

SPECIALTY RETAILER PREPARES FOR BENEFITS OF RICHER PAYMENTS DATA



**PAYMENTS
CANADA**

Key themes explored in this case study

- 1 What are potential opportunities that Canadian retailers can take advantage of as a result of payments Modernization?
- 2 How are Canadian retailers preparing for payments Modernization?

The organization in this case study is a small, specialty retailer in Canada with international operations offering prescription products online and in-store. It derives revenues from consumer purchases and insurance benefit co-payments. To date it has invested in advanced solutions to manage its inventory and sales processes and is using a cloud-based accounting platform. The organization has some awareness of key enhancements to payments infrastructure and processes associated with Payments Canada's Modernization initiative and is keen to embark on a strategy to address inefficient payment processes and sparse payments data as well as reduce frictions in navigating the payables process.

As the study shows, inefficiencies in the organization's accounts receivable and payables processes could be significantly improved as a result of a modernized payments infrastructure and through payments upgrades in the corporate-to-bank space. Productivity gains accorded by straight-through processing (when the payment travels from sender to receiver without manual intervention) once richer electronic payments data is enabled in the bank-to-bank space are evaluated.

While the organization has not enabled rich payments data capability within its accounting systems, it has started to map out the benefits of migrating to ISO 20022, the emerging international standard for payments messaging that allows relevant data to accompany electronic payments, in its payments activities. Use cases associated with recent enhancements to Automated Funds Transfer (AFT) infrastructure are also contemplated.

This case study was developed through in-depth interviews with individuals responsible for accounts payable, receivable and treasury processes as well as key change management and major project leaders within the organization.

EXECUTIVE SUMMARY

DRIVERS OF CHANGE



- The need to improve efficiency by reducing manual reconciliation of payments with invoices and error prone activities such as re-keying data.
- The need to facilitate payables and reconciliation.

POTENTIAL BENEFITS



- Annual benefits associated with eventual straight-through processing could approach \$55 thousand based on:
 - › Reallocation of store management resources from back-office reconciliation activities, to more productive customer relations and marketing activities.
 - › Facilitation of outbound payments and associated reconciliation with payables accounts.
- The organization could accrue over \$275 thousand in potential savings over five years.

SOURCE OF BENEFITS



- Productivity gains from increased automated matching of invoices to payments through richer remittance information.
- Reduced time spent generating payments through an online banking portal and subsequent manual reconciliation with accounting software.

PROJECTED EFFORT



- Some system changes and process updating will be required and training may be necessary to implement changes at an estimated one-time cost of about \$15 to \$20 thousand.
- The organization's point-of-sale (POS) vendor will have to integrate richer receivable data into a practice management software system.
- These efforts and associated benefits depend on infrastructure initiatives (e.g. ISO 20022-enabled payments systems) vendor and financial institution adoption.

EXECUTIVE SUMMARY

ACCELERATORS



- The retailer's existing cloud-based external accounting, POS and practice management software solution can be ISO 20022 enabled and will require comparatively little internal reconfiguration to take advantage of modernized payments.
- AFT service enhancements are already in effect.
- Operating as a relatively new retailer in the digital space, the organization has an adaptive mentality and is an adopter of new, efficient technologies.

LESSONS LEARNED



- Work can begin with software vendors and banking partners to modernize the corporate-to-bank space and ensure straight-through processing and other modernized enhancements are implemented as they become available.
- Reconciliation processes to ensure rich transaction data is integrated effectively with the POS and practice management software system will be necessary.
- Exploring payments use cases to determine the effectiveness of new payments innovations to minimize receivables payment friction would be beneficial.

Table 1. Estimated benefits, savings and costs of finance and payments-related activities

BENEFITS	
ACCOUNTS RECEIVABLE	● Automated reconciliation of insurance payments
ACCOUNTS PAYABLE	● Greater payments flexibility and integration with accounting journal
TREASURY	● Reduced accounting journal reconciliation for payables
SAVINGS	
Straight-through processing Enhanced corporate-to-bank messaging	Over \$55 thousand in annual cost savings amounting to over \$275 thousand accrued cost savings over five years
COSTS	
TECHNOLOGY	● Point-of-Sale and accounting system upgrade to ISO 20022
PEOPLE	● Training
PROCESS MAPPING	● Accounts payable and treasury process mapping
Technology upgrades Training Process migration	Estimated one-time cost is between \$15 - \$20 thousand

KEY:

- Internal upgrade
- Corporate-to-bank enhancements (ISO 20022)
- Modernization (bank-to-bank)

ABOUT THE ORGANIZATION

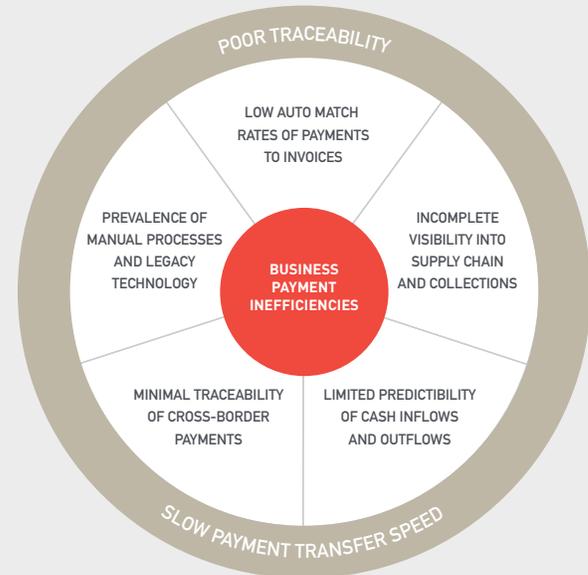
The organization is an international retailer of personal care products and services. Its products and services are available online and in-store at urban retail locations across North America and Europe. It receives payments primarily from online and in-store consumer sales and insurance reimbursements for health products. The organization's expenses include supplier payments as well as payroll and other operational costs. The business derives revenues entirely from product sales and associated services. Revenues for 2017 are estimated at about \$7.5 million on 42,000 sales.

Because the company operates internationally in Europe as well as North America, it does have some corporate knowledge of modernized payments infrastructure and services in the international context. However, there has been little application of European practices in Canada to this point. The organization also procures much of its retail products and components from offshore manufacturers, primarily in Asia, as well as domestic sources. This practice introduces significant friction involving long payment lags, transit risk and delayed shipping. The Canadian organization operates retail stores in three time zones across the country and interacts with insurers and customers from coast-to-coast online. It also offers products and services online across North America and internationally.

Finance and treasury activities could achieve greater efficiencies in several key areas identified by the 2018 EY and Payment Canada study, [Evaluating the costs of payments processing](#) (see figure 1), including:

- Automatic reconciliation of invoices with ISO 20022 enabled Automated Funds Transfer (AFT) payments. This could also eliminate the need for the insurer to separately convey remittance data via an online portal.
- Integration of flexible payables and account reconciliation within enterprise accounting software.
- More efficient cash management through reduction of cheque payments for rent and incidentals in favour of timely AFT or potential real-time payments.

Figure 1.



- More efficient supply chain management through data-rich globally-interoperable wire payments, potentially harnessing new services such as the Society for Worldwide Interbank Financial Telecommunication's (SWIFT) global payments innovation, international tracking and reporting.

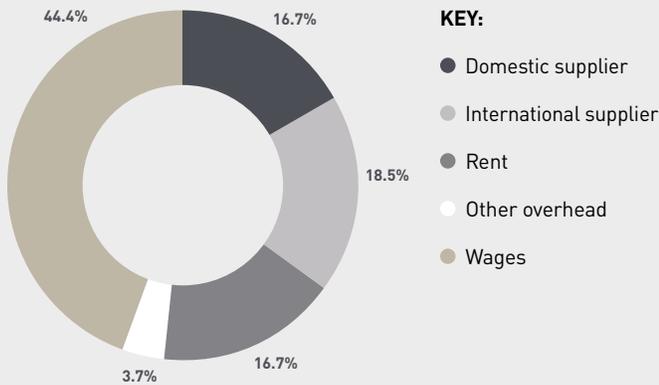
Accounts receivable and payable activities stand to benefit tangibly from payments Modernization and other upgrades. Based on Payments Canada estimates developed over the course of the case study, it is projected that manual reconciliation and payables cost savings alone could represent approximately \$55 thousand annually in addition to a number of intangible benefits associated with upgrades, forecasted for treasury, reporting and other accounts payable activities.

How is the organization preparing for the change?

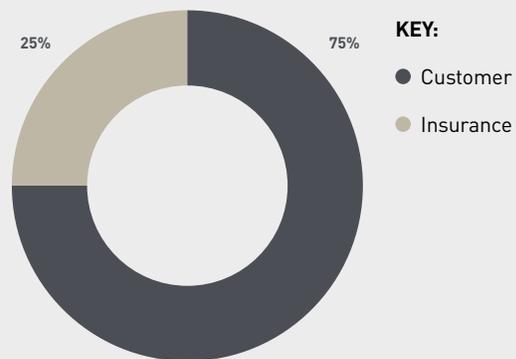
The organization has some appreciation of enhanced payments capabilities in its European operations relating to richer data and faster payments. To date the organization has not invested directly in ISO 20022 capability, although it has begun to explore the requirements and costs of migrating its point-of-sale and practice management software system to incorporate the new standard in its payments activities. The organization has invested in cloud-based solutions for its point-of-sale and practice management software activities such as inventory, sales and accounting needs, including accounts payable and receivable, cash reporting and payroll. It is well-positioned with adaptable and motivated software vendors to take advantage of ISO 20022 and modernized payments capabilities.

AT A GLANCE: FINANCE AND TREASURY PROFILE

Typical monthly payables



Revenue sources



Accounts Receivable

- The organization’s consumer products are often covered by employer health insurance plans and are accordingly co-paid between insurers and customers.
- Consumer purchases are largely made via credit card and, to a lesser extent, debit card. Use of cash and other payment methods is negligible.
- For co-payment, customers present insurance credentials and coverage is immediately manually assessed through an online portal with the appropriate insurer. The customer is charged the uncovered balance, typically paid by credit card, and the transaction is completed.
- The covered portion of the payment is subsequently received as part of a batch by AFT direct deposit to the organization’s cash account several days later. The insurer provides remittance information for each invoice via online portal.
- Incoming batch payments are integrated from the cash account statement into accounting software and are manually matched with individual invoices.
- Rare errors on invoicing (< 0.1 per cent) that require reversal to the insurer are onerous, requiring repayment by manual cheque.

Accounts Payable, Payroll and Expense Claims

- Operational payments include rent of retail space, utilities, insurance, payroll and domestic and international supplies.
- The organization relies on off-shore manufacturing for a significant proportion of its retail inventory, usually settled through international wire payment across correspondent banking networks.
- Rent has traditionally been paid by post-dated cheque but is in the process of being migrated to electronic transfer via pre-authorized debit or AFT direct deposit to avoid cash management issues associated with unpredictable deposits.
- Utilities, insurance and other regular operational expenses are paid with a combination of pre-authorized debit and online BillPay (Electronic Data Interchange) services through a banking portal.
- Payroll and credit card payments are made by AFT direct deposit and BillPay. Biweekly payroll payments of approximately \$100 thousand are made through its accounting software.

Treasury

- Cash position is updated manually through an online banking portal.
- Receivables and payables must be manually reconciled with journals through the treasury function.

ISO 2022

What can ISO 2022 offer?

ISO 2022 is the emerging international standard for financial messaging. The ISO 2022 standard features structured and unstructured data to provide rich remittance information (i.e. what the payment is for) and facilitate straight-through processing. The standard was developed by the International Standards Organization and has been adopted by SWIFT — the primary global provider of secure financial messaging services and the registration authority for the ISO 2022 standard.

It is important to differentiate aspects of the ISO 2022 payments message set when considering corporate adoption and benefits of ISO 2022 messages. Specifically, messages may pertain mainly to the corporate-to-bank space or the bank-to-bank space where Payments Canada's Modernization efforts are concentrated. In the corporate-to-bank space, a corporate end user may work with their financial institution to transmit payment initiation messages as well as transmit and receive cash management messages. Bank-to-bank exchange is enabled by payment clearing and settlement messages. In a typical end-to-end payment flow, a business might initiate payment with a message that contains detailed remittance information. The sender's financial institution receives the message and exchanges it with the receiving financial institution using a clearing/settlement message that retains the remittance information. The receiving corporate end user can then be notified by its financial institution and query the payment using cash management messages.

Payments Canada is promoting the standard and providing support for implementation as part of its larger Modernization initiative within Canada. ISO 2022 will replace the Payments Canada Standard 005 messaging currently being used for AFT payments. Additionally, new real-time payments and an enhanced high-value system will support ISO 2022 at launch.



Accounts receivable and cash management

ISO 2022 messaging for batch AFT payments will allow for straight-through processing of remittance information as part of the payment message when it is implemented in the bank-to-bank space. This will simplify reconciliation of incoming payments from insurers and would complement or potentially replace current remittance advice, typically sent by email or available via portal. In addition, the organization would benefit from richer detail associated with other AFT payments, including deposits from credit card companies showing which stores were the source of the payments as an example.

In the nearer term, cash position and payment querying messaging under ISO 2022 cash management messaging could allow the organization to better monitor and predict cash account balances.

Accounts payable

The organization pays international manufacturers and suppliers by wire payments. New payment reporting services such as SWIFT global payments innovation, offer the opportunity to work with suppliers to tighten the supply chain and facilitate inventory management.

AFT direct deposit for payroll could also be enhanced with messaging attached to the payment. This would require implementation through the enterprise payroll solution. Although rich remittance information is currently provided through portals and email, ISO 20022 could provide an opportunity for the organization to integrate its practice management software with its accounting and payroll solution to reduce manual entry and reconciliation.

Migrating rent payments from post-dated cheque to ISO 20022-enabled electronic payments, via pre-authorized debit or direct deposit, real-time solutions or, eventually, data-rich wire transfers would simplify the process

for both the property owners and the organization and help minimize cash shortfalls when one or many rent payments are withdrawn at unpredictable intervals. Utility and credit card payments, currently made via AFT and BillPay would likely be largely unaffected by richer remittance data at this point.

Implementation planning

The organization's cloud-based practice management software is currently equipped to initiate and integrate ISO 20022 messaging but requires network and downstream adoption to provide richer incoming payment data. Outgoing payments could be initiated via ISO 20022 payment initiation messages but will require intermediary adoption to support straight-through processing. In its international operations, the firm uses the richer message standard for integration of payments with its practice management software and this experience could assist in Canadian implementation.

Innovation opportunity

Richer payments data associated with ISO 20022 enabled messaging would give the organization better control and insight over outgoing and incoming transfers and create the opportunity to explore cost savings associated with leaner cash management. These benefits will only be realized when ISO 20022 capability is ubiquitously implemented in the bank-to-bank exchange, clearing and settlement space.

Degree of change required (Minimal – Moderate – Substantial)

The following table shows the impact of implementation of the ISO 2022 standard across key operational areas:

PEOPLE – MODERATE ●●○



- As the implementation effort will largely be borne by the practice management software vendor and insurance co-payers, the organization's staff will not be required to make major adjustments to make and receive payments with ISO 2022 messaging.
- There would likely be some education and training required for staff to learn how to make best use of enhanced cash management reporting and remittance reconciliation associated with new capabilities under the standard.
- Enhanced remittance and cash management information would free up resources currently dedicated to manual processes and allow the organization to take advantage of advanced analytics that can be realized with richer data.

PROCESS – MODERATE ●●○



- Processes will have to be modified to ensure that richer incoming data is incorporated into practice management software reconciliation and reporting functions.
- Cash management and payment tracking would need to be integrated into advanced reporting processes, whether generated manually or automatically, for adjustment.

TECHNOLOGY – MODERATE ●●○



- Supplier payment, payroll, operational expenses and incoming insurance reimbursements will have to be aligned with enterprise capabilities to realize the full capabilities associated with richer data. This will involve business process planning activities with the practice management software and point-of-sale solutions vendors.

ORGANIZATION – MODERATE ●●○



- The organization will have to re-envision the cash management process to fully take advantage of the capabilities offered by richer payments and reporting data.
- New analytics may drive innovation in the organization's revenue model and planning.

AFT ENHANCEMENTS

What can the AFT enhancements offer?

Automated Funds Transfers are a critical component of the payments landscape for business-to-business, business-to-consumer and consumer-to-business transactions.

AFT direct deposit payments are used primarily for B2B and are as familiar to consumers as payroll and benefit payments to individuals. Pre-authorized debit payments are typically used for regular consumer-to-business bill and housing payments. AFT offers a very cost-effective and secure channel and is typically processed in batches between financial institutions using the Payments Canada Standard 005 data structure which offers limited room for remittance data. This problem is compounded by inconsistent application of that standard across financial institutions, resulting in unpredictable message transmission between end users.

Payments Canada introduced enhancements to AFT batch processing, including a third exchange window that extends the time available for payments processing and two-hour funds availability to end users of direct exchange financial institutions. ISO 20022 standard messaging is currently available for clearing and settlement of AFT payments between financial institutions but the standard has not been voluntarily adopted by financial institutions in Canada to this point.

How will this organization accommodate AFT enhancements and harness its benefits?

A third exchange window supports better aligning AFT payments with business hours in western time zones. In addition, two-hour funds availability allows for AFT payments to be processed more quickly for time-sensitive transfers. These enhancements, combined with the promise of ISO 20022 remittance data, should encourage migration of cheque payments (e.g. rent) to more predictable electronic methods.

The organization also conducts its banking operations across two separate financial institutions and could benefit from faster AFT-based movements between accounts. When enhanced AFT

payments are paired with ISO 20022 payment status and cash reporting capabilities, the organization should be able to improve its cash management processes and reduce associated costs and resource dedication.

Degree of change required (Minimal – Moderate – Substantial)

The following table shows the impact of implementation of AFT enhancements across key operational areas.

PEOPLE – MINIMAL ● ○ ○ ○



- Payments may migrate to electronic methods and latencies for payroll may be shortened.
- Some additional treasury monitoring will be required, but processes and staff activities will not be significantly altered by the AFT changes.

PROCESS – MINIMAL ● ○ ○ ○



- There will be flexibility around processing payments in the western time zone. Incoming payments may be deposited earlier.

TECHNOLOGY – MINIMAL ● ○ ○ ○



- Current systems are presently compatible with enhancements.

ORGANIZATION – MINIMAL ● ○ ○ ○



- Beyond modest benefits to treasury activities, there is minimal impact on the organization.

TAKEAWAYS

The organization has awareness of key enhancements to payments infrastructure and processes associated with Payments Canada's Modernization initiative. It is eager to tackle pain points around unpredictability of payment inflows and outflows and corresponding cash position.

The organization believes payments Modernization can enable benefits including:

- **Operational improvement:** Improved inventory management and cash monitoring will drive down costs and inefficiencies, and release funds for more productive purposes.
- **Productivity improvement:** Finance and treasury activities may see cost savings through improved integration of payment information with enterprise accounting and other primary software services.

As the study shows, rich payments data messaging and more responsive AFT processing are key to achieving the organization's goals. The organization sees these benefits as critical to efficient allocation of resources, reduction of payment and treasury inefficiencies and tightening of operational strategy.

Want to share your experience? If you would like to share your organization's ISO 20022 journey, we want to hear from you.
Email: modernization@payments.ca.



Payments Modernization and ISO 20022

ISO 20022, the global message standard, is the foundation for payment messaging across all modernized payments systems. The transition to ISO 20022 will support interoperability with global payment ecosystems, enable new opportunities for financial products and services, and bring new levels of efficiency to the Canadian economy. To learn more, visit our ISO 20022 Resource Centre at payments.ca.

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About Payments Canada

Payments Canada ensures that financial transactions in Canada are carried out safely and securely each day. The organization underpins the Canadian financial system and economy by owning and operating Canada's payment clearing and settlement infrastructure, including associated systems, bylaws, rules and standards. The value of payments cleared and settled by Payments Canada in 2018 was \$53 trillion or \$209.7 billion each business day. These encompass a wide range of payments made by Canadians and businesses involving inter-bank transactions, including those made with debit cards, pre-authorized debits, direct deposits, bill payments, wire payments and cheques. Payments Canada is a proud supporter of the Catalyst Accord and the 30% Club. For more information about Payments Canada, visit payments.ca.