Research Brief

Cross-Border Payments Perspectives

September 2011

Research **conducted by Glenbrook Partners**

GLENBROOK

In conjunction with the Institute of Financial Operations

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Table of Contents

List of Figures

Executive Summary

Glenbrook Partners, in a project sponsored by Earthport, conducted two surveys to develop a detailed understanding of the ideal cross-border payments solution from the perspectives of both payments professionals and payments initiators.

- In March 2011 (Phase 1), Glenbrook Partners conducted a survey of payments professionals, which sought to consider strengths and weaknesses of solutions in the market, as well as characteristics of the ideal cross-border solution.
- In August 2011 (Phase 2), Glenbrook conducted a follow-up quantitative survey and qualitative interviews to gather the detailed perspectives of corporate payments initiators. The information gathered in Phase 1 informed the hypothesis and line of questioning for Phase 2.

Phase 1 Recap: Unmet Needs Drive Opportunities for New Payments Solutions

The Phase 1 Survey generated responses from more than 200 bankers and other payments professionals around the globe, who shared their views on unmet needs and opportunities for further innovation.

Payments professionals perceived the biggest cross-border payment challenges as time required for funds to clear, difficulty tracking payment progress and in-payment reconciliation, and lack of foreign exchange fee transparency. Respondents perceived large corporations, particularly those with their own treasury functions, to be well served by existing solutions. They perceived challenges for smaller businesses, particularly for those making payments of less than $10,000, especially those in the $500 to $2,000 range.

Phase 2 Highlights: Blueprint for Increasing Payments User Satisfaction

The Phase 2 Survey was made available to members of the Institute of Financial Operations, who largely act in the role of payment initiators. More than 60 responses were received. In addition, Glenbrook Partners conducted phone interviews with a subset of respondents to obtain more nuanced perspectives on cross-border payments practices.

In general, the Phase 2 findings validated the findings from Phase 1. The perceptions of payments professionals were closely aligned with the views of payments initiators—though we were surprised at the magnitude of challenges reported even by those companies with mature treasury and payments functions.

The recent corporate payments practitioner survey and interview findings confirmed numerous opportunities for improvement. Changes in cross-border payments could deliver three main benefits: reducing costs (65%), improving payments quality (55%), and improving relationships with suppliers (49%). In addition, the following themes recurred:

- The need for security is a given.
- Cost reduction is a major objective for companies of all sizes—though transaction fees are a bigger consideration than exchange rate impacts.
- Existing solutions are seen as fragmented and cumbersome; they contain multiple process irritations that must be addressed manually, increasing costs.
- Simplified reconciliation is a frequent wish-list item.
- An easy-to-use, cross-border ACH solution continues to generate interest.

Implications for Payments Providers

Analysts often refer to payments as a commodity business. And while many sectors of the payments industry show the unmistakable hallmarks of such—standardized features, price-based competition, low margins—this isn't true for cross-border payments. In fact, most providers in this space enjoy relatively attractive profit margins and do not use price as the primary basis for competition.

The solution providers in this space tend to fall into two groups: (1) banks using international correspondent banking relationships and (2) non-bank providers using proprietary networks to serve end users, but tapping into banking networks for financial settlement. Recently, this latter group has grown considerably with regulation of the new category of PIs (payments institutions) within the Payment Services Directive of the European Commission.

Our research findings are relatively clear: The market is voicing concern over current practices and prices while showing interest in new lower-cost alternatives. A host of products and services—many of them ACH-based—are emerging. Incumbent providers will need to evolve to meet these needs.

We think the opportunities are considerable—one could argue that this is today's largest unsatisfied opportunity in the payments industry. But we suspect that incumbent (bank or non-bank) providers will be caught on the horns of a classic strategic dilemma. Will they follow the market, and risk reducing revenues? Or will newer players, at less risk for loss of current revenue, gain significant share? We suspect that the smarter incumbents will approach this problem through more sophisticated segmentation.

Methodology

Phase 1 Respondent Profiles: Direct Cross-Border Payments Management Responsibility Around the Globe

Glenbrook's Phase 1 survey respondents represent a broad spectrum of international payments interests: banks, processors, cross-border payments solution providers, card issuers and acquirers, remittance providers, consultants, investors, and market watchers. Approximately 86% of the banks and service providers responding offer foreign exchange services for their customers. More than half (56%) of respondents indicated that cross-border payments were one of several services they offered, while approximately 12% indicated it was their primary business.

More than 200 individuals completed the payments professionals survey; many took the time to provide qualitative as well as quantitative input. Survey respondents included 173 banks and other payments service providers as well as 28 users, consultants, investors, and other participants in the payments industry. The typical respondent had direct management responsibilities related to international payments. More than 50% of responses came from companies headquartered outside the U.S.

Phase 2 Respondent Profiles: Direct Responsibility for Managing Cross-Border Payments

Phase 2 respondents from the Institute of Financial Operations membership are representative of midsized and larger North American corporate payments initiators. More than 80% represent the Accounts Payable function in their businesses; most are accounts payable managers or supervisors. In smaller companies, the finance manager or CFO responded to the survey.

More than 50% of payments initiators indicated that cross-border payments are of interest to their financial management teams.

Figure 1. Survey Respondents—Payments Practitioners (Phase 1)

Job Title/Role

n=229

Figure 2. Survey Respondents—Corporate Payments Initiators (Phase 2)

Note: Many corporate respondents declined to share demographic information about their companies.

What is the total number of employees in your company?

Answer Options	Response Percentage	Response Count
1–25	10.3%	4
26–199	10.3%	4
200–499	7.7%	3
500–2,000	33.3%	13
Over 2,000	38.5%	15

n=39

What is your company's annual revenue?

Answer Options	Response Percentage	Response Count
$0 to $49 million	20.0%	8
$50 million to $249 million	15.0%	6
$250 million to $499 million	17.5%	7
$500 million to $999 million	12.5%	5
$1 billion to $5 billion	25.0%	10
Greater than $5 billion	10.0%	4

n=40

Where is your company headquartered?

Answer Options	Response Percentage	Response Count
United States	78.6%	33
Europe	7.1%	3
Canada	4.8%	2
Asia	2.4%	1
Australia/New Zealand	2.4%	1
Middle East	2.4%	1
Africa	2.4%	1

n=42

Industries represented

Industry	Response Count
Manufacturing	10
Financial services	6
Other	6
Professional services	5
Retail	3
Computers	3
Services	2
Healthcare	2
Transportation	2
Utility	2
Pharmaceutical	1
Wholesale trade	1

n=43

Background: Cross-Border Payments

Globalization is driving corporations to transact more frequently across borders. Casual observation, as well as data from myriad public and private sources, confirms this. But consumers are also transacting more on a global basis—buying from foreign eCommerce sites; traveling, living, and working abroad. For the payments industry, the result is higher volumes of payments—in terms of both currency value and number of transactions. Interestingly, this is also leading to a consequent shift downwards in the average value of these payments.

As this paper will show, the ways these payments are made can be cumbersome, error prone, and expensive. Growth, after all, is often messy. Payments systems set up decades ago continue to be used—sometimes retrofitted, sometimes force-fitted—to meet the needs of modern corporations. And, not infrequently, the systems creak and groan as they bear the strain.

For users of these systems, on both the paying and receiving sides, it can be difficult and time consuming to learn how to use cross-border payments tools, and how to set up processes to make optimal use of them. Solution providers (both banks and non-banks) also face challenges, struggling to cobble together old systems to meet new demands. But for these providers, cross-border payments are both lucrative (especially given foreign exchange conversion revenue) and rewarding, in terms of the overall financial relationship created with the end customer.

The challenges for global payments are not simply those resulting from volume increases. A number of economic, political, and technical forces are changing the types of cross-border transactions conducted. Consider these factors:

- Corporations are making more cross-border purchases of services (as opposed to goods), as well as more purchases of complex fabricated parts rather than simple raw materials.
- Enterprises are purchasing from more countries, in more regions.
- Increased outsourcing is leading to new in-country and new cross-border intracompany transactions.
- More enterprises are participating in complex, automated supply chains, which in some cases drive automatic ordering and fulfillment.

- Online purchasing continues to grow, both by large enterprises as part of an automated procurement systems and by smaller enterprises purchasing directly.
- There is continued growth in the use of cross-border labor.
- Individuals are increasingly taking their investments abroad.

Categories of Cross-Border Payments

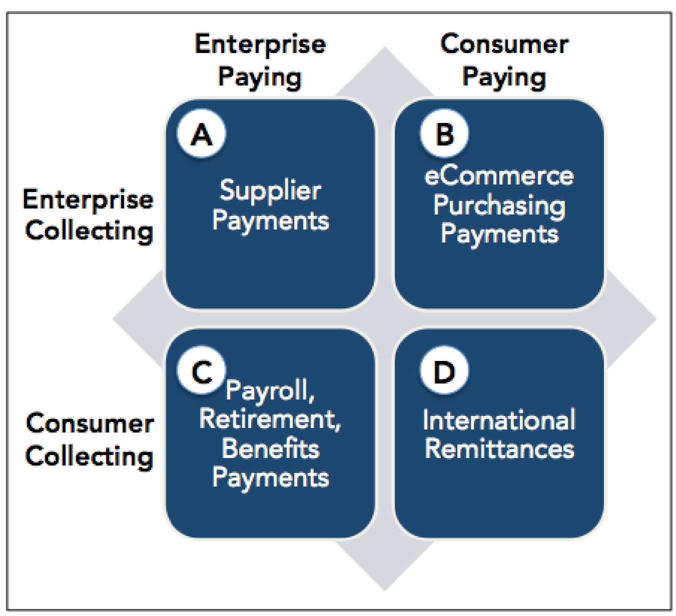
A) **Supplier, or B2B, payments** are made when one enterprise pays another. These payments may be made to regular, well-known parties or to occasional or one-time suppliers. In these transactions, the supplier frequently extends credit to the buyer—or may demand a letter of credit or other form of credit assurance.

B) **eCommerce purchasing** includes not only the purchase of physical goods (with all of the challenges of shipping, customs, and taxation) but also the travel and entertainment, digital services, and digital goods domains.

C) **Payroll, retirement, and benefits payments** are made by enterprises to counterparties in other countries. The payees are most often individuals, but this category can also include various B2B-like payments to licensees, franchise participants, and digital contract laborers.

D) **International remittances** are payments made by foreign workers to family members in home countries. As any given worker is apt to make payments to only one country, this domain is measured by country pairs, or "corridors."

Figure 3. Four Major Categories of Cross-Border Payments



Size of the Cross-Border Payments Market

The cross-border payments market is very large. For the purposes of this analysis, we are excluding settlement of financial market transactions, but the four categories described above can be sized using publicly available sources:

A) Supplier, or B2B, payments are financial transactions associated with import of goods and services. Sources put global imports at approximately US$13–15 trillion.[1] Payment revenue associated with these transactions, which includes both fees and FX components, is a rich source of earnings for global correspondent banks.

B) The bulk of eCommerce transactions are domestic; that is, consumers and businesses buying from eCommerce merchants based in their own countries. However, approximately 15% of eCommerce transactions are made by overseas buyers. This is fueled by large eRetailers in developed markets that localize their sites for sales to consumers in rapidly growing markets such as China and Brazil. In some markets (e.g., Canada and Australia), cross-border eCommerce is as high as 40%.[2] PayPal reports that nearly 25% of its transactions are cross-border; a significant portion of its volume is eCommerce, although it also handles significant B2B and remittance payments.[3]

C) Payroll, retirement, and benefits payments to current and former employees living overseas are a relatively small but constant component of corporate payroll. In addition, affiliate/royalty payouts are growing and expanding in scope to support global online advertising networks and application marketplaces, as is the use of overseas contract labor for activities such as software development.

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[1] Two different estimates of global import values:
$15.1 trillion 2009, World Trade Organization.
$13.6 trillion 2009, World Bank.

[2] *Australia:* 40% of online consumer expenditures in Australia are to overseas sites; Frost & Sullivan, July 2010. *Canada:* Foreign online spending (purchases made from non-Canadian sites) was 39.7% of all Canadian eCommerce in 2009, down from 43.3% in 2007; Statistics Canada, September 1, 2010.

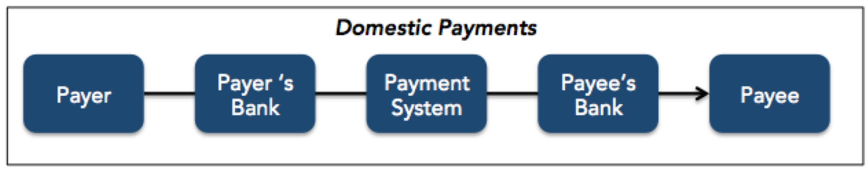
[3] PayPal Q2 2011 "Fast Facts."

D) Remittance payments to developing countries from foreign workers to friends and family in their native countries totaled $325 billion in 2010, according to the World Bank. Remittances to developing countries are expected to exceed $400 billion by 2013.[4]

Cross-Border Payments Options

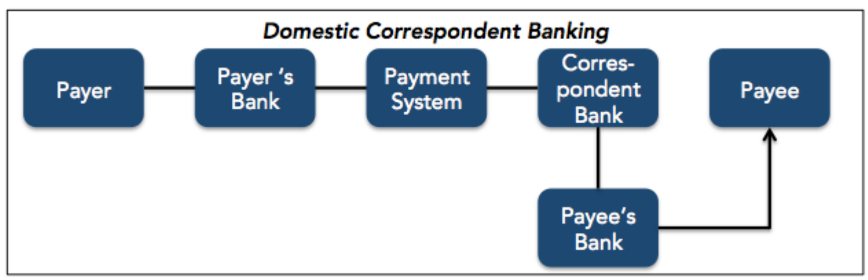
Domestic payments are most typically effected through open loop payments systems within each country. These systems may be paper-based, such as checking, or electronic, such as ACH, Giro, or debit card systems. Open loop payments systems depend on both the payer's bank and the payee's bank belonging to the same system (Figure 4).

Figure 4. Open Loop Domestic Payments Scheme



In cases where one bank does not belong to the system, that bank uses a *domestic correspondent bank* to act on its behalf (Figure 5).

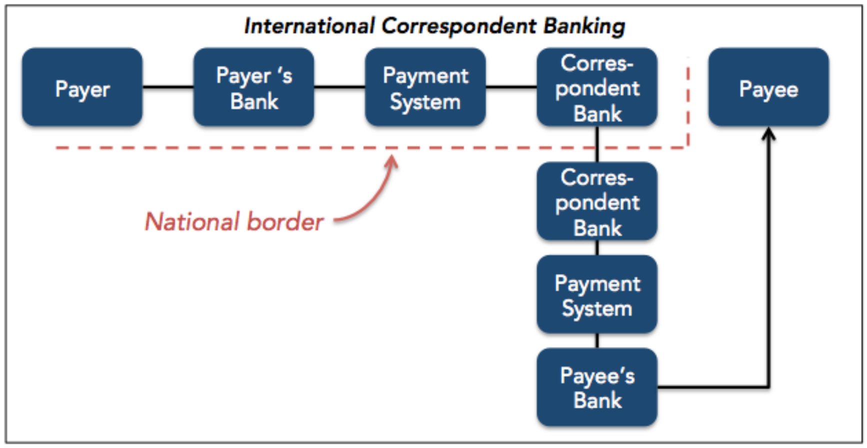
Figure 5. Domestic Correspondent Banking



Cross-border payments are complex because national payments systems do not support, as a general rule, direct participation by banks in other countries. Therefore, *every* non-cash cross-border transaction must be handled through international correspondent banking networks in one manner or another. If the end parties are dealing directly with their banks, they use the international correspondent banking system (Figure 6). (Alternative ways of effecting these transactions, without using international correspondent banking on a transaction basis, are discussed on page 14.)

[4] Latest, post-economic crisis, global remittance data and projections by the World Bank: *Migration and Development Brief No 16*, May 23, 2011.

Figure 6. International Correspondent Banking



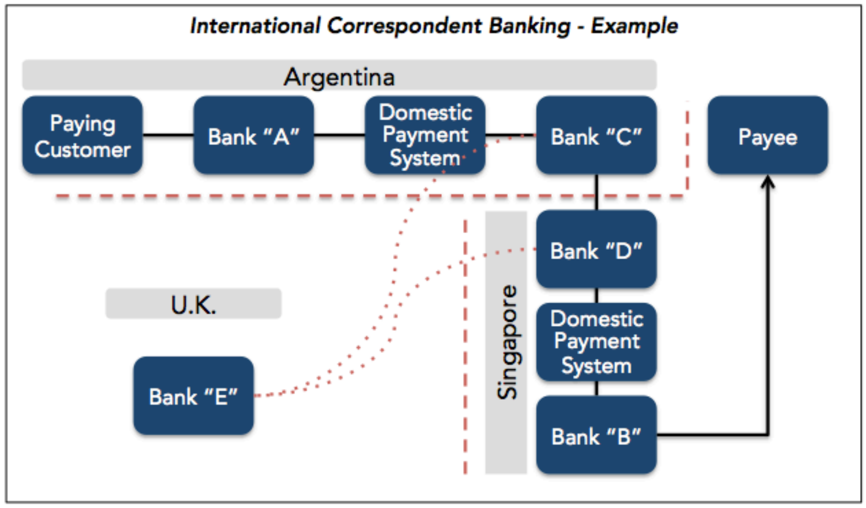
How International Correspondent Banking Works

International correspondent banking is, in essence, a giant, decentralized network. Each bank makes a decision as to how it wants to handle cross-border payments for its clients. These decisions can be—and often are—different for paying and receiving funds, and for different countries or categories of payments (e.g., B2B payments vs. person-to-person remittances).

Let's look at an example. Bank A, in Argentina, has a domestic customer that wants to send funds to a supplier in Singapore. That supplier has sent its customer the details of its bank account at Bank B in Singapore. Bank A receives the payment instructions from its customer (through its online banking system). Bank A has chosen a domestic correspondent in Argentina, Bank C, to handle these payments; it makes a payment to Bank C through its in-country wire transfer system. At this point, Bank A is finished! Bank C has an arrangement with Bank D in Singapore to handle such transactions. Bank C notifies Bank D that it wants a wire transfer sent from Bank D to Bank B, to credit Bank B's customer. Bank D effects the transaction and Bank B receives funds—which it credits to its customer's account.

All pretty straightforward—but one piece is still missing. Bank C has the money and Bank D has sent it out—how are these positions settled? In this example, as a part of their correspondent banking relationship, Bank C and Bank D have agreed to settle their transactions daily, on a net basis, by making funds available/withdrawing funds from a set of accounts both banks hold—in this example—at Bank E, in London.

Figure 7. Example—International Correspondent Banking



In each bank, there is a correspondent banking department staffed with people who have to keep these settlement transactions straight. Just to make it fun, these bankers speak Latin: the accounts are known as nostro accounts (our account with you) and vostro accounts (your account with me).

When considering how this works, keep in mind that each bank is making an independent decision about how to send, receive, and settle payments. The possible combinations and variations are staggering.

SWIFT

What makes it possible for this complex system to work at all is the SWIFT communication system. SWIFT is not a payments system, but rather a standardized messaging system that banks around the world use to tell each other what they have done and what they want done with these types of transactions. SWIFT provides the message codes and protocols that help Bank D understand the transaction that Bank C has sent it—so Bank D can act accordingly. (SWIFT is a cooperative owned by its member banks; it supports not only correspondent banking but also securities trading.)

More Payments Options

We haven't yet addressed the actual systems used to make the payments. In our example above, the payment between Bank A and Bank C was done via wire transfer in the domestic Argentinean system. Similarly, the transaction between Bank D and Bank B was done via wire transfer within Singapore. Bank A's customer probably thought of the whole transaction as a "wire transfer payment." It was, of course, a series of transactions rather than one single payment.

There are other options for both parties. Transactions on either side could be effected by ACH or Giro systems in that country—if the transaction instructions specified that, and if the correspondent banking relationships between the various banks agreed to accommodate it.

Checks and Balances

It is also possible to make—or receive—cross-border payments by check. To do so, a paying enterprise must decide whether it is paying in its own currency or in the currency of its counterparty. If the former, the foreign recipient will need to deposit the check in a local bank (Bank B)—which will need to arrange, through correspondent relationships, to collect funds on that check from Bank A. If paying in the counterparty's currency, the paying customer must either have an account in that currency (upon which to write the check), or use a bank or non-bank service to handle the transaction.

Wires and Cross-Border Payments: Overkill?

It is interesting to reflect on why wires became the *de facto* standard for cross-border payments. For most of the twentieth century, domestic correspondent banking relationships, particularly in countries such as the U.S., primarily served the check-clearing needs of smaller banks. Relatively rare cross-border transactions were similarly handled with checks—or with specialized drafts incorporating some form of credit assurance, such as banker's acceptances or letters of credit. As cross-border trade grew, and the SWIFT system developed to communicate bank-to-bank instructions, wires remained essentially the "only game in town"—the only electronic way to effect the domestic pieces of cross-border transactions. The ACH systems, working almost entirely in batch processing mode, were simply not up to par.

This use of wire transfers, of course, was in many ways a case of overkill. The domestic wire systems were developed primarily for use in financial market transactions—with exceptionally high security and immediacy of payment, qualities not necessary for most cross-border supplier payments. But banks in the international correspondent banking "chain" had no way to tap into a domestic payments system electronically. So wires—with prices reflecting their high-security, high-immediacy systems—became the standard.

If one were to design a cross-border payments system from scratch today, linked ACH-to-ACH systems would most likely be used, and energetic and admirable efforts to do so are underway (IPFA et al). Their eventual success, of course, will depend on changing the embedded practices of banks worldwide—a daunting prospect.

Challenges in International Correspondent Banking

There are great advantages to users of the current system of international correspondent banking. As virtually all banks participate in some manner, it is global by definition, broadly understood within the banking industry, and comprehensive in its reach. Such a decentralized, nonstandardized approach has inherent problems, however—problems that can cause pain for some corporate and retail customers. Challenges include:

- **No direct relationship with downstream banks.** If a problem occurs (for example, a payment is not received), the sending company—and its bank—may not be able to trace the transaction quickly or reliably.
- **Cost.** With multiple banks involved, each charging a fee and/or taking some share of the foreign exchange revenue, these transactions can be expensive for end users. Often, end users do not know whether costs are also assessed to their counterparties.
- **Limited data transport capabilities**. The payment initiator may wish to send information with a transaction; with multiple bank intermediaries involved, it may not be possible to reliably carry that data through to the receiving party.
- **Barriers to change**. In a decentralized system, it is relatively difficult to implement change. There is no central authority to mandate or direct new processes. Of course, we should acknowledge that SWIFT does play an important role in enabling change through setting and promoting new standards. But it cannot dictate the terms of correspondent banking relationships—so that there is no uniform way, for example, for a sending bank in one country to change the ways in which payments are made by its correspondents in receiving countries. For example, attempts to migrate more transactions to ACH from wire still demand tedious and laborious point-by-point negotiations and implementation procedures.

Alternative Cross-Border Payments Methods

The correspondent banking example we describe above is one in which both the paying and receiving parties deal directly with their banks. There are also many different types of alternative services that handle cross-border payments for payers and/or payees. As a group, these services effect the payment transaction for one or both end parties through proprietary systems and networks. They then settle the transactions financially by dealing with correspondent banks themselves, frequently on a net basis. These services fall into several categories:

- **International money remitters.** Companies such as Travelex and Western Union offer branded payments services to consumers and enterprises, usually with a variety of "money in" and "money out" options. Some banks, most notably Citibank with its WorldLink service, offer similar productized alternatives to traditional correspondent banking services. Some of these companies offer such services to both enterprises and banks—in effect outsourcing some aspects of international correspondent bank relationship management.

- **Payments services providers.** An emerging—and evolving—group of providers, such as Earthport, offer account-based payments transaction services for both end users and banks.

- **Global card networks.** Card networks including MasterCard, Visa, and American Express create the effect of seamless cross-border payments transactions. "Under the hood," the card networks handle foreign exchange conversion and settlement among participating banks, which are required to follow the networks' operating rules.

- **FX brokers.** In many countries, these brokers supply the needs of high-volume cross-border payments transactors, bundling management of foreign exchange conversion risk with the mechanics of payments.

- **Online payments services.** Services such as PayPal and Moneybookers are similar to the international money remitters, but focus on online-originated transactions, often (but not always) linked to online purchases.

- **Global payments gateways.** Businesses such as Global Collect, Digital River, and CyberSource (now owned by Visa) specialize in helping eCommerce merchants collect funds from cross-border customers. The paying customers, usually consumers or smaller businesses, can use familiar local payments systems to effect the payments.

- **Global ACH.** This term is used somewhat loosely to refer to efforts to connect domestic ACH or Giro systems in various countries. The IPFA (International Payments Framework Association), with the support of players including the U.S. Fed and the European processor Equens, is working on protocols to enable one bank's customer to pay a foreign bank's customer through linked ACH. Note that notwithstanding the use of terms such as "global ACH" and "international ACH," there is no single global ACH payments scheme. IPFA, for example, primarily sets standards. Individual end users, and banks, must still establish business relationships with other participants in order to take advantage of existing capabilities.

A great deal of innovation in cross-border payments exists among these alternative service providers, some of which, for example, are experimenting aggressively with the use of ACH/bank transfers as alternatives to wires, perhaps because their proprietary end-party relationships give them a global view of payments opportunities. (Consider, for example, that in traditional correspondent banking, each individual bank makes correspondent decisions based not just on payments, but on a variety of financial transaction types within the overall correspondent relationship. Alternative service providers, however, may take much more of a "service acquisition" point of view in arranging settlement capabilities.)

Alternative service providers face challenges, however, in accessing their markets. Many business payers think first—and only—of going to their bank to initiate cross-border payments. Although high-volume payers are becoming increasingly aware of alternative services, awareness remains an issue for many alternative service providers.

Survey Findings

Payments Practitioner Perspectives

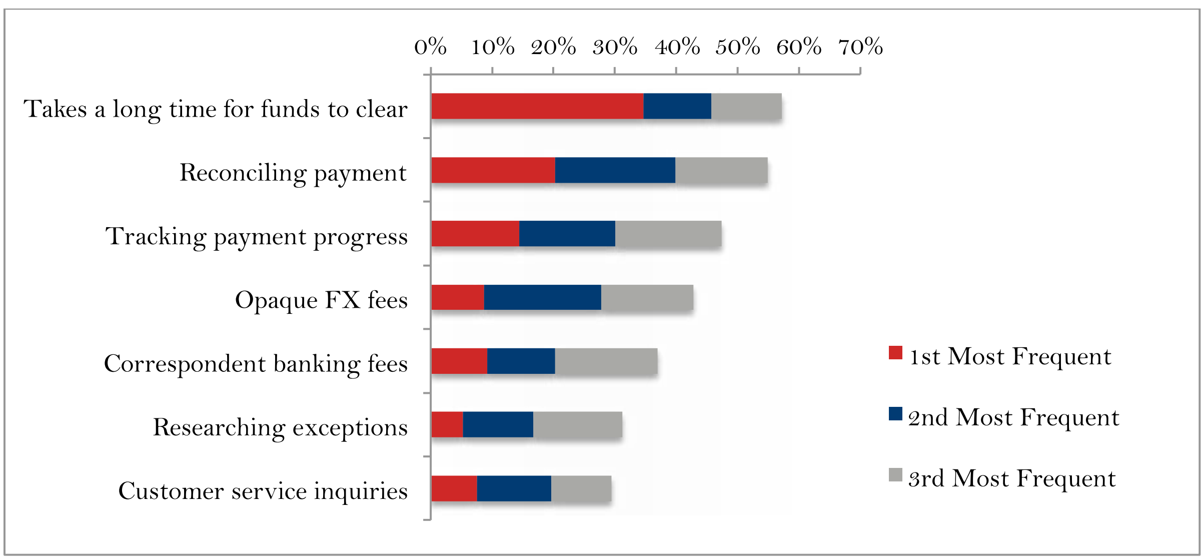
Spurred by efforts to connect domestic ACH payments schemes worldwide and other innovations in the international payments services arena, in March 2011 Glenbrook Partners conducted a survey of *Payments News*[5] readers, sponsored by Earthport. The objective was to understand current views on the services and features that financial institutions, payments services providers, vendors, and others consider most important for managing cross-border payments. The responses from experienced payments professionals from around the globe highlight unmet needs and provide guidance for innovation.

Challenges

A key goal of the survey was to understand how payments professionals viewed the cross-border payments challenges of corporate users. Banks and payments providers saw the biggest cross-border payments challenges faced by their corporate payments users as the time it takes for funds to clear, payment reconciliation, tracking payment progress, and lack of foreign exchange fee transparency:

Figure 8. Provider Perception of Corporate Challenges

Banks and payments service providers were asked, "What do you think corporate payments users feel are the biggest cross-border payments challenges?"



[5] Glenbrook Partners publishes *Payments News* (PaymentsNews.com), culling the most important payments industry updates each day. The publication reaches more than 12,000 subscribers.

Large Corporations Perceived as Well Served; Challenges Remain for Smaller Businesses

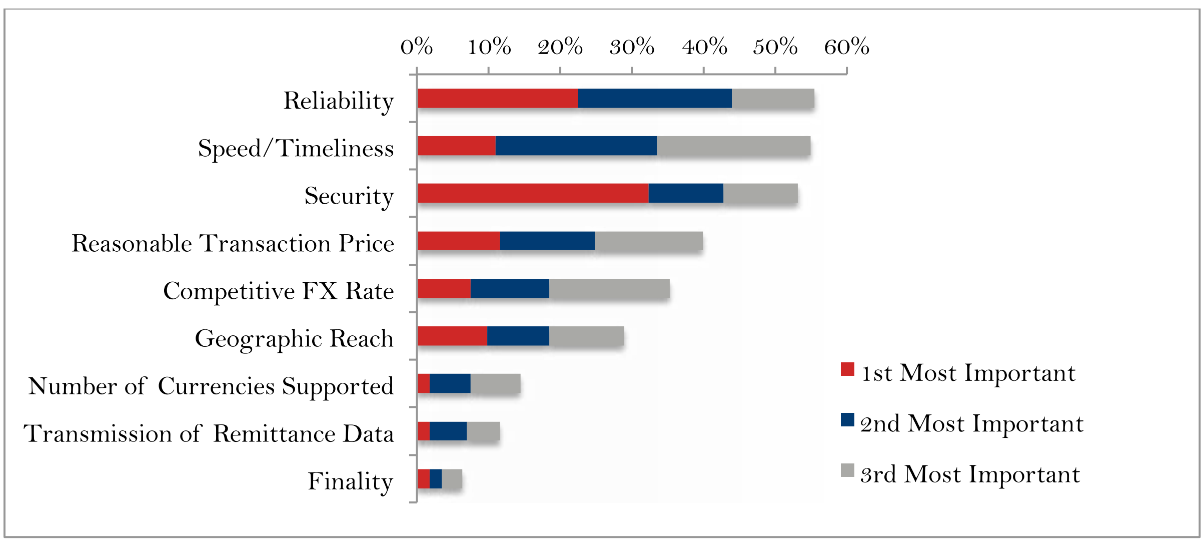
Respondents saw cross-border solutions as "pretty good for large corporates" and "businesses with their own treasury functions," but a problem for small-to-midsized businesses. At the other end of the spectrum, "low-end" international payments (typically under $500) were reported to be reasonably well served by PayPal and card networks, though some took exception to pricing. Frustration was strongest for payments in the "sub-$10,000 level, especially in the $500 to $2,000" range.

Efficiency and Pricing Remain Ongoing Concerns

Today's landscape is sometimes seen as a "confused choice of options for different purposes, destinations, amounts." Solutions are frequently viewed as "fragmented" and "cumbersome." Consolidation has been "slow to materialize," though it is expected to increase in the future. A number of respondents commented that pricing remains too high for cross-border payments. Specific areas of concern included sending U.S. dollar payments internationally, the number of currencies supported, and the cost of sending funds to destinations outside primary international payments corridors.

Figure 9. Provider Perception of Corporates' Preferred Features

Banks and payment service providers were asked, "What payments features do you think are most important to corporate payments users?"



Most Important Cross-Border Payments Considerations

Banks and payments providers identified the three most important cross-border payments features as reliability, speed/timeliness, and security (Figure 9).

Consistent with challenges previously noted, survey comments reiterated the importance of "reasonable" pricing and foreign exchange rates. There is also growing interest in use of mobile and online technologies for authentication and confirmation.

The "Dream Cross-Border Payments Solution"

In general, the cross-border payments arena is seen to be improving, but not quickly enough to keep pace with emerging needs. Many feel that the technology exists to address the current needs but that "the challenge is to provide true business interoperability at the policy, legal, and operational levels."

Simply stated, the ideal cross-border payments solution would be an easy-to-use, highly reliable system that could "route payments around the world through a variety of networks to provide the cheapest and most reliable route to the destination," resulting in "predictable access to funds." The perfect solution would enable "corporations to accept payments from consumers and businesses in surrounding and farther afield markets from the same provider as their domestic payment services."

Participants would like to move away from reliance on wire transfer systems, especially for mid-value international payments. They would like to see common standards applied, determined by clear business rules, preferably instituted by industry standards bodies (e.g., NACHA in the United States). However, there was some skepticism among survey respondents about whether banks would be willing to implement such solutions, particularly where they might cannibalize more lucrative revenue streams. It was suggested that perhaps "a group of vendors" might be able to offer the desired set of international payments attributes.

The ideal solution would entail a simple initiation process, offer full compliance with U.S. and international regulations, and "support the world's most relevant currencies" (though some would argue for an even broader range of currencies). Furthermore, this idealized solution would be easily incorporated into current accounts payable processes, provide integrated remittance details, and be flexible enough to minimize exception processing. Tracking would enable visibility of payment status from origination to final settlement.

Additional features might include enabling mobile phones for authentication, confirmation, or other information delivery.

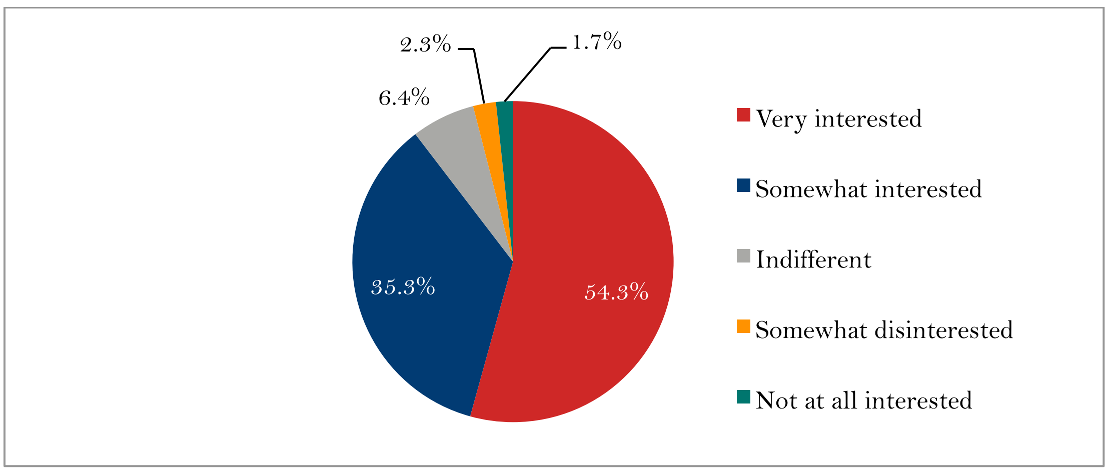
As summed up by one respondent, “Payments businesses seem to be in a constant state of flux and innovation due to changes in regulation, business economics and usage, and access preferences of end-user customers.” The shifting landscape “provides an interesting opportunity for innovators.”

Strong Interest in ACH-Enabled Solutions

One approach to realizing this idealized cross-border solution is to link existing domestic ACH payments schemes. As Figure 10 shows, there is strong appetite for cross-border payments solutions that connect local ACH/EFT schemes around the world for high-volume, low-value payments. Such a solution, if it could be made reliable at scale, would have the potential to be very popular. An overwhelming majority of survey respondents believe that the market is “very interested” (54%) or “somewhat interested” (35%) in this approach:

Figure 10. Market Interest in ACH-Enabled Solutions

Banks and payments service providers were asked, “Do you think the market is interested in cross-border payments solutions that connect local ACH/EFT schemes around the world, providing reliable, low-cost payments for high-volume, low-value cross-border transactions?”



Corporate Accounts Payable Perspectives

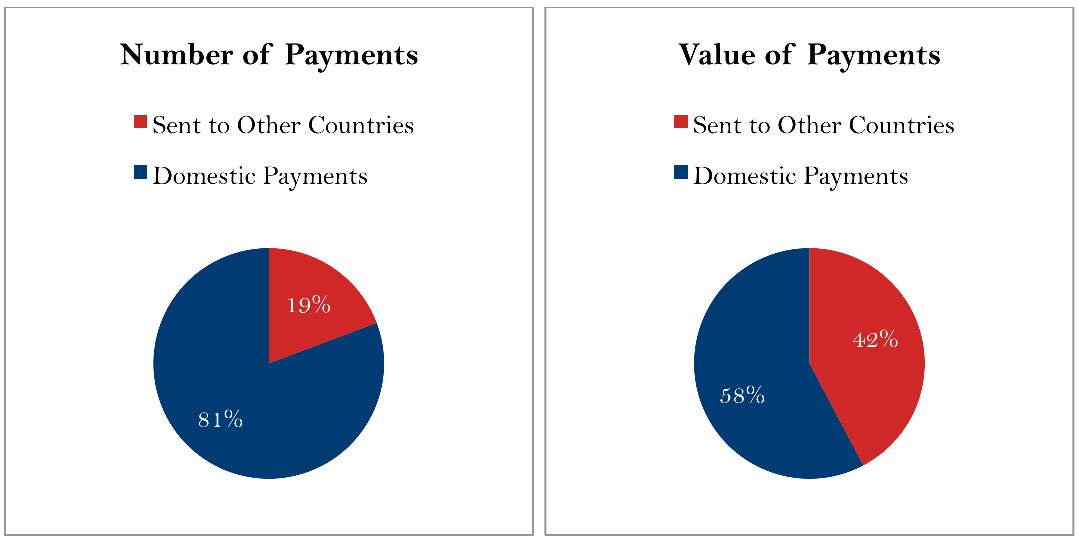
Cross-Border Payments Practices

Note that the majority of Phase 2 survey respondents are located in the United States; the results may therefore not be representative of global cross-border payments practices. Moreover, the sample size was relatively small, making conclusions directional rather than statistically valid. However, the results of the payments initiator survey are closely aligned with both the payments professionals survey data and anecdotal insights gleaned through our recent work in this area.

During the summer of 2011, Glenbrook partnered with the Institute of Financial Operations to survey corporate payments practitioners about their experience with cross-border payments. We sought to validate the findings from our Phase 1 survey of payments professionals and gain a more nuanced understanding of the perspectives of corporate payments practitioners.

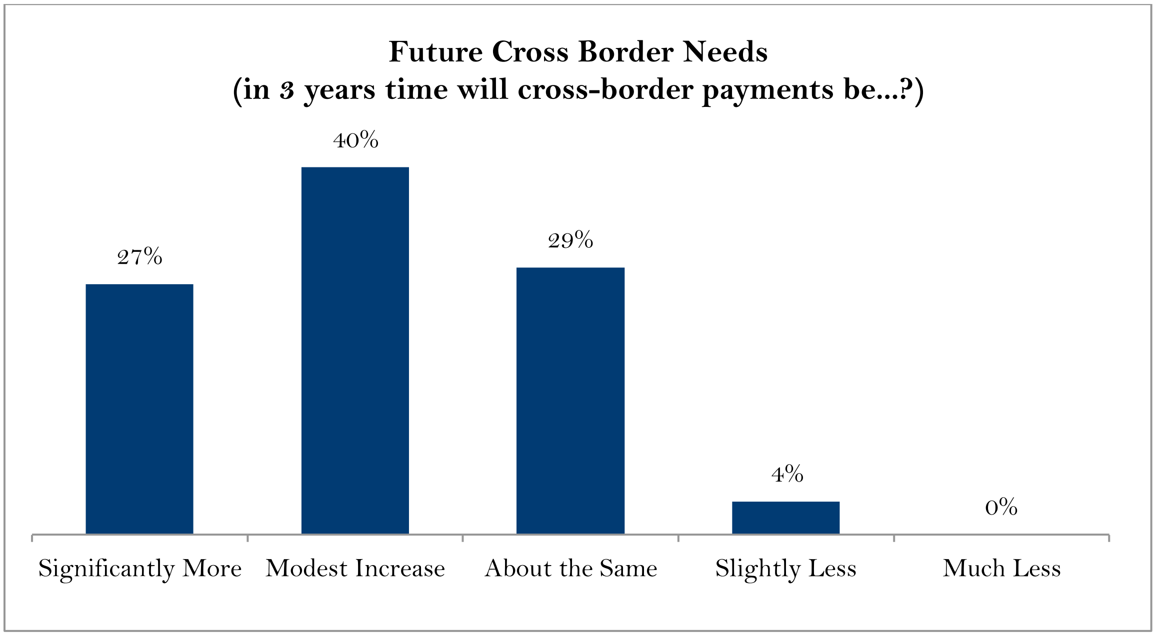
Survey respondents indicated that approximately one out of every five outgoing payments are sent to cross-border destinations. These transactions represent a disproportionately high value: on average, 19% (by number) and 42% (by value) of outgoing payments are sent to other countries:

Figure 11. Domestic vs. Cross-Border Payments



More than two thirds of respondents anticipated that their cross-border payments needs will increase over the next few years (Figure 12). Twenty-seven percent of corporates indicated that their cross-border payments needs will be “significantly more” in three years’ time:

Figure 12. Increasing Demand for Cross-Border Payments



Respondents' top trading locations (destinations to which they send funds) are Canada, Germany, and China. When asked which three countries will have the most cross-border payments growth in three years, the top responses were Canada, China and India (Figure 13):

Figure 13. Current and Future Trading Locations (by Country)

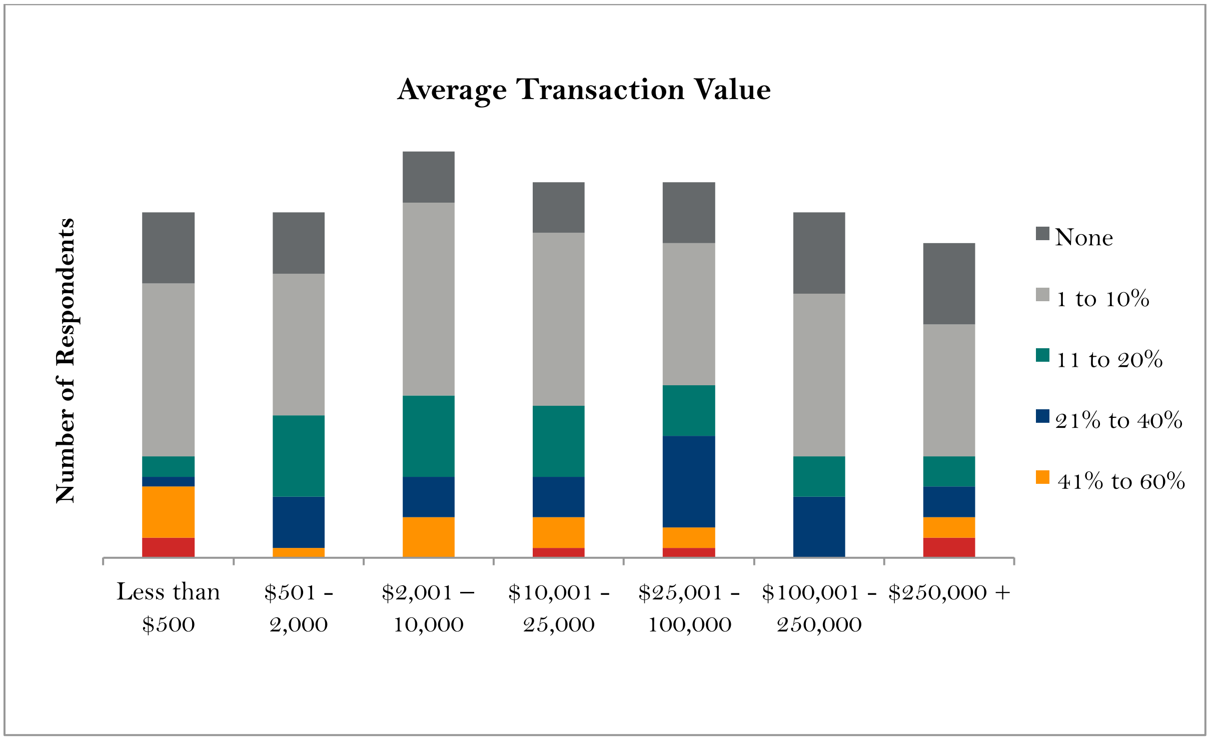
#1		#2		#3	
CURRENT CROSS-BORDER PAYMENTS NEEDS: **Top three trading locations today?**					
Canada	29%	Europe	9%	China	14%
Germany	7%	Canada	7%	Canada	12%
China	4%	Germany	7%	Japan	7%
FUTURE CROSS-BORDER PAYMENTS NEEDS: **Which countries do you anticipate having the most cross-border payments growth in the next three years? (Rank #1, 2, 3)**					
Canada	17%	China	11%	Canada	7%
China	17%	India	9%	India	5%
India	5%	Canada	7%	China	3%

Respondents' "top three currencies" included a range of more than15 currencies. However, the most frequently traded currencies—by a large margin—were U.S. dollars, euros, British pounds sterling, and Canadian dollars.

Cross-Border Transaction Value

The majority of cross-border transactions are between $500 and $100,000 in value (Figure 14). A relatively small number of respondents indicated that more than 60% of their transactions were less than $500 or greater than $250,000. Not surprisingly, larger companies are most likely to make higher-value (greater than $250,000) payments overseas. But even mid-market companies (revenue $50–499 million) indicated that they make large payments regularly. Smaller companies reported the highest proportion of smaller-value payments.

Figure 14. Average Cross-Border Transaction Value

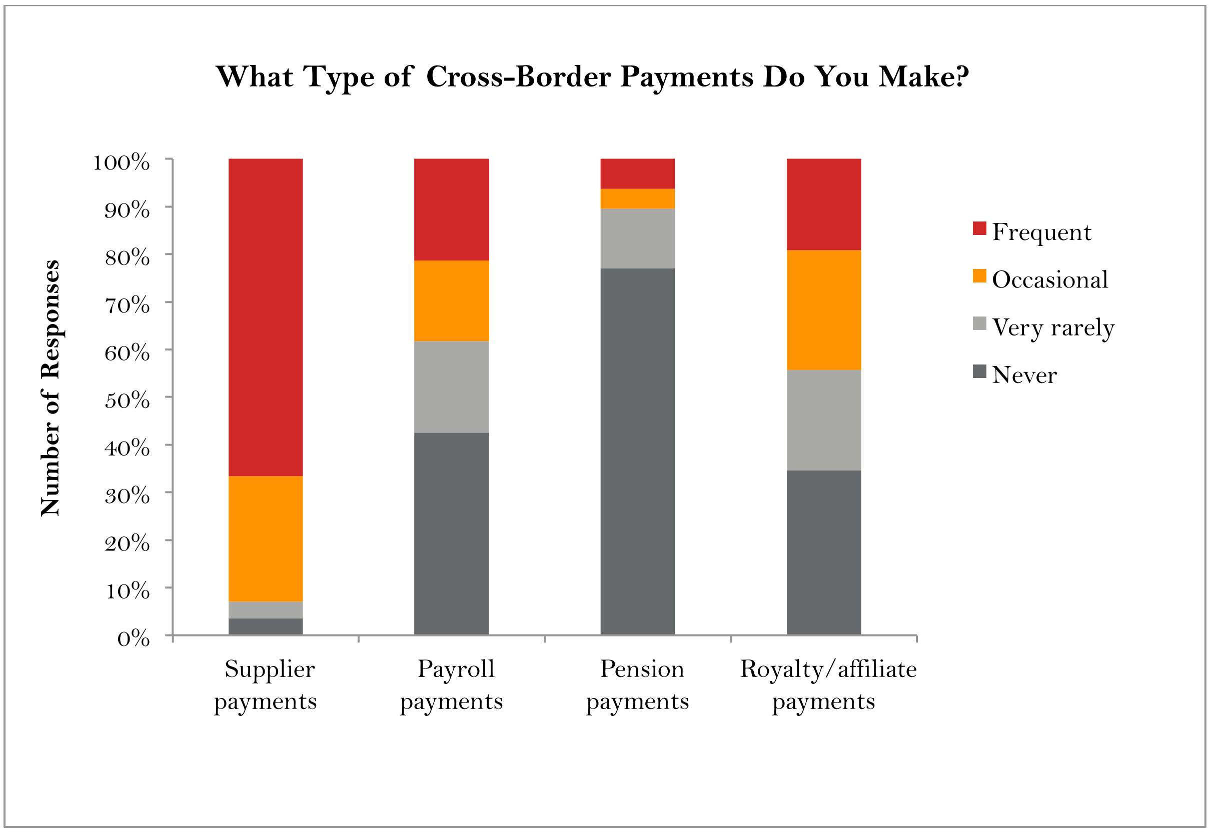


As shown in Figure 15, most cross-border payments are to suppliers. Approximately 94% of respondents make frequent or occasional cross-border supplier payments. This proportion was consistent regardless of size of business.

The second most popular form of cross-border transaction is for royalties/affiliate payments, which may be paid to individuals or companies; 44% of respondents make frequent or occasional royalty/affiliate payments. The majority of these transactions are traditional royalties paid to channel partners. However, due to the rise in application marketplaces (e.g., smartphone and tablet computer applications, social network games, etc.), Glenbrook has observed an increase in demand for smaller-value cross-border payments to support payouts to application developers. In addition, the rise of online advertising networks has increased demand for payments to both traditional media companies and website and blog publishers that host text and banner ads on their pages. Larger companies (those with revenues in excess of $1 billion) were more likely to pay affiliates overseas; smaller companies made none or only occasional payments of this type.

Pension and payroll payments are another important category of cross-border payments. Smaller businesses were more likely to have frequent cross-border payroll payments (33%) than was the overall respondent pool (21%). More than three-quarters (77%) of respondents never make overseas pension payments.

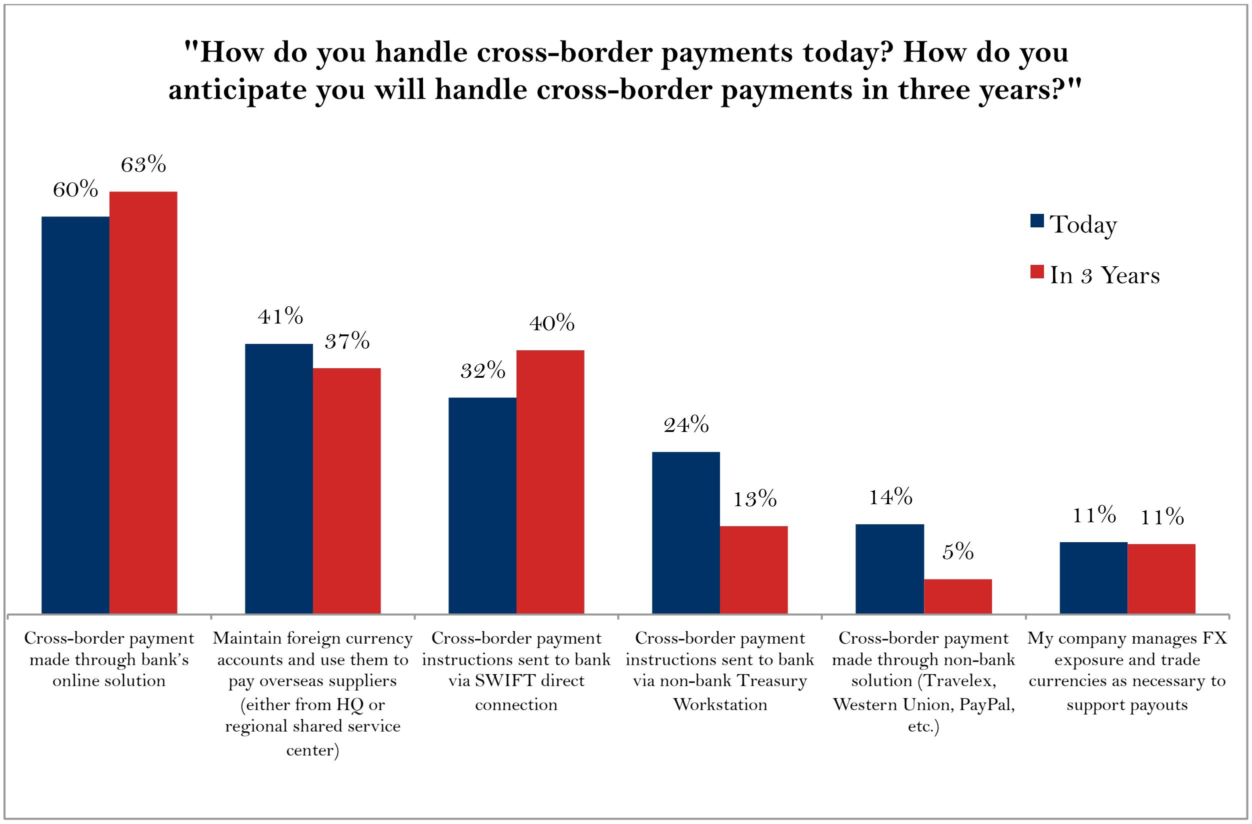
Figure 15. Nature of Cross-Border Payments



Payment Methods

Approximately 60% of payment initiators make cross-border payments through a bank's online presence, 40% maintain foreign currency bank accounts, 32% send cross-border payment instructions to a bank via SWIFT direct connection, and 24% send instructions to a bank via a nonbank treasury workstation. When asked to anticipate cross-border payment methods in three years' time, corporate payers indicated a slight increase in use of bank online solutions and a slightly more pronounced increase in use of direct SWIFT connections to transmit payments to banks. Corporate payers anticipated relying less on treasury workstations (from 24% to 13% in three years' time) and non-bank solutions such as Western Union and PayPal (from 14% to 5%).

Figure 16. Current Payments Methods

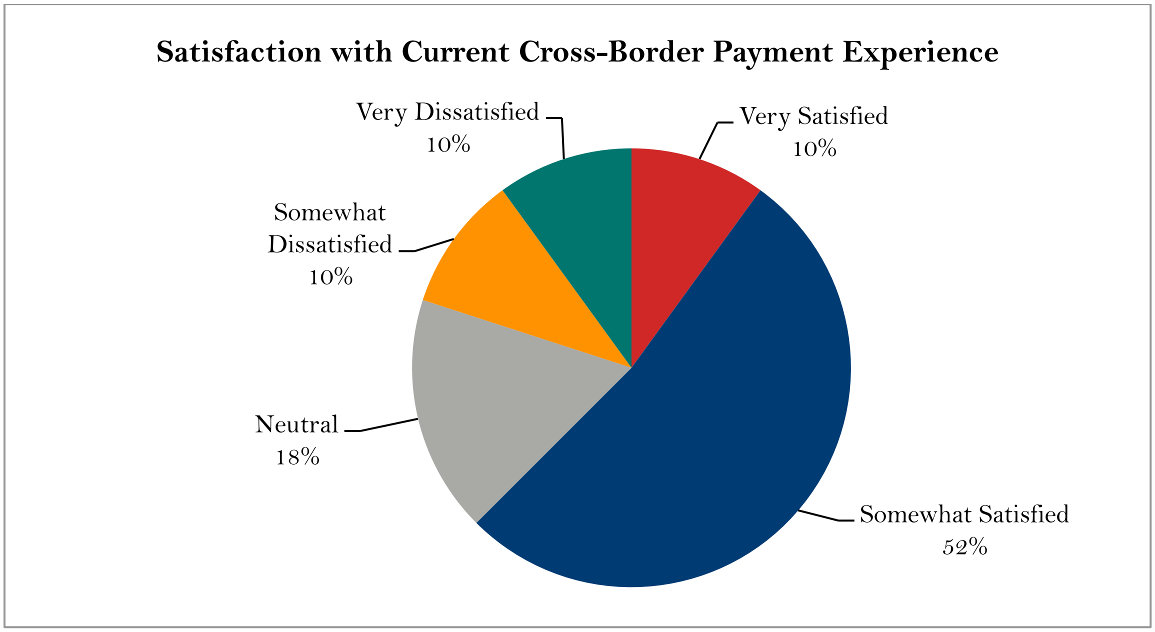


Respondents were instructed to select all methods that apply today or that they believe will apply in the future. Since many use more than one method, totals exceed 100%.

Satisfaction with Cross-Border Payments

Only 10% of corporate payments initiators were "very satisfied" with current cross-border payment experiences, while approximately half of respondents indicated that they were "somewhat satisfied" (Figure 17). This correlates with Glenbrook observations of and interviews with corporate users. Though corporate payments users do the best they can with the tools available to them, they are hampered by a complex ecosystem of interdependent ERP/accounting packages, payment approval workflow, treasury, and procurement processes and technologies.

Figure 17. Satisfaction with Current Cross-Border Payments Experience



In the Users' Words: A Composite View of Existing Challenges

An overwhelming majority of corporate respondents indicated that security is the most important cross-border payments feature. Qualitative comments underscore this point:

- "Need for security is a given."
- "System needs to accommodate multiple approval levels."
- Some concern about vulnerability in an all-encompassing solution: "I like the idea of a uniform solution but am concerned it might make it more accessible to thieves."

The corporate responses closely correlate with payments providers' perception of corporate needs (refer to Figure 9). Providers most often ranked security as the most important feature, and accurately identified reliability and timeliness as key attributes for corporate users.

Figure 18. Most Important Features, from the Corporate Perspective

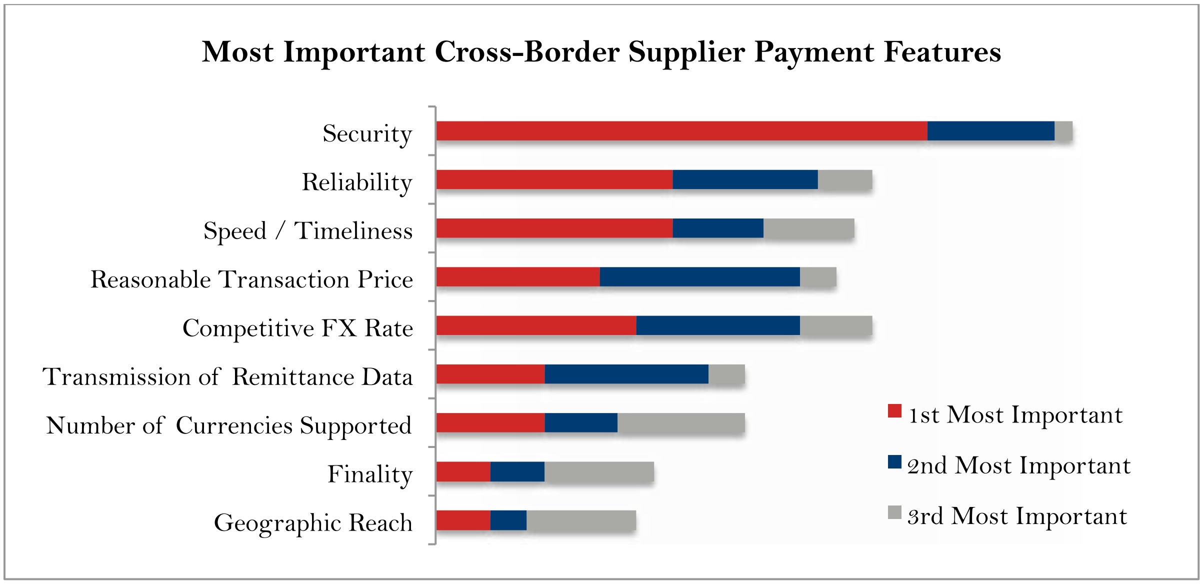
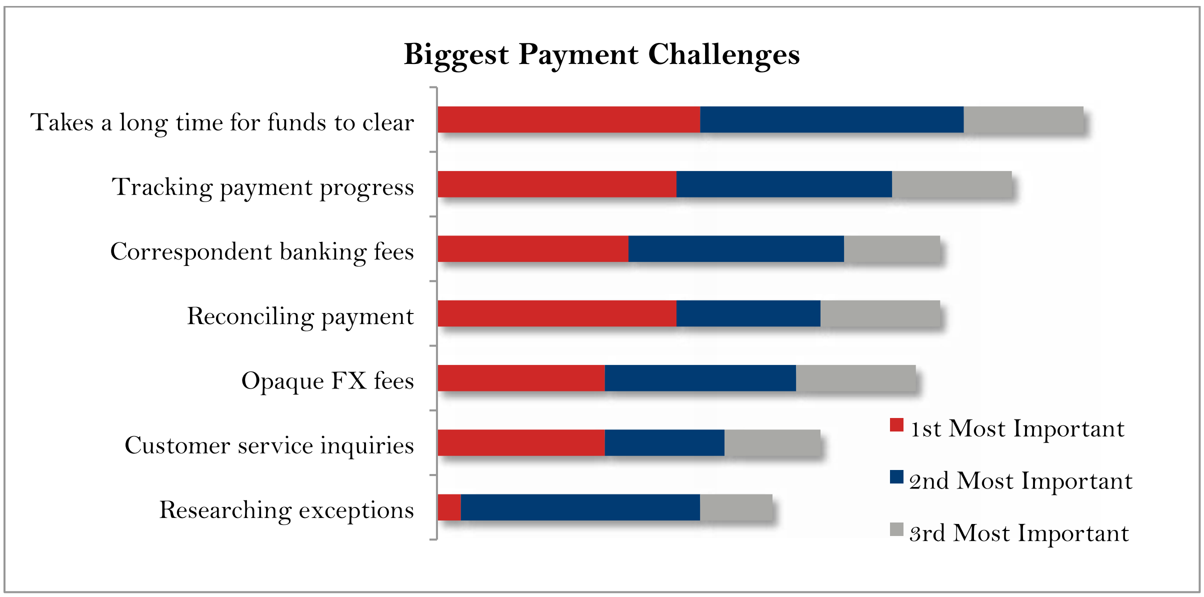


Figure 19. Cross-Border Payments Challenges, from the Corporate Perspective



Cost reduction is a major objective for companies of all sizes—with transaction fees a more important consideration than exchange rate impacts. From an accounts payable perspective, the cost of currency conversion is incorporated into the supplier cost, as the invoice value is entered in domestic currency into the accounting system. Transaction fees are more visible and therefore managed more closely. However, a survey of corporate treasurers would likely reveal higher sensitivity toward foreign exchange (FX) spreads; the treasurers are responsible for higher-value FX transactions, often in support of larger purchases or of a number of invoices in a given currency.

Once again, payments providers demonstrated that they are well attuned to corporate needs by correctly identifying more sensitivity to transaction fees than to FX spreads (see Figure 9).

Qualitative feedback from corporates underscores this distinction:

- "Transaction fees more of an issue than FX spreads."
- "Wire transfer fees are particularly an issue"—both sending and receiving overseas funds.
- "Incoming cross-border fees are a major irritant, often charged regardless of originating currency."
- "American Express makes it easy"; "no fees for cross-border transactions, just FX"

Some corporates identified transaction timing as a key feature, particularly as prompt payment is often associated with early payment discounts. Unpredictable payment timing and slow receipt of invoices via international post exacerbates the process challenge of obtaining discounts.

- "Would like to decrease late fees and take more early payment discounts."
- "There can be hidden costs when payments are slow. "Speedy processing saves money (for example, if invoice is received on Day 8 and payment needs to be received by Day 10 to get a discount)."

Today's cross-border solutions are seen as fragmented and cumbersome, containing numerous process irritations that require manual effort and increase costs for the corporate payment initiator.

- Corporates must use multiple solutions to effect cross-border payments; no single solution can optimize fees, FX spreads, and supplier requirements. A combination of bank services, treasury technology, accounting systems, and exception processes—often dependent on Excel spreadsheets and ad hoc reports—support corporate payments to overseas suppliers.
- Tracking payments is a challenge: "For wire transfers, I don't feel I can tell the vendor when the payment will be there."
- "It's time consuming to handle each wire individually."
- Cross-border payments "are becoming and more prevalent, but our system isn't configured to handle them properly."
- "Checks sent overseas never seem to make it there except for Canada."

- "We've had some issues with items going through our treasury workstation being paid twice because invoice numbers were not entered."

A better means of reconciling payments is high on the "wish list" of corporate payments initiators. This problem is multifaceted. Payments initiators often must use a different process for cross-border transactions than for standard domestic payments. This nonstandard process typically involves manual reconciliation of cross-border transactions, initiated via a bank website or by the Treasury Department, with open invoices in Accounts Payable. On the receiving side, the supplier needs data on what payments are for, in order to close out invoices in its receivables system. Often this data does not travel reliably with funds.

- "Need the backup to explain why funds might be deducted from payment—such as for damaged goods."
- "Can't make the payment side better and the reconciliation side worse" because it passes the problem on to key suppliers.
- "Foreign currency payments are outside of Accounts Payable until they are completed by Treasury."
- "Raw materials payments may have 48-hour terms buying commodities on the exchange. The biggest issue is internal tracking."

Ideal Solutions: The "Dream Cross-Border Payments Solution" Revisited

In an earlier section we explained that payments professionals saw the ideal solution as an easy-to-use, highly reliable system that can "route payments around the world through a variety of networks to provide the cheapest and most reliable route to the destination," resulting in "predictable access to funds." The perfect solution would enable "corporations to accept payments from consumers and businesses in surrounding and farther afield markets from the same provider as their domestic payments services."

The views of the payments initiators echoed those of the payments professionals, though payments initiators included more detail. The ideal cross-border payments solution "should be a platform that offers faster payment processing with lower charges across the globe." "The closer to wire without being a wire and at the cost of ACH is the ideal. In other words, to reach multiple currencies with ACH cross-border payments at materially lower transactions cost, FX aside."

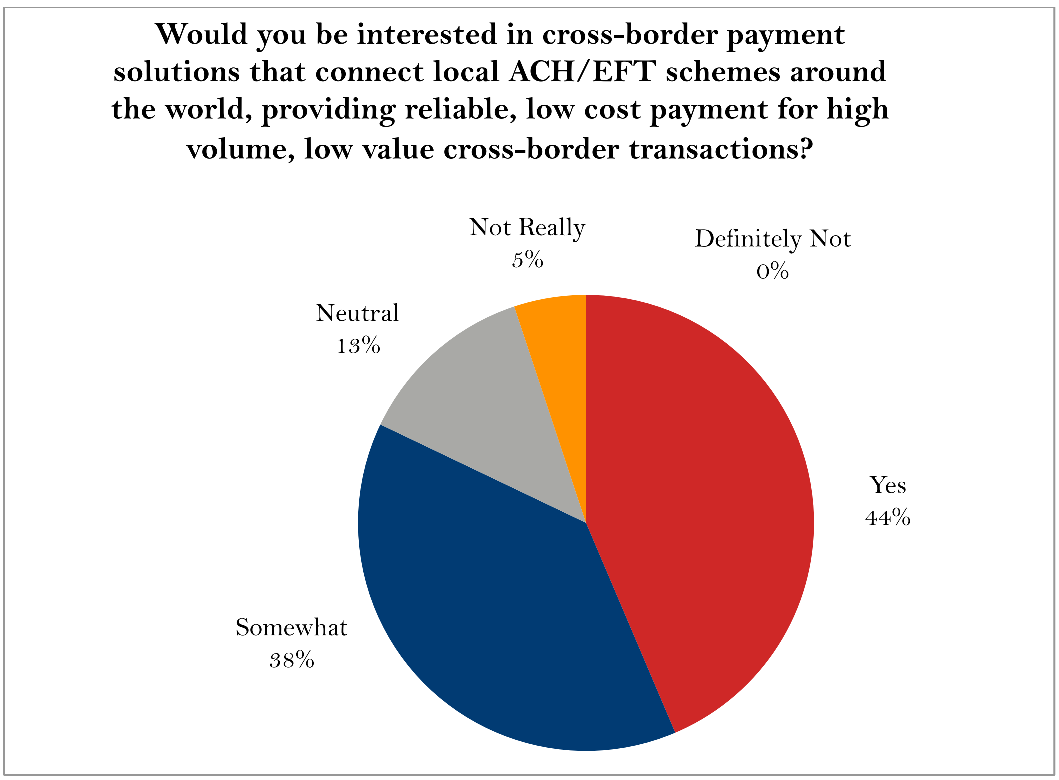
Such a system would "be fairly easy to implement, and would work with our ERP systems" and "would report data required for Form 1042."[6] It would include a "tool that can manage keeping up with all the different country banking rules, and all we have to do is send payment instructions that say who and how much."

Strong Interest in ACH Solutions

The majority (85%) of Phase 2 corporate payer respondents indicated that they were "very interested" or "somewhat interested" in cross-border payments solutions that connect local ACH/EFT schemes around the world, providing reliable, low-cost payment for high-volume, low-value cross-border transactions.

This is nearly the same level of interest indicated by the payments professionals surveyed in Phase 1.

Figure 20. Corporates Demonstrate Strong Interest in ACH-Based Cross-Border Solutions



Qualitative comments underscore the interest:

- "It would be cheaper to send, give us a good exchange rate, and make it easier to track payment status."

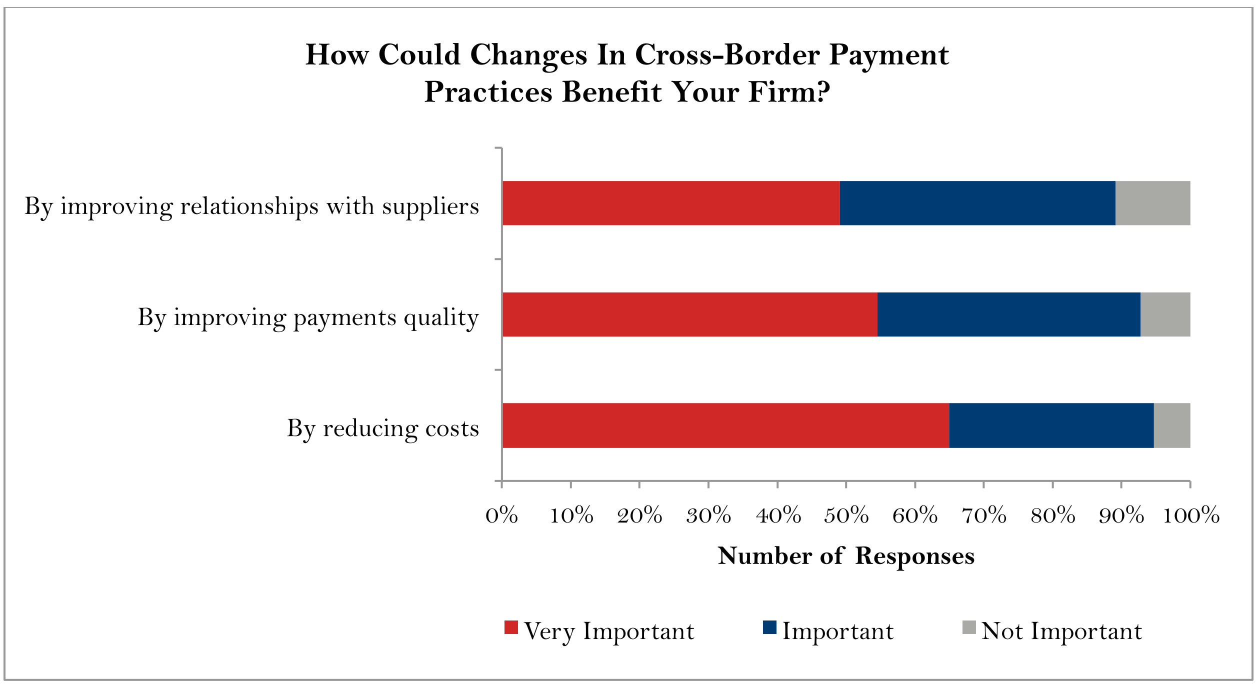
[6] The U.S. Internal Revenue Service requires that companies complete Form 1042 annually to report tax withholding on U.S. income paid to foreign persons, including nonresident aliens, foreign partnerships, foreign corporations, and foreign estates and trusts.

- "Would enable one solution for all the countries we deal with."
- "The reach of wire at the cost of ACH would be the ideal."

There is a strong interest among corporate users in ACH—largely motivated by an expectation that cross-border ACH transactions will be priced similarly to domestic ACH transactions. Yet process and regulatory challenges accompany international transactions, driving up bank costs for those transactions. Despite these operational challenges, there is clearly demand for more affordable cross-border payments.

In addition, there is strong interest in consistent and predictable payments processes regardless of destination. Corporate payments initiators are frustrated by having two processes—one for domestic transactions and another for cross-border transactions. The inherent complexity of correspondent banking (and the handoff of transactions from one bank to another) make payments tracking difficult, though industry participants and SWIFT endeavor to address this need.

Figure 21. Corporate Benefits Associated with Changing Cross-Border Payments Practices



Implications

Cross-Border Payments are Ripe for Change

Cross-border payments today demonstrate a perplexing contradiction. Corporate payments initiators are underwhelmed by cross-border payments solutions, but simultaneously indicate a preference to continue to pay via their banks. It may be that they cannot imagine an alternative.

Yet the inherent complexity of international correspondent banking, and the resulting inability to predict payment timing or track wayward transactions, may drive further dissatisfaction as cross-border payment volumes increase. Tolerance for inefficient and costly solutions will diminish as volumes increase, particularly as anemic economic recovery further drives cost-cutting and reduces back-office staffing.

The disconnect between corporate payment initiators' ACH cost expectations and the operational reality of payment via international correspondent banking is likely to cause consternation for bankers in the next few years. Product managers in the ACH disbursement silo—eager to solve for corporate needs—may inadvertently challenge the revenue expectations of their wire and correspondent banking divisions. Such internal conflicts could delay bank action, enabling non-bank providers to fill the gap despite corporates' stated preference to obtain payments services from banks.

Glenbrook Perspective

New technologies, including modular services and APIs, may be the key to masking process complexity and knitting together disparate domestic payments schemes to overlay a consistent payments experience with predictable outcomes.

Globalization is focused primarily on the so-called BRIC countries, and our survey results indicate that China and India are particularly important supplier locations. There is an opening for providers that can deliver easy payment to suppliers and other counterparties in fast-growing payment destinations to gain market share and attract loyal customers.

A solution that enables corporate payments initiators to maintain one process for both domestic and international payment destinations, while masking the complexity of cross-border transactions, could disrupt this market and capture significant share.

Recommendations for Payments Initiators

- Understand how your current cross-border payments are being made, by category of payment; determine if higher-priced methods are being used for transactions that do not require these features.
- Demand updates from banks and payments providers on availability of ACH-based solutions for cross-border payments.
- Investigate means of benchmarking FX rates that can be embedded at the time of payment.

Recommendations for Payments Providers

- Develop guidelines for implementation of ACH or other lower-cost payments methods, based on payment and client type.
- Participate in emerging trials and pilots of global ACH-based systems.
- Take advantage of new wire formats for remittance data, to ensure that payments that do need to be made by wire are full featured and can be appropriately priced.

Information

Upcoming Research from Glenbrook Partners

Q4 2011	*Who's In Charge of Payments? Corporate Organizational Structure & Responsibilities*
Q1 2012	*E-Invoicing from the Supplier AR Perspective 2011*
Ongoing	Glenbrook's eCommerce Market Analysis Reports are designed to help U.S. companies better understand eCommerce markets around the world—why they might be attractive expansion targets, what makes them unique, what payments options are necessary to reach the broadest possible cross-section of online buyers, and which payments providers can help companies enter the market. So far we've covered Argentina, Brazil, China, India, Mexico, Poland, Russia, South Africa, South Korea, and Turkey.

About Earthport

Earthport offers a range of white-label cross-border payments services to help banks and other commercial organizations simplify processing, lower costs, and improve service levels. The company also makes international payments for small businesses, corporate clients, and banks on a pay-per-transaction basis. Earthport services are based on the epClearing system, which can make direct-to-account payments in more than 60 countries and territories globally. Earthport was awarded the Best Alternative Payments Programme award in the prestigious Card and Payment Awards 2011.

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Learn more: Earthport.com

About the Institute of Financial Operations

The Institute of Financial Operations is the umbrella group encompassing four organizations for finance professionals: International Accounts Payable Professionals (IAPP), International Accounts Receivable Professionals (IARP), the National Association of Purchasing and Payables (NAPP), and The Association for Work Process Improvement (TAWPI).

Headquartered in Orlando, FL, the Institute serves as a global voice, chief advocate, recognized authority, acknowledged leader, and principal educator for people in financial operations around the world. Its products and services are particularly focused on accounts payable, accounts receivable, automation, document management, and procure-to-pay.

Under the Institute, the affiliates share one board of directors, one staff, and a portfolio of member benefits, including the *Financial Operations Matters* magazine and news portal. Offerings include conferences and events, career development, volunteer opportunities, online tools and other leading-edge resources, and educational offerings including e-learning and certification.

The Institute of Financial Operations
IAPP | IARP | NAPP | TAWPI

Learn more: FinancialOps.org

About Glenbrook Partners

Founded in 2001, Glenbrook Partners focuses exclusively on payments consulting. In addition to acting as consultants, each of Glenbrook's principals has long experience as a senior executive in the payments business, having dealt with both strategy formulation and the day-to-day realities of execution under the pressure of budgets and timelines. Glenbrook helps its clients to track a number of related markets to assess trends, surface opportunities, and identify threats, and then develop aggressive responses to these forces. The company is able to do this by bringing to bear a valuable combination of specialized skills in payments, decades of hands-on experience, and a network of high-level professional relationships.

Glenbrook works across the payments industry—with banks, merchants, billers, processors, networks, alternative payments providers, and a variety of investors—as well as across all payment methods (card, ACH, alternative, Check 21/imaging). We have deep expertise in payment domains including eCommerce, POS, bill payment, P2P, B2B, and income.

Glenbrook is the publisher of Payments News, the "blog of record" for payments professionals, more than 12,000 of whom read it each day. In 2009, Glenbrook launched a companion blog, Payments Views, featuring commentary on the payments news of the day.

Glenbrook's Payments Boot Camp program offers intensive "deep dives" into the world of payments. The Boot Camp is offered several times a year for the public, or as a private onsite workshop. More than 3,000 industry executives have attended to date. We recently launched a series of payments education webinars on special topics and published the book *Payments Systems in the U.S.* See PaymentsEssentials.com for more information on course schedules and book purchases.

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About the Authors

Erin McCune, *Partner*

Erin focuses her efforts at Glenbrook on client engagements in B2B payments, global eCommerce, and the emerging field of social/Web 2.0 payments. She has over twelve years of experience leading increasingly complex B2B payments initiatives for corporate clients and advising financial institutions on the development of their cash management capabilities.

Erin's practice enables her corporate clients to reduce costs and increase working capital through technology enhancements, electronic payments, increased ERP efficiency, and strategic implementation of treasury management solutions. In addition, she helps financial institutions and technology companies develop profitable treasury products that deliver effective results for their corporate customers. Erin's blog posts and articles cover topics related to corporate finance, treasury technology, B2B payments, change leadership, and financial process improvement.

Before joining Glenbrook, Erin was the founder of Forte Financial, a consulting firm focused on corporate finance efficiency, accuracy, and technology. Her work is grounded in proven change leadership and program management methodology, ensuring lasting results. She believes that "great strategy and clever technology solutions are too often casualties of poor execution," and is therefore committed to supporting clients from concept to reality.

Carol Coye Benson, *Founding Partner*

Carol is a founding partner of Glenbrook Partners with over 25 years of experience in product, marketing, and strategy development with leading financial services providers in both wholesale and retail banking.

Before founding Glenbrook, Carol was a managing director of the Global Institutional Services division of Deutsche Bank, in charge of marketing, client online services, and Internet development. At Visa International, she led a group conducting early work on the use of credit cards online, and a project that pioneered database marketing and related consumer privacy issues. Carol also founded and managed Visa's European product development office, where she led a series of electronic commerce and chip-card projects designed to bring European banks online. Prior to her career with Visa, Carol spent twelve years with Citibank, where she managed the development and market introduction of new payments products. Carol began her career as a corporate lending officer for large multinationals at both Bank of America and Citibank.

In addition to her work as a consultant, Carol oversees Glenbrook's unique Payments Boot Camp program, which provides executive training for professionals in the payments industry. Glenbrook Payments Boot Camps are held throughout the year, both as public events and as customized, private sessions for clients.