

ICBA BANCARD DIGITAL PAYMENTS STRATEGY GUIDE



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EXECUTIVE SUMMARY

The Small-Business Edition of ICBA Bancard's Digital Payments Strategy Guide, commissioned by ICBA Bancard and produced by Aite Group, is a market overview of the digital payments landscape that assists participants with developing a small-business digital payments strategy for their bank. Key takeaways from the study include the following:

- Approximately 85% of U.S. banks believe increasing their success with small businesses is critical to their bank's overall success. Payments are a key component to that success, but many community banks struggle to determine the right strategy, product mix, and supporting technology to achieve success.
- Community banks have much to gain by taking a tactical approach to building out their small-business digital payments strategies and offerings. Small-business payments offer the opportunity to deepen client relationships and generate new streams of fee-based revenue while also accumulating much-needed deposits for a bank's lending business.
- While the majority of community banks rely on their core banking providers for payments capabilities, a growing number are finding that their solutions are no longer meeting required levels of innovation and new customer expectations. As a result, best-of-breed point solution providers and emerging fintech companies are beginning to play a larger role in community banks' small-business payments strategies.
- For some institutions, creating and implementing a digital payments strategy can appear to be a monumental task requiring significant investment and knowledgeable resources. However, based on the data collected in interviews with community bankers across the U.S., innovation is alive and well at small financial institutions. While the amount of investment varies, the products and services being developed by some community banks are keeping pace with those of larger institutions.
- The return on investment (ROI) for a small-business digital payments solution can be measured in various ways outside the typical profit and loss (P&L) analysis. Most institutions report an immediate increase in small-business deposits and fee-based revenue. Others see new cross-sell opportunities and possibilities for market differentiation, and thus new business. Finally, payments offer a new entry point for conversations with prospects and far more opportunities beyond lending.
- The definition of "digital payments" often varies, but for the purposes of this paper, it is broadly defined as any financial transaction that occurs without the use of physical currency (cash, check, or card). Additionally, small businesses are defined as those businesses generating less than US\$10 million in annual revenue.

INTRODUCTION

Having the right small-business payments strategy with technology-supported processes is critical to community banks remaining competitive, retaining existing customers, securing deposits for much-needed client loans, and cross-selling products for new streams of revenue. Nevertheless, many community banks have been slow to evolve. Most institutions continue to maintain a lending-first mentality, operate in silos, and take a disjointed approach to payments. Many offer either consumer payments capabilities or business platforms that do not align with the changing environment and fall short of expectations for more seamless transactions. With so much innovation and change in the payments space, it is difficult for community banks to determine what should be prioritized and what is merely buzz. A payments strategy without direction and the right technologies is doomed for commoditization and forgoes several opportunities.

With this white paper, ICBA Bancard seeks to guide community banks through the current digital payments landscape, describe the inherent challenges and opportunities that await, and provide a roadmap for building a more successful strategy to achieve their desired outcome. By answering a series of questions in the accompanying model, a bank can determine where along the maturity curve the institution is and identify the recommended steps and actions to advance to the next level.

METHODOLOGY

In order to identify and gather the relevant data and insights regarding small-business digital payments in the community bank environment, Aite Group analysts conducted interviews from March 2020 to April 2020 with ICBA executives, community bankers, and industry experts in the United States. The information gathered was combined with Aite Group's existing knowledge base and proprietary research to develop this white paper, which includes an interactive exercise allowing users to gain a better understanding of the market. While the definition of a small business often varies from bank to bank, this paper defines it as a business generating less than US\$10 million in annual revenue.

OVERVIEW OF DIGITAL PAYMENTS

There is no doubt that business-to-business (B2B) digital payments represent an important and growing product area for banks. Small-business payments, in particular, present a large opportunity for financial institutions with the right strategies and capabilities. Small businesses are more technologically savvy than ever before and continue to grow in sophistication, thus requiring a broader range of integrated digital payments capabilities than what has historically been offered by most community banks.

Digital payments, in the most simplistic terms, are transactions that don't involve physical cards, checks, or cash at the point of sale. Common payments types, such as electronic bill payments, ACH (including payroll), wires (mostly domestic), and remote deposit capture, are considered table stakes for any institution serving small businesses. Administrative capabilities or hierarchical permissions to approve payments are also viewed as critical among businesses with multiple employees or that allow individuals such as accountants to access their finances. Many institutions also include small-business credit cards and contactless cards as part of the mix that represents revenue-growth opportunities, thus requiring card program controls and transaction reporting capabilities.

However, as described in this paper, as technology evolves and customers increasingly expect "instant" everything, including newer payment methods, such as Same Day ACH; real-time payments; and digital payments are growing in priority. Regardless of the level of customer demand banks are seeing for these capabilities, they will inevitably become required in time, and community banks must be prepared.

Finally, the definition of payments is expanding to include capabilities such as expense management, cash forecasting, and electronic invoicing, as ways to tie invoicing to payments, receipt reconciliations, and ultimately money management.

Unfortunately, there is no magic formula for creating the perfect small-business product portfolio. Bank offerings will and should differ based on banks' locations, the makeup of their small-business customer bases, and their target markets. However, community banks should not limit themselves to current needs and must strive to position themselves to attract customers early in their life cycle and retain them as they grow while also better preparing for an evolving customer base with new expectations. With the broader business environment now undergoing a period of significant economic change, digital payments solutions that can create efficiencies, add automation, and improve the customer experience will prove increasingly critical for community banks.

THE IMPORTANCE OF DIGITAL PAYMENTS

Aite Group estimates that 85% of U.S. banks believe increasing their success with small businesses is critical to their bank's overall success. Payments are a key component to that success, but achieving it requires community banks to implement the right strategies and technology. Success also requires a change in mindset and a shift away from past practices. While small-business lending has historically been the lifeblood of many community banks,

digital payments are crucial to gathering the deposits necessary to originate those loans. This is especially true now that the COVID-19 pandemic has increased the demand for business loans. Further, payments products also “anchor” clients with services they will continue to need and use beyond the term of the loan. Community banks need to focus on growing their digital payments business and tying it to their balance sheets.

While payments have historically been an afterthought for many community banks, payments offerings can serve as revenue generators in their own right, while also being a means to grow deposits and deepen relationships with small-business customers. Most notably, small-business credit cards can serve as revenue centers for community banks due to interchange rates, which are higher than for standard consumer cards (running as high as 3% or more, compared to consumer rates that are typically below 1%), as well as annual fees and interest income. New digital capabilities, such as mobile enablement and virtual cards, can help to grow transaction volume and, in turn, increase interchange revenue, as businesses of all types move from paper-based to electronic payments.

As the perceived importance of small-business digital payments rises in the ranks at most community banks, especially the more commercially focused ones, banks are also recognizing that small-business relationships don't always have to begin with a loan, nor is a loan the only entry point into a bank. In fact, payments products offer more opportunities to deliver value and deepen the relationship with customers that may require loans in the future. Payments are an intrinsic part of any business's activity, and deeper entrenchment here can provide community banks with a daily touch point with clients, deepen relationships, and help expand cross-selling opportunities.

High-performing banks are creating dedicated groups made up of individuals with payments backgrounds to grow this business. They are also investing in modern, flexible, and feature-rich business banking platforms that enable them to better serve the evolving needs of small businesses. They have both the support and buy-in of their executive teams as well as the green light to invest in the area. Their senior management view digital payments as an opportunity to create a new revenue stream as well as a way to place community banks on a better playing field with larger national and regional banks. The recent debate and grassroots movement around the Fed's real-time payments system, FedNow, raised payments awareness and got many community bank executives more engaged and knowledgeable about payments initiatives required to remain competitive.

Fintech companies have also raised the bar and expectations around small-business payments, leaving banks little choice but to ramp up their capabilities or risk losing business and important relationship-building opportunities with their critical small-business customer base. All businesses, regardless of size, make payments and will continue to do so. It is up to banks to determine if they want that business or are willing to let it go to a competitor along with its strong fee-based revenue stream.

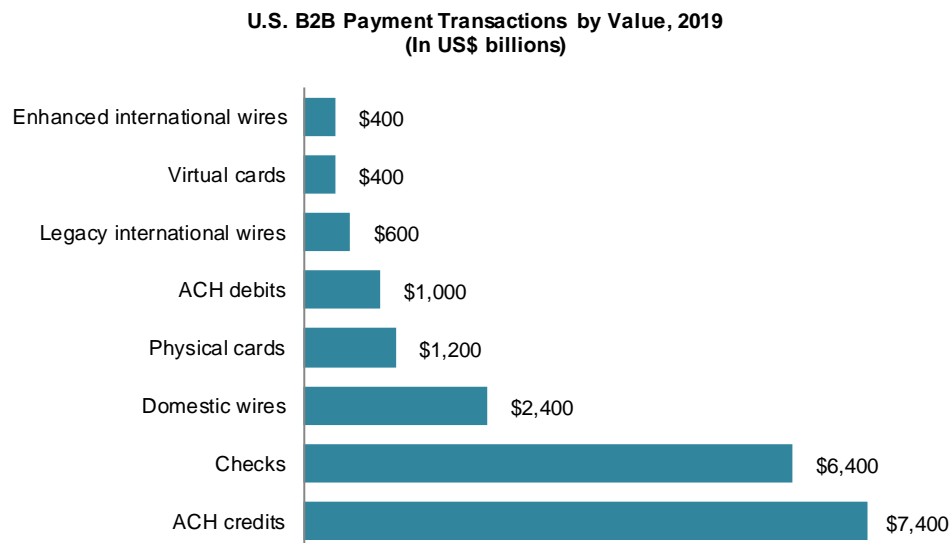
MARKET SIZE AND GROWTH FORECAST

The small-business payments market remains a sizeable and critical, yet often overlooked, component of the broader payments landscape. Small businesses make up over 99.9% of the

32.1 million active businesses in the United States, and together account for 44% of U.S. gross domestic product.¹ These organizations generate a significant amount of payments activity that, in aggregate, represents a sizeable opportunity. While precise figures are not available, Aite Group estimates that the overall B2B payments space saw nearly US\$20 trillion of transactions in 2019 (Figure 1). Even though small-business payments account for less than 30% of the total B2B market volume, their contribution is significant.

On a value basis, ACH credits and checks dominate the market at US\$7.4 trillion and US\$6.4 trillion, respectively. From there, the value of transactions trails rapidly, with domestic wires at US\$2.4 trillion, and cards at US\$1.2 trillion. Aite Group notes that although they are a relatively new digital payments tool, virtual cards have already expanded to nearly US\$400 billion in annual transactions in 2019. While virtual cards are not yet in wide use in the small-business space, they hold significant potential for growth as businesses of all sizes seek to automate and modernize their payments capabilities.

Figure 1: The Total U.S. B2B Payments Market Had Transactions of US\$20 Trillion in 2019



Source: Aite Group, AFP

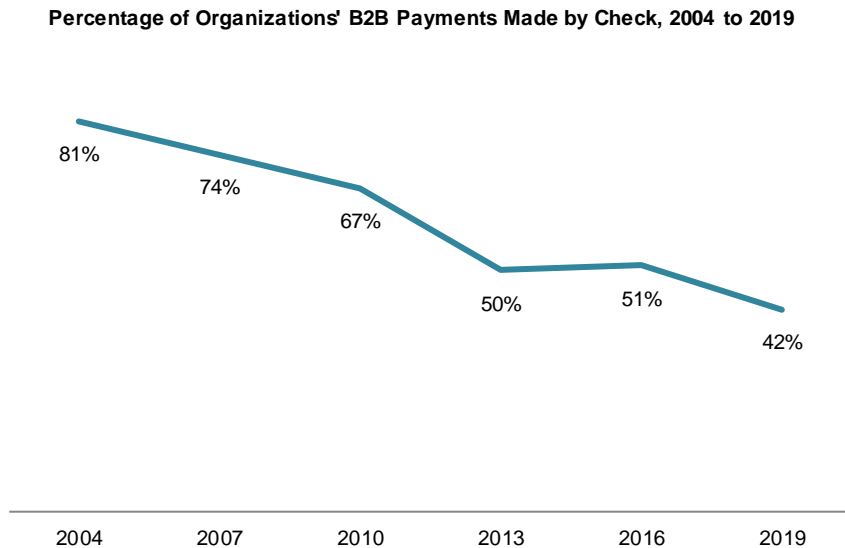
Recent years have seen significant growth in B2B payments volume, with commercial cards experiencing growth of 29.8% between 2016 and 2019. 2020 and beyond, by contrast, is likely to see pressure on overall payment volume due to wider economic shocks, and this will lead to a decline in overall transaction volume in the B2B space. This will be most strongly felt at the small-business level. Despite these significant challenges, the shift toward digital payments is unlikely to slow. The added efficiencies and cost benefits of digital payments, not to mention

1. "Small Businesses Generate 44 Percent of U.S. Economic Activity," U.S. Small Business Administration Office of Advocacy, January 30, 2019, accessed May 5, 2020, <https://advocacy.sba.gov/2019/01/30/small-businesses-generate-44-percent-of-u-s-economic-activity/>.

better availability and flexibility in terms of business continuity planning, means the shift to digital payments will only increase in the near term.

Most symptomatic of this long-term shift toward digital payments products has been the near steady decline of checks in the B2B space. Although checks still account for approximately 42% of all B2B payments by volume, their frequency of use is declining rapidly in favor of alternatives, most notably ACH and cards (Figure 2).

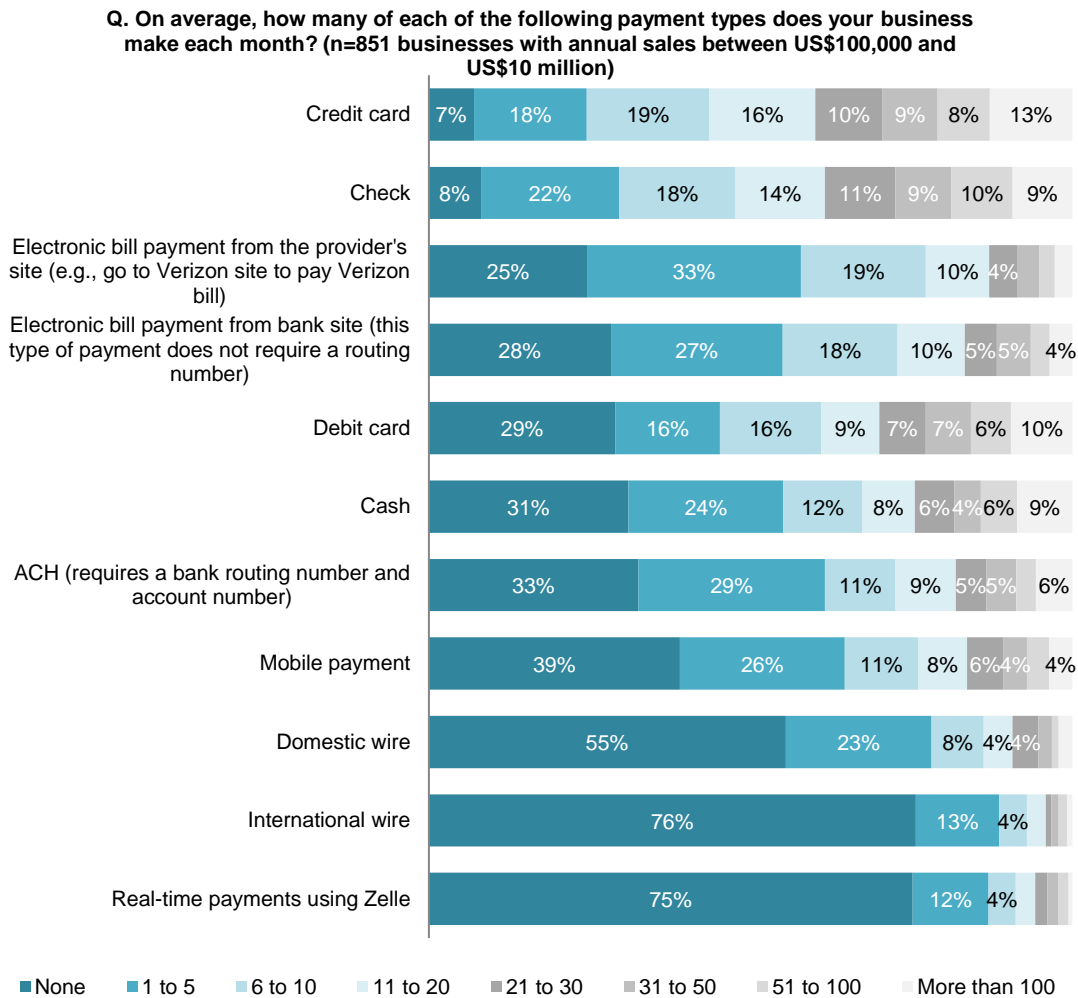
Figure 2: Checks Accounted for 42% of All B2B Payments by Volume in 2019



Source: Aite Group, AFP

Check usage remains higher in the small-business space, driven in large part by a lack of alternatives that suit small-business needs, but, nonetheless, check usage is expected to continue to decline as alternatives, including real-time capabilities, become more widespread. Small businesses are already showing signs of a greater willingness to try new payments methods (Figure 3).

Figure 3: Breakdown of Monthly Payments by Type



Source: Aite Group’s survey of U.S.-based small businesses, July 2019

THE EVOLUTION OF DIGITAL PAYMENTS TECHNOLOGY

Most banks have historically served small businesses with the same products and capabilities offered to consumers. Thirty percent to 40% of community banks continue to serve them in this way. While this strategy may be sufficient for micro businesses generating less than US\$1 million in annual revenue, intuitive banks increasingly recognize it is not an effective small-business strategy. As businesses, these customers require business-specific capabilities. Failing to offer them the right capabilities often leaves them feeling misunderstood and underserved. A July 2019 Aite Group survey of U.S.-based small businesses found that only about half of small businesses view their primary bank as a true partner and more than just a place to deposit and borrow funds. Further, 40% of the smallest businesses (generating between US\$100,000 and US\$1 million in annual revenue) and 54% of larger businesses (generating between US\$5 million

and US\$10 million in annual revenue) do not feel as though their primary financial institution understands their needs.

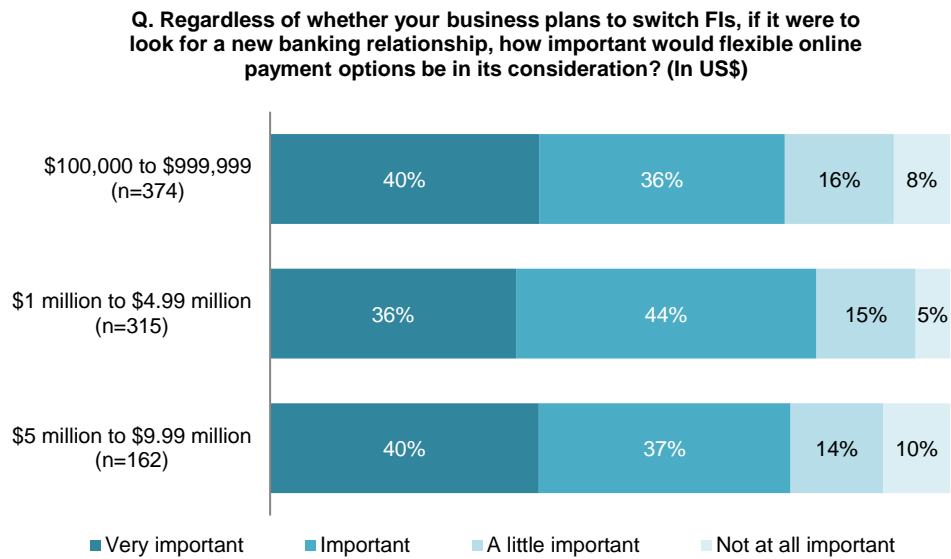
Consumer banking platforms too easily camouflage business customers as consumers, and this often result in banks limiting their ability to serve and deepen relationships. Community banks must roll out digital business banking/commercial platforms for their small-business customers. These platforms must have business-specific capabilities (such as different payments options, approvals, and positive pay) for effective payments and money management.

Additionally, small businesses place great weight on the digital experience, online and mobile functionality, and online account-opening capabilities when choosing their partners. This trend has been building over the last several years and will continue as technology's increasingly important role in our personal lives carries over to our business lives. In fact, a comparison of Aite Group small-business survey data since 2011 shows how the importance of an institution's online offering has grown as a criterion for selecting a new banking partner. While only 65% of small businesses considered robust digital banking capabilities to be important or very important in 2011, 81% feel that way today. Thus, banks failing to continually invest in their digital capabilities have little chance to attract new customers.

A bank's digital payments capabilities are also critical to attracting small-business customers. As such, more than three-quarters of small businesses consider the availability of flexible digital payments options to be an important or very important consideration when selecting a new bank partner (Figure 4). This high level of importance exists regardless of business size. The availability of flexible digital payments is also likely to continue to grow in importance over the next few years as businesses run by millennials or Generation Xers are more likely to value this than are those run by baby boomers. Its importance will continue to increase in time, as millennials, who are currently starting the majority of new businesses, make up a larger share of the market.

Furthermore, the demographics of small businesses will likely see considerable change as a result of the COVID-19 pandemic, with a higher than normal attrition rate across the segment. Once the crisis is over, many new businesses will emerge to fill the gaps left by the market churn, and many of them will have high expectations for digital-first payments capabilities.

Figure 4: The Importance of Flexible Online Payments Options



Source: Aite Group’s survey of U.S.-based small businesses, July 2019

While banks must continue to expand their available payments options, it is also critical that they simultaneously examine and evolve their payments processes and infrastructures, and their ease of use. This requires that small-business payments not be viewed in silos by type, nor should they be presented in a “one size fits all” way. Payments knowledge varies considerably from customer to customer, especially in the small-business banking space, and many of them will benefit from bank-led education. Payments process efficiency, access to data, and customer experience all offer banks opportunities to differentiate themselves for this customer base and attract and retain customers. It is becoming clearer and clearer that the bank that owns the payments owns the customer. Because payments are part of a broader process for businesses, by extension, banks that improve and automate the process will have more value to offer businesses.

KEY PLAYERS IN THE DIGITAL PAYMENTS UNIVERSE

The majority of community banks rely on vendor-built solutions to meet their payments and other technology needs. The key players in the digital payments universe include the core providers, the best-of-breed providers, and the fintech companies. Figure 5 highlights the key characteristics, strengths, and weaknesses of each.

Figure 5: Digital Payments Vendor Types

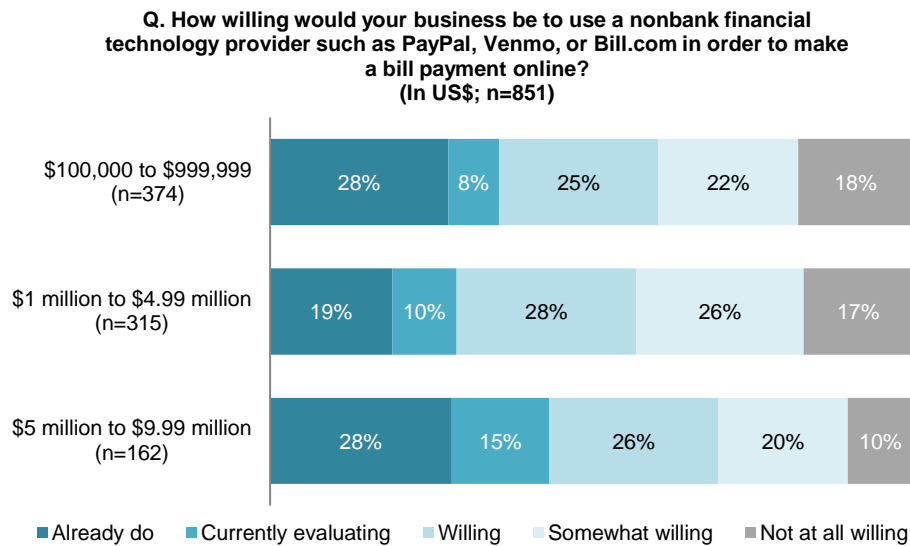
Digital payment provider type	Core providers	Best-of-breed providers	Emerging fintech companies
Key characteristics	Large-scale core banking platform vendors	Typically midsize point solution providers	Emerging disruptive technology vendors
Strengths	<ul style="list-style-type: none"> • Single vendor solution • Compatibility between product features • Established and proven offerings • Emerging focus on API enablement for fintech implementation 	<ul style="list-style-type: none"> • Very strong product offering • Well-established with proven track record • Strong functionality and user experience • Open, easy-to-integrate systems 	<ul style="list-style-type: none"> • High levels of innovation and strong customer experience • Often flexible pricing and business models • High levels of support even for small customers
Weaknesses	<ul style="list-style-type: none"> • Fast followers • Lack of agility • Ownership of data – costly to access • Overly focused on larger customers • Poor understanding/delivery of SMB needs • Can be roadblocks to fintech partnerships 	<ul style="list-style-type: none"> • Not end-to-end, gaps in product portfolios • Require banks to work with multiple vendors • At risk of consolidation by larger players • Cost of integration to the core 	<ul style="list-style-type: none"> • Implementation can be challenging on a bilateral basis • Long-term stability is always in question • Scalability and resourcing as business grows can be problematic

Source: Aite Group’s survey of 1,008 U.S.-based small businesses, July 2019

While the majority of community banks rely on their core banking providers for payments capabilities, the core model, which has served bankers well in the past, is no longer proving to be nimble enough to keep pace with current levels of innovation. As a result, best-of-breed point solution providers are beginning to play a larger role in the small-business banking and payments space for community banks. These vendors are increasingly winning business from commercially focused community banks looking to implement stronger business-specific payments capabilities. Their systems are open, often more comprehensive, and easier to integrate with other systems for a more cohesive experience. However, while these providers often offer more of what small businesses require, they too have some gaps they are quickly looking to fill, especially as the definition of business payments continues to expand. Those gaps have allowed fintech companies to enter the space.

Of businesses surveyed, Aite Group found 26% already use a nonbank fintech provider to make online bill payments, while an additional 36% are either currently evaluating this or willing to do so. (Figure 6 shows the responses broken down by business size.) Similar percentages exist for mobile payments (25% and 35%, respectively). Banks must ramp up their capabilities or risk losing this critical business. By not effectively meeting needs, banks are leaving themselves vulnerable to attrition and disintermediation.

Figure 6: Willingness to Use Fintech Companies for Online Bill Payments

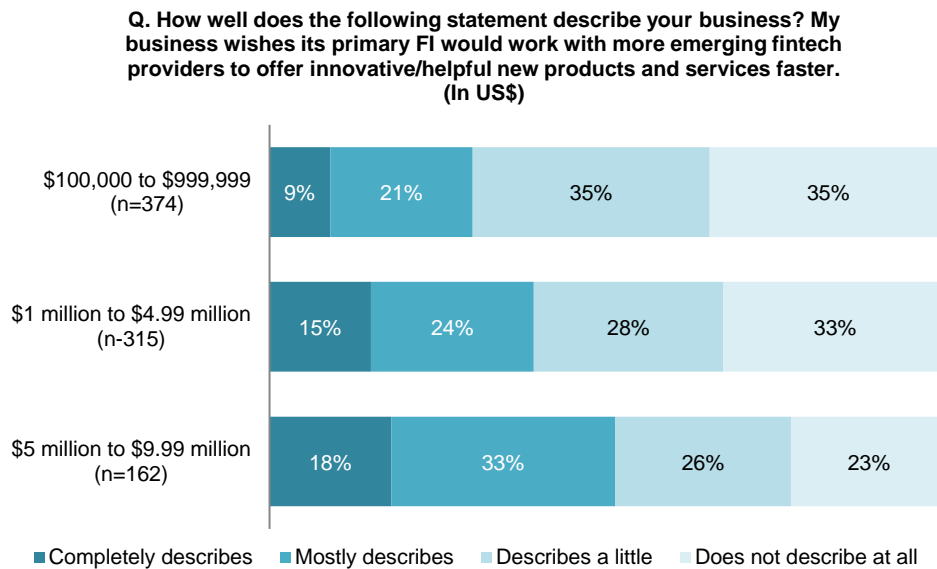


Source: Aite Group’s survey of U.S.-based small businesses, July 2019

While banks initially viewed fintech companies as competitors, many now see the great potential benefit of partnering with them. The banking industry is often a fast follower rather than a leader in technology, despite the billions of dollars spent each year on new systems and upgrades. In fact, less than half of small businesses describe their primary bank as being innovative and regularly offering the new services they need. Fintech companies, on the other hand, have quickly established a reputation for being nimble, fast-moving, and innovative. Of businesses surveyed, more than 60% believe fintech companies are more likely than their banks to offer products and services they are willing to pay for. Thus, while banks deliver security and a safe place to deposit their funds, fintech companies are doing a better job at delivering value and messaging that resonate with business customers and make them more willing to pay. Banks must align themselves with fintech companies not only to broaden their product offerings but also to position themselves as being more innovative in the eyes of their customers and to increase their potential for new streams of revenue.

About two-thirds of small businesses wish to some degree that their primary financial institution would work more with emerging fintech providers to offer more innovative/helpful products and services faster. Businesses generating greater than \$5 million in annual revenue are most likely to feel this way, but the sentiment crosses all revenue groups (Figure 7). Unfortunately, many of the core banking vendors have been slow to help community banks in this area.

Figure 7: Desire for More Fintech Company Partnerships



Source: Aite Group’s survey of U.S.-based small businesses, July 2019

Some community banks may try to partner directly with fintech companies, but this can be challenging due to the need for implementation resources and staffing. The vast majority will rely on their technology providers and partners such as ICBA Bancard to do the vetting and help them navigate the vast payments fintech community. The ICBA is a trusted source that makes unbiased recommendations through the ICBA ThinkTECH Accelerator. It is seeing a growing number of community banks interested in learning more about potential fintech partners and seeing increased interest in its Accelerator program. While most interest to date involves consumer use cases, there is a definite shift toward small-business applications through which revenue can be generated. Many banks initially dabbled with fintech partnerships on the alternative lending side and have now moved to payments.

Digital banking providers offer an alternative option to community banks seeking help with fintech partnerships. Many of these vendors are building out fintech ecosystems/small-business marketplaces with tight integration to their portals via APIs. Bank customers will be able to either access capabilities from within their bank’s portal or click on a link that takes them to a fintech offering recommended by their financial institution. Both options better position the bank as a provider of value-added services and demonstrate a recognition of customer needs.

DIGITAL PAYMENTS OPPORTUNITIES AND CHALLENGES

Community banks have much to gain by taking a tactical approach to building out their small-business digital payments strategies and offerings. As previously described, payments can deepen client relationships and generate new streams of fee-based revenue while also accumulating deposits for banks’ lending business.

Other benefits and opportunities follow:

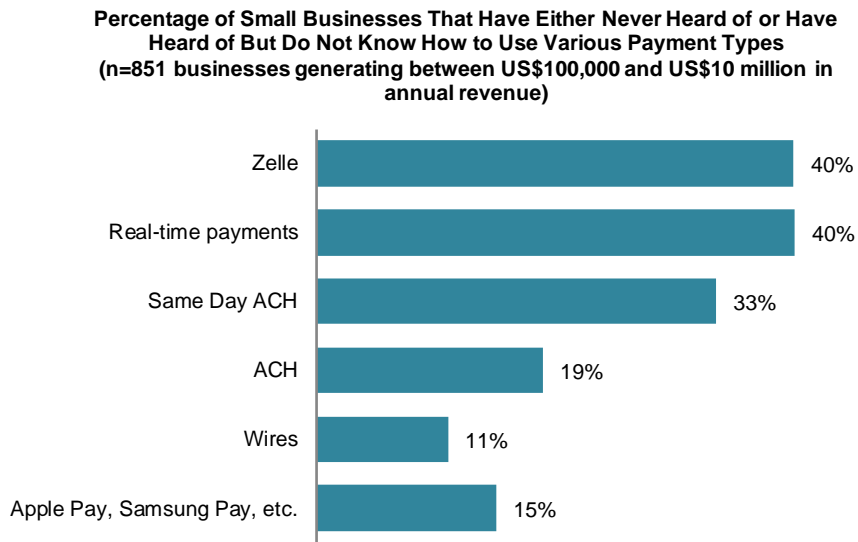
- **New-customer attraction:** Today's small businesses lack loyalty. Approximately 15% state they are likely to switch banks in the next two years. Those banks with the right payments strategies and offerings are best positioned to win their business, while those not making the necessary investments are more likely to fall victim to higher rates of attrition. Additionally, payments are a "sticky" business, meaning once you win it, you are likely to keep the customer as long as you continue to invest in products.
- **Potential for a broader product offering:** All small businesses make some types of payments. Approaching new prospects with a breadth of payments options is more likely to unlock a potential partnership than relying on a business's need for credit.
- **Ability to provide value:** Banks increasingly risk being viewed as transaction providers and not partners if they are not able to provide value-added services to clients. The increasingly complex payments landscape can be challenging for small businesses to navigate, thus creating opportunities for their banks to guide them and offer advice as partners.
- **Spotlight on payments:** The establishment of real-time payments and community bank efforts around FedNow is placing new emphasis on the potential for payments and causing many banks to rethink their digital payments strategies. It is also creating interesting potential use cases for community banks and small businesses, such as providing business customers with cash concentration management. Moving toward real-time push payments will be a major boon for small businesses.

Community banks also face several challenges in the digital payments space. Some of the greatest challenges follow:

- **The rise of fintech companies:** As mentioned previously, more user-friendly and innovative digital payments options available through nonbank providers in the fintech community are increasingly targeting small businesses and raising expectations for user experiences and payments capabilities. As fintech startups increasingly move into the commercial banking space, they are, for the most part, targeting small businesses as a market entry point. If community banks don't find ways to partner with them, they risk lost business and potential disintermediation. Banks are not reacting fast enough and risk losing business and deposits to fintech companies.
- **Lack of readiness for real-time payments:** The Clearing House has created a sense of urgency for real-time payments, but many community banks are waiting for the rollout of FedNow. Larger banks are able to initiate real-time payments, and community banks will have to be able to at least receive and settle transactions or risk losing volume. Those banks ready to roll out real-time payments are sometimes being slowed down by core banking providers whose platforms may not be able to receive real-time payments.
- **Limited community bank options:** Digital payments technology has existed but until recently hasn't been packaged, processed, or delivered in a manner that works for

community banks. As a result, they have been forced to cobble together different solutions, leading to a disjointed experience for customers. Community banks need a single integrated platform with a pay-as-you-go model that better accommodates their lower transaction volume.

- **Balancing high touch and high tech:** Community banks differentiate themselves through their relationships with customers. They need to find a way to leverage technology to provide the high-tech automated experience customers desire without losing the personal touch that drove them to the community bank in the first place.
- **Payments silos and lack of consolidated views:** Bank silos often make it difficult for bank customers to get a consolidated view of their finances and payments without having to go to multiple screens or log into multiple systems, a challenge faced by more than 60% of small businesses. A more consolidated view will make payments more efficient.
- **Low small-business awareness of new bank payments types:** While small businesses are exploring and utilizing different types of payments, Aite Group estimates that only 40% of small businesses know the difference between various electronic payments options and are confident they are selecting the right payments type to meet their needs. Unfortunately, as new payments types continue to be added, the problem is growing worse. The level of awareness of newer bank payments methods, such as real-time payments, Zelle, and Same Day ACH, are especially low, in most cases, with more than one-third of small businesses having never heard of them or not knowing how to use them. That bank efforts around the marketing and education of these new products has fallen short is especially evident when comparing these businesses' lack of awareness of these products with their lack of awareness of those new payments types more commonly used in our personal consumer lives, such as Apple Pay. The Apple Pay comparison highlights the need for banks to focus on educating customers about new payments options as well as implementing new digital tools to guide customers' payments-type decisions (Figure 8).

Figure 8: Low Small-Business Awareness of New Payments Types

Source: Aite Group's survey of U.S.-based small businesses, July 2019

- **Low awareness of bank capabilities in general:** Unfortunately, low customer awareness is not limited to just new payments capabilities and extends to small-business product portfolios in general. Banks have not done an effective job of marketing their capabilities and keeping customers educated on what's available.
- **Lack of direction:** Small businesses often lack the resources and don't know where to begin when building a successful small-business payments strategy. They need guidance and some type of "toolkit in a box" with campaign and outreach material to help them.

DEVELOPING A DIGITAL PAYMENTS STRATEGY

For some institutions, creating and implementing a digital payments strategy can appear to be a monumental task requiring significant investment and knowledgeable resources. But based on the data collected in interviews with community bankers across the U.S., innovation is alive and well in small financial institutions. While the amount of investment varies, the products and services being developed are not only keeping pace with larger institutions but also are creative solutions tailor-made for the banking customer and the community.

As a result of the information collected during the executive interview process and market research conducted by Aite Group, ICBA Bancard has created an interactive exercise that allows users to answer a series of questions regarding product offerings, client market base, and existing digital payments offerings. At the end of the exercise, users will be provided with maturity model illustrations depicting their current states and a list of next steps to consider in the development of a digital payments strategy.

FINANCIAL INSTITUTION PROFILE

The questions in Table A are in reference to the physical makeup of the bank and whether the bank offers a true small-business banking offering to customers. This will help establish the market opportunity and potential product reach for digital payments. In order to provide an accurate assessment, users are asked to answer each question to the best of their knowledge and not to leave any question unanswered.

Table A: Institution Profile

Question	Categories
Q1. Asset size (in US\$)	Less than \$100 million
	\$100 million to \$250 million
	\$251 million to \$500 million
	\$501 million to \$1 billion
	\$1.1 billion to \$5 billion
	More than \$5 billion
Q2. Number of small-business customers (defined as businesses generating less than US\$10 million in annual revenue)	Fewer than 200
	201 to 500
	501 to 1,000
	1,001 to 5,000
	More than 5,000

Question	Categories
Q3. Does your bank focus on or specialize in specific industry verticals? (e.g agriculture, timber, oil & gas, etc)	Yes No
Q4. Primary bank focus	Primarily a consumer-focused bank Primarily a business-focused bank Equal focus on both consumer and business banking
Q5. Primary small-business lines of business	Deposits Payments—electronic bill payment, ACH, wires, etc. Lending Small-business credit, debit, prepaid, virtual cards Other
Q6. Please select which statement best matches your bank’s small-business online banking offering.	Small businesses are served the same products and services as consumers Small businesses are mostly served like consumers with some business-specific products, such as business bill pay or a small-business card Small businesses are offered unique business-specific capabilities (e.g., the ability to assign transaction permissions to different users, more robust payment options)

Source: Aite Group

STRATEGIC PAYMENTS FOCUS

The role of small-business payments within any bank can vary considerably, from being an afterthought to being a major center of innovation and revenue growth. Most community banks today fall somewhere on a spectrum, from maintaining the status quo to being reactive to small-business customer demands to being forward-looking proactive developers of new payments solutions that offer opportunities for differentiation. Growing numbers of banks are now formalizing their payments focus through the development of dedicated payments teams, buy-in from executive management, and the development of long-term strategic payments roadmaps that encompass a variety of payments developments.

The questions in Table B are focused on the staffing resources dedicated to payments, perceptions of the importance of payments among executive management, and the existence of a formal payments roadmap for the bank.

Table B: Strategic Payments Focus Q&A

Questions	Categories
Q1. My bank has a dedicated payments product management team.	<p>Yes</p> <p>No</p> <p>Not yet, but we plan to over the next 12 to 24 months</p>
Q2. Which statement do you feel best describes how your bank's executive management team perceives small-business digital payments?	<p>Digital payments for small business are not at all a priority for my bank's executive management team</p> <p>Small-business digital payments are on the radar of my bank's executive management team but are a low priority</p> <p>My bank's executive management team knows small-business digital payments are important but needs further education</p> <p>Small-business digital payments are a high priority for my bank's executive management team</p>
Q3. Which statement do you feel best describes the strategic roadmap your bank has in place regarding small-business digital payments?	<p>My bank does not have a small-business digital payments roadmap and has no plans to develop one</p> <p>My bank does not have a small-business digital payments roadmap but likely will one day</p> <p>My bank does not have a small-business digital payments roadmap but is actively developing one</p> <p>My bank already has a small-business digital payments roadmap</p>

Source: Aite Group

LEGACY AND DIGITAL PAYMENTS CAPABILITIES

There is some confusion in the definition and understanding of what a digital payments product is. For the sake of clarity, the product definition for this exercise is a financial transaction that occurs without the use of physical currency (cash, check, or card). The digital environment in which the transaction takes place would be considered the channel.

BREADTH OF DIGITAL PAYMENTS CAPABILITIES

A full suite of digital payments capabilities is available to address the wide array of payments types many small businesses are using. Traditional payments vehicles, such as credit cards and checks, have the strongest user penetration, but electronic bill pay and ACH payments are also used to some degree by about two-thirds of small businesses. Additionally, a growing number of

businesses are showing interest in mobile payments capabilities, a number that is likely to continue to rise in time as tech-savvy millennials who have grown up with technology run more businesses that will continue to constitute a larger share of the total small-businesses segment. These businesses bring with them a strong desire and expectation for mobile capabilities. The level of urgency for community banks to roll out these capabilities should be determined after the bank performs a close analysis of its current and targeted client base to understand those clients' specific needs.

MOBILE PAYMENTS

While only about one-third of small businesses have adopted mobile banking, usage will continue to rise in time. The most common uses by small businesses are quick uses, such as checking balances, making internal funds transfers, approving payments, and depositing check images.

While not yet a high priority for many community banks, offering robust mobile banking and payments capabilities to small businesses will be critical going forward. Despite lack of readiness to use it, small businesses expect banks to offer it. Not doing so makes a bank look outdated and out of touch. These capabilities are especially important to millennials and Generation Z and will likely be expected by future generations of business owners as mobile payments become a more regular part of our personal lives.

REAL-TIME PAYMENTS

As we increasingly become a society expecting instant gratification, the desire for faster payments is growing. The current crisis is further justification for greater payments speed. Early Warning, through its Zelle offering, was one of the first to make real-time payments capabilities an option for banks. Unfortunately, while many banks see its importance, Zelle's affordability for community banks has been questioned. For fast-moving banks, real-time payments have become a priority, but it is not a priority for the vast majority, because client demand is not yet high. Many community banks will instead wait for the rollout of FedNow in 2024.

Real-time push payments hold considerable potential benefits for small businesses, including greater visibility for payments transactions, enhanced speed of money movement and significantly improved liquidity, and the potential for major automation of payments transactions. These features are becoming more crucial as even the smallest small-business firms have increasingly sophisticated back-office and accounting systems. While awareness of these benefits is low among small businesses, and arguably many banks, these value-added capabilities will grow in importance as the wider business environment changes and businesses of all sizes seek to streamline, lower costs, and improve their liquidity.

Another important use case for real-time payments is payroll. Such capabilities will become essential as the gig economy continues to grow and payments upon completion of a job is expected. The ability to immediately pay workers has the potential to become an industry standard for the sector, with implications for banks.

ANALYTICS

When it comes to analytics, banks don't have a data problem, they have a usage problem. Community banks have a wealth of data that often sits idle with no defined strategy for use beyond fraud prevention. While large banks are a little further along with analytics tools, they too face challenges leveraging their data. This will be an explosive area over the coming months and years as banks look for ways to better utilize analytics and machine learning to make data more meaningful and processes more efficient. Some forward-looking banks are investing money in creating data lakes to consolidate data and have data analytics experts on staff to better understand and predict customer needs for cross-sell opportunities. One bank interviewed uses analyzed data to have regular meetings with clients to review their product usage and make suggestions for greater efficiency and new products. Later stages will enable them to present more actionable information and enhanced data-driven advice to customers for further differentiation in the market.

Leveraging analytics technology to better utilize data should be a priority for community banks. However, it is critically important when doing so to first identify the challenges to be solved and then leverage data to solve it. Education and staffing resources may be needed. Pressure must also be placed on core banking vendors to make their data more easily accessible for analysis, as the canned reports they offer often have limitations and can be difficult to access.

EXPANDING DEFINITION OF PAYMENTS

The definition of payments continues to expand as small-business customers are increasingly looking to their banks to tie their payments to their receivables and ultimately help them create a better cash flow forecast and clearer picture of their cash position. New tools additionally being required follow:

- Invoicing capabilities (ability to both send an electronic invoice and receive payments on it through various payments options)
- Strong integration with accounting systems, such as QuickBooks
- Cash forecasting tools

The questions in Table C are focused on current and planned electronic payments products and digital capabilities.

Table C: Existing Digital Product Q&A

Questions	Categories
<p>Q1. Please indicate whether your bank currently offers or plans to offer the following digital payment products to your small-banking business customers. (Yes my bank offers this; No my bank does not offer this yet but has a roadmap launch plan in place; No but it would like to in the future; No, my bank does not have this, and it’s not of interest)</p>	<ul style="list-style-type: none"> Small-business electronic bill pay ACH Domestic wires International payments Same Day ACH Real-time payments receiving Real-time payments initiation Business credit cards Virtual cards for business purchasing Business card expense management Business card contactless payments Electronic invoicing Cash flow forecasting Integration with small-business accounting systems
<p>Q2. Please select the statements that describe your bank’s activities regarding “mobile payments” for small-business customers. (Select all)</p>	<ul style="list-style-type: none"> My bank offers a mobile-optimized web portal for small-business customers that lets them see basic account information My bank offers a dedicated mobile app that lets small-business customers see basic transaction information My bank’s small-business customers can initiate or approve payments via a mobile app or portal My bank offers a variety of mobile tools and services for small-business banking customers My bank can integrate small-business payments directly into third-party apps, such as mobile wallets (e.g., Apple Pay) or accounting platforms

Questions	Categories
<p>Q3. Please select the option that best describes your bank’s activities regarding “real-time payments” for small-business customers. (Select all)</p>	<p>My bank currently offers real-time payments services to small-business customers</p> <p>My bank plans to offer a real-time payment service such as Zelle to its small-business customers over the next 12 to 24 months</p> <p>My bank currently offers RTP from The Clearing House to its small-business customers</p> <p>My banks plans to offer RTP from The Clearing House to its small-business customers</p> <p>My bank would like to offer RTP but it is cost prohibitive due to the cost of core integrations and/or other RTP solutions</p> <p>My bank is waiting for the launch of FedNow before investing in real-time business payments capabilities</p> <p>My bank’s small-business customers are not interested in real-time payments, so it has no plans to invest in these capabilities</p>
<p>Q4. Please select the statement that best describes your bank’s use of data analytics or machine learning for use cases outside of fraud detection.</p>	<p>My bank makes no use of data analytics or machine learning to make small-business payment transaction data more meaningful and processes more efficient, and it likely won’t do so in the near future</p> <p>My bank makes no use of data analytics or machine learning to make small-business payment transaction data more meaningful and processes more efficient, but it would like to in the near future</p> <p>My bank makes some use of data analytics or machine learning to make small-business payment transaction data more meaningful and processes more efficient, but it would like to do more</p> <p>My bank makes extensive use of data analytics or machine learning to make small-business payment transaction data more meaningful and processes more efficient</p>

Source: Aite Group

DEVELOPMENT APPROACHES

Determining how banks can develop new payments capabilities and gain awareness among end users will be helpful in determining potential strategies for product development and market outreach. Community banks lack the internal resources enjoyed by many of their larger competitors, thus their choice of development partner for digital payments services will be critical to long-term success. Similar to this, small-business customers in many instances are not fully aware of the potential ramifications of new digital payments technologies, but once they

are educated, they quickly view many of these services as essential. Rolling out new services is not limited to direct customer contact but also includes outreach to internal bank staff and relationship managers who often act as the primary contact point with small-business customers and are critical to the successful rollout of new capabilities. The questions in Table D aim to get a better understanding of who banks are working with and how banks are aiming to educate the market.

Table D: Q&A for Customer Data

Questions	Categories
<p>Q1. Does your bank have any outreach programs or strategies currently in place to educate internal staff about new small-business digital payment products and services?</p> <p>If yes, please list your source(s)</p>	<p>Yes</p> <p>No</p>
<p>Q2. How do believe your small business customers learn about new digital payment products? (Select all that apply)</p>	<p>Through my banks marketing activities</p> <p>Through my banks relationship managers, sales staff and other personnel</p> <p>Through trade or industry press</p> <p>At tradeshows or other industry events</p> <p>Word of mouth from other businesses or customers</p> <p>TV, online or mass market advertising</p> <p>Directly from payment providers or fintech vendors</p>
<p>Q2. Which of the following outreach processes or strategies are currently in place at your bank to educate customers about new small-business digital payment products and services? (Select all that apply)</p>	<p>Information inserts mailed with bank statements</p> <p>Banner ads within the bank’s online banking or website</p> <p>Emails</p> <p>Personal outreach by relationship and account managers</p> <p>Capability demos in branches</p> <p>My bank does not have any processes in place for client education</p>

Questions	Categories
Q3. Which statement best describes your bank’s positioning on small-business digital payment service providers?	My bank only works with our core platform vendor for digital payments and has not investigated alternatives
	My bank only works with its core platform vendor for digital payments but is likely to work with other providers in the future
	My bank currently works with its core platform vendor for digital payments but plans to launch services from best-in-breed solutions or fintech providers
	My bank currently works with several vendors for its small-business digital payments offerings

Source: Aite Group

FINANCIAL REVIEW

When developing a small-business digital payments strategy, identifying opportunities for revenue growth and expense reduction is a fairly common practice. The bank will need to validate the existing P&L for the various product suites being considered and then overlay each digital option/capability to determine the opportunity. Depending on the current product offering and existing digital products, the financial institution may already have a model developed for this purpose.

The “build or buy” question is usually the first to be addressed in a product development scenario; however, developing and integrating a digital platform from scratch for most banks is cost prohibitive. While getting digital products in the hands of the small-business customer might be the call to action, it’s imperative that all digital services are integrated on the back end to avoid the common siloed infrastructure. The ability to quickly access customer data and analyze trends at the enterprise, portfolio, and account levels will pay dividends in the long run.

Whether a digital payments strategy is a prudent investment at this point has more than likely already been decided. The discussions are probably more focused on prioritization and execution. The ROI for a small-business digital payments solution can be measured in various ways outside the typical P&L. Most institutions report an immediate increase in small-business deposits and fee-based revenue, especially once they move business customers off consumer banking platforms and offer more robust business payments capabilities that they can charge for. Others see new opportunities for cross-selling and market differentiation, and thus new business. Customer acquisition and retention opportunities are made much more efficient by leveraging digital marketing channels. Marketing campaigns should be developed to target different subsegments and take into account the generational preferences that often exist. For example, millennial-run businesses tend to be more tech-savvy and interested in mobile payments than are businesses run by baby boomers. Digital solutions should be viewed as long-term investments based on initial development expense; however, most financial institutions experience multiple short-term benefits, including increased customer engagement and reduced costs.

The questions in Table E are focused on the perceived importance of digital payments, factors considered for investment, and payments model.

Table E: Financial Overview Q&A

Questions	Categories
<p>Q1. Please select the statement that best describes your bank’s perceptions of small-business digital payments.</p>	<p>Small-business digital payments are not a priority for customers and thus are not a priority for my bank</p> <p>My bank views small-business digital payments as somewhat important, but its capabilities are mostly reactive to customer demand</p> <p>Small-business digital payments are viewed as important and are a midlevel priority for my bank</p> <p>Small-business digital payments are crucial to my bank’s long-term strategy and competitive differentiation, and are thus a high priority</p>
<p>Q2. Please select the statement that best matches your bank’s decision-making when deciding whether to invest in new small-business digital payments capabilities.</p>	<p>New digital payments capabilities must provide a clear revenue stream, or my bank will not invest in them</p> <p>Improvements in the customer experience are enough of a driver for investment in new digital payments capabilities</p> <p>My bank will only invest in new small-business digital banking capabilities if customers ask for them</p> <p>Small-business digital payments are an important competitive differentiator, and my bank wants to be seen as innovative; a clear initial ROI is not required</p>
<p>Q3. Is your bank actively targeting millennial-run businesses?</p>	<p>Yes</p> <p>No</p>
<p>Q4. Which of the following best describes your bank’s payment model for charging for business-specific payments capabilities?</p>	<p>Tiered pricing (a flat monthly fee for a designated number of payments that incrementally increases as new thresholds are reached)</p> <p>Per-transaction fees</p> <p>Monthly service charge and per-transaction fees</p> <p>Determined through account analysis</p> <p>My bank does not charge fees for business payments</p> <p>Other</p>

Source: Aite Group

MATURITY MODEL

Based on how each question was answered, Figure 9 depicts the bank’s current state in the development process and includes a brief summary of suggested next steps.

Figure 9: Small Business Digital Payments Maturity Model



Source: Aite Group

CONCLUSION

- Successful banks can't ignore the opportunity that exists within small-business digital payments.
- A well-thought-out and phased approach to implementing a strategic small-business digital payments plan will enable community banks to maximize their success and ROI while minimizing risk and low product adoption. Clear communication from the executive level, combined with a simple outline of the plan, usually address most concerns; however, a consistent, recurring update on progress will help ensure that the level of prioritization remains high.
- Don't try to be everything to everyone or to build the quintessential small-business digital payments offering. Align your strategy and offerings with your target market and look to carve out specialty areas and niches to better differentiate.
- Recognize that your bank doesn't always have to lead with lending. Outreach officers and relationship managers should be able to talk about a variety of capabilities and products as well as have expertise beyond credit. In fact, they may find even more opportunities exist within payments.
- Communication is critical. Community banks know their customers, but they need to talk to them more about what can be done to make their business better. They must listen to their customers first and then deploy technology to support them. There is sometimes a tendency or temptation to rush or go after the new shiny object. Banks must instead do what makes sense for their specific clients, their organizations, and their strategies.
- There is no one strategy for all community banks. Each needs to consider its own bank and clients and proceed from there.

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ICBA Bancard® is the wholly owned payment services subsidiary of the Independent Community Bankers of America. ICBA Bancard's community bank issuers generated \$29.3 billion in sales volume in 2018 and are ranked collectively as the 24th largest credit card portfolio in the United States. ICBA Bancard enables thousands of community banks to provide competitive credit card, debit card, ATM and merchant processing solutions. The company also provides exclusive services to issuers including its Fraud Loss Protection Plan, marketing support, and product education. For more information, visit www.icbabancard.org.

Tina Giorgio

President & CEO, ICBA Bancard

tina.giorgio@icba.org

202-821-4315

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AUTHOR INFORMATION

Christine Barry

617-398-5040

cbarry@aitegroup.com

Gilles Ubaghs

416-818-1874

gubaghs@aitegroup.com

PRESS CONTACTS

Nicole Swann

VP, Communications

nicole.swann@icba.org

202-821-4458

Aite Group PR

617-398-5048

pr@aitegroup.com

OTHER INQUIRIES

Aite research and consulting services:

Aite Group Sales

617-338-6050

sales@aitegroup.com

ICBA payments services:

ICBA Bancard

bancard@icba.org

All other inquiries:

info@aitegroup.com