

Payment Systems in the U.S. and Latin America: Contrasts and Similarities

The evolution of the payment systems in the U.S. offers some important lessons to countries in Latin America.

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The Check is Still King in the United States

Despite double-digit annual growth rates for electronic and credit card payment methods, checks still command 75 percent of the payment transaction volume in the U.S. It is estimated that the number of checks written will increase until the year 2025.

There are three reasons why the check is still widely used in the U.S.:

- First, when the U.S. Congress passed the Federal Reserve Act in 1913, it created the Federal Reserve System. At that time, the 12 Federal Reserve banks and their branches were established to provide an efficient system of clearing checks among member banks on a nationwide basis.
- Second, the U.S. Postal Service, established in the late 1700's, is considered one of the most reliable in the world. Unlike postal systems in many other countries, the U.S. Postal Service is commonly used for mailing both invoices and payments.
- Third, approximately 90 percent of the households in the U.S. have checking accounts, giving them the access and ability to write checks.

The check is king in the U.S. because a strong and efficient infrastructure has supported and encouraged its use. Checks are convenient and reliable for both consumers and businesses. Almost 27 billion (40 percent) of the 67 billion checks written annually are from the business sector.

Check Writing in Latin America

When comparing the use of checks in Latin America to that in the U.S., we see several major differences. Consider these factors:

- On average, fewer than 30 percent of the households in Latin America have bank accounts (Chile is highest at 40 percent).
- The mail systems in Latin America are considered unreliable and never used for making payments.

- Many central banks in Latin America have not established centralized systems for clearing checks, and in-country transportation systems have been limited or unreliable. Until recently, check clearing generally had been arranged by the individual banks within the countries.

Looking at these factors, the environment in Latin America has not been conducive to a proliferation of check writing among consumers. While Latin America has its share of emerging market challenges, it does not face the enormous task of migrating the majority of its adult population from checks to electronic payment methods.

Collecting Payments in Latin America

The lockbox is widely used in the U.S. to collect both consumer and corporate payments. It has been successful because of the efficiency of the U.S. mail and check-clearing systems, and because almost 90 percent of U.S. households have checking accounts.

In Latin America, the concept of a lockbox does not exist because payments are never mailed. On the business-to-business side, most companies maintain checking accounts and payments are generally made by check. These checks may be delivered to the supplier's office via courier, deposited into the supplier's account using a special deposit ticket, or picked up from the buyer by the supplier's "cobrador" (collection agent).

On the consumer-to-business side, most payments are made in person, by cash or check, either at the billing company's office or at a bank. Throughout Latin America, it is common to see long lines in bank branches and outside a company's offices as consumers wait to pay their bills. Whether a consumer pays in cash or by check, the payor receipt, not a cancelled check, becomes proof of payment.

Payment Alternatives to the Check in Latin America

Most Latin American countries have not had electronic payment or collection systems. The exceptions are Brazil and Mexico, which both have electronic payment systems in place. Brazil's system, based on the "bloquete," is nationwide and has been in operation for several decades. Cecoban, the bank-owned automated clearing house (ACH) operator for the Mexican ACH system, was established during the 1990s. Argentina, Chile, Colombia and Panama are in the early stages of rolling out ACH systems, and it is anticipated that ACH systems will be used in these countries as an alternative to check writing.

While the concept of direct deposit of payroll and pre-authorized debits for recurring consumer payments, such as cable and utility bills, has existed for some time in Latin America, its widespread use has been restricted by a lack of an inter-bank exchange system for electronic payments and the limited number of adults with bank accounts. For example, to utilize direct deposit of payroll, a company typically would have to open checking or savings accounts for each of its employees at one specific bank. That bank would, upon receiving instructions from the company, credit the employees' accounts using internal or book transfers. Companies gen-

erally have paid for these employee bank accounts because it made direct deposit of payroll possible.

Similarly, to initiate pre-authorized debits for consumer collections, a company originating the file of direct debits would need to send separate files to each of the banks in which its consumers maintained their accounts. (As noted earlier, consumers without bank accounts pay invoices in cash at banks or company offices.)

With increased use of the new ACH systems, the need for companies to open checking or savings accounts for their employees at a single bank will be reduced or eliminated. It will also allow companies initiating direct debits to send a single file to one bank, which will then “split” and send files to the various banks maintaining the consumer accounts. This, of course, will depend upon the banks in each country being “ACH capable.”

Other commonly used consumer payment alternatives to check writing in Latin America include cash and credit cards. However, due to the low level of “bancarization” (individuals with bank accounts), credit cards are relatively new and limited to the high-income earners. Interest rates for consumer credit are generally high in most Latin American countries, with annual rates in the 50 percent range not uncommon.

ACH in the U.S.: Lessons and Opportunities for Latin America

The evolution of the ACH system in the U.S. offers some important lessons that countries in Latin America can learn from.

From 1989 to 1997, the annual volume of ACH debit and credit transactions in the U.S. grew from 850 million to almost 4 billion, while the number of companies using the ACH increased from 100,000 to 750,000 during this same period.

The single most influential user of the ACH has been the U.S. federal government which began converting social security benefits to electronic credits during the early 1980’s. Since then, numerous state and government agencies have instituted electronic payment programs, many mandated or required.

In general, U.S. consumers have become more receptive to receiving electronic credits. At the end of 1997, almost 56 percent of the private-sector workforce used direct deposit of payroll, compared to 12 percent in 1989. The level for government employees was almost 95 percent during 1997, up from 75 percent in 1989.

In the area of pre-authorized consumer debits, the insurance industry led the way in the 1980s in gaining consumers’ acceptance of electronic premium payments. Now, most recurring payments can be made using pre-authorized debits. Other examples include telephone, utilities, mortgage and loan payments, as well as mutual fund purchases. Initially, many companies were slow in adapting their internal financial systems to accommodate direct debit or in pro-

moting direct-debit programs. While consumer acceptance of pre-authorized debits has been slow, it is proving to be reliable, convenient and more widely accepted by consumers. As control is a key consumer concern, the ability to select the date of the direct debit and to receive advance notice of the amount to be debited has greatly increased consumer participation.

Payroll cards and electronic benefit transfer (EBT), new payment technologies designed for individuals who do not have bank accounts, are becoming more popular in the U.S. They will help reduce the volume of checks written and minimize the problems associated with lost checks and check fraud. Payroll cards are popular with retailers, such as department stores, supermarkets and fast-food restaurants, which typically have a higher percentage of employees without bank accounts. A growing number of large U.S. banks offer payroll cards. EBT is currently used in over 30 states.

On the business-to-business side, very few companies will accept a direct debit to their bank accounts. There are some exceptions in the area of tax payments. To protect companies from unauthorized debits to their accounts, many banks introduced “debit protection” services that screen out and reject unauthorized direct debits.

Most companies will gladly accept an electronic credit. However, receiving an ACH credit without an addenda record or with limited information frequently creates an exception to receivables processing. For this reason, financial electronic data interchange (FEDI) has become more important in business to business transactions.

Promoting of Electronic Payments: How Latin America can get There Faster

The U.S.’ experience with electronic payments should be shared with Latin American countries – they can benefit and learn from our experience during the last 25 years. Sharing will also help Latin American countries identify ways to promote and increase usage as these new ACH systems are introduced and will help them avoid many of the pitfalls the U.S. experienced. While a major challenge in Latin America today is the limited number of adults with bank accounts, both the private and public sectors can play a major role in increasing the use of electronic payments.

First, the federal, state or provincial governments can be major drivers and users of the new ACH systems. Electronic collection of corporate tax payments and electronic direct deposit of pension benefits and salary payments to government retirees and employees are two usage possibilities.

Second, the private sector can promote the use of the new ACH systems by increasing its use of direct deposit of payroll and aggressively offering pre-authorized debit programs. Industry sectors that represent immediate opportunity in the region are insurance, private pension fund, utilities, cable and cell phone companies.

Third, the central banks can play an important role in increasing the use of new ACH systems by encouraging all banks within their respective countries to develop the technological capability to send and receive ACH files. Central banks can also require all commercial banks to be members of the ACH and ensure that the ACH is not operated as a “private club” among a few banks with major entry barriers for other banks.

In addition to ACH systems, new payment technologies like the payroll card and EBT can be introduced today to promote the concept of electronic payments among those without bank accounts. The payroll card is already being used in several countries, including Brazil, Chile and Colombia.

Conclusion

As the number of individuals with bank accounts continues to grow in the region, businesses and governments must offer incentives to consumers to utilize electronic payment options. The past decade has seen numerous positive changes in Latin America, and the coming years will bring many more exciting banking and cash management innovations. Latin America has a unique opportunity to take advantage of existing and new electronic payment technologies without having to unlearn old habits.

Tips and Strategies for the Corporate Treasurer and Cash Manager

The public and private sectors in Latin America will play a major role in increasing the use of electronic payments in the region; however, the corporate treasurer and cash manager can play an active role as well.

How a company approaches the bank selection process for the region will depend on the size and nature of the company’s operations and its corporate treasury objectives and philosophy. Many companies want to use a single or primary cash management bank for the region or sub-regions such as the Southern Cone or Andean countries. If this is your company’s strategy, then you will need to identify and evaluate banks that can meet both your local country and regional needs and objectives.

Alternatively, some companies are taking a country-by-country approach and identifying the “best in class” cash management bank within each local country. In this scenario, the same bank may or may not be used in other countries in the region.

Whatever your company’s regional treasury strategy, developing a set of criteria for selecting a cash management banking partner in Latin America is critical. As with any banking relationship, the partner should possess cutting-edge technological capabilities and have experience in the country and region.

Be sure to ask the following questions when evaluating a Latin American banking partner:

- What is the bank's role in leading or participating in the development of local country ACH systems? In countries with ACH systems, is the bank ACH capable today?
- What is the functionality of the bank's electronic banking system? Is a standard platform used in all countries throughout the region? Can the platform link your Latin American operations with regional and/or global treasury headquarters?
- What role will the Internet play in the bank's electronic banking strategy for the region?
- What is the bank's commitment to new payment technologies, such as the payroll card? In which countries does it offer such capabilities?
- Does the bank offer outsourcing of payables or payroll services? Does it accept a transmission of payment instructions from a subsidiary's office in the local country or region directly to the bank? Can payments be made via the new ACH systems?
- What innovations is the bank offering or planning in the area of electronic collections, particularly in those countries where collections are still dependent on large branch networks?

Approaching the bank evaluation and selection process in Latin America with a well-defined set of criteria designed around both current and capabilities will enable you to build a stronger and more flexible foundation from which to develop and enhance your local country operations and regional strategy. You will also be better positioned to take advantage of the new banking and cash management innovations as they continue to emerge throughout the region.

Author's Note: It is important to recognize that while this article is an overview of the environment and trends in Latin America, each country has its own unique banking and cash management systems. Furthermore, some countries are farther along in the development of electronic payment and collection systems than others.

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