JANUARY 2023

TOP 10 TRENDS IN COMMERCIAL BANKING & PAYMENTS, 2023

MOVING TOWARD A PERIOD OF GROWTH AND CONNECTION

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COMMERCIAL BANKING & PAYMENTS TEAM

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IMPACT REPORT

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TOP 10 TRENDS FOR 2023

Technological development and innovation in commercial banking and payments continue to accelerate faster than most financial institutions can adapt. As the financial services industry moves past the fire alarms of the COVID-19 pandemic with a renewed focus on technology and automation, corporate end users want quick and easy delivery of services that create more seamless cash management and payments experiences. FIs must get closer to end-customer needs to meet them; they must tune into the next normal, an evolving state of financial services technology innovation across the industry.

The return on investment of new and better solutions is not instant, creating challenges in this environment. The sales cycle, implementation, and adoption of new solutions take time. A 2023 investment may take until 2024 to be realized, so FIs must be strategic and tactical simultaneously. Stagnating is not an option, as the choices of cash management and payments solutions available to businesses of all sizes continue to grow in accessibility and availability. Technology and automation solutions must aggressively progress to future-proof the commercial banking portfolio across cash management and lending.

Aite-Novarica Group identifies 10 trends that will shape commercial banking and payments around the globe in 2023 and beyond:

- Payments infrastructure enables real-time everything.
- Sustainability emerges as a new focus in commercial banking in payments.
- Life cycle banking and enterprise resource planning (ERP) integration become critical.
- Investing in onboarding starts to grow into a competitive advantage.
- Interest in virtual account management grows.
- Embedded lending separates the haves from the have-nots.
- Fintech funding and enablement start to slow down.
- Demand for accounts payable solutions and automation increases.
- Business travel payments return.
- Continued mergers and acquisitions (M&A) activity impacts IT spending.

PAYMENTS INFRASTRUCTURE ENABLES REAL-TIME EVERYTHING

By Erika Baumann and Gilles Ubaghs

Real-time payments have become entwined in the essential payment infrastructure around the globe. While some regions implemented immediate payments decades ago, others are just catching up. The value propositions of modern, faster payments schemes—including paying just in time, improving operations, enhanced liquidity management, access to better data, and improving working capital—are critical for businesses to access. Faster settlement of funds is just one element of this value proposition. To offer a competitive end-to-end payments solution, FIs must provide businesses with a way to disburse in real-time, have immediate availability of funds, and create infrastructures that can also support real-time reporting and forecasting. Market-leading banks in the U.S., Europe, and other global regions have accomplished this. However, many FIs still struggle to prioritize and understand the necessary infrastructure changes.

The consequences of FIs lagging in modernization efforts has led many businesses of all sizes across all regions of the globe to seek fintech partnerships to provide payment services. Motivating this trend is the need to access real-time payment networks, simplify the file submission process, create operational efficiencies, and have more robust reporting and forecasting capabilities. FIs that are not critically planning to close gaps to provide faster access to payments, new features, and reporting will find their business customers actively entertaining alternative providers—other FIs or fintech firms directly.

The “real-time everything” trend has led to a new infusion of payment hub implementations. However, these implementations look much different than they did a decade ago. Just as customers demand real-time payments and reporting and robust functionality that simplify their processes without a heavy onus on internal IT resources, many FIs are looking for the same. Partnerships with fintech firms providing flexible and scalable infrastructure that can be implemented in pieces as the FI is ready to consume them will dominate the technology movement headed into 2023. With this, not only are the pain points within domestic payments a focus, but the cross-border prospects are also looking brighter. With viable solutions built using ISO 20022 messaging standards, international real-time is seeing drastic improvement. Of particular note is the IXB pilot, facilitated through the partnership of The Clearing House, SWIFT, and EBA Clearing.

SWIFT is expected to formally launch its long-in-development ISO 20022 capabilities in 2023, following an eleventh-hour delay to its previous 2022 initiation date. 2023 is set to see an acceleration in the global shift to the new messaging format. Clearing and settlement mechanisms and regulators in markets including the EU, Canada, the U.K., and Singapore have already begun transitioning to the new format or have clear roadmaps and timelines for when they will do so.

The next few years will see an acceleration of ISO 20022 implementation; this will gain added prominence as SWIFT nears the end of its planned tandem operating model with SWIFT MTs in 2025. The format will trend toward ubiquity as more countries implement the standard at a national level and greater integration into back-office systems for FIs and their corporate customers. The additional messaging and data aspects of ISO 20022 will add to the richness of real-time payments, ironing out many of the pain points of today's payments infrastructure while providing end users with greater visibility, integration, and analytics. The ongoing migration to ISO 20022 is easier said than done, but the process is fully underway and will only grow in importance in 2023 and beyond.

SUSTAINABILITY EMERGES AS A NEW FOCUS IN COMMERCIAL BANKING IN PAYMENTS

By Benjamin Nestor and Erika Baumann

Environment, social, and governance (ESG) initiatives have grown significantly over the past several years and will continue to impact the private sector (and commercial banking, by extension), developing more in the year to come. However, ESG initiatives in the financial industry continue to encounter critical hurdles that have hindered wider implementation. These include a lack of standardization in reporting, varied regulatory frameworks across geographies, slow development of value-added services, and a growing concern among corporate clients and FIs about pursuing objectives outside of core business goals during turbulent economic times. However, ESG goals have moved beyond a trendy fad; providing solutions that meet or assist businesses with ESG goals is becoming increasingly important.

Aite-Novarica Group research has suggested that "sustainability" is more than a new buzzword to maintain momentum for ESG initiatives. Instead, sustainability reflects continued and growing demand among consumers and investors for actionable solutions among organizations to reduce or eliminate negative externalities of doing business without many of the pain points and hurdles that corporate customers have experienced pursuing ESG goals. The refined objective of companies seeking to reduce emissions and other negative consequences on the environment aligns with FIs and financial services vendors scaling existing and new solutions to assist corporate clients in meeting these goals at a greater frequency this coming year. For commercial banking clients, this also means helping businesses reduce paper and manual processes, using vendors with ESG accountability, and access to payments that reduce a company's carbon footprint.

FIs that have invested in sustainable initiatives and have been early adopters of ESG solutions recognize that banks are uniquely situated to assist corporate clients in realizing sustainable goals. This trend will accelerate over the next year and beyond because banks have access to payments and other transaction data, such as supply chain finance. Data of this nature provides a historical record of business relationships and maps business-to-business (B2B) relationships, which can help companies reduce emissions, lower their carbon footprints, maintain regulatory compliance, and align with nongovernmental sustainability objectives. Corporations will increasingly partner with FIs that utilize transaction data and provide services and guidance corresponding to sustainability features embedded in existing payment, trade finance, and cash management products.

Embedding sustainability analytics into transaction products and offering advisory and guidance services form the bedrock of how FIs will help corporate clients achieve better sustainability ratings going forward. Sustainability-based payment solutions can lead toward more favorable terms for transactions involving sustainable assets or transactions with counterparties that have improved sustainability scores. Banks can also offer better terms for digital payments or for companies that automate payments to reduce cash and check usage. Commercial cards can also take a sustainable angle through carbon-offsetting features or better terms for sustainable purchases.

As the integration of sustainability into payments and transaction data matures, supply chain finance is likely to become a source for helping corporate clients achieve carbon reduction goals. Buyer-led and supplier-side trade finance mechanisms can integrate sustainability ratings and lead toward adjusted financing rates and dynamic discounting dependent on sustainability ratings. FIs might also provide additional guidance through data analytics of supply chains based on existing data embedded with sustainability metrics, which could be used to advise clients to modify supplier relationships.

Transaction data can also provide banks with the ability to create industry benchmarking by offering companies with knowledge of sustainability performance among peer companies or enabling FIs to offer guidance to smaller businesses based on tested sustainability improvements in larger companies.

FI-provided sustainability services and products exist but have yet to achieve maturity. Expect to see continued growth and demand for integrating sustainability solutions into existing transaction-based products and advisement services in the coming year.

LIFE CYCLE BANKING AND ERP INTEGRATION BECOME CRITICAL

By Enrico Camerinelli

Pushed by market dynamics and competitive pressures, nonbank entities (e.g., fintech vendors, corporate enterprises) are demanding access to banking capabilities. They also want to make these capabilities available from their IT systems to increase and strengthen engagement with existing and new clients. Propositions called Banking-as-a-Service (BaaS), open banking, embedded finance, and embedded banking represent trending answers to such needs.

Aite-Novarica Group's ongoing research on BaaS and embedded banking asserts that these terms are not interchangeable. BaaS is a banking product created and offered as a service to a potential user. BaaS originates banking capabilities; therefore, somebody must have a banking license. Embedded banking is the orchestration of financial products consumed because they are relevant (i.e., embedded) in the context of use. BaaS products represent the most effective enablers for implementing embedded banking.

From BaaS to Life Cycle Banking

Aite-Novarica Group's research has coined the term "life cycle banking," representing the next evolution of BaaS and embedded banking. Life cycle banking embeds within BaaS capabilities the entire knowledge of the user's daily activities, including tasks to execute and objectives to reach, all within the company's supply chain processes. The generated data and information typically trigger a payment, collection, or loan request, all of which are flows of the financial supply chain.

Life cycle banking incorporates financial supply chain capabilities consumed as BaaS components and triggered by events in the physical supply chain. Such processes are particular to the industry sector's physical supply chain dynamics. Hence, the life cycle banking capabilities are not only transparent to the user (as in embedded banking). Life cycle banking capabilities are executed according to the sector-specific process flows; they create, process, and store data specific to that sector. If the value of banking transactions resides in the data exchanged, life cycle banking maximizes this value.

INVESTING IN ONBOARDING STARTS TO GROW INTO A COMPETITIVE ADVANTAGE

By Paul Kizirian and David O'Connell

FIs are fragmented when it comes to funding major onboarding improvements. In 2023, some FIs will break from the pack with improved and even transformational onboarding experiences. Almost all bankers vouch that onboarding is critical and in need of improvement. Still, only a minority of institutions indicated in a survey that onboarding receives funding sufficient to make material improvements.[1]

- FIs that have invested in material improvements to the customer journey will differentiate themselves and retain higher levels of customer loyalty. Over time, as news spreads, this will refresh their brands. They will begin to win larger wallets within small-to-midsize (SMB) business lending and treasury.
- Customer experiences at institutions allocating marginal to low funding will improve incrementally but will begin to exhaust the limits of internal team collaboration and repository tools as these are largely dependent on human effort.
- Third-party solutions will continue to expand robust onboarding ecosystems, targeting solutions to address small business demand deposit account (DDA) openings and commoditized loan products (e.g., SBA, mortgage, SMB lending, and others).
- Institutions that infuse deeper customer voice insights into operations and support processes and systems will make better decisions on where and how to improve the onboarding experience.

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1 See Aite-Novarica Group's report Onboarding at Commercial Banks: The Untamed Blight Threatening Banks' Business, July 2022.

Certain Elements of FI Culture Will Harm Returns

The slow pace of improvement for onboarding might reflect a deeper and underlying culture within banking that places a premium on the concept of stickiness. This would make sense based on funding priorities allocated based on strategy, sales, and internal organizational priorities. Over time, these conditions can create a culture within an FI that prioritizes customer acquisition over delivering a good experience. Simply put, delivering a good experience won't appear as a key performance indicator and is unlikely to influence a sales team's priorities.

The power of "stickiness" has unfortunately held: A mediocre solution set would be so difficult and costly for a customer to abandon that they would think twice, and the bank relationship team would retain the business. This "pain avoidance" cultural model differs vastly from and will run up against a vast array of fresh, new value propositions aimed at competing based on easier ways of doing business.

FIs that don't focus on an integrated customer journey while retaining the belief that stickiness is a virtue are likely to misjudge the opportunity cost to risk-adjusted return on capital.

Revenue Forgives All Sins Except Poor Onboarding

Entry into a new market is often subsidized by offering significant discounts on mature solutions. Sometimes, multi-year contracts are packaged with multiple services and are discounted so heavily that it gives the effect of "buying the business." Taking these deals puts businesses in a situation where they may be gambling with their operational integrity: swapping out solutions that facilitate cash flow and working with a largely unknown entity to reduce banking fees significantly.

The bank may win the account, but the business staff will remember a negative onboarding experience and perhaps even resent it. Over time, if performance doesn't improve, they may become inclined to leave the bank relationship at the end of the contracted period or, upon maturity, a credit extension. In the best of situations, the business will shop its noncredit services to other institutions, traditional or otherwise. Doing so will lead to insidious leakage of risk-adjusted return on capital. If poorly detected and not troubleshot, the resulting loss of income and return will create a lousy experience for both borrowers and non-borrowers. It may seem reasonable for FIs to leave their onboarding problems unaddressed—it's a tough nut to crack—but it's far too expensive in its impact on revenue and churn.

Sales Bottlenecks

From a treasury speed-to-revenue perspective, the weakest link in the chain isn't sales—it's onboarding. It can unduly slow an organization's ability to transact and recognize billable revenues. From an experience perspective, customer interaction is far more complex than a conceptual sales conversation.

The reuse of data from credit, as an originating product, to treasury is typically fraught with systems gaps and organizational incongruities. Systems and changes that provide ownership and data integration between these two offerings will offer better customer experiences.

INTEREST IN VIRTUAL ACCOUNT MANAGEMENT GROWS

By Enrico Camerinelli and Paul Kizirian

Virtual accounts (VAs) are pseudo-sub-accounts that mask an established bank account. They allow corporations to account for and represent funds segregated by sub-entities (e.g., subsidiaries/ department of a business), a counterparty to a payment transaction, or a transaction by itself (also known as "contextual" VAs) created, for example, for each payor to track and reconcile repayments over time. VAs are less expensive to manage as there is no physical money to handle. They do not require clearance to gather the liquidity under the physical header account since they are not connected to a clearing system/SWIFT like a physical account is.

Corporations use VAs to create financial hierarchies that automatically centralize money positions while providing discreet accounting and origination tracking, making it unnecessary to move large amounts of money by cash concentration. In essence, funds segregated in VAs are auto-aggregated under one physical bank account and are literally self-concentrating. PSD2 regulations give third parties access to accounting information, so a multi-banking VA management (VAM) solution can mirror the account information across multiple banks, providing customers with an overview of the VAs maintained under different banks.

VAs From the Bank's Perspective

A bank can provide a VAM user interface through its corporate banking channels, enabling the client to view and administer VAs maintained with other banks using virtual account numbers (VANs) to process payments via the banking system. A VAN can be used as an identifier of an individual transaction or specific originator that allocates transactions to discrete subledgers (i.e., the VAs) within the physical account. When reflected in transaction reports, bank customers can more effectively match transactions within their accounting systems. The reference is used to automate reconciliation tasks in the accounting department.

Banks provide clients with self-service capabilities to open, transact, manage, and even close these accounts independently. By enabling the end user to take over much of the account setup process, bank costs in account maintenance are reduced. As the cost of providing services falls, banks can service a wider range of clients, pushing to small businesses. Under Basel III rules, banks cannot compute liquidity ratios by netting the outstanding balances of accounts. The ratios must be based on the gross value of individual accounts, so banks must place provisions against each. With VAs, banks can keep all funds in one physical account and calculate liquidity provisions against it. The benefit for FIs is that customers continue to have debit balances on their VAs without the FIs needing to account for them in risk-weighted asset calculations.

From a risk and compliance perspective, VAs also alleviate the need to perform lengthy Know Your Customer requirements with each account since this activity was already assumedly performed before the establishment of the main account.

Aite-Novarica Group anticipates that VA offerings will represent a competitive differentiator for banks. Some VAs will operate exactly like physical bank accounts, while others will have selected focus on specific payment instrument types.

VAs From the Corporation's Perspective

VAs allow users to integrate their banking systems more easily with their accounting or ERP systems and segregate the funds received from clients or related stakeholders. VA corporate adopters can better track intra- and intercompany money movement with improved mechanisms to define and manage intra- and intercompany lending and borrowing, thereby optimizing and rationalizing interest positions for the corporate sweeps. Focusing on transactions enables corporate treasurers to hedge foreign exchange positions better while minimizing fraud risk by concentrating on fewer physical accounts.

Local bank accounts, also known as “virtual” international bank account numbers (IBANS), are a flexible solution to manage domestic value-added tax repayments. Clearing systems recognize these “virtual” IBANS, which are in the local entity’s name. Corporate users must remember that VAs require intercompany lending books and tax calculations to be maintained, similar to what is required for physical sweeps. Aite-Novarica Group research found that a general good practice for treasurers is to open VAs for new business operations, testing the capabilities offered by the FI partner as an alternative to opening new (and costly) physical accounts, reducing any potential risk. This option allows treasurers to test the VAs for a new line of business. The proliferation of VAs generates complexity, so it’s a good practice to open VAs only if necessary.

For example, a business might use VAs to support accounts receivable by establishing a different VA for each major customer that pays electronically. Accounts receivable typically needs to research each transaction before posting it to the general ledger. Each day, the accounts receivable staff can download the prior day’s transaction reports (segregated by VAs) and post those to their receivables module. Without associating each transaction with its originator, funds attributed to a VA can automatically post to the correct customer general ledger account.

Aite-Novarica Group recommends that corporate users ensure banks offer VAs that correspond to what is needed from a physical account. The offered VAM system must manage ISO 20022 standard, beyond the VA being multicurrency, multibank, and multicountry. Corporate users planning to integrate a VAM with their ERPs, treasury management systems, or other back-office systems must inquire about each VAM provider’s API or connection-level capabilities to ensure swift integration into the enterprise IT back end.

Assigning a new (virtual) account number to an account into which many different clients make payments can prove challenging. Some banks may need to close the physical accounts before replacing them with the VAs.

EMBEDDED LENDING SEPARATES THE HAVES FROM THE HAVE-NOTS

By David O’Connell

Embedded lending—the use of APIs by lenders to integrate over the firewalls of their borrowers into their accounting systems for broader, more granular, and always-on underwriting—is destined to transform the SMB lending world. (Yes, you’re about to read a bold prediction of a long-term nature.) As terrific and seemingly inevitable as this is, not everyone is on board. Anecdotal evidence indicates that community banks often pass on the technology, citing a familiarity and knowledge of their borrowers that is, well, community-based and doesn't need to be enhanced, technologically or otherwise.

On the other end of the FI size spectrum, several large banks also think they already know enough about their borrowers and are worried about what the regulators will make of the impact of embedded lending on their lending practices. Some are concerned that embedded lending might run afoul of Section 1071, which will extend the Consumer Financial Protection Bureau's legal and regulatory scope to SMB lending—that is, if this institution survives the recent legal finding (currently under stay and appeal) that its funding is unconstitutional.[2]

Nevertheless, it will be transformative, for embedded lending has a killer business case supported by those who have embraced it and are enjoying some of its benefits and those who plan to adopt it. First, there's the impact on the borrower experience (BX). When a lender integrates into a prospective borrower's accounting records, all those pesky tasks required in underwriting to get financial records, namely the manual exchange of financial statements, are vaporized for borrower and lender alike. Oh, and also automated away almost entirely is spreading, that highly ritualistic process of translating a borrower's accounting data into a lender's lingua franca for its credit culture.

All this automation brings two heavy hammers borrowers seek in the BX (whether or not lenders know it): speed and ease. It's important to note here that leaders at SMBs tend to like speed and ease a great deal. Not because they need the money right away, but because running a small business, where they wear many hats, is epically difficult. Eliminating anything on their to-do list will invoke substantial gratitude, be it to a fintech firm, online lender, or traditional lender.

But enough about the borrower; embedded lending is also terrific for the lender. After all, SMB lending is profoundly difficult to scale. The more email exchanges, document misplacements, document hand-offs, and manual spreading an FI eliminates from its credit onboarding and underwriting, the better it will accommodate the brutal economics

2 The Wall Street Journal editorial board, "CFPB Funding Is Ruled Unconstitutional," The Wall Street Journal, October 20, 2022, accessed on December 19, 2022, https://www.wsj.com/articles/cfpb-funding-is-ruled-unconstitutional-11666306073.

of SMB lending, wherein one begins losing money after spending more than an hour underwriting a borrower.

But wait, there's more. Embedded lending also deters and detects fraud better. After all, if a lender has access to a borrower's banking data—as tends to be the case during underwriting and after the close—and cross-correlates it with accounting data gained as a result of embedded lending, fraud becomes almost impossible. It's just too difficult for a fraudster to tell the same lie to the many integrated data sources available to the lender.

However, SMB lenders are an uneven bunch regarding embedded lending, based on an Aite-Novarica Group survey from Q4 2022.[3] Among the examined SMB-lending FIs, 19% have adopted embedded lending, 6% plan to adopt it, and 50% are considering it. Possession of a killer BX by a soon-to-be 25% of the market will leave non-adopters at a significant disadvantage. Adoption can be expected to improve: Among the examined lenders, 44% indicated that multiple vendors of embedded lending systems had pitched them. Add to these data points generally favorable takes on the benefits achieved by adopters, and the word on embedded lending is indeed out.

If you're reading this, run an SMB lending operation, and think embedded lending isn't for you, here are a few things to consider: You may not think that your borrower wants to interact with you over embedded lending infrastructure or that your BX is fine the way it is, but your borrower probably did not call its cable provider 10 years ago requesting streaming video.

And if you're the FI offering the lending equivalent of shipping discs in red envelopes through the mail, you're probably headed for trouble. Perhaps you think you already know enough about your SMB borrower by examining the principals and guarantors. Think again: Your embedded rivals, examining borrowers with data that is more voluminous, broad, and granular, are probably safely lending to SMBs that you incorrectly think are outside of your credit box but are actually in it.

3 Aite-Novarica Group survey of 20 SMB-lending FIs, Q4 2022.

FINTECH FUNDING AND ENABLEMENT START TO SLOW DOWN

By Gilles Ubaghs and David O'Connell

Technology companies have become the new titans of industry in the 21st century, much in the same way oil companies rose to power in the early 20th. With such growth has come huge levels of finance and investment from venture capitalists (VCs), private equity, and other investor categories across a wide range of technology sectors. Tech investment has risen enormously in recent years, and investment into emerging fintech firms has been among the most active sectors. Many high-growth fintech providers have proven to be hugely disruptive and hugely profitable, with clear-cut monetization models that generate returns much more rapidly than many other technology segments. The likes of Uber and Amazon took years to reach some level of profitability after billions in losses; the same cannot be said for fintech firms such as Stripe or Adyen.

Investment in fintech firms remained surprisingly stable during the initial volatility of the COVID-19 pandemic and reached record levels in 2021. VC investment into fintech startups is estimated to have grown by a factor of 2.8 in 2021, rising from US$45 billion to US$125 billion globally, breaking all previous records by a substantial margin.[4] Much of this growth and market exuberance came from an acceleration of trends brought on by the pandemic. Businesses and consumers flocked to more convenient, digital forms of financial services, and legacy financial services providers quickly increased their investment into their capabilities to meet shifting customer demands.

However, such high levels of investment are unsustainable long term. Greater economic headwinds are now buffering most markets in the form of inflation, rising interest rates, and growing expectations of outright recession in many regions. Aite-Novarica Group expects to see a continued slowdown in fintech investment in 2023. The market is not yet seeing consolidation or fire sales of various fintech vendors. Still, reports are emerging that budgets are tightening, and emphasis is growing on emerging fintech vendors proving their revenue models and becoming less profligate in some of their spending.

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4 "Fintech 2021 Report," dealroom.co, January 2022, accessed October 16, 2022, https://dealroom.co/uploaded/2022/01/Fintech-2021-recap-1.pdf?x84064.

As Warren Buffet famously put it, "You only find out who is swimming naked when the tide goes out."[5] A tighter investment environment will renew a focus on existing fintech providers delivering value to their customers. It will likely lead to a reduction in the number of "me too" and vaporware fintechs clamoring for market attention. These conditions pose potential benefits to existing FIs and fintechs partners, as they will help separate the wheat from the chaff in terms of which fintech providers can offer a long-term proposition. It also suggests there may be opportunities and bargains for banks and vendors in potential acquisition targets and bringing some of these fintech capabilities fully in-house.

Complementing Buffet's sage insights are observations from those of us for whom this is not our first speculative-bubble rodeo. Some fintech cultures invoke the sense that the adults aren't quite in charge. Examine enough fintechs, and one can observe employees in influential positions who have never worked in the industries for which they are building capabilities. Sometimes, they seem to care far more about public relations, logos, and the big initial public offering (from which customers get zero benefits) than about features, functionality, or deployment benefits.

FIs are large, unwieldy, risk-averse, and heavily regulated. They have embraced fintech firms a fair bit, but they see plenty of fintech pitches and demos that are notably absent core takeaways, such as how the business case would be made to support adoption and what distinct competitive competencies the fintech possesses.

DEMAND FOR ACCOUNT PAYABLE SOLUTIONS AND AUTOMATION INCREASES

By Paul Kizirian

Whoever owns the invoice process will own the payments and the customer—and while payments are a penny problem, invoices will become a dollar business.

FIs have begun looking to find and work with the right vendors to provide effective invoice management and automation solutions for their customers. In 2023, banks will transition from partnerships that only engage customers upon completing a payment file to partnerships that bring customers an ecosystem for invoicing processing and payments.

5 Timestaff, "Swimming Naked When the Tide Goes Out," Money, April 2, 2009, accessed October 16, 2022, https://money.com/swimming-naked-when-the-tide-goes-out/.

Engaging Customers After They Produce a Payment File Is a Limited Solution

Accounts payable exerts significant effort to legitimize each invoice it receives, then it pays them. These two distinct operations form the basis of its daily work.

Multiple fintech providers engage accounts payable once a payment file is created. This approach avoids the more difficult work of invoice processing, but they gain market share by taking the file and making the payments. They also provide access to newer payment services and rails. For smaller middle-market businesses, they appreciate the value of services such as white glove vendor onboarding and clean UI dashboard reporting to give them a new incentive to try. The promise of rebates from expanding virtual card payments doesn't hurt, either.

A service that starts with a payment file provides a quick market entry, but it also means newer entrants can enter the market just as quickly and compete—and competition is already fierce. The size of a business also influences its behavior, needs, and inclinations around payments. A payment file processing approach yields a limited value for larger middle-market businesses and large corporations, which drive significantly higher payment volume.

With a battlefield full of fintech providers eager to process a payment file, FIs will begin to see the importance of listening to their customer's voice to filter and identify which partnerships and solutions would be best. FIs will likely hear something like this: "It's great that you can process my payments, but can you help my team?"

Customer Voice Will Become a Compass

Qualitative CFO interviews reveal that despite the buzz in the payments space, they remain laser-focused on improving efficiency across core financial operations, including accounts payable. Accounts payable will welcome help with payments. Still, holistically helping them will add much more value, given the effort it takes to legitimize each invoice that results in a payment.

Holistic help brings significant value. The dynamic produces a magnitude and scale: To wit, a company can receive 40 invoices from the same vendor that end up in one payment. An accounting team can dedicate 40 staff to manage invoices and only need one to push a payment file. Further, while an electronic payment costs pennies, the invoice management process can represent a significant expense by many orders of magnitude.

FIs will want to solve dollar problems and not compete for penny solutions. By doing so, their business customers will shift their perception of their FI from being a vendor to being a business partner.

BUSINESS TRAVEL PAYMENTS RETURN

By Gilles Ubaghs

Few areas of financial services were hit by the pandemic in 2020 as quickly and dramatically as the travel payments sector. Other product categories, from lending to real-time payments, saw dramatic shifts in customer demand and bounced back to new highs very rapidly. Still, travel and expense (T&E) corporate cards collapsed almost overnight and will take several years to recover to previous highs. With lockdowns and travel restrictions brought on by the pandemic (hopefully) in the past, travel payments are bouncing back. The stage is now set for market innovation and deployment of new capabilities in this previously neglected space.

Aite-Novarica Group estimates that global business travel spending fell from US$1.4 trillion in 2019 to US$661 billion in 2021. Since then, the market rose to estimated spending levels of US$1 trillion in 2022 and will reach US$1.2 trillion in 2023 before returning to 2019 levels in 2024. Shifts in corporate travel policies have undoubtedly occurred in the age of remote working and Zoom calls. However, demand is now returning for corporate travel and (bar any unforeseen market shocks) will continue to rise in the near term.

T&E card use dropped precipitously in recent years, but the broader commercial cards and corporate payments space saw a rapid acceleration in new digital capabilities that led to significant growth and greater availability of commercial cards to end users. Initiatives such as virtual cards, instant issuance, ERP and accounting platform integration, and mobile wallet capabilities have led to an expansion of the market. Commercial cards have become more convenient for end users and solve many of the challenges legacy payment mechanisms face. Travel payments and T&E cards have not experienced this same level of innovation in recent years.

The return to business travel also holds the potential to help expand the fuel and fleet card segment. Fuel and fleet payment solutions have seen some innovation in card management and program controls in recent years. Still, the market remains dominated by a small number of specialist players. Newer fintech vendors such as Coast are now entering the market and will help to increase competition levels and shift end-user expectations.

The lack of innovation in travel payments is unlikely to remain an unfilled niche for long, as business travel expands, and businesses seek better and more efficient means to pay. Expect to see a significant focus on corporate travel payment mechanisms placing greater emphasis on instant issuance, mobile wallet integration, new reward programs, and integration to enterprise infrastructure in 2023 and beyond.

CONTINUED M&A ACTIVITY IMPACTS IT SPENDING

By Christine Barry

Banks are under tremendous and continuous pressure to evolve their strategies and product offerings to keep up with new customer demands and a challenging economic and competitive landscape. Many have joined forces over the last decade through M&A activities to fill product gaps and broaden their geographic footprints. These M&A activities have been rising worldwide, especially in the U.S. The FDIC estimates that the number of banks in the U.S. has decreased by approximately 32% since 2012.

The pandemic slowed down some of the activity in 2020, but pent-up demand and continued competitive pressures promise this trend will continue in the near future. If levels remain consistent, the market could see at least 200 U.S. banks merge next year. The average deal size of bank M&A activities has also increased—from US$165 million in 2016 to US$693 million in 2021 across U.S. banks—as a growing number of larger banks also partake in these activities. Some notable recent deals include the merger of Bank of Montreal and Bank of the West, M&T Bank and Peoples United, and Webster Financial and Sterling Bancorp.

The result of M&A activity has been fewer but stronger banks with more sophisticated needs. These banks have increased resources to invest in digital technologies and meet client needs better, find points of competitive differentiation, and move further up-market to meet the needs of larger businesses. For some banks, merger activities will be a major distraction as planned initiatives are put on hold, and integration initiatives become the priority. Banks must decide which bank systems will remain intact and which will be replaced. For some banks, this process can take several months as multiple platforms run simultaneously. However, the sooner they make these hard decisions and complete the integrations, the sooner the new entity can look forward and reap the benefits of its combined strength.

M&A activities are no easy feat, but those institutions with solid plans have much to gain. M&A allows them to take a step back, examine all major platforms, determine where enhancements are necessary, and right-size their portfolios. This is good news for best-of-breed technology providers, as they will surely see higher deployments and greater cross-sell activities. Commercial and corporate banks are most likely to emphasize the following areas in 2023 as they look to enhance their capabilities:

- Building out API activities
- Tighter integration across platforms
- Enhanced data exchange within the bank and with external systems
- Building out fintech partnerships
- Replacing cash management systems
- Investing in new tools for better client servicing

Banks will also be closely examining the user experience within their digital platforms; Aite-Novarica Group research has found that more than 40% of banks admit they fall short of client expectations in this area.

During 2023, banks will continue to focus on enhancing their digital capabilities, improving integration and automation, and better leveraging data within their organizations while making it more assessable and actionable for clients. Increased M&A activity will create some challenges but will ultimately strengthen offerings and the overall experience for clients.

CONCLUSION

In 2023, Aite-Novarica Group anticipates the following trends in commercial banking and payments:

- **Payments infrastructure enables real-time everything:** The infrastructure and solutions that provide real-time payments are also critical to improving operations, access to better data, and working capital. ISO 20022 initiatives are finally going live with notable scale and activity into 2023 and beyond. This will also contribute to real-time everything capabilities and drive market growth.
- **Sustainability emerges as a new focus in commercial banking and payments:** ESG initiatives in commercial banking are likely to continue growing as an area of investment and focus. In many instances, ESG goals have proven unwieldy, and solutions remain just out of reach. Sustainability products enable FIs to narrow the focus through go-to-market solutions already in demand with commercial clients.
- **Life cycle banking and ERP integration become critical:** Life cycle banking capabilities are executed according to the sector-specific process flows. They create, process, and store data specific to that sector. If the value of banking transactions resides in the data exchanged, life cycle banking takes this value to its highest possible.
- **Investing in onboarding starts to grow into a competitive advantage:** Onboarding is going to become even more critical when it comes to the adoption of new customers. For those that continue to lag, business customers will start looking to third parties and open banking initiatives to bypass the hassles they've come to expect during FI onboarding.
- **Interest in virtual account management grows:** VA offerings will represent a competitive differentiator for banks. Some VAs will operate exactly like physical bank accounts, while others will have selected focus on specific payment instrument types. A general good practice for corporate treasurers is to open VAs for new business operations, testing the capabilities offered by the FI partner as an alternative to opening new (and costly) physical accounts.
- **Embedded lending separates the haves from the have-nots:** In the tricky game of SMB lending—where scale, speed, and throughput have been elusive for so long—early adopters of embedded lending will pull ahead of their competition. The

transition won't be seamless, and firms will have to overcome some cultural discomfort. By embracing APIs to access borrowers' financial and operating data, these early adopters will deliver a superior BX, obtain the data required to identify false credit negatives, and obtain sustainable scale.

- **Fintech funding and enablement start to slow down:** Fintech vendor funding reached record highs in 2021, but this was not sustainable long term. Funding will continue, but belts will tighten, and fintech vendors will need to focus on driving profitability and reducing excess expenditure. These conditions may lead to good acquisition opportunities for FIs and vendors and reduce the growth of "me too" fintech vendors.
- **Demand for accounts payable solutions and automation increases:** FIs wanting to deepen business customer relationships will seek to provide services that support accounts payable's invoice processing and payment needs. Customers sold solutions that primarily address accounts payable payments will chase the significant value offered when a full-service accounts payable ecosystem is presented.
- **Business travel payments return:** Commercial travel is back after a particularly brutal collapse due to the pandemic, leading to increased transaction volume on existing travel payment products. However, the market has seen little innovation in recent years, and providers that can deliver newer, better travel payment products have the potential for added market growth.
- **Continued M&A activity impacts IT spending:** M&A activity across banks will remain strong throughout 2023. These activities will be a distraction for some, but they will ultimately increase banks' IT spending and create new cross-sell opportunities for technology providers.

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Aite-Novarica Group is an advisory firm providing mission-critical insights on technology, regulations, strategy, and operations to hundreds of banks, insurers, payments providers, and investment firms—as well as the technology and service providers that support them. Comprising former senior technology, strategy, and operations executives as well as experienced researchers and consultants, our experts provide actionable advice to our client base, leveraging deep insights developed via our extensive network of clients and other industry contacts.

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