

Complex Payments

Financial institutions and businesses are faced with a complex world when it comes to managing payments. To thrive, each entity must manage a multitude of variables, as we will operate in a blended world for the foreseeable future.

By Bob Murphy

Overview

Integration and payments go hand in hand. More than ever before, companies must manage a multitude of payment variables on a transaction-by-transaction basis. Each payment process has its own rules, standards, regulatory requirements and risk. Each banking relationship may require proprietary formats and processes and security protocols. Each supplier may require a unique interface to its systems. And, for the foreseeable future, companies must efficiently process both electronic and paper-based payment streams, each requiring, at a minimum, its own processes, rules and reporting requirements. Clearly, the payment processing landscape is a complex environment.

Managing these complex payments means tying together disparate systems, and on the typical company's to-do list that means some form of enterprise integration. And so companies have set out to integrate payments information with all due haste; they write custom interfaces between systems, they re-key data, they dedicate specialists to resolve payment exceptions, they maintain spreadsheets, and they try to get the job done. Unfortunately, cobbling payments systems together isn't enough.

The question for financial institutions and their corporate customers to ask is: "When will this complex payments world become less fragmented and easier to migrate?" Unfortunately, that answer is: "Not in the foreseeable future."

The right question now is: "What payment systems, architectures and processes are required to help run the business in this complex environment, to save time and money, attract new customers, generate new revenue, and leverage existing technology investments?" The answer to that question is fairly simple: systems that can efficiently and economically manage the blended world of paper and electronic, while ensuring flexibility for internal business processes along with consolidation of critical payment data for cash management.

Complex Payments Defined

Succinctly stated, complex payments are defined as those that require the management of a multitude of variables on a transaction-by-transaction basis. Simple payments, on the other hand, are exactly what their name implies. They are primarily cash and low-value electronic consumer card transactions with little or no payment instructions or associated information. Largely for this reason, the market for simple payments is limited to the

consumer segment. Since the channel for simple payments is electronic (excluding cash) – with well-defined processes and well-established standards – and the payee sets rules, there also are few payments exceptions.

Complex payments, on the other hand, are quite different. How? In six critical ways:

1. Multiple Payment Formats

Complex payments may arrive or depart in paper (check, money order or traveler's check), electronic (wire transfer, electronic data interchange, automated clearing house) or card-based (purchase card) format. Each format requires a unique workflow process, security, and financial network for clearing and settlement.

2. High Average Transaction Value

Complex payments have an average transaction value of \$3,000 versus a paltry average of \$115 for a simple transaction, according to the Nilson Report (2004). Higher transaction values require more attention for authorization and overall quality inspections.

3. Large Volumes of Instructions and Related Information

Complex payments include large volumes of instructions and related information, typically in multiple formats and data structures. Commercial payments, for example, average four pages of invoices per transaction, usually with multiple line items on each page; no wonder that 96 percent of invoices processed for payments require keying of data from paper – a costly, time-consuming and error-prone task. Additionally, the development of standards for the transmission of remittance data is one industry initiative that lacks any momentum – a major barrier for conversion to electronic based commercial payments as discussed below.

4. Multiple Channels for Receivables and Payables

Complex payments have multiple channels for receiving and disbursing payments – from mail, Internet and phone, to branch capture and accounting packages – each with their own level of unpredictability in volume and frequency, as well as unique processing and security requirements.

5. Lack of Standards

There are limited standards for complex payments – and none on the invoice processing and ERP posting side. As one example, no single standard exists for remittance information – a barrier to improving the efficiency of the financial supply chain cited by 79 percent of respondents to a survey by the Association for Financial Professionals (AFP, 2004). As another example, accounting systems typically are not integrated with electronic payments systems; 64 percent of respondents to the AFP survey singled this out as a barrier to improving financial supply chain efficiency. And standards are not well defined for business-to-business (B2B) electronic invoice presentment and payment (EIPP) – hampering not only adoption of the technology, but also the potential operational efficiencies provided by this service. Contrast this lack of standards with simple payments, where message formats, security protocols and overall operating rules are well defined by the card associations, VISA and MasterCard.

6. Payors Set the “Rules”

With complex payments, “rules” are set by the payor. This means, for instance, that one payment may be consolidated for multiple invoices by the payor, leading to a high percentage of exceptions and manual intervention by the processing financial institution.

Considering these characteristics of complex payments, along with data from a recent survey among 100 global banks which shows that 84 percent are satisfied with their bank’s approach to payments (Economist Intelligence Unit 2005), businesses should not expect any changes to this complex environment anytime soon.

Market Segments

While simple payments by definition are limited largely to consumer applications, complex payments impact a much broader range of market segments, including, but not limited to:

- **B2B payments**
- **Wholesale banking**
- **Government**
- **Mortgage**
- **Insurance**
- **Healthcare**
- **Brokerage**
- **Others**

Each segment, and each company within a segment, has specific requirements, business processes and product offerings that dictate unique processing methods for payment management.

A Complex Environment – Now What?

If businesses must operate and manage payment processing in this complex environment, how do they ensure cost control, profitability and innovation? Businesses need a solution that can optimize complex payment processing for multiple payment formats and in multiple market segments.

For instance, in a receivables environment where there is a mix of incoming paper and electronic transactions with large volumes of invoice data, complex payments optimization delivers cost savings by employing highly effective workflows, consolidated reporting and data exchange across multiple payment formats.

In a cash management or treasury services environment, complex payments optimization can help streamline related processes, including high-value, bulk, and cross-border transactions.

Meantime, in a distributed capture environment where corporations electronically manage paper checks and invoices and transmit them to their bank for deposit, complex payments

optimization provides the depositor with accelerated funds availability and operational savings, while its bank reaps enhanced efficiencies and new revenue opportunities.

Similarly, for Check 21 enabled banks, complex payments optimization drives real-time image analysis, enabling fraud safeguards as well as risk management for image exchange.

Solution Profile

The strategy for optimizing complex payments consists of:

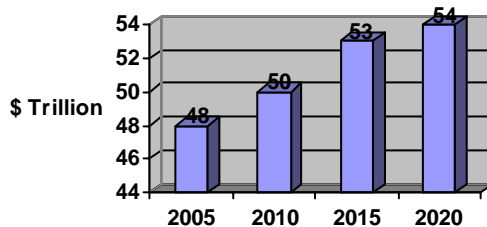
- Eliminating duplicate efforts
- Reducing manual processes
- Centralizing the administration and operations of enterprise payment systems
- Moving payments and data between channels, systems and applications in any format (paper, electronic or card-based)

To get there from here, financial institutions and businesses can turn to new solutions for optimizing complex payments, which can handle:

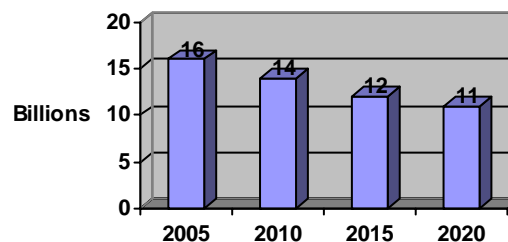
- **Paper and electronic formats**

There's an old saying that payment mechanisms are never eliminated, only added. Case in point: the paper check. Despite all the hype about a check-less society, more than 16 billion commercial checks will be generated in the United States this year – accounting for over 90 percent of the total dollar value of checks written according to the Nilson Report (2004). Eighty percent of commercial payments are currently made via paper check. Even with the recent enactment of Check 21, industry analysts project that commercial check volumes will still total 11 billion in 2020, with the dollar value of those checks actually rising. In light of the staying power of checks, any complex payments solution must be able to seamlessly handle both paper and electronic transactions.

Commercial Check - \$ Volume



Commercial Check - Transactions



Charts based on Nilson Report Data

- **Complex workflows**

Solutions will require sophisticated workflow tools to bridge the disparate formats, processes and rules used in complex payments to seamlessly automate all payments and to consolidate data into a single view for critical cash flow reporting and visibility. The proliferations of new payment channels – wireless, mobile,

telephone, online – will only add complexity to the payments environment, notes Financial Insights (2004).

- **ERP Integration**
Complex payments optimization solves the rigid connectivity issues with ERP systems, enabling electronic updates and integration into SAP, Oracle and such.
- **Broad reporting requirements**
 - Complex payments optimization facilitates comprehensive reporting for bank customers, and in multiple formats: paper, electronic, physical storage medium. Financial Insights sees greater demand from businesses for timely access to payment information, challenging banks to provide transparency. Moving payments and data between channels, systems and applications in any format (paper, electronic or card-based)
- **Visibility across the enterprise on payments information**
Complex payments optimization consolidates all transaction information across the enterprise, providing the visibility into payments that is critical to complying with regulatory mandates. Moreover, achieving an enterprise view of payments may be necessary to ensuring future payment profitability, according to a majority of the banks, intermediaries and networks polled by the Global Concepts research firm (2004).

The solution diagram for optimizing payments within this complex environment is shown below in Figure 1.

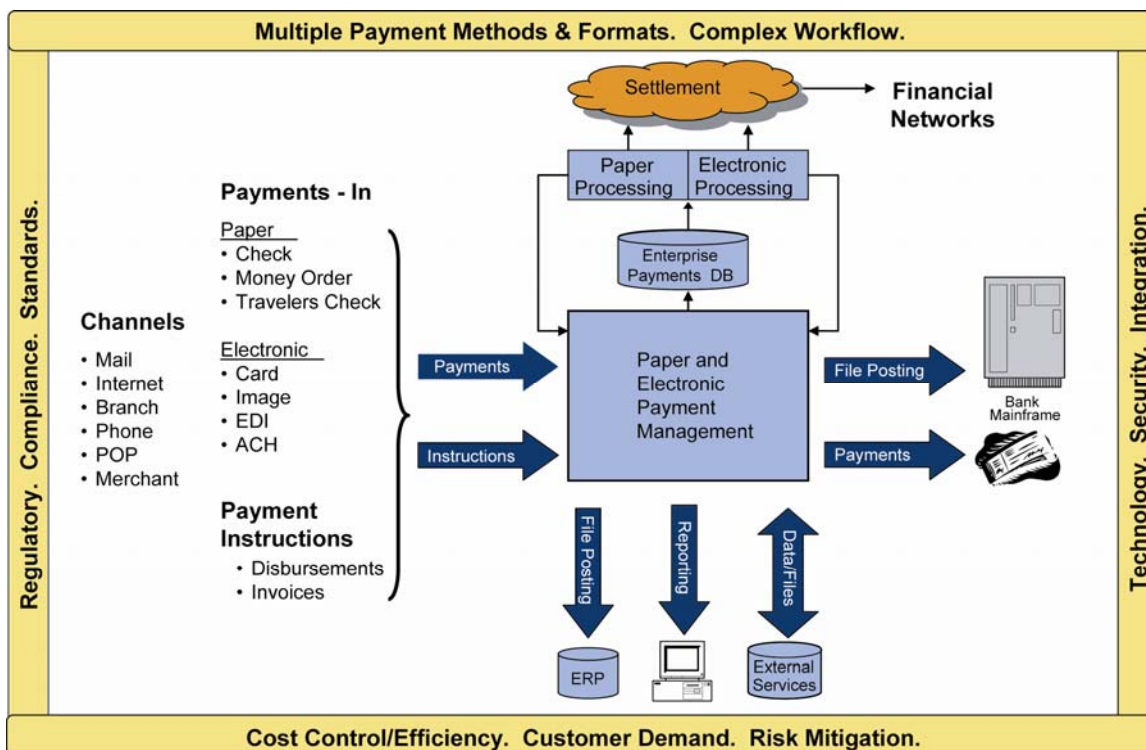


Figure 1



The Payoff

Dramatically minimizing the multitude of variables associated with payment processing: Industry dream? Not on your life. Optimizing the management of complex payments is possible, and the benefits it provides across the financial supply chain are numerous:

- **Greater visibility of payment transactions**
- **Increased operational efficiency**
- **Superior business processes**
- **Compliance with regulatory changes**
- **Improved operational risk management**
- **Streamlined compliance documentation**
- **Improved operational responsiveness**
- **Increased customer retention**

Clearly we operate in a complex world when it comes to payment processing, and the situation is not going to change anytime soon. Payment processing will require the management of multiple variables for a long time to come. Financial institutions and businesses must accept this situation as an opportunity, not a problem. Solutions are available today to help manage this complex world that deliver the innovation required to stay ahead in a highly competitive market. To learn how these solutions can impact your complex payments environment, and set your company on a positive course for the payments evolution that lies ahead, contact VICOR at 510-621-2000.

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