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The future of business payments

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The processing of payments, especially global payments, is a big business that's only getting bigger. According to the McKinsey & Co.'s 2018 Global Payments Report, 2017 saw an 11% increase in global payments, boosting generated revenue to $1.9 trillion.[1] In addition, revenue is projected to grow by another $3 trillion in the next five years. Nevertheless, McKinsey points to innovation as a critical inhibitor to growth.

But this isn't just another story about how industries need to innovate to survive. The situation with global payments processing is different.

As consumers in 2019, we are surrounded by state-of-the-art technology that allows us to pay and be paid in seconds. Paying for almost anything is as simple as waving a phone, providing a thumbprint or clicking a button. And we love it.

Nevertheless, global business payments are still stuck at the corner of 42nd and Broadway in 1975. The photos of gritty streets of Manhattan back then, with trash piled up on the sidewalks, seem almost unbelievable now. Yet sending a payment across the globe today works virtually the same way now as it did then.

Why? Well, the answer lies in the evolution of payment systems. We need to learn from the past and present to create a better future.

We can tackle this problem by viewing payments not as transactions but as a way to nurture global business relationships. We need to look at both sides of a transaction and think beyond the individual payment to the relationship between the payer and payee — and to the network of connections that facilitate their business. But first, let's look back on how we got here.

FIRST GENERATION: WIRES AND SWIFT

By trying to make it easier to send money internationally, banks have made it harder. It's 2019, and I still have no idea where my money goes after it leaves my bank account. It's harder to track thousands of dollars for my business than it is to track a pizza or a package. Unfortunately, this is especially true for business owners.

As large international payments jump from bank to bank, customers don't just accrue traditional fees. Both sides of the payment transaction are also hit with very high foreign-exchange markups that take a cut of the money being sent. That means the payment sender and the receiver are taken advantage of. Plus, the fees seem to come out of nowhere. By the time the payment gets to the receiver, both parties are hit by charges of 5% or more.

These payments are facilitated by the Society for Worldwide Interbank Financial Telecommunications system, commonly called SWIFT — a network created in the 1970s that enables banks worldwide to send and receive information about transactions.

One of our customers, Dechel McKillian, bootstrapped a fashion company called Galerie.LA. on her own, and all she wanted to do was pay her overseas suppliers. She says, "I was using bank transfers, which had ridiculous conversion rates and charged very high fees … which came out of Galerie.LA's commission."

This is a common complaint among business owners, about something that significantly damages their bottom line.

Aside from creating pricing issues, the traditional SWIFT model of international payments causes significant transaction delays. Intermediary banks don't just tack on fees; they also increase the processing time of transactions, further delaying an already long process.

Before the money moves an inch, customers have to fill out forms with information about themselves and their receivers. Frequently, these forms must be completed in person, which means the customer must walk into a bank, speak with a teller and fill out paperwork — just to send money digitally.

Now, imagine you're a business owner with a physical disability and you are in a rural area, unable to safely get to your bank on a regular basis. Wouldn't it be easier to just turn on your computer or use your phone to send a payment?

Terry Boike is a proud Texan, entrepreneur and semi-disabled business owner. He owns and operates ClearwaterLED, a business that sells underwater fishing lights, and he works with suppliers in China.

"For me, to go to the bank is not always an easy task," Boike says. "At times, my wires would just sit because I'd have to put off going to the bank depending on how sore I was. But we all know that if you're going to do business overseas, you've got to pay on time.

"Nobody touches anything to do with your business until you pay for it," he adds.

The payments of the past weren't built to benefit the customer, business owner or not. They maximized profit for the banks, regardless of how hard they made it for everyone else.

But the problem is that these aren't just payments of the past. They're also the payments of the present. While startups have emerged and some financial institutions have made strides, sending wires through banks is still the predominant method for international payments processing around the world — a point highlighted in the McKinsey report.

Businesses and banking customers are fed up. They pay too much, and they wait too long. Things are finally changing, however.

The second wave of international payment options introduced itself years ago. To everyone's surprise, traditional payment rails could be combined with the internet to put the power of payments back into the hands of users.

SECOND GENERATION: REMITTANCES AND FOREIGN EXCHANGE PROVIDERS

A new breed of service providers emerged to compete with bank wires, luring customers on the promise of a better user experience and cheaper foreign exchange rates. The math is simple — banks take a significant commission off the top of payments by excessively marking up the exchange rate without any transparency. No reasoning, no notifications, no insight.

The players in this second generation come in two flavors — remittance providers that specialize in the movement of money for individuals from one country to another, and foreign exchange companies, commonly called FX shops, that provide currency exchange. These businesses were created in direct response to the issues customers were having with bank wires and the SWIFT network.

In a remittance model, the service provider acts on behalf of the sender The service is delivered on a promise of better customer support, cheaper foreign exchange rates and a more streamlined user experience.

The fundamental issue with the remittance model is a lack of awareness of the receiver's needs. The payment sender ends up doing the same amount of work as it did when it sent money through its bank. It has to gather all its own information as well as required information from the receiver to complete the payment. This includes personal and business information, bank information and more. This is extraordinarily time consuming and ultimately slows down the process.

Another problem with the remittance model is that the payer is forced to pay for the foreign exchange difference, forcing the supplier to invoice in their own local currency. To combat the high foreign exchange markups, FX shop companies began to offer discounted FX rates. A large part of their model revolves around offering a better foreign exchange rate on international payments. They basically buy wholesale FX currency at lower rates from specialized banking institutions and resell it to the customer at a lower rate than banks offer.

But there's a problem here as well, and it's shared with the remittance payment model. In both scenarios, the sender is valued more than the receiver.[2] The sender has the onus to provide all of the information to complete the payment, and the receiver has no relationship with the payments platform. The payment does not foster the development of a relationship, as both sides are kept separate.

Payments not only tie two separate parties together' they're also connected by a common purpose and a common goal — a relationship. These transactional payment models have kept the parties separate for too long. Not only have they run their course; they are creating inefficiencies for all parties involved while favoring middlemen who take a piece of the pie along the way.

As our world continues to become smaller and more connected — and new markets continue to emerge — we need to set up businesses for success and help make transacting anywhere in the world as easy as splitting the dinner bill by using your phone. Let's explore the world of relationship-based payments.

THIRD GENERATION: RELATIONSHIP-BASED PAYMENTS

Uber and Lyft have a key advantage over the traditional taxi model: a mobile app that ties the driver and the passenger together in a relationship.[3] There's certainty on the timing of pickup, tracking of the driver and where they are relative to the passenger, as well as a communication model whereby the passenger and the driver can communicate directly. The end result is a successful ride that translates into feedback, giving the network valuable information for the next rider and driver, the next ride after that and so on.

Certainty is created by an experience that is fundamentally different from the experience offered via the traditional taxi system, resulting in a more pleasant, trusting relationship between the driver and the passenger. This is brought to you by an intermediary service. And it's not a coincidence that the overall service is much better than the traditional taxi experience. This is because the network has created incentives for everyone to do their best.

The term for two party models where each side is active on the platform is known as "peer to peer." While the language describes the actual interaction, some prefer to use the term "relationship-based models." It's not about the fact that one person can directly send a payment to another; instead, the focus is on creating a relationship between parties while using the payment as the point of connection.

These relationship-based payment models are the future of all payments, but they're also already here.

Peer-to-peer payment networks such as Venmo are popping up everywhere,[4] in every industry around the world. Sending payments now takes seconds and consists mainly of finding the receiver, who is typically already on the network or invited to join it. The sender goes through a simple process for sending money, and the receiver can see where the money is coming from by tracking the payment details.

There are many reasons why it's its beneficial to have both sides of a transaction tied to one network, all of which create a better payment experience for the users and the platform they're paying through. Let's explore a few.

SECURITY

In a relationship model, the payer doesn't have to know the receiver's bank account information and the receiver doesn't have to give that information to the payer. The payer uses standard communication systems such as email, text messaging or international messaging systems such as WeChat to notify the other party that there is a payment ready to process.

The receiver provides their own bank account information to the network to collect the payment. Each party in this model maintains their bank account information on the network (rather than with each other) and the network tracks any further changes to the information. This is a security and privacy benefit for both parties.

COST SAVINGS

Relationship-based payment platforms are mostly unburdened by intermediary banks, while still benefiting from the security and established credibility of a user's bank. The platforms themselves act as the intermediary, processing the payments from one institution to another. That means no money lost on fees and generally better foreign exchange rates.

CURRENCY EXCHANGE OPTIONALITY

Unlike remittance platforms that are tailored to the sender's foreign exchange needs, relationship-based payment systems allow the currency exchange to be paid by either the sender or the receiver, at lower rates offered by their banks. This offers flexibility to both sides of the payment, and it ensures there are no unexpected losses for either side.

PAYMENT TRACKING

In the relationship-based model, both parties have visibility into the other side of the transaction. This eliminates the need for back-and-forth notifications about payment status.

In addition, payment tracking capability creates certainty and reduces anxiety — especially for large, time-sensitive transactions. This is possible only if both sides of the payment transaction are active on a network and connected via payment.

ONE PLATFORM TO SEND AND RECEIVE

Whereas remittance and FX-based models are accounts payable-centric and tailored to the needs of the sender, relationship-based models are two-way connections that are designed to meet the needs of both the sender and the receiver. This is important because each business has two functions tied to payments — payables and receivables — which are sometimes performed by the same person or department (typical with small businesses) and sometimes by separate departments (if the business is larger).

The same platform can be used to execute both of these functions as sometimes, depending on the transaction, the same customer may be a sender or an invoicer who collects the funds. Having the ability to manage both types of payment connections is another step toward simplifying and streamlining business financials and smoothing operations.

INTEGRATION OF DATA, PAYMENTS AND ACCOUNTING SYSTEMS

A key characteristic of the relationship model is the flow of data along with the payment (in particular data like invoices, contracts and purpose of payment details), making it easier for the receiver to reconcile which payment belongs to what invoice and add that data flow into accounting systems.

In the bank wire and remittance worlds, the invoice, the payment and the accounting systems are separate rails that require manual integration by the customers on each end of the transaction. In a relationship-based payment model, the integration occurs in the system and is offered to both sides as a complete package that contains all the necessary information required to reconcile transactions.

BETTER CONNECTIONS

Miss the timing on a payment and the alarms go off. Whether it's a payment for labor, a shipment, moving money between bank accounts or collecting from a buyer to prepare items to ship, they all put stress on a partnership. With a relationship-based model, the certainty of the payment, and trust of both users, is the priority. The model makes sure each side of the transaction sees the status of the payment and is able to communicate with the other.

Transactions with transparency and a genuine connection are now a way of life in the consumer world but have been strikingly absent from the global transfers ecosystem. With relationship-based payment models the opportunities are endless and the benefits are vast.

Yes, it is all about the relationship. Relationships matter. They really matter. Relationship-based payments are not only vital to the evolution of the global and domestic payments space; they're better for payers and payees because they get everyone on the same page regarding the transfer of funds.

Payments are the most important part of a business relationship. At the end of each commerce interaction there is a payment that signifies the establishment of trust between parties and creates a foundation for a successful business partnership.

Connections and relationships are the future of payments. No more opaqueness, roadblocks or hidden fees.

Payments will eventually become invisible, even in the global payments space. Money will flow between trusted parties, regardless of location, unburdened by the inefficiencies of the past and without the unnecessary steps that destroy value and create uncertainty. The great news is that we are well on our way to that future.

NOTES

[1] https://mck.co/2HePq6t

[2] https://bit.ly/2hkkotS

[3] https://bit.ly/2XIDOAw

[4] https://n.pr/302rtVg

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