP), revealed the mix of B2B payment transactions is beginning to change, with expectations for significant change over the next three years.

Today, the typical organization makes 74% of its B2B payments by check versus 81% in 2004. Electronic payments (cards, ACH wires) are gaining ground, especially among organizations with annual revenues more than $1 billion and those with high payment volumes (Figure 3.1).

The AFP survey also shows that organizations are more willing to adopt electronic payments today than they were just a few years ago. In 2007, 43% of respondents expect that their
organizations are “very likely” to convert the majority of their B2B payments to major suppliers from checks to electronic payments (cards, ACH, wires) in the next three years. In AFP’s 2004 survey, only 28% of respondents indicated that their organizations were very likely to do so (Figure 3.1).

Among the varied benefits of sending and receiving electronic payments, the top two are cost saving and improved cash forecasting. No single factor is considered a “major” barrier to increased use of electronic payments by the majority of respondents. However, when evaluating the barriers overall (both major and minor) three issues stand out: IT and integration constraints, inability of trading partners to send or receive automated remittance information, and difficulty in convincing customers and suppliers to adopt electronic payments.

These barriers are similar to those identified in AFP’s 2004 survey. Nevertheless, many organizations are gradually overcoming them and reducing their reliance on checks. On the other hand, organizations that are identified as being “less likely” to convert the majority of their B2B payments to electronic, two other obstacles stand in the way: gaining priority funding for electronic payments projects and convincing senior management of the business case.

Some of the other key findings in AFP’s 2007 study include:

- Organizations are more likely to have integrated their accounting systems with their card and/or ACH payment systems (89%). Of those who have not integrated systems, 25% plan to do so in the next three years.

- The key benefits of integrating electronic payment systems with accounting systems include:
  - More efficient posting and reconciliation processes (87%)
  - Additional cost savings and reduced staffing requirements (76%)
  - Further working capital options and gaining the ability to take early payment discount (33%)

- Purchasing cards are used by a majority of organizations (61%) to make B2B payments and nearly half of organizations accept purchasing cards from their business customers.

- The key benefits of using purchasing cards for B2B purchases include:
  - Reducing the volume of purchase orders, invoices and other documents (62%)
  - Receiving rebates (45%)
  - Improving spend management and reporting and facilitating the process of paying infrequent payees (45%)
### 3.2 Forces Driving Change

There are a number of forces that are driving the electronification of corporate payment practices. A good perspective on these change forces comes from TowerGroup Research (Figure 3.2.1).

#### Figure 3.2.1

<table>
<thead>
<tr>
<th>Change Force</th>
<th>Summary Description</th>
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<tbody>
<tr>
<td>Business Process Efficiency</td>
<td>Corporate treasury and accounting departments continually search for ways to reduce costs by various methods, including:</td>
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<td>• Putting their cash management business out for competitive bid</td>
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<td></td>
<td>• Automating functions that had been performed manually</td>
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<td></td>
<td>• Outsourcing many functions that previously had been performed internally</td>
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<td>Business process outsourcing across the whole range of the financial supply chain, from purchase-to-pay (accounts payable) and order-to-cash (accounts receivable), is receiving increased focus and attention from corporate executives in many industries.</td>
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<td>Optimization Of Working Capital</td>
<td>Whether a corporation holds excess cash or is in a net borrowing position, optimizing the company’s working capital remains the key responsibility of the corporate treasury area.</td>
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<td>Critical to wringing out inefficiencies in the use of working capital is the ability to accurately forecast both inflows and outflows of cash.</td>
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<td>Increased adoption of electronic payment initiation by corporations facilitates more accurate cash forecasting because the clearing time of electronic payments is fixed. With low interest rates and the gradual elimination of check float, corporations will receive more cash-flow benefit by issuing large-value supplier payments in electronic form.</td>
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<td>Investment In ERP Systems</td>
<td>As corporations invest in large-scale ERP applications, they are looking to leverage their investments to the highest degree possible. Elimination of manual tasks such as payment creation and bank account reconciliation require greater integration with banking applications than before.</td>
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<td>The major ERP vendors are committed to facilitating this level of integration through participation in XML standards groups. Even in the absence of a single XML standard, the largest corporations are requiring their banks to accept ERP formatted electronic payment files in order to achieve straight-through processing. This deeper integration between corporates and banks will remove a significant barrier to companies that want to move toward more B2B electronic payments.</td>
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<td>Sarbanes-Oxley Requirement</td>
<td>The burden for corporate treasury and accounting departments of complying with the Sarbanes-Oxley Act is heavy and is another driver that is causing more companies to consider outsourcing business processes. It is providing another impetus for investment in straight-through processing and elimination of manual tasks that could have a material impact on accounting or financial reporting or both.</td>
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<td>As companies look to automate payments-related tasks, they are provided an opportunity to rethink the traditional method used to pay suppliers and consider how reducing their use of checks (and eventually eliminating them) can contribute to greater levels of control.</td>
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These four forces of change are having a major impact on the electronification of payment practices both in terms of payment mechanisms used by accounts payable and the submission of invoices by suppliers. PayStream Advisors, a leader in business automation concludes from their consulting and research practice that by 2010 the number of B2B invoices delivered in electronic format will exceed the paper invoices (55% electronic, 45% paper). By 2012 the invoice mix will be 65% electronic and 35% paper (Figure 3.2.2).

3.3 Forces of Change Driving New Solutions

To further illustrate this electronification, the four forces have also driven changes in the solutions that are available to buyers and suppliers. While imaging, workflow, electronic invoice presentmen tand payment (EIPP) tools and ERPs themselves provide automation and other operational efficiencies, they also require significant capital expenditures. Other options that provide these benefits but without significant investment are now available. The option receiving the most traction is the cardless payment account and it is revolutionizing the paymentspace.

Cardless payment accounts can be integrated with existing business processes but result in paper-free supplier payments. All of the purchase-to-pay processes can remain in place including purchase orders, goods receipts and invoice processing. The only thing that is truly changed is the payment method.

A leader in B2B payments is U.S. Bank Corporate Payment Systems with their cardless payment account offering, U.S. Bank Access® Online Payment Plus. Not only can this solution be easily integrated, it offers increased automation, increased control, reduced risk, enhanced working capital and additional opportunities for revenue sharing.

Instead of issuing checks, ACHs or wire payments, approved supplier payments are initiated by the buying organization using payment instruction files that are routed through Access Online, straight-through to the suppliers. Only at this time are cardless payment accounts opened and limits increased to the amount of the approved purchases. When not in an active payment status, accounts are temporarily closed and remain dormant without any approved purchase dollars. These dynamic account settings provide the additional control long sought by auditors and risk managers because they prevent unapproved purchases from ever being placed on the cardless payment accounts. It also facilitates the payment of larger-dollar invoices on the cardless payment accounts. In fact, cardless payment accounts, including single-use accounts, can easily handle payments of all sizes with reports
of transactions ranging from just a few dollars to multi-million dollar payments.

Suppliers receive an e-mail notification to process the payments and use their existing point-of-sale processes, so there is very little change management involved. Each notification also includes full remittance details so the supplier knows exactly how to apply the cardless payment account payment within their accounts receivable system. These suppliers also gain the efficiencies of removing paper checks from their accounts receivable processes while receiving full access to payment funds within three business days which means their collections efforts are eliminated and Days Sales Outstanding are often greatly reduced.

Additional operational efficiencies are gleaned from the reconciliation processes. Once the transaction is processed, it is automatically matched within Access Online to the original payment instruction and can be automatically extracted to financial systems as needed.

Beyond the operational efficiencies, buying organizations also gain enhanced working capital opportunities. Suppliers are paid timely with the cardless payment accounts but repayment to U.S. Bank is cycle-based, allowing the buying organization to hold their cash longer. The buying organization’s cash position is further strengthened by the increased revenue sharing opportunities. Because Access Online Payment Plus is an extension of a commercial card program, clients can easily increase the rebate dollars they earn by converting from other payment methods.

### 3.4 Reengineering Decision-Making

While payment methods continue to evolve, decision-making processes do too. To gather insights on how reengineering decisions are made, MasterCard fielded an internet survey in May 2008. MasterCard interviewed corporate financial executives with a qualitative survey, in effect an “electronic focus group” (Figure 3.3).

The survey findings indicate the major reasons for changing current payables processes are to reduce expense and increase revenue. There were three secondary reasons: reduce risk/increase control, improve cash flow and automate manual processes. The cost of implementing a new system was the most significant barrier to change.

Senior financial management is the primary decision maker for selecting payment mechanisms, with limited input from accounts payable, procurement and compliance.

### 3.5 Representative Case Studies

U.S. businesses have been exploring ways to reengineer business payments for quite a few years. Some of these efforts have achieved significant results in a number of areas:

- Operational savings
- Payment automation
- Risk mitigation
- Supplier satisfaction

To provide further evidence of the change forces, solution selection and decision-making processes, the following are three examples of
ways businesses are using Access Online Payment Plus to reengineer their existing payment process with minimal interruption to their existing systems. (Figure 3.5.1).

**Case Scenario: eProcurement**

In many organizations payment method changes are not pursued because there is not a perceived need or benefit. For other companies change is not pursued because there is fear of losing valuable eProcurement data, especially line-item detail. These perceptions enable less efficient processes such as paper check payments to remain in place. The following scenario illustrates how integrating a cardless payment solution into an existing eProcurement process can support the retention of important payment details while providing greater payment automation.

**Solution**

A large regional healthcare provider wanted to grow their purchasing card program but not at the expense of the eProcurement system data. As a result, traditional checks remained the primary payment method.

When approached about using Access Online Payment Plus for settlement, there was skepticism. However, a phased, pragmatic approach involving the conversion of a few suppliers at a time to the new payment method began to gain traction.

The integration of the cardless payment accounts resulted in better results than originally expected because data integrity was maintained, additional control was added through the cardless solution’s dynamic account features and the buying organization realized the additional rebate from growing their commercial card program. An unanticipated benefit included the additional purchase control gained as the accounts were temporarily closed and did not carry any approved dollars until they were authorized for specific supplier payments by the healthcare provider. Specific outcomes include:

- Increased process efficiency gains by eliminating checks without impacting the existing invoice business processes
- Improved cash flow by using the cardless payment account allowing timely payment to suppliers with repayment to U.S. Bank based on existing cycle terms
- Strengthened cash position fueled by the influx of new rebate dollars, a result of the additional qualifying volume on their commercial card program
- Enhanced buying power supported by full data from every step of the procure-to-pay cycle, Procurement was able to further leverage their data and pursue strategic sourcing relationships

Due to the success of the cardless payment account, the healthcare provider is supporting future program growth by empowering their Procurement group to include the cardless payment accounts in their contracts as the preferred payment method going forward.

**Case Scenario: Beyond Traditional Purchasing Cards**

Purchasing card programs are very prevalent today in organizations of all sizes. Most are proficient at capturing traditional spend
categories such as office supplies with their purchasing cards. By allowing employees to make the lower-dollar and lower-risk purchases with the purchasing cards in their employees’ wallets, organizations are able to avoid many costs such as those associated with invoice processing.

However, there are many purchases that require closer oversight including budgetary approvals and control. These purchases tend to be handled by a multi-step business process involving requisitions, purchase orders, approvals, invoices, receipts and payments. These steps are closely monitored to ensure that purchases follow corporate policies and usually result in paper check payments due to the items that are being purchased and the total dollars due. Most organizations are not able to convert these purchases to card programs and therefore, the inefficiencies of paper-based payments continue.

Solution

A large North American service organization with various operating units across the United States, Canada and Mexico was seeking to grow their already widely successful purchasing card program. They realized that the benefits of payment automation and revenue sharing would bring added efficiencies and cash to their organization. They also did not want to lose control or visibility as a result of any changes.

When presented with a cardless payment solution (Access Online Payment Plus), the organization was immediately interested. The current business processes remained in place with the exception of the payment. By changing the payment method only, the integrity of the purchase orders, approvals, invoices and receipts remained in tact. Some specific outcomes include the following:

- Control was not lost and in fact, it increased because the dynamic account controls only permit payment when authorized for specific payment instructions. High-dollar checks were no longer in the postal system and risk was truly mitigated. Audit, risk and compliance concerns were fully being met.

- Suppliers were not daunted by accepting very large payments. In fact, multi-million dollar cardless payment account transactions are being processed. The benefits to suppliers include reduced Days Sales Outstanding, improved cash flow and reduced paper to process with the removal of checks.

- Additional cash flow was created as the program increased. The organization continued to drive efficiencies and reap the rewards of the revenue sharing program with their issuer. The increased rebate dollars provide additional cash flow to the organization, allowing them to continue to optimize their cash position.

The organization is now targeting additional payments to convert to cardless payment accounts to leverage the benefits across their many operating units.

Case Scenario: Achieving Success Across Organizations

Organizations that enjoy the benefits of a widely deployed ERP system and embrace automation can almost always find room for continued improvement. These business process leaders are not satisfied with the status quo, even when they are firmly entrenched with eProcurement engines, ACH payments and mature commercial card programs.

Solution

A large international retailer specializing in electronics wanted to expand their efficiency efforts. However, they were seeking a solution that would allow them to have a positive impact across the entire organization (Figure
3.5.2), require minimal change management and be completely aligned with their corporate goals...Access Online Payment Plus was the answer.

The existing business processes for purchase orders, invoices, receipts and approvals remained intact within the ERP so the investment in the system and process would not be supplanted by the new payment method.

In addition, enterprise-wide visibility to spend was maintained. Impact to departments such as procurement, accounts payable and all cross-operational end-users, was minimized as they did not have to undergo major cultural changes that tend to occur when payment processes are reengineered.

Benefits include:

- Additional controls of the cardless payment accounts, especially the dynamic account regulation, provided the automation and mitigation of risk desired by the corporate auditors and risk managers to support Sarbanes-Oxley compliance.
- Greater cash float and rebate opportunities enabled Treasury to fund additional corporate development and investments.
- Better process efficiencies were gained by AP as cardless payment accounts became the preferred payment method over checks or ACHs. AP staff no longer had to oversee payment runs or take numerous supplier inquiries regarding the status of payments. Payments were sent directly from their ERP to the suppliers.
- Faster payment and the elimination of manually processing checks drove efficiencies within the supplier organizations as well. Posting payments was greatly improved because every cardless payment account was accompanied by full remittance details including invoice numbers and their corresponding amounts due. Suppliers also enjoyed improved speed-of-pay and streamlined business processes (Figure 3.5.2), positively impacting Accounts Receivable, Treasury and Audit/Compliance.
- Superior reconciliation for both the buying organization and their suppliers. The retailer did not have to follow-up on outstanding checks as most of the cardless payments reconciled automatically. The suppliers received full remittance information with the cardless payments so the application to accounts receivables was streamlined.

Figure 3.5.2
Disciplines Positively Impacted by Cardless Payment Accounts

Buying Organizations
- Accounts Payable
- Treasury
- Procurement
- Audit/Compliance

Supplier Organizations
- Accounts Receivable
- Treasury
- Audit/Compliance
4. B2B Conclusion

The overwhelming consensus of the recent payment industry studies selected for this white paper is that B2B payments continue to transition from paper checks to electronic payments. The advent of cardless payment accounts is clearly leading the way, allowing organizations to reap many benefits and rewards without significant investment of time or funds. Buyer and supplier adoption has proven this to be a viable option and the electronification of B2B payment is expected to continue. As more organizations realize how business processes can be easily streamlined while adding cash to the bottom-line, solutions such as cardless payment accounts are expected to expedite the overall B2B electronic payment transformation.

For more information regarding B2B payment solutions, contact U.S. Bank Corporate Payment Systems at 866-274-5898 or paymentsolutions@usbank.com.