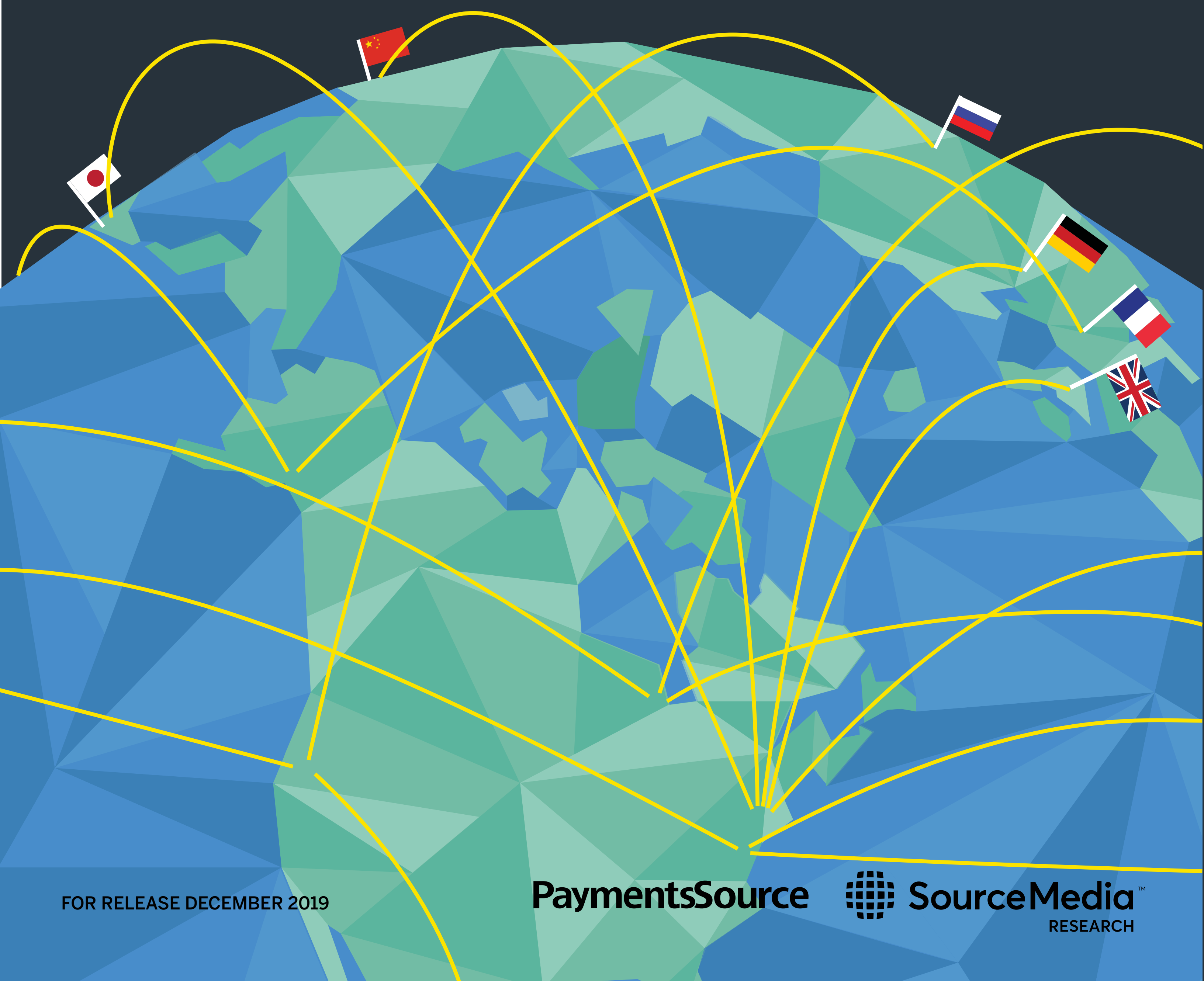
Cross-border B2B payments: Despite trade tensions, demand is up – and so is competition

Tariffs and other macro factors have introduced new uncertainty into international trade. That trend has businesses looking to manage risk and a growing number see real-time B2B payments as one way to do that. In response, a growing number of fintechs and other nonbanks are exploring ways to compete for this currently bank-dominated business.



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PaymentsSource SourceMedia™ RESEARCH

Cross-border B2B payments: Opportunity in uncertainty

INTRODUCTION

Broad adoption of smartphones and increased access to high speed internet are just two technologies that are bringing businesses across the globe closer together and driving an increased volume in cross-border business-to-business (B2B) payments. While the ability for businesses to conduct commerce across national borders is becoming easier, making payments to finalize these transactions is actually becoming more difficult.

Over the past 12 to 24 months there has been a hefty increase in the willingness of governments to engage in new tariffs, taxes and regulations in an effort to influence cross-border trade and the companies that engage in it. Additionally, interest rate reductions and currency devaluations by central banks have also increased the foreign exchange (FX) risks being borne by companies buying and selling across borders. These factors have made the growing cross-border B2B payments market more complex and difficult to navigate for financial institutions, as well as their vendors and clients.

Rising to the vast, yet often overlooked opportunity of cross-border payments are fintech startups and non-banks such as TransferWise, Veem and PayPal; along with three major card networks — Visa, Mastercard and American Express — seeking to cash in on the rising business demand. Not only are a variety of companies seeking to fulfill the needs of businesses where financial institutions may be falling behind, but also a host of new technologies such as blockchain, cryptocurrencies, payment gateways and real-time solutions are seeking to make simpler, faster payments and reduce FX risk.

In an effort to provide further insight into the market's needs as it relates to cross-border B2B payments, SourceMedia Research conducted its second annual survey of bank executives to provide further insight on the market's needs.

This year's report takes the insights one step further to understand how the trade wars are affecting business and the threat posed by fintechs to bank cross-border business. The report also covers which technology has achieved the most increased adoption among banks and what are the biggest unmet needs in the marketplace.

ABOUT THIS REPORT

Issues + Actions reports are produced by the editors of *American Banker* and *PaymentsSource* in partnership with SourceMedia Research. The reports draw on proprietary research that probes the activities, experiences and perceptions of C-suite and other senior-level banking professionals.

In addition to the survey conducted with 53 bank executives during October to November, 2019, website research and industry interviews were also conducted for background material purposes. In selected charts data from the 2018 cross-border B2B payments report was also included which was based on a survey conducted in October 2018.

The report examines how financial services executives are responding to, and capitalizing on, the fundamental forces that are changing the industry. Each report provides exclusive and authoritative analysis and insight on a topic of vital interest to the operation of a banking company. The target readership includes senior executives, line-of-business leaders, marketers and technology providers seeking deeper, more actionable industry perspectives, whether as clients or competitors. The reports are available for purchase singly or by subscription.

This report's primary narrative was written by Michael Moeser. *American Banker* is the leading resource for commercial banking professionals and *PaymentsSource* is the leading information resource for payments professionals. *American Banker* and *PaymentsSource* are SourceMedia brands and support a full line of professional content as well as research, data and conferences.

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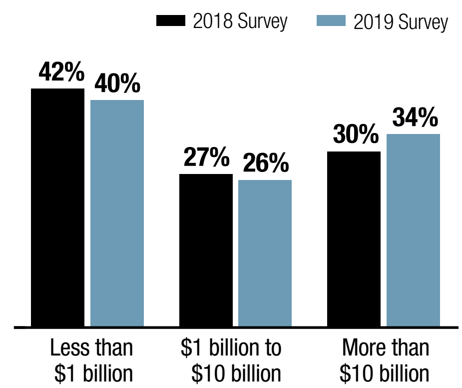
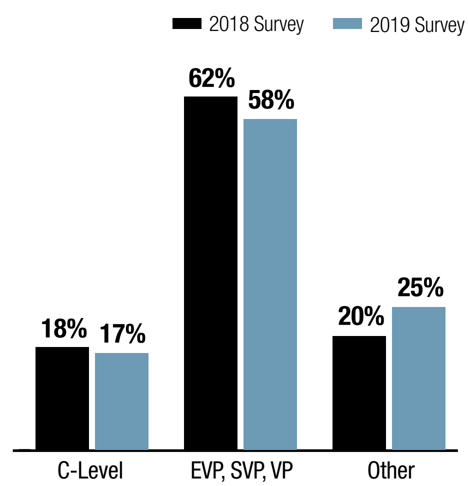
Figure 1: Respondents by asset size



Source: 2018 and 2019 SourceMedia Research Surveys

Figure 2: Respondents by title



Source: 2018 and 2019 SourceMedia Research Surveys

NOTE

KEY FINDINGS

- Demand for new cross-border B2B payment options is rising, with 40% of those surveyed in 2019 reporting that their customers were asking for new solutions compared to 23% in 2018. While this is a marked improvement in demand, it still remains below half of those surveyed, so it would be best characterized as "moderate with improvements."

- The overwhelming driver behind customers asking for new B2B cross-border payment solutions was to lower costs, with 90% of respondents stating this from the customers who had asked about new solutions. The next set of factors: to gain faster receivables access at 62%, followed by faster vendor payments at 57% and ease of payments at 57%.

- Roughly six in ten bank executives reported their vendors have offered them AP automation tools to resell to their customers, making this the top promoted new solution. In turn, about half of the respondents reported that their customers had recently implemented AP automation, making it the most popular new tool adopted.

- Between the 2018 and 2019 surveys, one product line had a notable shift in adoption — virtual cards. The adoption rate for virtual cards in 2019 was 34% of respondents' customers, up from 13% in 2018.

- The finance sector was the top industry for new cross-border B2B implementations in both 2018 and 2019 SourceMedia surveys, with 45% of respondents reporting adoption in 2019. The difference in adoption between 2018 and 2019 was statistically significant, as the response rate doubled.

- One in four bank executives felt that increasing preponderance of tariffs and trade conflicts had altered demand for real-time B2B cross-border payments among their customers. For that group, three-quarters saw increased demand for real-time payments solutions as a way to manage risks like currency fluctuations and government interference.

- However, approximately a third of bank executives surveyed said that the trade wars were negatively affecting B2B cross-border payment volumes or new account generation.

- Payment speed was the greatest single unmet need among bank executives for cross-border B2B payments, having captured one-third of the votes.

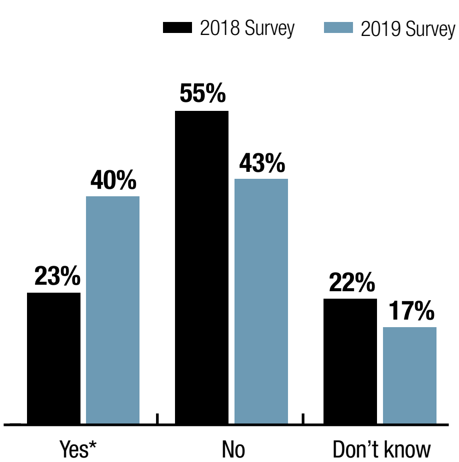
CUSTOMER DEMAND RISING FOR B2B CROSS-BORDER PAYMENT SOLUTIONS

Demand for new cross-border B2B payment solutions is rising, with 40% of those surveyed in 2019 reporting that their customers were asking for new solutions, compared to 23% in 2018. This is a marked improvement in demand, but it still remains below the 50% level of those surveyed, so it would be best characterized as "moderate with improvements" (see Figure 3).

Roughly two in five respondents reported that their customers were not asking for new solutions, so it is important to note that more bank executives are having conversations to determine potential demand.

B2B transactions make up the bulk of the volume of cross-border payments being sent, accounting for roughly $124 trillion of the total $127 trillion payment market in 2017, or about 98% according to a report by McKinsey & Co. The next largest segment of cross-border payments is consumer to business (C2B) coming in at $1.5 trillion in volume in 2017. The McKinsey report also noted that the revenue generated from B2B cross-border payments was approximately $127 billion, comprising fees, foreign exchange and float from the transfers; and growing at an annual rate of 6%.[1]

Figure 3: More customers are asking for B2B cross-border solutions



Source: 2018 and 2019 SourceMedia Research Surveys
Note: * Denotes statistically significant difference at a 95% confidence level

[1] https://www.mckinsey.com/~/media/McKinsey/Industries/Financial%20Services/Our%20Insights/Global%20payments%20Expansive%20growth%20targeted%20opportunities/Global-payments-map-2018.ashx

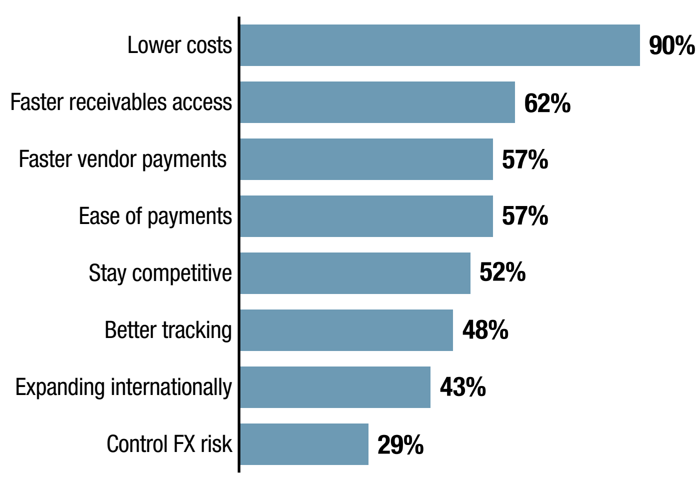
Customers overwhelmingly ask for new B2B cross-border payment solutions to lower costs, with 90% of respondents stating this reason, from the customers who had asked about new solutions (see Figure 4). The next three factors were very close in demand: to gain faster receivables access at 62%, followed by faster vendor payments at 57% and ease of payments at 57%.

Given the high cost of cross-border business payments, which tend to be larger in size than consumer payments, it should not come as a surprise that there is demand to lower the costs of making those transactions. Despite constant currency fluctuations in the global market, fewer than one in three respondents stated that controlling FX risk was leading to customers asking for new B2B cross-border payment solutions.

It is possible that some customers were already controlling for FX fluctuation risk with existing bank products such as currency hedges. It is also possible that U.S. customers could be arranging some of their contracts in dollars, thereby removing the need to hedge since the FX currency risk had been shifted to the foreign suppliers.

Bank technology vendors are promoting first and foremost accounts payable (AP) automation solutions and when they are promoted by the bank, their customers are implementing them. Roughly six in ten bank executives reported their vendors have offered them AP automation tools to resell to their customers. In turn, about half of the respondents reported that their customers had recently implemented AP automation making it the most popular new tool adopted. (see Figure 5).

Figure 4: Lower costs and speed are driving customer demands

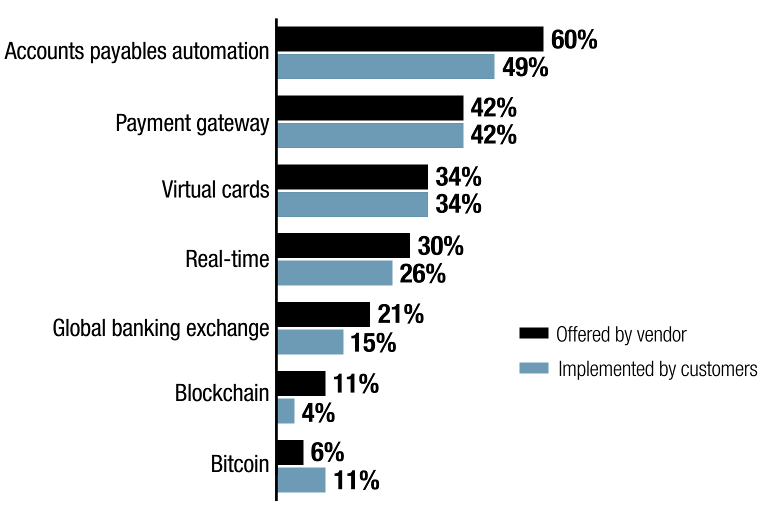


Source: 2019 SourceMedia Research Survey

Payment gateways were both the second most popular product promoted by vendors to banks and also the second most recently implement cross-border B2B payment solution, both at four in ten being offered and clients implementing. It should be expected that payment gateway offerings will rise, particularly when being promoted by the card networks due to major acquisitions conducted in the last 12 months. Earlier this year Visa acquired Germany-based PayWorks and Mastercard acquired New York-based Transfast. Additionally, in 2018 PayPal acquired Hyperwallet for $400 million to strengthen its payout capabilities and help it provide an integrated suite of payment solutions to e-commerce platforms and marketplaces around the world.

The next most popular option was virtual cards, with one in three banks reporting that their vendors were offering the service to them and customers implementing them, followed by real-time cross border solutions. Since virtual cards are a common tool in domestic B2B and C2B transactions, it should not be a surprise that they have a relatively good adoption level in cross-border situations. However, when it comes to real-time payments, the U.S. market still lags in real-time adoption despite the advent of push payments from the card networks. The Clearing House introduced its real-time payment (RTP) network in the last year, with more solutions offered by ACI Worldwide, FIS, Fiserv and others. In other words, B2B domestic payments have not yet widely adopted faster payments, so cross-border adoption is likely impacted as well.

Figure 5: Banks and customers are readily adopting new solutions



Source: 2019 SourceMedia Research Survey

Real-time cross-border B2B payments is an area that should see significant growth in coming years for two main reasons. First, vendors have been spending billions of dollars acquiring companies that offer cross-border money transfers and payments such as Earthport (by Visa) and Payvision (by ING), as well as making major investments in startups such as Transferwise and Currencycloud. Second, as faster domestic payment networks launch and achieve widespread adoption in places like the U.K. Singapore and Australia, the next step would for driving widespread adoption of cross-border real-time payments. In fact, there are already real-time cross-border payment solutions being deployed that are starting to gain traction among banks and their clients such as Swift's Global Payment Initiative (GPI) and the Single Euro Payments Area (SEPA) Instant Credit Transfer Scheme.

Between our 2018 and 2019 surveys, there was only one product line that had a notable (statistically significant) shift in adoption rates — virtual cards. The new solution adoption rate for virtual cards in the 2019 survey was 34% or one-third of respondents' customers, up from 13% in 2018 (see Figure 6).

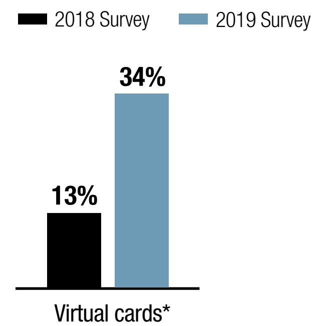
Two big drivers behind growing virtual card adoption have been increased traction by the card networks to promote their adoption for B2B payments, and card issuer processors such as Marqeta that can deliver virtual cards to digital wallets such as Apple Pay and Google Wallet.

Examples of card network traction include the partnership announced this year between Visa and Sabre to target the travel industry, and Mastercard launching its Virtual Card Receivables Service in collaboration with invoice-to-cash and accounts receivable technology firm VersaPay. In 2018 American Express launched its own virtual card issuing tool called American Express Go.

The finance sector was the top industry for new cross-border B2B solution implementations in both 2018 and 2019 SourceMedia surveys with 45% reporting adoption in 2019. The difference in adoption between 2018 and 2019 was statistically significant, as the response rate on implementations doubled (see Figure 7).

The next three leading industries in terms of new implementations in 2019 were telecommunications, software and insurance. These were among the top industries in the 2018 survey as well, and had statistically significant differences in adoption rates from 2018. Adoption in telecommunications and software tripled, while the insurance industry implementations grew five-fold.

Figure 6: Virtual cards have dramatically grown in adoption



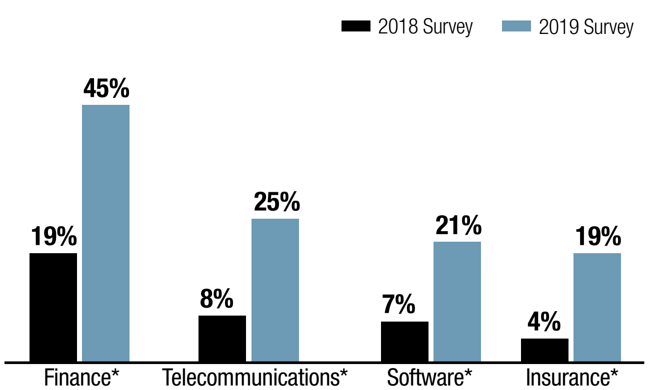
Source: 2019 SourceMedia Research Survey
Note: * Denotes statistically significant difference at a 95% confidence level

TRADE WARS: THE EFFECT ON B2B CROSS-BORDER PAYMENTS DEMAND

Tariffs, currency devaluations and trade restrictions have all increased over the last 24 months as the governments from the U.S., China, the European Union and others have sought to promote their exports while limiting imports from others. Such political maneuvers can have negative impacts on cross-border trade and B2B payments across a wide swath of industries, including ones not being targeted by governments. However, trade wars can also have the positive benefit of spurring demand for new payment technologies such as real-time payments, which can provide less FX risk and quicker settlements.

Twenty-eight percent of bank executives felt that the increasing preponderance of tariffs and trade conflicts had altered demand for real-time B2B cross-border payments among their customers (see Figure 8). For this group, three-quarters said that it had increased demand for real-time payments as it more readily addresses FX risk caused by currency fluctuations and

Figure 7: Several industries adding new cross-border solutions



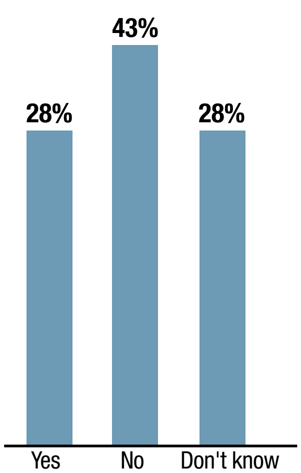
Source: 2019 SourceMedia Research Survey
Note: * Denotes statistically significant difference at a 95% confidence level

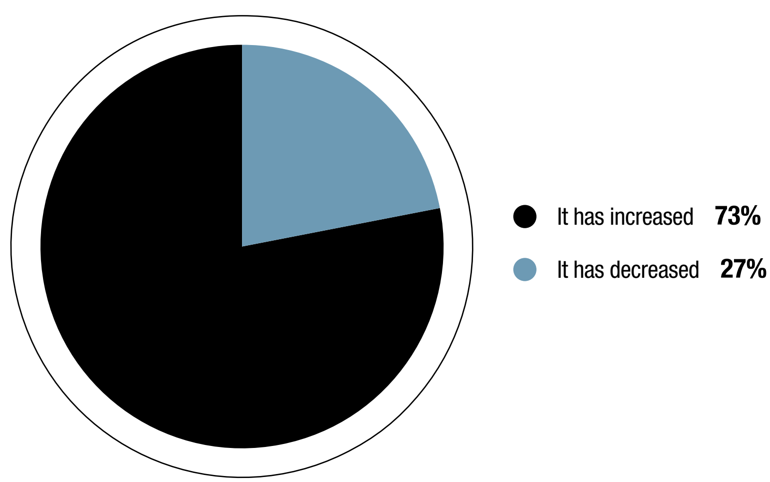
reduces the amount of time governments have to interfere with payment transactions.

Some respondents felt that a trade war was bound to happen due to the nature of U.S. policies that have favored importation of goods to feed the country's consumption-oriented economy. The U.S. global trade deficit with China, its largest global trading partner according to the Office of the U.S. Trade Representative, was $419.2 billion in 2018, representing an 11.6% increase over 2017.[2]

By and large, however, most respondents viewed the situation as business-as-usual. The balance of bank executives who did not see trade wars driving increased demand for real-time cross-border B2B payments were four in ten (43%) reporting "No" and about one in four stating that they "didn't know." A key factor in why so many executives are still up in the air relates to the lack of consensus over whether or not there is actually a trade war occurring or just some short-term political posturing ahead of the 2020 U.S. Presidential elections.

Figure 8: Have tariffs and trade conflicts altered demand for real-time B2B cross-border payments among your customers? If so, how?





Source: 2019 SourceMedia Research Survey
Note: * Denotes statistically significant difference at a 95% confidence level. Follow-up question only asked of those who replied "yes" to first.

[2] https://ustr.gov/countries-regions/china-mongolia-taiwan/peoples-republic-china

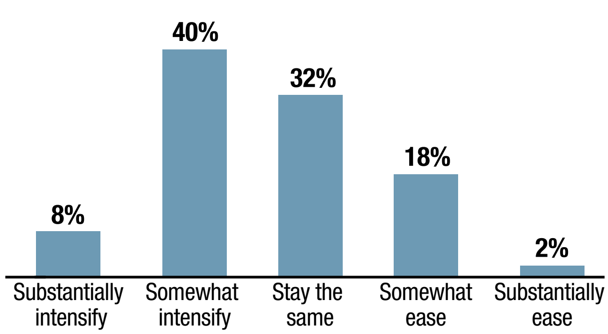
Almost one-third of bank executives surveyed felt that trade tensions were negatively affecting B2B cross-border payment volumes or new account generation. There were minor groups of respondents that reported both positive and negative impacts on payment volumes and new account generation, which is likely due to the fact that the trade wars with China, Europe and others being more industry specific vs. broad-based.

Half of survey respondents felt that the trade and tariff disputes would intensify over the next 24 months, due to a combination of political and economic factors, while one-third felt the situation would remain at the same level of intensity as it has been (see Figure 9).

The political factor drawn out most heavily was an amalgam of the trade tensions between the U.S. and China being raised as a political issue, the U.S. 2020 presidential elections, and Brexit. It is true that the U.S. has run massive trade deficits with China for many years, but the decision to turn that deficit into a matter of overt conflict is a of much more recent vintage. The oft-delayed Brexit was also noted as creating additional political instability in Europe which could impact future trade.

The economic factors were an expected global economic slowdown and the high trade deficits that have continued for years, which could stymie future U.S. growth. In the global economic slowdown, China was mentioned as being particularly affected, along with Europe. One bank executive said: ”Uncertainty around U.S./China trade deals and the continuous delay of Brexit, and other minor, and less popular trade tensions between smaller

Figure 9: Not much optimism on trade relations



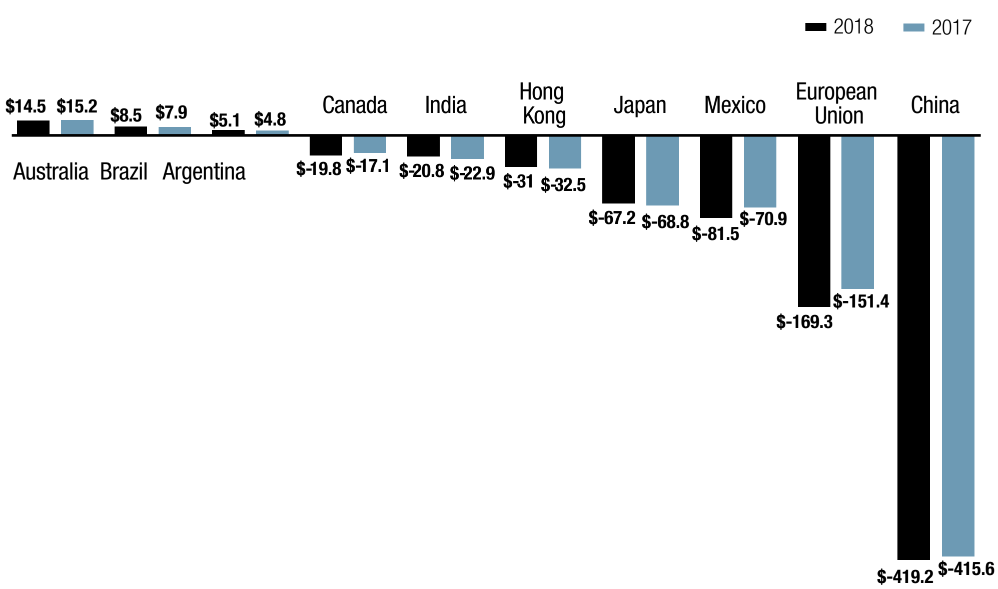
Source: 2019 SourceMedia Research Survey

countries, somewhat intensifies my concern of global tariffs and trade tensions rising in the near future, to the point where I think this may be the major catalyst in the next recession."

The U.S. market largely runs trade deficits, where foreign imports exceed exports, with most of its global trading partners and the deficits are continuing to increase yearly. In 2018, the U.S. trade deficit with China stood at $419.2 billion, with the European Union at $169.3 billion and Mexico at $81.5 billion and Canada was at $19.8 billion up 16% from 2017 (see Figure 10). The U.S. ran a surplus with only a few such partners last year, including Australia, Brazil and Argentina.[3]

About one-quarter of survey respondents expect the impact of the trade war tensions on cross-border payments to increase over the next 24 months (see Figure 11). Given that issues such as the U.S. presidential election, a delayed Brexit deal and global trade agreements are events that will unfold in the next 12 to 24 months, many executives are likely taking a longer-term view of potential impacts.

Figure 10: The state of U.S. trade balances with key partners



Source: 2019 SourceMedia Research Survey

[3] https://ustr.gov/countries-regions

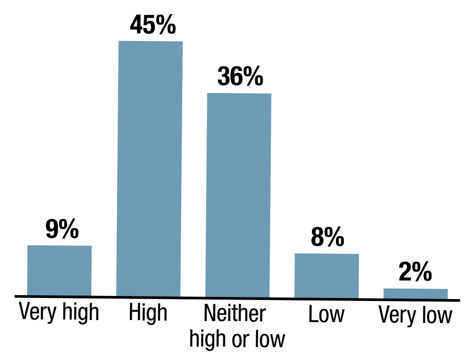
COMPETITION FROM FINTECHS AND SWITCHING B2B PAYMENT VENDORS

While banks and credit unions have the inherent home field advantage when it comes to providing cross-border payment services to businesses, they are not immune to competition, particularly when it comes from more agile organizations with point-to-point solutions dedicated to serving market niches. The bank advantage generally lies in the fact that they provide treasury management services, merchant acquiring, lock box services and other offerings that cater to the domestic operations.

Upstart financial technology firms such as TransferWise, Veem, Earthport (recently acquired by Visa) and Transfast (acquired by Mastercard) have targeted specific elements of the cross-border B2B payments trade by becoming best-of-breed technology providers — in comparison to traditional banks that tend to be "Jack of all trades."

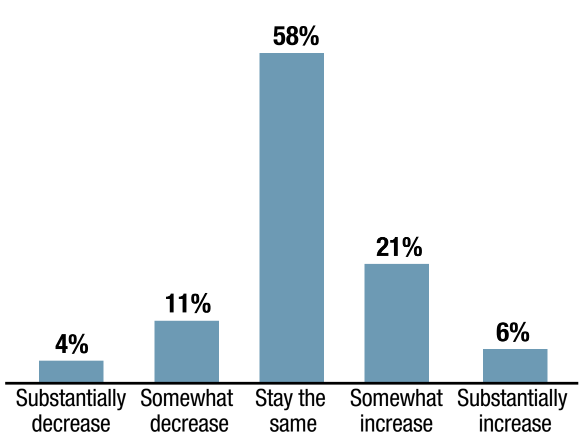
As a result of this onslaught of fintechs into the cross-border payments arena, a slight majority of bank executives (54%) reported that the level of threat that they felt posed by these companies was high or very high (see Figure 12). About one-third felt neutral about the fintech threat. One in ten felt that the level of threat fintechs posed was low or very low. Given the size of the cross-border P2P payments volume being north of $124 trillion and dominated by banks, the actual threat fintechs pose is likely to be low — with the caveat that they tend to focus on the most lucrative parts of the business.

Figure 12: Fintechs' threat to cross-border payments



Source: 2019 SourceMedia Research Survey

Figure 11: How will trade wars affect future payments?

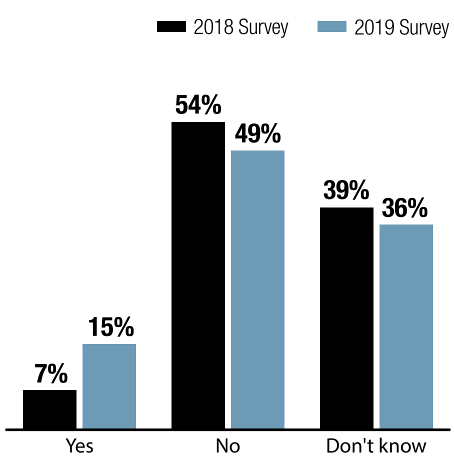


Source: 2019 SourceMedia Research Survey

The willingness to switch B2B cross-border payment solution providers in the next six months was low, at 15%, reflecting a sentiment that bank executives must be satisfied enough or seeing enough new technology from existing vendors to stay the course (see Figure 13). While the 2019 results were double the 2018 scores, 15% vs. 7%, the overall takeaway is that dissatisfaction levels remain low enough to avoid a mass shift in vendors.

The fact that over one-third of survey respondents in both 2018 and 2019 were unsure if they would switch B2B payment vendors in the next six months is reflective of the rapid change taking place in the market. Generally, switching payment vendors is not an easy task, but the threat from existing competitors and new ones must be high enough to keep bank executives on edge to be constantly evaluating their vendor set.

Figure 13: Many are still undecided on switching B2B vendors



Source: 2018 and 2019 SourceMedia Research Surveys

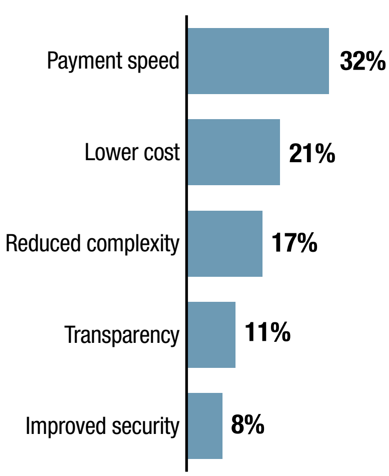
UNMET NEEDS FROM B2B VENDORS REMAINS VARIED

Payment speed was the single greatest unmet need customers were reporting to bank executives for cross-border B2B payments. However, since this matter captured one-third of the votes, it is reflective that no single unsolved issue is pervasive among all financial institutions (see Figure 14).

Lower costs were highlighted as the second-greatest unmet need by one in five bank executives. However, when bank executives were asked about what was driving their customers to ask about new solutions and were able to choose multiple unmet needs, 90% of them reported that their customers were asking about lower cost. Since many vendor costs are often simply passed on through to corporate customers, this could be a problematic disconnect for banks, since many fintechs place their value propositions on lower cost, increased simplicity/transparency and often faster speed.

In other words, 90% of customers are asking for lower cost solutions from their bank executives, yet when executives were asked to filter it down to the single greatest unmet need for their customers, lower cost came in second place.

Figure 14: Payment speed, cost and complexity are big unmet needs



Source: 2019 SourceMedia Research Survey

CONCLUSION - DESPITE TRADE WARS CROSS-BORDER B2B PAYMENTS COMPETITION HEATS UP

Cross-border revenues are growing at a 6% annual rate encompassing $124 trillion in payment volumes, which is a healthy market to attract significant competition from all corners of the industry and globe. Banks will want to protect their market share, while fintechs will want to target the most lucrative segments in the process and corridors. Companies are clearly on the prowl for lower cost solutions and being able to gain faster access to receivables and driving faster payables.

Everyone should expect more competition and margin pricing pressure.

The trade wars appear to be more talk than action with a deep-rooted political bias aimed at the 2020 U.S. presidential election. A favorable deal with China and possibly Europe — or lack thereof — could potentially influence the outcome of the election. The issue with Brexit is on top of executives' minds yet it seems to be less of a problem than U.S-China trade relations and does not appear to be driven by a single individual, unlike the U.S. trade war.

Expect technology solutions such as AP automation, payment gateways and virtual cards to grow in both offerings to banks and adoption by corporate customers as these having been receiving significant investments and acquisitions. These three solutions are readily available and address issues such as lower costs, faster payments, higher security and simplification/ transparency of process. Blockchain and cryptocurrencies are still nascent solutions that need to more fully develop before they achieve broadscale adoption.

Customers are increasingly asking their bank partners for new B2B cross-border solutions with lower costs being the key driver followed by faster access to receivables and faster payments to vendors. The fact that banks place cost second in consideration and faster payment first is an important disconnect that could drive open a gap for fintechs to enter the most lucrative parts of the cross-border payments market.