

## “Leaving money on the table”: The corporate and SME experiences of digitizing business payments in the Philippines

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Businesses are leaving substantial “money on the table” by failing to realize the cost savings that could be achieved through the use of digital payments. If the corporate sector adopted digital payments instead of checks and cash, it could save an estimated 46% of its invoice-handling costs. Further, if the banking sector also adopted digital payments, it could boost net profit by an estimated 8.5%. To achieve these benefits, further initiatives are needed to build on the Philippines’ progress so far. In particular, the switching costs and ongoing fees for digital payments for both payees and payers need to be lowered and made more transparent. This case study sets out the experiences of three medium- and large-sized businesses, and highlights the key obstacles they faced in their shift to digital payments.

### Checks remain dominant, but are highly inefficient and lock up business capital

As of 2014, when research for this case study was conducted, checks remained the dominant payment method for big businesses and many small and medium enterprises (SMEs) in the Philippines. This is largely because banks usually do not charge a fee for issuing checks, provided the business maintains a minimum balance of cash holdings with the bank. Any check issued by any bank can be deposited at any other bank, usually clearing within two days, providing proof of payment and transactional information that helps businesses to reconcile their accounts.

Further, because banks frequently require businesses to hold high minimum balances in return for no-fee checking services, this capital is not available for businesses to invest in productivity and growth-enhancing measures, like training, new technologies, or business expansion.

Noting that many businesses have limited awareness of the major cost savings that digital payments can provide, this case study modeled potential savings in the Philippines and found that a full transition to digital payments and processing could save businesses an average of 46% of their current invoice-handling costs, mostly from reducing time spent by staff and management in preparing, signing, and distributing paper checks. In the banking sector, adopting digital payments could boost net profit by approximately 8.5%. However achieving results like these will depend on overcoming a range of obstacles to digitization, outlined further in this case study.

<sup>1</sup> Research and survey support was provided by Wajiha Ahmed, Laura Cojocar, and Johann Bezuidenhout from Bankable Frontier Associates, as well as Jay Sandoval from Social Weather Stations and consultants Jing Gusto and Jun Perez.

## Inter-bank digital payments attract high fees, and lack transparency on pricing and key transaction information

Among the obstacles to further digitization of payments, many businesses report a lack of transparency on the high fees banks charge both payers and especially payees for inter-bank digital payments. In particular, bundling services together and charging aggregate fees makes it difficult to isolate and predict digital payment costs. In addition, inter-bank digital payment receipts frequently do not provide enough information about the transaction to allow businesses to adequately reconcile their accounts.

Instead of using inter-bank digital transfers, corporate buyers often require suppliers to open accounts at the buyers' preferred banks. As a result, suppliers commonly open multiple bank accounts with different banks, creating significant inefficiencies and administrative duplication.

The Philippines has an Automated Clearing House (ACH) equivalent in the Electronic Peso Clearing System (EPCS) to support inter-bank transfers. However it is not widely used in the banking system, with only 1.7 million transactions annually – equal to only 1% of the volume of checks cleared. There are three key reasons why adoption of electronic payments is limited. First, checks are accepted as confirmation of tax payments (particularly VAT), whereas e-payment records are not always accepted. This creates difficulties for businesses in relation to tax lodgments and audits (which are still predominantly

paper-based), thus discouraging the use of e-payments. Second, banks benefit from holding float capital for the extra time it takes for checks to clear. Third, there remains a strong preference for intra-bank transfers for many key payments (such as payroll), as intra-bank transfers have the effect of retaining funds within the bank.

There is a clear need to create better incentives to encourage greater use of ACHs, including tax reforms to recognize e-payments as evidence of payment, and clear rules around permissible charges, fees, and the timeliness of credits.

## Central bank leading the way, but further policy reforms are needed

The Bangko Sentral ng Pilipinas (BSP), the Philippine central bank, has made a concerted effort to promote digital payments, setting out a vision “to see the rapid development of a widespread, efficient, and low-cost e-money ecosystem.” To achieve this vision, it has worked to build a more accessible, interoperable payment system and has put in place a real-time gross settlement system (RTGS) for large-value payments.

However, despite these achievements, as of 2014 when this research was conducted, there had been very little movement towards digital payments among Filipino businesses. This is in part because the BSP's vision had not been matched by government policies to change incentives and fee structures in the banking system that discourage digital payments in favor of payments by check or cash.



## The obstacles and opportunities in practice: three businesses in profile

Since the payment systems available are not designed for businesses, many businesses devise complex payment arrangements that meet their needs. This case study sets out the payment experiences of three medium- to large-sized businesses, using data collected from them in 2014. The companies profiled here represent three distinct sectors of the retail industry: direct selling (Avon), health and pharmaceutical products (The Generics Pharmacy, an SME franchisee), and casual restaurant chains (Global Restaurant Concepts). Their experiences highlight the key obstacles to digitizing payments in the Philippines, as well as areas of progress and opportunity.

### Avon: Relying on checks in the absence of convenient and affordable inter-bank transfers

Avon Cosmetics makes direct sales of cosmetics to consumers, maintaining a head office in Manila, 20 Avon-owned branches, and 148 independent franchises. With annual revenue of US\$375 million, Avon holds 28 corporate bank accounts to make and receive cash payments from 800,000 direct sales representatives.

Avon does use an intra-bank digital facility to make payroll payments to 250 of its employees' checking accounts. However, it does not use this method to pay suppliers because electronic receipts do not include enough information to allow Avon to adequately reconcile its accounts. Avon notes that neighboring countries (notably Singapore, South Korea, and Malaysia) are far more advanced in this respect.

Instead of digital payments, Avon pays all suppliers by check, writing about 1,000 checks manually each month, which suppliers must collect in person. This process alone requires three clerks to prepare invoices and arrange internal check approvals. At the time of this study, Avon was planning to outsource its

check payments, which it considered less costly than switching to digital payments because Avon does not pay check processing fees (provided it maintains a minimum daily balance at its main bank).

Avon does not use inter-bank digital transfers, citing fees levied on both payers and payees, as well as administrative inconvenience. However, Avon noted that having access to affordable and reliable inter-bank transfers would deliver "huge savings in admin work, as well as time spent on the road making withdrawals and deposits physically in the branches, while online is more comfortable, quicker, and safe."

### The Generics Pharmacy: Maintaining multiple bank accounts to avoid high inter-bank transfer fees

The Generics Pharmacy has multiple franchisees in the Philippines. The franchisee interviewed for this case study generates over US\$2.5 million in annual revenue through its 21 outlets. It pays most of its 100 employees by intra-bank digital transfer, but makes all other payments by check.

The franchisee has seven bank accounts at five different banks close to each outlet. The manager of each outlet makes daily deposits to the nearby bank to allow for accurate sales tracking and to avoid holding too much cash. To avoid the high fees involved with inter-bank transfers into one central account, the franchisee makes payments by check out of each separate account. As online banking is not available to manage cross payments from these accounts, the franchisee updates each account in person at each bank – a process that takes three hours per week in total.

The franchisee would prefer to maintain a lower balance in each account so as to deploy capital more productively. However all the accounts have high minimum balances ranging from US\$22,000 to US\$67,000.

Three of the franchisee's banks offer an inter-bank digital payment service, however the franchisee has not used these services because of the fees and the perception that payment rejection rates are high and that data for reconciliation is difficult to access.

## **Global Restaurant Concepts: Progress on digital payments to employees, but resistance from suppliers**

Global Restaurant Concepts (GRC) has exclusive rights to develop restaurant chains for brands including California Pizza Kitchen, P.F. Chang's, and Morelli's Gelato.

GRC uses an intra-bank digital facility to make payroll to nearly all its 800 employees' ATM accounts. Switching salary payments from check to intra-bank transfers has saved almost four days of processing time every month. However GRC pays bills and suppliers entirely by check, through at least 100 monthly bill payments and 1,000 monthly supplier payments. It pays most taxes by check, delivered manually to local or national government offices.

GRC says suppliers and vendors are resistant to inter-bank digital payments due to the risk of high fees for receiving payments. However, GRC estimates that inter-bank digital transfers could save time, reduce costs, and streamline its accounting department from 30 people to 12.

### **“Leaving money on the table:” Many businesses fail to realize the savings they could achieve through digital payments**

As none of the businesses interviewed had analyzed the potential cost savings of digital payments, this case study modeled potential savings using the Better Than Cash Alliance Invoice Calculator. As noted, this modelling found that a full transition to digital payments and processing would save businesses an average of 46% of their current invoice-handling costs.

While this model shows a clear cost incentive for businesses to transition to digital payments, progress remains hampered by perceptions that checks are “free” as long as minimum balances are maintained, and that digital transfers come with high or hidden costs.

Banks themselves largely bear the costs of issuing and processing checks, without receiving fee income

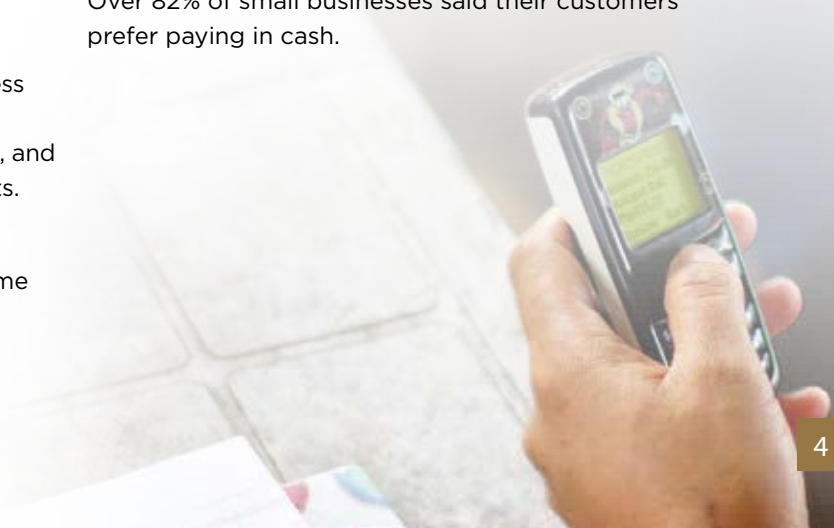
for the service, although banks do enjoy the capital benefit of holding corporate check float in deposit. However even if the Philippines moved entirely to digital transfers, the banking sector as a whole would still hold the same float in aggregate.

Based on transaction costs from similar studies by the European Central Bank and the Reserve Bank of Australia, Filipino banks could save an average US\$1.52 per transaction by moving from check to digital direct credits. This case study calculates the resulting annual net savings for the banking system at US\$272 million, equivalent to approximately 8.5% of the banking sector's entire net profit in 2013. While it is likely all banks would save costs by switching from inter-bank checks to digital transfers, the net benefit to any one bank would vary depending on how much float that bank held, relative to other banks.

## **Small businesses remain unbanked, putting the digital economy out of reach**

The challenge to small businesses is much simpler: The vast majority are unbanked. Most small but formal businesses function almost entirely in the cash economy, and are not even able to use checks. In a survey conducted for this case study, 70% of Filipino small businesses had no bank account at all. (As a point of comparison, the corresponding figure in Nigeria is 17%.)

The high proportion of unbanked small businesses in the Philippines translates to very low levels of digital payments. Only about 1% of small business payments were made digitally. Even small businesses that are banked are largely not using digital payments, because they operate in an environment dominated by cash. Over 82% of small businesses said their customers prefer paying in cash.





# Lessons

This case study presents several lessons to help governments, regulators, and businesses transition to greater use of digital payments.

## 1 **Align banks' interests with those of businesses and the government's vision.**

The Philippines Government has shown clear leadership in digital payments by itself, becoming the largest digital payer in the country. It now has an opportunity to build on this progress with policies that encourage banks to adopt practices that will cut the costs of digital payments for businesses, or at the least make fees more transparent.

Substantial progress may require new incentives or even penalties on check volumes or cash withdrawals, drawing on effective reforms in other countries, where in some cases public discussion about the possibility of introducing penalties has prompted banks to take constructive actions.

At the same time, the more policymakers can do to help banks understand the cost savings they stand to enjoy – as set out in this case study – the more incentive banks will have to embrace digital transactions.

## 2 **Aim for an intermediate step via auto-check payments.**

Clearly the incentives are not strong in the current environment for medium to large businesses to move away from checks as a payment instrument. However, businesses could realize large cost savings by switching to automated check processing – cutting overall checking costs by up to 41% simply by eliminating manual checks. This would allow businesses to retain their check float without needing to persuade suppliers to accept digital payments, until such time as digital payment fees are reduced in the future.

Even so, increasing inter-bank transfers should remain a key objective due to the major efficiencies and cost savings they can deliver, as highlighted by the comments of Avon in this case study.

**3 Encourage businesses to explore lower-cost payment services.** As the experience of the Generics Pharmacy in this case study shows, many businesses are incurring significant inefficiencies and avoidable costs maintaining their current payment methods. Businesses can benefit in the short term from assessing the true costs of their current payment methods, and using that information to shop for better, more efficient services. By measuring the potential savings of shifting from check to digital payment transfers, medium and large businesses in particular will be better equipped to negotiate with banks, and find more cost-effective methods of payment.

**4 Encourage banks to market digital payments to small and medium enterprises.** The need for banks to convincingly market the benefits of digital payments to SMEs is identified as one of the three top actions to overcome the impediments to digital payments in the Philippines. Helping SMEs to better understand the labor efficiencies and cost savings of digital payments will be a critical next step for the Philippines, provided this is accompanied by policy and product changes that make digital payments better value for SMEs, relative to the many paper-based payment methods currently available.

**5 Assess whether rules and regulations for consumer credit and debit digital payments are needed.** To increase consumer and SME adoption of digital payments, the fees on these transactions must be examined closely. It is likely that these will need to be substantially reduced in order to achieve significant change.

## Conclusion

The Philippines is at the early stages of its transition to digital payments. It will take substantial actions from policymakers and banks to create the right incentives to drive further progress. Collaboration between government, businesses, and banks on communicating the cost savings of digital payments will be critical, so that these benefits can be shared equitably, supporting further progress and wider inclusion in the digital economy.



## About the Better Than Cash Alliance

The Better Than Cash Alliance is an alliance of governments, private sector and development organizations committed to accelerating the shift from cash to electronic payments. The Better Than Cash Alliance is funded by the Bill & Melinda Gates Foundation, Citi, Ford Foundation, MasterCard, Omidyar Network, USAID and Visa Inc. The UN Capital Development Fund serves as the secretariat.



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- 1 This report was authored by BFA's Malawi country project team: Country Director: Jamie M. Zimmerman, Measurement Expert: Kristy Bohling, Payments Expert: Brian Le Sar, Country Analyst: Brian Loeb, and Country Support: Neil Nyirongo and Titus Kavalo.
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- 5 GSMA Intelligence: <https://gsmaintelligence.com/markets/2370>.

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