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The squeeze on B2B card payments and the convergence of payment mechanisms

By Alex Hammond | 25 April 2017

Q&A with Alex Mifsud, CEO, & Andrew Auden, Business Development Director, Ixaris Systems

Do card payments make up a substantial percentage of the B2B payments landscape?

Card solutions have always remained steadily in the background, with constant low levels of penetration overall, in the B2B spend volume.

Most commercial card solutions run on an unsecured credit basis, and all companies want to hold on to money longer if they can, so you would assume there is an incentive to make use of these credit lines, but it doesn't happen.

The value equation for those products at the moment is skewed very much towards the buyer. The buyer gets the credit benefit, the buyer potentially gets paid a rebate from the card provider on the transaction, and then the supplier gets hit with the charge for taking the payment alongside overhead costs for hosting card acceptance capabilities.

There is therefore a reluctance on the supplier side to take card payments and corporations are unable to fully leverage credit available to them. Cost challenges and process challenges that make it hard for the supplier to justify accepting cards. That's been the fundamental blocker to card payments getting significant traction in B2B.

There is a range of different payment mechanisms out there but really it's only the card channel that delivers this unsecured lending that the banks are able to extend to the corporations and provide some guarantees to the supplier that no matter what the buyer does they are going to get paid, but there isn't adoption traction because of the cost on the supply side.

2% of global B2B payments happen on cards, and that figure is skewed by the US. Outside the US it's far less, maybe 1% in Europe, fractions of that in other markets.

Where are B2B card payments currently being utilised?

There is a spectrum of payables in an organisation that sits around a classic 80/20 split (80% of invoices representing 20% of spend and vice versa) – actually it skews farther than that in many organisations – which results in a very long tail of large number of invoices of very low value with a wide range of suppliers.

And then a concentrated pool of spend with strategic suppliers, which tend to be less frequent, high value transactions. There are different buying models for those two contrasting ends of the spectrum.

Cards has sat between these two modes. You'd think that they would be great for ad hoc transactions, and they are when the supplier takes the card, but they're not that applicable for the higher transactions because the cost starts to become really painful. These are the suppliers that corporates have the best relationship with, however.

The sweet spot for B2B card payments is therefore low value, high volume transactions i.e. merchants you transact with regularly but for low amounts, where you can create a process that takes account of cost of payment but there is enough velocity in the number of payments that means it makes sense for the supplier to invest in the card acceptance method.

Are banks now realising that there is a flaw in the industry?

The commercial card industry is very aware of this, and in fact things are getting worse, partly because alternatives to cards are improving. There is a squeeze on all sides.

At the moment the industry survives because interchange is high and buyers are highly incentivised to use cards. Even with this incentive, buyers are effectively getting up to 1% cash back, the amount they are able to run through cards is very limited.

If this changes, if interchange for commercial cards gets hit by the regulator for example, then that might be the death of the current rebate-focused commercial model. This is a very important period of uncertainty for commercial card issuers.

What's been the trigger that has increased B2B card payment competition?

There have always been segments of spend in commercial cards, the original segments are fairly static and not under threat. This is typically the cards staff carry to pay for expenses in the field etc. These fulfil a certain purpose, but this market is not growing, and revenues here are under threat from regulators.

The big growth area, and the trigger that caused the increase in competition, is the move into virtual cards for procurement, which happened approximately eight years ago. Since then much has been invested into building portfolios.

That initiative is now facing a threat. It has plateaued and is now facing additional headwind. It grew to a level where it couldn't grow anymore because it hit some structural barriers, mainly card acceptance amongst suppliers.

Where is the pressure causing the revenue squeeze coming from?

The margins are being compressed by the regulatory threat. We've already seen interchange regulation take a chunk of revenue out of the walking plastic business and there's a threat that in 18 months' time the regulators will look at the remaining commercial card products and choose to take the same action. That's a relatively likely outcome.

And on the other side all the banks are offering the same product so it has become commoditized i.e. it becomes a pricing game, or who can pay the most rebate, so even while the market grows the bank margins get compressed by supply volume and customer expectation.

That is where the squeeze is being created.

How should/are banks reacting to combat the issue?

There is a broader trend of convergence of payment mechanisms to platforms that can separate the payment rails from the user. At the back end a system works out that a requested payment by its nature should be processed on a card, or a bank transfer, or via an international payment, but to the user there is one ubiquitous payment method.

This trend is putting pressure on banks more generally to find ways of moving away from an environment in which banks have several different payment businesses all running different products. In most commercial banks there will be a team running cards, a team running BACS, a team running international payments, all with their own product roadmaps and strategies. Customers just want to make a payment to all suppliers from a single platform and don't care about the plumbing, so there is a discord there.

What is preventing corporates returning to a bank-based payments model only?

There are some benefits to cards. One of the things that doesn't work with bank-based payments is that they are very data poor and clunky. There is a lot of time and data involved in reconciliation – essentially you eyeball a transaction on your bank statement and you have to work out what it is for, which might include guesswork.

Single use cards have started to automate that process. A card can only be used for one purpose, so the statement for that card tells you uniquely what it was used for.

This ability to automate, as well as being able to tap into unsecured lines of credit provide huge benefits for card payments, but structural obstacles prevent these from being fully realised.

How can fintech help address the problem?

This is the state of the industry, the equilibrium at the moment is that 2% of B2B payments are made with cards, and companies have to employ vast numbers of people in their finance department simply because of a lack of data. **So the question is: "What if we could have the best of both worlds?"**

What if we could enrich the bank-based transactions with data and what if we could take the card transactions and make them work economically and like bank-based payments?

We recognise that the world of cards has some great qualities to offer. We also recognise that bank-based payments are changing and can be evolved to encompass the benefits of cards. That is at the heart of what we do.

How easy is it to connect into these legacy systems?

Our tech is agnostic on the payment rails. Today we talk about faster payments and cards but tomorrow we might be talking about a distributed ledger arrangement. Our system doesn't assume what type of transaction it will be, just that there will be an interaction with a source of value and a way of delivering that value to a destination.

We have a concept of connectors that interact with a legacy system. We translate all the conversations that might happen, whether it be a card-based network, or a bank-based network, or blockchain, and let them talk to each other. So we create an overlay that is data rich but also orchestrates transaction between different ways of delivering value. Being able to speak to legacy systems and also new technology is our core IP.

Are banks welcoming the solution fintechs are bringing to the table?

In the commercial space we are seeing banks think about how they can bridge the gaps of their different siloed product offerings that they run today and give the customer a better experience overall.

This gives the customer a better process to make payments through, but also starts to add value by capturing additional data for bank-based payments. Banks can also now start to push some of these bank-based payments to a credit line that corporates have but aren't utilising.

As banks continue to see their virtual cards becoming more and more commoditized we're starting to see that they're more interested in that type of solution.

Is the major motivation for banks to bridge legacy systems offering a better user experience?

Particularly when you look in the large corporate space it is very common that corporates are multi-banked; they'll typically spread their business across a number of providers. So if banks can offer a processor portal that converges their products and offer a stickier solution there is a retention play for them. But it is not purely customer experience, access to data and access to credit are also key.

Corporates typically end up using about 10% of a credit line the bank has provided because they can't use the product where envisaged they would. The bank has lent them the money, and provisioned for that lending, costing them money to extend that credit line, but it can't be leveraged. Giving organisations the ability to access the credit you've already extended to them is extremely valuable. It adds tangible value to companies, especially as interest rates rise.

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