

# The Evolution of Payments

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English naturalist Charles Darwin (1809-1882) once said, "It is not the strongest of species that survive, nor the fastest, nor the most intelligent, but the ones most adaptable to change."

While Darwin may have uttered those words more than a century ago, retail and wholesale lockbox processors should keep his message in mind as they try to adapt to changes in the payments space.

As a result of the changing payments mix, the technologies and processes that retail and wholesale lockbox operations are used to employing are not only becoming antiquated, but also costly. This could put lockbox processors in a very bad spot both competitively and internally as their operations risk being saddled with higher costs and greater inefficiencies. Additionally, lockbox operations may not be as well positioned to meet customer service demands.

Four key trends are challenging the status quo in retail and wholesale lockbox processing:

1. The number of check payments made in the United States each year is declining, while the total number of electronic payments made each year is increasing rapidly.
2. Billers face a growing variety of payments methods, complicating the receivables process.
3. These new payments streams have resulted in siloed payments processing environments.
4. The lagging economy, and the growth of new electronic payment channels, is creating a need for increased fraud control, risk management, and audit and reporting tools.

## **The Changing Payments Mix**

Remember when life was simple? When a payment meant a check? Now, the typical lockbox operation must manage: checks, several types of automated clearing house (ACH) transactions, card transactions, mobile payments, cash, wire transfers, and remotely captured transactions. Not to mention the capture of data from supplemental documents (invoices, orders, etc.), or the clearing of check payments via Check 21 (image cash letters) and/or Accounts Receivable Check Conversion.

And you can't get the genie back into the bottle.

Last year, the Federal Reserve reported that two-thirds of all non-cash transactions are now made electronically. Between 2004 and 2009, the percentage of non-cash payments represented by checks dropped from 40 percent to 25 percent, while debit cards grew to a 36 percent share of the payments mix from 22 percent in 2004. In that same time span, the total number of non-cash payments rose from 88 million transactions a year to 121 million transactions a year, the Federal Reserve reported.

Additionally, billers of consumer accounts report that 60 percent of their bill payments now originate from the web; in 2009, e-checks and debit cards comprised most of these web bill payments, say analysts. As for clearing, more remittance processors are making image cash letter deposits to one or more banks, and the Federal Reserve now receives more electronic deposits than paper deposits.

While electronic transactions have made great strides in consumer payments, paper checks are showing great resilience in business-to-business payments. Data from NACHA, Nilson, the Federal Reserve and Glenbrook Partners shows that checks represented more than 80 percent of business-to-business transactions in 2008. There are three reasons for the staying power of business checks: 1) all businesses are set up to print and receive paper checks, while some businesses still do not have electronic payments capabilities; 2) until recently, most electronic payments channels didn't provide the ability to send the remittance data that businesses require for posting; and 3) businesses have been leery of the fraud controls for electronic payments. All of this is beginning to change.

However, it is clear that business checks will be around for some time to come. That means that lockbox processors must be prepared to process both paper-based and electronic transactions.

The evolution of the payments space is creating other challenges for lockbox processors.

One example is the potential for more fraud. Treasury Strategies predicts that losses from fraud could cause 10 financial institutions to fail in the next several years. Suspicious activity reports (SARs) already have risen 13 percent from 2007 to 2008, according to FinCEN. And credit risk in payment collections has increased significantly during the recent recession, industry observers agree.

The challenge for lockbox processors is that fraud detection and risk control is complicated by their outdated, siloed payment systems, which create data gaps, limit visibility across payment channels, and don't optimize clearing channels to reduce the potential of fraudulent or returned transactions.

The solution is to adapt to the new payments environment with systems and processes that centralize the processing of multiple payment channels (so-called enterprise payments solutions or integrated receivables hubs) to help identify suspicious activities such as duplicate items or multiple returns. This approach also allows lockbox processors to apply fraud detection consistently across channels.

Another way that lockbox processors can adapt their operations to reduce their payments system risk is to expand their clearing capabilities to accelerate posting, in turn, reducing their number of NSF's.

This centralized approach also pays dividends in operations efficiency, reporting, and more.

### **A Roadmap for the Future**

There's no question that the evolution of payments processing requires lockbox processors to rethink the technologies and processes they use. Some key considerations as they begin this process:

- Completeness of the solution
- Their vendor's long-term vision
- Their solution's ability to meet current and future processing requirements
- Their solutions' scalability (up and down) to meet future needs
- The modularity of their processing infrastructure
- Their new solution's ease of integration with existing applications
- Their vendor's support for both a system migration and ongoing development

Armed with a more adaptable processing infrastructure, lockbox processors can achieve streamlined operations (e.g. the ability to eliminate redundant systems and processes), centralized control of their payments operations (for risk management, system monitoring, information reporting and auditing),

and faster response times to changing market dynamics and new business opportunities. But most importantly, by adapting their infrastructure, lockbox processors can help ensure their survival.

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