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Data is the new oil in B2B banking

TRAXPAY

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FinTech has often been portrayed as a disintermediation for banks. 18 years ago PayPal, at the time a new market entrant, began its quest to shake up the financial services industry and ultimately captured a very big piece of the B2C payment pie. It has been enormously successful, and other B2C payment providers have since joined the movement to challenge banks in this space. While banks continue to dominate in other B2C segments such as real estate financing, retirement planning, and consumer investment strategies, they must now turn their focus to threats looming in the market for B2B transactions – a global market that has been estimated to be worth more than USD 300 trillion annually.

B2B networks: the new threat to the banks

There is an ever-increasing demand for integrated and innovative financial products in the B2B market. Enterprises are seeking convenience and flexibility, automated transaction processing, and optimised working capital. They need streamlined processes to succeed in the age of international commerce which has become infinitely more complex, competitive, and costly. For far too long banks relied on the monopoly they represented in the financial industry, and on their long-standing customer relationships. This has resulted in a huge innovation gap which new competitors are anxious to fill.

In recent years, B2B networks have developed an enormous global customer base on their platforms which connect suppliers, distributors and logistic providers, and simplify trading. They have now recognised the huge opportunity to supplement their SaaS revenues by cross-selling financial products to their customers. Ariba's partnerships with American Express, First Data and Prime Revenue, amongst others, speak to their ambitious goals in this regard.

In B2B business, banks face a very real threat of having to relinquish a great deal more to imminent competitors who will be able to execute a whole array of transactions within their networks. Should they not take action, they may be left to simply act as processors with access to central bank payment services and as market makers who take a transaction fee. A resulting price war based purely on cost efficiency could ultimately threaten their most important asset: the trust of their customer and the underlying personal relationship. If that is lost, banks will become nothing more than neutral, interchangeable service providers.

Unfortunately, history has proven that even the value of trust can be outweighed by the convenience factor; perhaps less so in B2B than B2C, but banks still should be very wary.

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The race for data

In 2006 Clive Humby, the renowned data scientist and innovator, coined the phrase "data is the new oil!" Banks are desperate to capture the data that would enable them to cross-sell on a big scale.

Their data analysis and credit decisions would improve significantly with a better data base. For example, it is quite likely that an invoice which has been paid on time, every time for the past 30 months will also be paid next month. Alternatively, the risk of a one-off bill not being paid is substantially higher. Information on what an invoice is for can also help assess the risk of non-payment, as companies generally pay for strategically important purchases more readily than unimportant C goods even when liquidity is critical. By way of illustration, a company is more likely to prioritise paying the invoice for its servers than it is to pay for its last company Christmas party.

But exploiting this new kind of data is only the beginning of the potential for cross-selling.

It moves credit decisions to another level: today some banks utilise data that is months or years old to make credit decisions; the new era will enable automated decisions based on the most recent customer situation and behaviour.

Some banks, in an attempt to reach this ambitious goal, have recently taken to partnering with or investing in B2B networks. But this type of partnership is like playing with fire, and in the mid to long-term, if they do not choose carefully, they could very well get burned. Merely investing in a non-bank provider of invoice financing or factoring does not give a bank access to this invaluable data. And of course, the banks run the risk of being disintermediated by these very same partners.

The opportunity

The complexity of wholesale banking transactions demands a very high level of technical and human expertise on both the customer and the bank's side, not only in terms of formal training but also experience gained within these organisations. Finance specialists like treasurers and CFOs are traditionally risk averse, which is a huge benefit for the existing bank/client relationship.

Despite the plethora of challenges to innovate and strengthen their competitive position for the future, many major corporate banks actually own networks of active clients which are much larger than those of their B2B network competitors, but which they do not exploit at all.

At its last Ariba Live Conference in Las Vegas, for example, the company claimed to have over 2.5 million customers. Of those, we can assume that approximately 1% are big buyers, approximately 25,000 large corporations. On the other hand, Bank of America, for example, boasts 3 million corporate customers.

Based on Metcalfe's law, global banks have the potential, in theory at least, to exploit an enormous network of potential customers. In addition, the question arises as to why the banks don't activate their own networks and begin offering SaaS products. Typically, only B and C goods are procured on B2B procurement networks such as Ariba. Banks could potentially enable transactions for those strategically important suppliers offering A-class items as well.

The financial services they might offer are also not limited to reverse factoring (payables finance) and dynamic discounting, but could include factoring as well as standard bank products such as credit lines. Those suppliers who often require refinancing have little regard for the product range, focusing rather on the best way to improve their liquidity shortages. Today, they have to optimise across the various silos mentioned above, which is complicated and in many cases not even possible. Offering them an integrated solution to these challenges would certainly generate a great deal of interest.

For example, a supplier has given his claims to a factoring company and usually does so with a range of letters, such as all his invoices to buyers whose names start from A to E. He issues an invoice to BMW, and although he has a good liquidity situation at the moment, he has to sell the invoice at a high refinancing rate to the factoring company. Conversely, if he writes an invoice to Volkswagen and needs the money urgently, he doesn't have the possibility of refinancing due to the terms of the contract. Refinancing of the invoice on an ad hoc basis would be desirable, but it is only possible if you have all the data required to automate the assignment.

On the other hand there are the cash-rich buyers who wish to invest excess cash for maximum return. While they would welcome existing reverse factoring offers, they would be even more interested in standard factoring offers for which interest rates are usually higher. On a flexible platform, they could step in and offer a better price than any third party. Especially in the case of the negative interest rates in Europe today, any CFO would see this as an attractive alternative. The risk of a direct settlement between buyers and sellers is zero, which makes the transaction all the more attractive.

There are also buyers who want more attractive payment terms for cosmetic reasons so as not to aggravate their suppliers or simply because they know their supplier wouldn't cooperate. With complete transparency it would be very easy to turn to an intermediary who could provide optimised solutions for the different needs of both parties. The consequence would be more flexible maturities on the basis of bilateral agreements between the buyer and the supplier or with the involvement of a third party.

One of the most important problems is still reconciliation in Accounts Payable and Accounts Receivable. As long as invoicing cannot be allocated with a fully-automated process, it is very difficult to refinance it on a flexible, ad hoc basis. It's generally accepted that the average invoice in B2B is worth EUR 10,000. A 60-day maturity at 3% would yield EUR 50 of interest. Since most reconciliation studies are based on higher yields, refinancing on a one-off basis makes little sense.

Conclusion

There is no doubt that data will become ever more important in the future, especially in the B2B space. The question remains, however, whether banks will harvest and use this data themselves, leave the field to third parties, or work in tandem with them. Currently there are few providers that have established themselves as a partner who can help banks collect and analyse this data, without the threat of disintermediating them. Those who make use of big data and artificial intelligence to develop new products together while allowing banks to continue to control their customer relationships will be in great demand. And, coming back to Humby's analogy, the banks that find the right partner will have the opportunity to tap into the largest oil wells of the 21st century.

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Editorial Comment: selected strategic and tactical implications

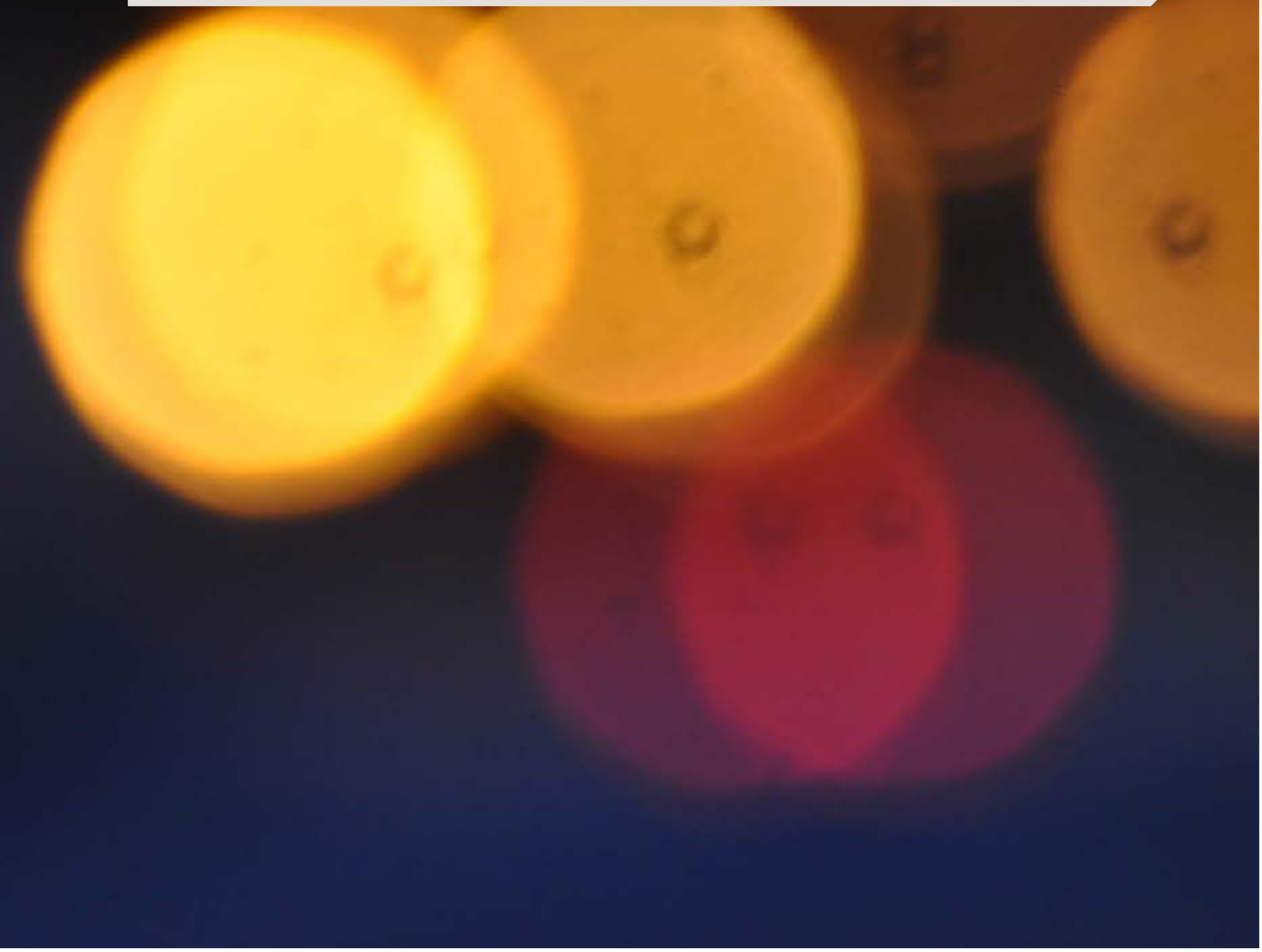
Strategic implications

The industry is increasingly conscious of the tremendous potential inherant in an environment where massive amounts of data are coupled with unprecedented analytical capability. More recently, the complementary value of creafully slected strategic alliances is being brought into the mix through fast-growing FinTechs with compelling propositions.

The use of large amounts of data to inform credit decisioning and risk analytics is clearly an area of focus, and translating the potential value of data from a range of sources in the international environment will be commensurately complex, but proportionately valuable. Trade financiers will advance the efficacy of the industry by assessing new sources of insight and data acorss borders and supply chains.

Tactical considerations

The viability of collecting, validating and leveraging large amounts of data in support of higher-quality transaction-level decisioning merits greater analysis, both at the level of individual institutions and industry.



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