Harvard Business Review
ANALYTIC SERVICES

Pulse Survey

DIGITAL B2B PAYMENTS FOR MID-SIZED FIRMS

How to Complete the Job

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Completing the Transition to B2B Digital Payments

Middle market companies, similar to mainstream consumers, have long recognized that when it comes to payments, paper can be a problem. Traditional paper-bound methods of managing and processing B2B payments are time-consuming, costly, and prone to error and fraud. At the enterprise level, limited visibility into individual transactions means that companies must operate with a hazy approximation of their cash flow position.

At Capital One, we have worked closely with companies across the middle market that are moving to digitize their payments processes and financial operations. We partnered with Harvard Business Review Analytic Services to gain a broader picture of the extent of this transition as well as the challenges companies encounter as they attempt to navigate it.

The good news is that many middle market companies are starting to embrace digital payments. The survey revealed that 36% of companies in the middle market—with annual revenues of between $25 million and $2 billion—have digitized between 70% and 100% (by value) of their B2B payments.

The survey also demonstrated that digitization, which could include automated payments, virtual card and payment portals, among other things, is delivering its hoped-for benefits. Forty-seven percent of executives surveyed reported lower costs through personnel efficiencies, while 43% reported lower costs through real-time visibility into incoming invoices and outgoing payments, as well as faster transaction processing, and 41% said greater convenience for partners, suppliers, and employees led to lower costs.

At the same time, we were disconcerted to discover that despite these benefits, 20% of executives say their companies have as yet digitized less than 29% of their payments, and that 15% do not know how far digitization has progressed, suggesting that they have not embarked on the process in a sustained way. In addition, the poll suggests that the majority of companies are only partially digitized. For most middle market companies, the full potential of digitalization has yet to be realized.

In our experience, there are a number of issues that deter companies from adopting an end-to-end digital payments platform. At the top of the list are compatibility with existing financial systems and supplier acceptance. The survey reinforced this perception. Lack of interoperability was cited by 35% of the participants and supplier resistance was mentioned by 36%.

Cost was also a factor. It was cited by almost a quarter of the participants as the biggest obstacle to getting B2B digital payments systems deployed faster in their organization.

The survey data suggest that the perceived costs of adopting a B2B digital payments system may be overblown. Of those whose companies have gone digital, 20% said the project paid for itself within a year.

Although compatibility is a genuine cause for concern, Capital One makes sure to include application programming interfaces (APIs) and standardized file formats in the digital payments projects it is developing, ensuring compatibility on a technical level.

Supplier acceptance, however, requires a more individualized approach, since it depends on factors such as the nature of the industry. We have found that when we partner with our customers to develop a sequenced, customized supplier acceptance strategy and help them implement it, suppliers can be weaned off checks.

Overall, while the promise of B2B digital payments is as compelling as ever, the transition is not without its pain points, but none of these obstacles is insurmountable. By selecting their payments partner carefully, middle market companies can go a long way toward ensuring a smooth transition.

DIGITAL B2B PAYMENTS FOR MID-SIZED FIRMS

How to Complete the Job

Mid-sized firms can harvest even more benefits from automated payment processes than they have thus far.

Business-to-business (B2B) digital payment processes have been embraced by most mid-sized companies in the United States for a significant number of their transactions, but most managers aren't satisfied. Although their organizations have enjoyed significant benefits from the conversion to digital payment processes, they are frustrated by the imposing obstacles they face in trying to complete the transition, according to a new survey by Harvard Business Review Analytic Services.

Lower costs, more efficient operations, improved customer service, and other benefits have already been achieved, but most mid-sized organizations seem stuck when it comes to increasing the proportion of their transactions that are digitized. Many of the 159 survey respondents noted that incompatible technologies and a lack of digital payment standardization are to blame, but they and leading consultants also note another big challenge: too many business partners or suppliers are resistant to the idea of digital payments.

Digital payment experts say more than standardization and software consolidation will be required for mid-sized companies to get to the next stage. To get to the point where almost all such payments are digitized will require the support of almost all of their business partners, given the nature of B2B.

And as of today, that support isn't there.

HIGHLIGHTS

59%
USING ELECTRONIC FUNDS TRANSFER TO PAY BILLS

ROUGHLY HALF OF TOTAL PAYMENT VALUE HAS BEEN DIGITIZED BY ROUGHLY HALF OF THE MID-MARKET COMPANIES

The Current Scene

Almost all mid-sized companies—defined here as those enterprises with annual revenues of at least $25 million but less than $2 billion—have digitized at least some of their transaction streams. Roughly half of total payment value has been digitized by about 50% of the mid-market companies. FIGURE 1

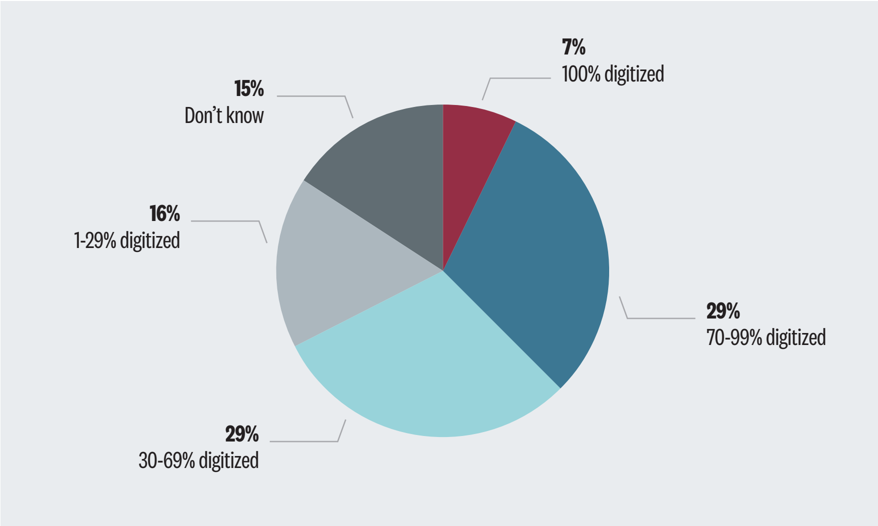
"Companies still have a hybrid approach. It's not all or nothing," says Julien Courbe, the financial services advisory leader at global accounting and consulting firm PwC. "That doesn't mean you're cutting the cord with everyone else who is not yet digital."

Consultants say that the few recalcitrant organizations mistakenly think that paper-based transactions provide them with a financial benefit. "Many buyers still issue checks because they think they get more float from the time the payment is in the mail," says Chris Millner, principal and payments/fintech industry sector lead at the

FIGURE 1

DIGITAL B2B PAYMENTS LANDSCAPE

The percentage of the total value of their payments streams that are made electronically rather than via paper checks.

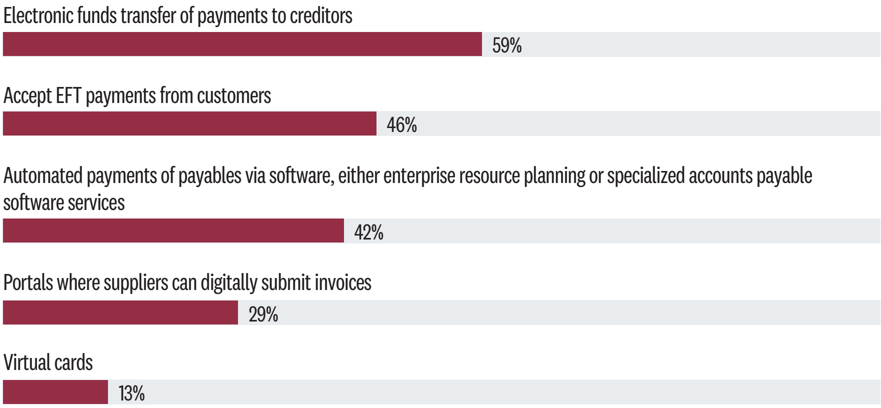


SOURCE: HARVARD BUSINESS REVIEW ANALYTIC SERVICES SURVEY, AUGUST 2018

FIGURE 2

EFT RULES AS OTHERS GAIN TRACTION

More advanced forms of digital payments, such as via software or web portals, are less popular now but poised to grow. [MULTIPLE ANSWERS PERMITTED.]



SOURCE: HARVARD BUSINESS REVIEW ANALYTIC SERVICES SURVEY, AUGUST 2018

Atlanta-based consulting firm North Highland. "This is usually not a huge benefit, especially not in a historically low interest rate environment. The benefits from efficiency and payment cost usually outweigh any benefit from float, if there is any at all."

Mid-sized companies have embraced a variety of digital payment technologies, though they are more likely to adopt digital processes for outgoing funds than for incoming. Mitch Siegel, the national financial services strategy and transformation leader at KPMG, said that B2B transactions are much easier in Canada, the U.K., and Australia "because you only have a handful of big banks and big corporates." In those regions, take care of the top players "and you've conquered nearly 80% of the challenge. In the U.S., we have so many banks and corporates of all sizes that it makes B2B digital payments more complicated, because they all have to register their identity and credentials so that they are part of the same network of buyers and sellers."

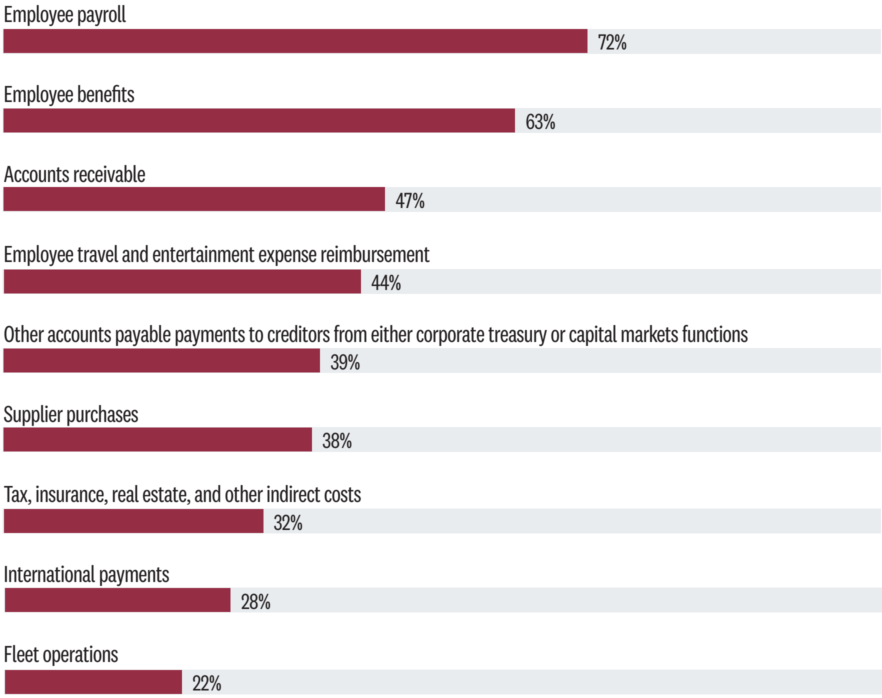
Electronic funds transfer (EFT) rules as the favorite technology, though online/internet portals are rapidly gaining in popularity. FIGURE 2

Payments consultants say portals are an area with a lot of potential. "Supplier portals, whether part of an ERP [enterprise resource planning] system or a third party, provide buyers with a way to control their spending and streamline their procurement and payables processes," notes North Highland's Millner. "These systems allow greater control of spending by enforcing business rules and requiring approvals for exceptions. Although many suppliers may complain about having to load invoices to a website, which can be cumbersome, there is a benefit for the suppliers. They get visibility into the approval and payment status of the invoices. Otherwise, the accounts payable department at their buyers can be a black hole. It is not uncommon for a supplier to have no idea that there is a problem with their invoice until it is already past due. Portals usually solve this problem."

FIGURE 3

INTERNAL TRANSACTIONS FIRST

Percentage of respondents indicating the current digital status of each of the following functions in their organization



SOURCE: HARVARD BUSINESS REVIEW ANALYTIC SERVICES SURVEY, AUGUST 2018

Analysts and consultants also predict that virtual card adoption to increase sharply due to the substantial benefits. A virtual card, also known as a one-time-use card, prevents fraud and protects privacy. The mechanism authorizes a temporary account number and a specific value to be associated with a traditional payment card. That number and the value attached to it (much lower than the credit limit on the payment card itself) can be used only once, preventing further charges or use of any information about the owner of the payment card.

"Virtual cards are a great way for buyers to eliminate some friction in the payment process by enabling a clean, electronic payment as part of a comprehensive digital accounts payable system," adds Millner. "The rebates on these programs can also be an attractive way to offset the administrative expense of your accounts payable operations. The buyer gets rebates from the interchange generated as part of the transaction."

Steve Murphy, director of commercial and enterprise payments advisory service for payments consulting firm Mercator Advisory Group, says that virtual cards can boost working capital for buyers and suppliers, and have the potential to improve relations with suppliers and distributors by paying them faster. In addition, he notes, interchange fee costs typically can be much lower for virtual cards than for other payment card options.

Survey respondents specifying which payment processes were already digitized, or would be within the next few years, highlighted payroll processing as the most frequently digitized. Currently, some 72% have digitized paying their employees, closely followed by benefits payments. FIGURE 3

Myriad of Benefits

Survey participants noted, in almost equal numbers, a variety of benefits accrued to date from adopting digital payment processes. They found lower costs through personnel efficiencies, real-time visibility into incoming invoices and outgoing payments, the ability to better analyze spending, increased transaction processing speed, and greater convenience of digital B2B payments for partners, suppliers, and employees. FIGURE 4

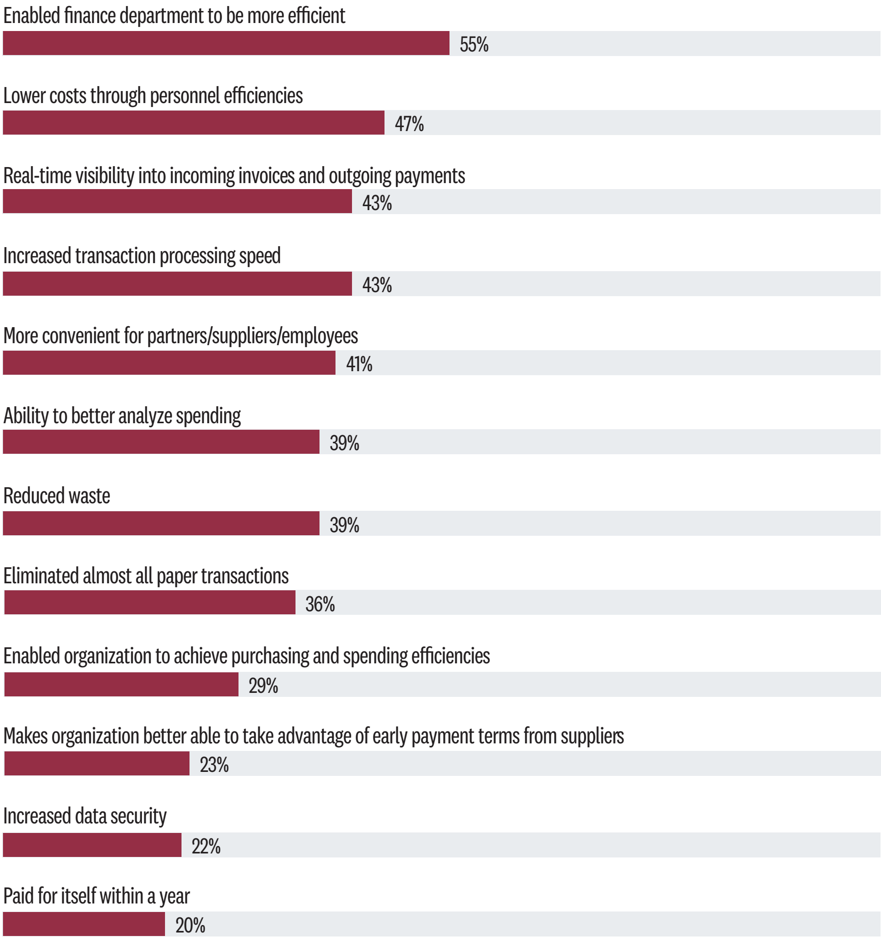
Consultants argue that increased security is an underappreciated benefit of digital payment processes these days, especially for mid-sized firms. "We believe that digitizing payments is a very strong way to lower theft, fraud, and other types of financial crime," says Courbe, adding that checks and cash are monetary mechanisms that thieves know well and that are rife with security holes.

Of course, consultants note that securing digitized payments is a challenge, too. Brian Shniderman, the global cross-industry payments practice leader for Deloitte, says

FIGURE 4

WIDE RANGE OF BENEFITS

Percentage of respondents selecting the results from implementing a B2B digital payment system



SOURCE: HARVARD BUSINESS REVIEW ANALYTIC SERVICES SURVEY, AUGUST 2018

real-time payments could also impact security. “We can speed things up with real-time payments, but can we keep up with the fraudsters, who might have very good technology?” Shniderman asks, asserting that the faster speed might play to the strength of nimbler, better-funded, and better-equipped overseas cyber thieves. “Do we have the tools in place to keep up with those guys in this shorter time frame?”

Challenges and Solutions

“B2B payments are where dreams go to die,” says Conrad Sheehan, a managing director in Accenture’s payments practice, referring to adoption and implementation challenges. Indeed, the top nightmares cited by survey respondents are a lack of standardization; interoperability with existing financial systems, including ERP; and too many business partners or suppliers not yet using them or being resistant to the idea. FIGURE 5

Millner acknowledges that a key problem with portals and other B2B digital payment processes is the lack of standardization. This burdens many suppliers, that have to know how to work with many different types of systems. “The lack of standardization is a problem for suppliers,” he notes. “Because buyers typically have more ability to dictate how they will be invoiced and, to some extent, how they will pay, this leads to a situation where the suppliers have to be able to invoice through any number of different portal technologies at their different buyers. Although there are options that allow suppliers to integrate with some portals to streamline the process, this requires some investment and ongoing management of each of those integrations. This effort simply does not make sense for many suppliers, so they still have people manually submit invoices through portals. Submitting each invoice through a manual process can take several minutes or even longer if the submitter is new to a particular portal.”

Accenture’s Sheehan says an aggravating factor for portals is the positive experience officials of mid-sized firms have when they are not at work and are functioning as consumers. “On the consumer side, we have a set of expectations about how fast and fluid and easy our lives are. Then we go to work and we have five different portals and five different password schemes,” Sheehan says. “The multiplicity of portals is problematic. There will be different formats, even with the same exact product from the same vendor. The CFO and the accounts payables department are frustrated by this. It creates opportunities for banks and fintechs.”

Given these challenges, accelerating

adoption of digital B2B payments is an aggravating chicken-and-egg dilemma for the industry. Many trading partners of mid-sized firms—suppliers, distributors, virtual salesforce, and supply chain managers, for example—are hesitant to fully deploy B2B digital payments until the standards groups and compliance officials agree on the details. Meanwhile, standards and compliance people wait to see which approaches and applications banks, fintechs, and especially end-user companies support with their dollars. Standards groups are hoping for some de facto standards to emerge to make their choices easier. In short, each side is waiting for the other to act first—a common occurrence with new technologies.

Referring to the survey results, "I was pleasantly surprised to see the consensus around the need for standardization. It's an age-old problem given the heterogeneity of the economy," Sheehan says. "It's very hard to get consensus on anything."

Sheehan specifically pointed to ISO 20022, along with efforts from the National Automated Clearing House Association (NACHA) and the U.S. Federal Reserve Board, as examples of early B2B payment digitization standards efforts in the United States. Another organization involved in the standardization efforts is The Clearing House (TCH), a group of 25 large banks including Bank of America, Barclays, BNY Mellon, Capital One, Citibank, Fifth Third Bank, Deutsche Bank, HSBC, and Wells Fargo.

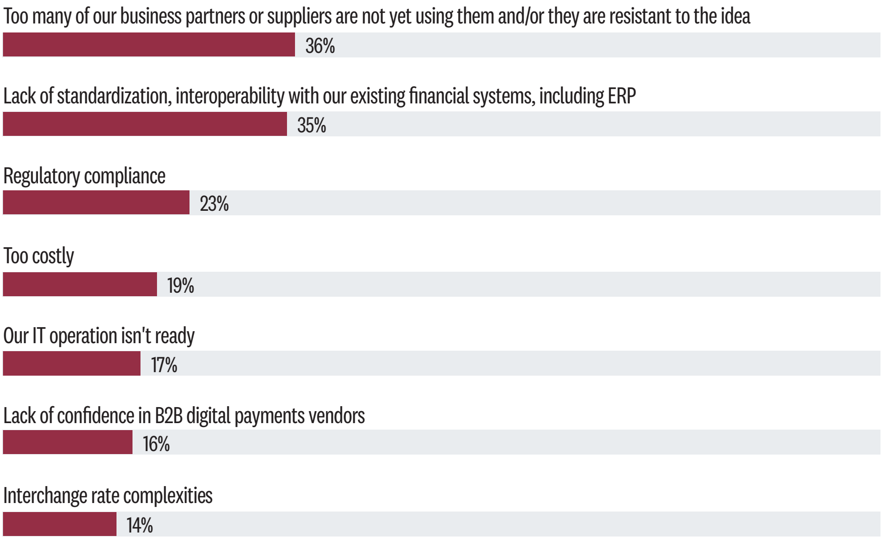
"It's a matter of everyone getting on the same exact standard. This speaks to the need for standardization or harmony," Sheehan says. "Think of ISO as a giant dictionary, dealing with semantics and syntax. The industry has to agree to the meaning of those B2B payment digitization words. Right now, there's no common lexicon out there."

North Highland's Millner predicts that the standardization hurdles will lessen in the next few years, as deployments of more modern payments software systems accelerate.

FIGURE 5

ADOPTION MORE THAN A TECH ISSUE

Resistance to change and lack of standardization are the biggest obstacles to increased digital B2B payments. [UP TO THREE ANSWERS ACCEPTED.]



SOURCE: HARVARD BUSINESS REVIEW ANALYTIC SERVICES SURVEY, AUGUST 2018

"The lack of standardization and interoperability should be changing as more modern approaches are implemented. Today's cloud-based approaches are typically more flexible than the big ERP systems of the 1990s and 2000s," Millner says. "I would expect the 35% response statistic (for a lack of standardization as a key hurdle) to decrease over the next year or two."

Another consideration with standardization for B2B digital payments—and this is especially true for mid-sized companies, as well as smaller businesses—is making sure that the companies have either the needed technology or the willingness to invest in getting it.

"What you don't want is to create more friction with suppliers upfront, due to a lack of standardized approaches," says Mercator's Murphy. "The industry has to make the adoption process easier, and that speaks to the importance of new technology such as application program interfaces (APIs). But a lot of these mid-sized companies are using older technology and don't have

“It has to be on the banks and the payment processors to **create that standardization** and harmony to **facilitate these electronic payments** between businesses,” says Erika Baumann, senior wholesale banking analyst, Aite Group.

the IT resources to create something customized. Banks have to deliver solutions, to say ‘I am going to make it easy for you.’ It’s up to the industry, the sellers of these services, to make this adoption easier.”

Erika Baumann, senior wholesale banking analyst at financial research and payments consulting firm Aite Group, agrees that banks need to play a prominent role to facilitate B2B digital payments for mid-sized companies, along with the payment processors. “It has to be on the banks and the payment processors to create that standardization and harmony to facilitate these electronic payments between businesses.”

Another consideration with B2B payment digitization, even for mid-sized firms, is that it’s unwise to think of the interactions as solely payment transactions.

Deloitte’s Shniderman says that by looking at these transactions from a much broader technology perspective—potentially by integrating internet of things capabilities—the business can potentially benefit far more.

Shniderman offered as an example a company monitoring the level of oil it has in a tank. “When the oil drops below a certain level, the system can automatically purchase more oil and can place that payment to whomever is the lowest-cost provider at that moment,” he says, explaining that the transaction can then ride the payment rails to digitally make that payment. It’s all about leveraging technology and payments to deliver more business benefits.

“If we can leapfrog by using technology, we now have the opportunity to make really big strides in B2B payments,” Shniderman says. He offered a second example of a rented backhoe that can be equipped with either a hammer or a bucket. By precisely tracking how much time is used on each piece of owned or leased equipment, the lessee can factor in “the depreciation and the payment the lessor requires for each hour, and immediately go and secure the money, perhaps using same-day ACH [Automated Clearinghouse] or even real-time payments within 15 seconds. Real-time is good because you can grab the money now in case that renter runs out of money.”

B2B digital payments can also contain far more information about payment interactions than non-digital payments can. That is very good for analytics and for understanding and tracking all manner of payments-related data, but it can be very bad for privacy and data-retention policies. In a hospital, for example, such a payment system might reveal the name of the patient who was tested and the suspected medical condition.

Shniderman and others recommend avoiding the inclusion of protected data—personal or other information subject to regulatory controls such as the Health Insurance Portability and Accountability Act of 1996 (HIPAA) or the European Community’s General Data Protection Regulation (GDPR)—out of the metadata included in payment records. If it is crucial to include such data, make sure there is a sunset provision—that the data self-destructs after a certain number of days.

What They Need

Interestingly, analytics and other advanced tools were not among the top choices on respondents' wish lists of improvements to existing B2B digital payment capabilities. Of course, lower costs were the number one request, followed by other practical functionalities such as easier access for employees, easier-to-use tools, and access for partners or suppliers. FIGURE 6

The best way to counter the cost issue is a strong return on investment (ROI) outcome, but it can be quite difficult for managers of mid-sized companies to make a compelling ROI argument to top execs. The problem isn't that the ROI doesn't exist—in fact, it does—so much as that the metrics are difficult to quantify in a concrete way.

"When dealing with back office operations, proving ROI is notoriously difficult. Not every department has a good handle on costs," says Mercator's Murphy. "It's very hard to quantify how much I am going to reduce cost on each invoice I am handling. It's hard to sell someone on the opportunity costs of not doing more analytics. Hard costs are harder to quantify and the soft costs are harder to sell to senior management, typically the CFO." Adds Aite's Baumann: "They don't know what they don't know and there is some fear in that."

Conclusions and Recommendations

Fortunately, there are a multitude of cost-effective approaches out there from banks, third-party processors, and software vendors to reduce and perhaps eliminate most of the fear and confusion of executives of mid-sized companies over further digitization of B2B payment processes.

Experts recommend mid-sized firms follow these four steps to accelerate their transition to digital B2B payment processes while waiting for the standards groups and compliance powers-that-be to take the next steps and offer specific guidelines:

FIGURE 6

SHOPPING LIST

The #1 most important new capability or attribute requested

26%	13%	13%	12%	11%	9%
Lower costs	Easier access for employees	Easier to use tools and access for partners or suppliers	Easier implementation and integration	More sophisticated security	Better integrated analytics capabilities

SOURCE: HARVARD BUSINESS REVIEW ANALYTIC SERVICES SURVEY, AUGUST 2018

1. Begin transitioning to digital payments in areas where there is already widespread adoption, such as for payroll and benefits.
2. Evangelize the benefits to your suppliers and partners—contact them early and often with data on time and money saved, and offer success stories.
3. Offer to share your technology and experiences with your partners and to guide them through the process. Make it as easy as you can.
4. Urge your financial institutions, fintechs, and software companies to do more. Encourage them to offer services of interest to your entire value chain, and ask for their expertise and assistance in transitioning your partners to accept digital payments.

METHODOLOGY AND PARTICIPANT PROFILE

To determine the current status of and challenges faced by mid-sized U.S. companies adopting digital B2B payment processes, in August 2018 Harvard Business Review Analytic Services launched an online survey of *Harvard Business Review* magazine subscribers, website visitors, and select lists of other business officials. The 159 respondents to the survey questions represented a wide variety of company sizes, industries, and roles.

SIZE OF ORGANIZATION

55% $25 MILLION TO $249.9 MILLION	**21%** $250 MILLION TO $499.9 MILLION	**25%** $500 MILLION TO $1.99 BILLION

SENIORITY

22% MANAGER/ SUPERVISOR	**18%** EXECUTIVE MANAGEMENT (EVP, SVP, MANAGING DIRECTOR, VP)	**13%** C-LEVEL	**10%** DIRECTOR

KEY INDUSTRY SECTORS

17% HEALTH CARE	**15%** FINANCIAL SERVICES	**11%** MANUFACTURING	**11%** TECHNOLOGY	**10%** OR LESS OTHER SECTORS

JOB FUNCTION

14% FINANCE/RISK MANAGEMENT	**13%** GENERAL/ EXECUTIVE MANAGEMENT	**13%** IT	**12%** SALES/BUSINESS DEVELOPMENT/ CUSTOMER SERVICE

Figures may not add up to 100% due to rounding.

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