Payment hubs bring new dimensions to the supply chain

Temenos Opinion Piece

> Banks that used to be focused on competitive advantage are moving towards client enhancement and client experience because it is a competitive world and disintermediation is a real possibility.
>
> Andy Schmidt - CEB TowerGroup

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Introduction

The continued after-effects of the recent financial crisis are forcing companies to re-evaluate how they manage their business and in turn expect more from their bank. Bank ratings are declining, government takeovers are increasing and new market players are emerging. The consequence is that customer confidence continues to decline. As a result supply chain finance solutions are becoming increasingly sophisticated and are proving to be essential in improving corporate liquidity.

Supply chain finance is the end-to-end sequence of financial processes that take place in a commercial transaction. They include the processes associated with the managing of that commercial transaction, ie. sourcing inventory (goods and services) and those that include customer service and retention processes as well as supplier management. It has long been understood that these processes are key to best practice working capital management. Few realised that the credit crunch in 2008 and the cash crisis in 2012 would result in supply chain finance being so crucial to corporates and their corporate banks today. It's importance, is because analysis of where cash is actually coming from and where it is going to and in particular the timing, the value and the accuracy of each cash transaction in each scenario, will determine whether or not an organisation is sustainable by way of cash in the future. However, the opportunity to extend this sophistication at the payment processing stage at bank level has been largely overlooked, until now.

While corporate banking systems have started to embrace supply chain finance solutions and acknowledge their importance, the payments market has also seen the arrival of a new generation of solutions. These systems, known as 'payment hubs' allow banks (and their customers) to benefit from a new unified and agile approach to payments. According to Andy Schmidt, at CEB Tower Group, a payments hub is 'a construct that takes into account the capabilities, restrictions and requirements of a bank's various payments systems in delivering a unified payments capability to end users, leveraging shared services to deliver common functionality across payments types.' So how can these new types of payment system support corporates (and their banks) in increasing their efficiencies and cost savings?

Processed first or last; you decide

Corporations, especially multi-nationals, face a big challenge in managing their supply-chain financing, often with thousands of suppliers across the world in many different currencies. To support this they are able to use advanced software specifically designed to give them a dynamic view. This allows them to move money to ensure their accounts remain in credit or perhaps to fund regional deals.

New types of payment hubs can also support this approach. For example, a key market opening for banks has been providing finance for early payment of suppliers, which allows companies to extend their payment terms while still allowing suppliers to sustain liquidity. This new generation of hubs is sufficiently agile to be easily configured within the bank to enable the development of new products swiftly and support the management of payments dynamically. With this level of control now available, banks can allow their corporate customers to decide when they want their payments to go out. Banks can offer their clients the facility to be processed first or when they require, or enter and store the transactions for later date execution if a balance is not yet available. This allows companies to pay according to their cash positions. It also provides a tool to support supplier relationships, for example the ability to pay early in return for discounts or to withhold payments according to agreed conditions. In addition, hubs can enable corporates to set up regular payments and make changes directly and in real time.

Making Big Data for Payments a reality

Payments hubs are able to also support the opportunities that 'Big Data Analytics' offers to corporates. The last few years has seen payment systems allow bank clients, such as corporate treasurers, to look up current and previous balances with detailed and graphical summaries of individual and consolidated corporate accounts. This functionality can be used to support liquidity management, including understanding surplus/deficit values, viewing the last 'n' days balance summaries, average balances, interest rates on accounts and overdraft limits through intuitive dashboards. Corporates could for example use the information from the hub to anticipate liquidity events over the next few months to allow decisions to be made. It could provide access to consolidated accounts summaries over time and the ability to pull or push funds from or into their own accounts. The data comes from the underlying systems such as information coming through the supply chain finance system or coming through the hub or those systems tied to the hub. These tools can be marketed to corporate clients to support new revenue streams along with client retention. For example, with an advanced payment hub financial institutions can leverage or insulate existing payments types, and present a single interface to the customer online, including for example an option for social media payments.

One system, one view

One huge benefit to banks is the ability to bring their disparate payment systems from all their regional banks together. This function offers significant benefit to international corporate customers. In many banks, the creation of a payment hub coincides with the reorganisation of the payments group so a corporate customer is now able to deal with a single entity for all payment types. Payments hubs, and in particular, enterprise payment hubs, can provide a consolidated view of a company's assets, including incoming payments and accounts payable. This not only gives banks a holistic view to simplify compliance and operational needs but allows corporates to see a true picture of their overall business from a payments perspective and beyond. Having everything able to talk to each other would give insight on overall liquidity needs, payment needs, payment flows, payments you might want to expedite and payments you want to slow.

So therefore an integrated payables and receivables hub can support the supply chain from a payments perspective; highlighting who money is owed to, if there are terms to be taken advantage of which might lead to least cost routing and smart routing. When you look at competition for clients or for new revenues, then tying everything together makes logical sense. In fact, banks and their clients, could eventually use this comprehensive view of payments and balances to better manage risk and liquidity on a larger scale. The data would come from the underlying systems, pushed from disparate sources in supply chain finance or payments. Once aggregated, it could allow users to ask questions and run scenarios.

Multiple territories, one contact

And the advantages of a universal solution don't just stop there. It supports enormously from a customer service perspective, as with one system banks can offer their corporate customers one single point of contact. A universal payments hub and it's single view of the overall corporate customers of a company means that they are able to handle any issues quickly and efficiently both in terms of resolution and from a customer management perspective. With a sophisticated enterprise payment hub, a bank can flexibly respond to their corporate customer's needs through a dashboard where a corporate can see inbound and outbound payments. They can also choose to pay in a variety of ways such as electronic payments, pcards, credit or even by cheque (and with over 50% of corporates in the US alone still paying staff and suppliers through this method this information is key).

This opportunity to support customers through a universal hub approach can be seen from a recent example of a large North American bank which has just reorganised its payments operations. They confirmed that corporate customers like dealing with just one sales person who can offer a full range of payment services and their new system offers this benefit.

Managing risk through consolidation

This universal approach of course also supports risk management. A payment hub should reduce the complexity of processing a payment for a bank and the associated issues. It reduces the systemic risk in the inherent complexity of multiple systems because it enables systems to be consolidated. In fact, if a hub system operates using rule-based conditions, full data integrity is ensured and that any changes and errors can be addressed automatically, without the need for recoding, thus greatly reducing risk and the need for expensive testing. Banks and their corporate customers therefore reduce the likelihood of systems downtime, an issue that we have recently seen. This idealistic universal approach may be out of reach for some banks at present however, it should not be dismissed as this is what the future will hold: 'If I were building a bank from scratch, I would want to be able to see a bank in a common way and how it is tied together' says Andy Schmidt from Tower Group 'It's a lot easier to manage certainly from a security standpoint in terms of fraud and AML. Certainly easier to manage from a liquidity perspective, because I can see everything that's going on, instead of having dark corners that I might miss but it is a different kind of banker that would see that value'.

Real-time payments can also support the supply chain

Real-time payments processing is inevitable. We are increasingly seeing countries across the globe moving to this channel. Real-time gives corporations much more control over their destiny and can support liquidity; the ability to make instant decisions based on cash positions for example. However, without a payments hub, real-time and forecasting requirements are high to ensure risk is managed properly, for example what if a corporates inbound payment is delayed but an outbound isn't? This would be a real problem; without the ability to tie all the elements together then a complete picture is not available and errors will occur. A payments hub enables these elements to come together and of course enables corporates (and their banks) to make real-time decisions.

The missing link

So the advantages of having a bank who uses a payment hub can be vast, but can a payment hub fit within the actual supply chain process? A hub can combine payment processing with information, so the purchase order travels to the supplier and back again with the goods and an invoice. Tying the information to the payment creates value and saves on the costs of manual processing and reduces reconciliation. Hubs provide banks with the opportunity to improve revenues by offering corporate customers new, chargeable services. Centralised hubs also offer the potential to add valuable services such as fraud prevention, risk management, compliance and data analytics while reducing errors and improving STP rates. Often these added services can pay for the cost of developing a payment hub.

An enterprise hub beyond payments

In summary, an enterprise hub solution could even be used as a tool to bring other systems together to provide a holistic view of a corporates' overall financial position. In fact looking at this broadly, beyond payments an enterprise approach can be used to create a portal interface that brings together information across all financial products for both corporates and consumers. For example, it could show information on credit cards, mortgages, deposit accounts, this can come together through the underlying core banking system, such as T24, and be delivered through this common portal.

So arguably any system that you want to touch could be accessed by bringing together the systems such as lending, mortgage, payments and elements of the core system. This would benefit a variety of areas throughout the business such as gaining greater revenue through lease cost routing and lines of credit because a more intelligent view will be available. Banks could possibly be supported by the argument that an enterprise system could support payables and being take advantage of trade terms for example the financial benefit of an enterprise solution to address these factors can be easily seen. At present this is unlikely to get past the concept stage as the key elements required are so complex that most banks are not in a position to adopt this approach. However, if banks were to look to pull the data using an enterprise system then the impact on the current systems would be lower and therefore this concept is not unrealistic.

Conclusion

It is widely acknowledged that a corporate banks relationships with their corporate customers is deepened through the introduction of supply chain finance tools. However, with the introduction of a payment hub approach within a bank the benefits to itself and it's corporate customer are greatly extended. The advantages of having full control of a payment are clear. The ability to enable payment prioritisation and deferral along with data analytics tools to support liquidity management can be realised today easily through the roll out of a hub solution. However, if a corporate bank moves to adopt a universal model using common infrastructure, rolling out the payments transformation across the whole business, the true value of a payments hub can be realised for both the bank and their corporate customers. The days of proprietary systems need to be over so we must find a way to be able to use all the information that we have to our advantage. We are at a point in time where the value of the payment data is worth more to both banks and their corporate customer than the value of the actual payment itself.

The ability for a corporate to view their payments business altogether and manage and analyse the business with this information provides endless opportunities from a liquidity and efficiency perspective. And the advantages of a hub don't just stop there. This system will in time be able to adapt to support other areas of a bank and in turn it's corporate customer. After all, by improving the scope and depth of a banks supply chain finance and payment services, they can maintain and expand their relationships with corporate customers against competition from other bank and from non-banks. This is crucial as not only are banks risking disintermediation by new players but the larger corporates have the ability to start to operate their own internal banks and borrow from themselves and even run a payment from a local subsidiary as opposed to through a bank where there is an FX fee involved.

The importance in providing improved corporate products has been acknowledged by Andy Schmidt: 'Our IT Investment Adoption survey has revealed that a lot of the responses from banks that used to be focused on competitive advantage are moving towards client enhancement and client experience because it is a competitive world and disintermediation is a real possibility. So the question isn't if a corporate bank will adopt a payment hub approach but when?

Author

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About Temenos

Founded in 1993 and listed on the Swiss Stock Exchange (SIX: TEMN), Temenos Group AG is the market leading provider of banking software systems to retail, corporate, universal, private, Islamic, microfinance and community banks, wealth managers, and other financial institutions. Headquartered in Geneva with 57 offices worldwide, Temenos software is proven in over 1,600 customer deployments in more than 150 countries across the world.

Temenos' products provide advanced technology and rich functionality, incorporating best practice processes that leverage Temenos' expertise around the globe. Temenos customers are proven to be more profitable than their peers: in the period 2008-2012, Temenos customers enjoyed on average a 42% higher return on equity, a 32% higher return on assets and an 8.1 percentage point lower cost/income ratio than banks running legacy applications.

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