Cheque-ing Out

Prepaid's move to help Canadian businesses break the habit.

PART 1 OF 2

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Introduction

Despite their country's progressive financial system, Canadians, like Americans, are still writing tons of cheques. Canadian businesses and consumers wrote almost a billion cheques in 2014, valued at CA$3.9 trillion, most of which were written to and from businesses or governments, rather than consumers.

These cheque payments amounted to 46 percent of the total transaction value of all payment segments in 2014 and cost CA$2.00 – $3.85 per cheque more to originate, administer, reconcile, clear and settle than the average electronic payment. And these costs are significantly higher when one or more handwritten signatures are required on the cheque.

Canadians wrote nearly a billion cheques in 2014 valued at CA$3.9 trillion.

To put this into context, the U.S. is still the biggest cheque-writing market in the world. Americans wrote 18.3 billion cheques in 2012, with a value of USD$26 trillion. But even with a smaller overall market size, Canada is ahead of the U.S. on the path to eliminate expensive, cumbersome cheques from its financial system.

Having implemented chip and PIN EMV nearly a decade ago, Canada is globally recognized as a market that's ready to embrace modern payments. The country has made considerably more progress toward the adoption of the universal financial industry message standard. Known as ISO 20022, it's a technical standard for electronic data interchange between financial institutions that will define an internationally agreed-upon approach and "language." ISO 20022 will modernize Canada's clearing and settlement infrastructure, which, in turn, will speed the transition away from paper payments to electronic transactions – including prepaid card solutions.

Payments Canada forecasts that by 2020, virtually all cheques written by businesses and governments in Canada will have migrated to electronic means of payment, and prepaid card products are well-positioned to capture a significant share of this market. We're already seeing early adopters among the underbanked, budget-minded innovators and individuals who are looking to step away from traditional financial institutions and banking products, but that's just the tip of the iceberg.

There are several key reasons why prepaid is more easily integrated into the financial landscape in Canada, beginning with the regulatory environment. In 2014, the Canadian government introduced the Prepaid Payment Products Regulations and, as a result, Canada operates in a more stable prepaid environment compared to the U.S. This is a key factor for bringing established American prepaid programs north, as program managers can more quickly and efficiently build compliant and profitable programs.

Why will today's cheque-writers embrace prepaid instead of credit or debit? Prepaid solutions are uniquely positioned to capitalize on the ways that Canadians want to manage a wide variety of payments scenarios, because it reduces fraud, guarantees funds, eliminates transaction friction, sidesteps debt and frees buyers and sellers from the restrictions of traditional banking relationships. "At the same time, prepaid cards still deliver a lot of the benefits of cheques, but with the guarantee of good funds and no exposure of an account," said Ben Jackson, Director, Prepaid Advisory Service for Mercator Advisory Group.

"Prepaid cards still deliver a lot of the benefits of cheques, but with the guarantee of good funds and no exposure of an account."

-Ben Jackson, Mercator Advisory Group, Director of Prepaid Advisory Service

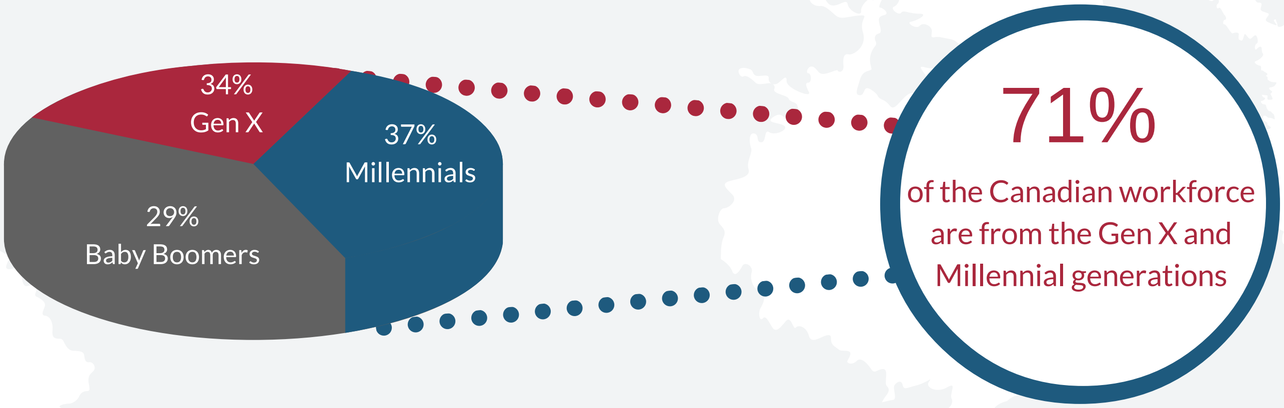
The first in a two-part series, this paper summarizes the current volume and trends of cheque use in Canada, explores key catalysts and market opportunities for reduction in cheque use, and outlines three of the six top payment scenarios in which a prepaid card solution is the best cheque replacement option.

Cheque Use in Canada and Catalysts for Change

A Generational Shift: Canadian Demographics

There are still more than 3.8 million people aged 55 and older in the Canadian workforce for which corporate cheques were – and still are – the foundation of the payments structure. These Baby Boomers built the processes and systems that are at the very core of many businesses today. But as of last year, millennials for the first time made up the lion's share – 37 percent – of the Canadian workforce. Together with Gen X, these two generations account for nearly 71 percent of working Canadians and will undoubtedly redefine how businesses, governments and consumers make payments for decades to come.

Canadian Workforce Demographics



As this workforce transition occurs, prepaid is a natural part of the mix, because these generations will draw on their personal spending preferences to inform their business decisions. Millennials, in particular, are less likely to be tied to the country's traditional banks or credit unions, even though, like every Canadian, they have the option of holding an account.

We already see this in the U.S., where a Federal Reserve study shows cheque use declining by more than 50 percent as long ago as the year 2000, and a study by WePay reports that 52 percent of American millennials never use cheques. We're also seeing the comfort level that younger Canadians have with the idea of digital transactions and mobile wallets that run on prepaid, such as Koho in Canada (and Simple in the U.S.).

A 2015 “Marketing to Millennials in Canada” report shows that Canadian millennials are 1.5 times more likely to switch banks than other generations. And according to the Canadian Prepaid Providers Organization (CPPO), 90 percent of Canadians are embracing emerging payments.

This is important because it unravels the popular notion that all Canadians are loyal to a traditional bank. Instead, they are seeking out the provider that best meets their needs, often choosing “alternative” financial service providers.

While every Canadian is entitled to a no-fee bank account, should they want one, more and more Canadians are either supplementing their traditional bank account with alternative financial services, or have opted out of the traditional Canadian banking system altogether. At the same time, millennials share their parents’ concerns about debt. Nearly half of millennials in Canada (48 percent) feel “constantly stressed about their money,” which drives demand for savings and budgeting tools that are not readily available with a traditional bank account, as they shy away from acquiring new debt. Consumer debt in Canada is on the rise – reaching CA$1.59 trillion by year-end 2014, and the CPPO reports that more than half (60 percent) of all Canadians want online services or mobile apps to help them budget.

Canadian Business Trends

The future of Canada’s economy will arguably be driven by the country’s small and medium enterprises (SMEs), which make up more than half of the nation’s GDP and almost 90 percent of the private-sector labor force.

CAD$3.4 trillion
in cheques issued by Canadian businesses

More than three-quarters of the new jobs created in Canada in the past decade are in SMEs. These businesses also make up more than 98 percent of employers, while large businesses account for a mere 1.7 percent of employers in Canada.

In 2014, businesses issued an estimated CA$3.4 trillion in cheques, which equates to roughly 87 percent of the value of all cheques and paper payment items in Canada. This leaves immense opportunity for prepaid card products, as the country begins to transition away from cheques toward more efficient payment methods.

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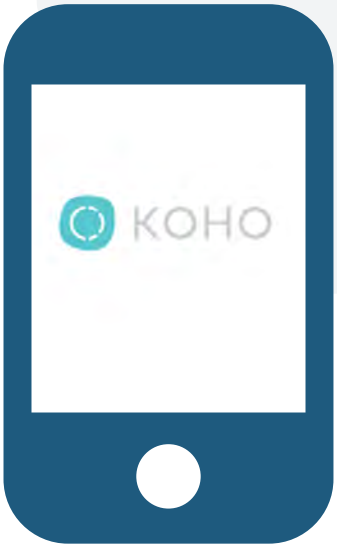
Opportunity for Rapid Adoption: How Prepaid Fits into the Canadian Market

As mentioned, prepaid is more easily integrated into the financial landscape in Canada, because the Canadian regulatory environment is more stable than that of the U.S. With stable prepaid regulations, established American program managers can more quickly and efficiently build compliant and profitable prepaid programs in Canada.

But doing so requires a keen understanding of the whole Canadian payments system. The second paper in this series will provide keys to understanding how Canada's regulatory environment governs prepaid programs.

Canada also benefits from the high percentage of merchants that accept Visa and MasterCard, and thus the open-loop prepaid cards that run on their networks. This is particularly relevant when compared to many other global markets, including Latin America, Asia and Africa. Companies looking to get their feet wet with international expansion will do well if they start with a market where the friction for electronic payments is already reduced, and where prepaid cards are widely accepted.



In addition, because of the large and well-disbursed nature of SMEs in Canada, the opportunity to participate in the corporate prepaid market is broad and open to a variety of competitors, not consolidated among a few mega-players.

And in recent years, Vancouver and Toronto have developed into competitive hubs for fintech players, becoming home to startups like Koho. Koho is activating prepaid through mobile apps and using it in innovative new ways to reach the millennial market utilizing the services of Peoples Trust Company.

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Canadian Open-Loop Prepaid Market: 2015 study reveals the open-loop prepaid card market in Canada reached CA$3.1 billion in total dollars loaded onto cards.

So which segments of the CA$3.1 billion prepaid market will drive cheque replacement? The corporate environment is likely to drive the most growth in the coming years as businesses squeeze inefficiencies out of their operations, respond to employees' needs and improve their record keeping and anti-fraud practices.

The recently-released CPPO-Mercator Advisory Group study entitled, *Canadian Open-Loop Prepaid Market: 2015*, highlights 17 active open-loop segments in the Canadian market, compared to 19 in the U.S., showing growth opportunity for both existing and yet-to-be-tapped segments. Seven of those 17 are corporate-funded (three others are government funded):

Consumer-Funded*	Corporate-Funded*
General purpose reloadable	Campus
In-store gift cards (RAN for retail)	Consumer incentives
Mall gift cards (RAN)	Corporate purchasing
Open-loop gift	Employee benefits
Remittance/P2P	Employee and partner incentives
Single-load general purpose	Insurance claims
Travel cards	Payroll cards

* "Funded" refers to the origination of the funds from a corporation or consumer.
Source: Mercator Advisory Group, 2016

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Corporate-funded prepaid segments

In this paper, we detail three of the seven corporate-funded segments that are leading the way in replacing cheques in Canada.

Consumer Incentives 1

Rewarding customers is a great way to drive loyalty and repeat business, but consumers are no longer willing to fill out rebate cards or wait weeks to get a cheque in the mail. And, if they do receive a cheque, they are far less likely to spend those funds with the company that provided them. Clearly, the old-fashioned paper trail puts a huge damper on results.

Using prepaid cards in lieu of cheques offers the most flexibility and opportunity to drive results. How so? Prepaid accomplishes three key things that cheques cannot in the consumer incentive space:

Prepaid cards can be customized by buyer segment, which has been proven to increase response rates and better drive long-term buyer behaviour. Consumers now expect more personalized offers that resonate with their individual needs, and timing is everything. Cards can even feature product- or market-specific designs and can be loaded or activated immediately in connection with a customer activity, and the value can be customized to tie to segment-specific offers or promotions. Hyper-local promotions add marketing emphasis and drive loyalty that is not possible with cheques.

Prepaid incentives support the ever-important call to action in real time, or over time. We all know how powerful instant gratification can be – and because prepaid incentive cards can be activated immediately, they drive consumer purchase decisions, as well as repeat or incremental spend on the spot. But sometimes it makes sense to deliver benefits over time, as spending milestones are hit or consumers take other action. Prepaid, whether via a physical card or a virtual account, allows for immediate or scheduled delivery of incentives.

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Prepaid lets you measure what matters. Once an incentive or rebate cheque has been issued and cashed, there's no telling where those funds go. And some cheques never make it that far, becoming a record-keeping burden for issuers who must hold the funds committed to those cheques for the requisite timeframe before they become invalid. In addition to protecting companies from funding benefits that don't get redeemed, prepaid incentive cards can be delivered or funded when a customer takes a specific action – closely linking rewards to behaviour and building a treasure trove of data. This allows marketers to evaluate and learn from consumer behaviour to build better future programs and increase engagement. Marketers can also reclaim unspent funds after a certain amount of time. Consumers get cards by engaging with a brand online, in market, or at the point of sale, and program managers only fund the cards that are activated, maximizing efficiency.

Corporate Purchasing 2

Some companies choose to rely on credit to fund day-to-day expenses, or use their employees' credit card or cash via a cheque-based expense reimbursement policy, which is typically accompanied by a labour intensive, manual process. Prepaid cards provide options when credit is not appropriate, and solves several significant problems with these traditional models for SMEs.

Credit: Many SMEs can't or don't want to take on the personal credit liability that comes with issuing a corporate card. Prepaid removes this additional risk, ensuring that employees or contractors only spend available funds.

Workforce Trends: Many employees and contractors – younger and daily workers in particular – are not willing or able to pay expenses out of pocket on their employer's behalf – essentially floating money to their employer – but a company credit card is often not the right solution. Prepaid cards save the employee from being out of pocket and can be used for fuel, supplies and other business expenses. Restricted Authorization Network (RAN) cards help to ensure that funds are used only at approved vendors, if needed.

Financial Controls and Fraud Reduction: The average expense and reimbursement system is rife with errors and fraud. Spotty record keeping, paper records and manual processes make it hard for accounts payable teams to keep up with and identify improper use of funds or abuse. Prepaid cards offer a unique solution for many expense situations because limits can be set, payments can be tracked in real time online, and loads can be adjusted on the fly. General purpose reloadable cards for travel and entertainment expenses are a great example. For example, an employer can load a CA$75 travel credit on a card each day for food and incidental expenses, and any remaining funds can be swept at the end of each day.

Payroll 3

As millennials are redefining how employers hire, motivate and retain their workforce, payroll is one of the most impacted business operations. In both the U.S. and Canada, more workers are looking for faster payment from their employers and more millennials are choosing to be unbanked, often using prepaid-based mobile apps as the core of their financial system.

The shift away from employees to independent contractors in the “on-demand economy” in many industries is also driving demand for prepaid. Industries like agriculture, oil and gas, construction, transportation and hospitality often need to pay employees at the end of a shift or by the job, which is highly inefficient and sometimes impossible with a paper cheque. Some employers resort to cash payments which has even more drawbacks.

Regardless of industry, many employees struggle to make ends meet in between traditional biweekly or even monthly pay periods, and companies are more frequently offering more frequent and flexible payment alternatives to remain competitive. When these systems run on a prepaid platform, employers have more options to be responsive to employees’ varying needs. Using a prepaid platform allows companies to load employees' earned funds onto a payroll card; who can then spend or transfer their funds as they choose. It's important to note that, while the funds distributed by the employer, they are technically employee "owned."

Canadian Prepaid Market Holds a Wealth of Opportunity

As the Canadian market becomes the North American front-runner to eliminate cheques, it's a fertile ground for global prepaid program managers to capture this market spend, and create a success case for future transition in the U.S. market. But understanding Canada's markets, and financial and regulatory structure are essential to be successful.

While the U.S. prepaid market is clearly far more developed and sizable than Canada, it's also more encumbered. Most, if not all, U.S. prepaid programs are significantly overloaded by continuous rule changes that have struck at the very foundation of the industry. Programs are too burdened with increasingly onerous and complex regulatory requirements and compliance has become a massive undertaking.

As friendly as the Canadian market is to the U.S. and other foreign program expansion, it's not to be approached without a comprehensive go-to-market plan. A stable and transparent regulatory structure still requires strategies operating within that structure and understanding how your program will integrate with the Canadian financial system.

Stay tuned for:

PART 2: CHEQUE-ING OUT

Cheque-ing Out Part II *will explore three additional prepaid payments segments leading the way and take a deep dive into navigating the Canadian prepaid regulatory market, along with providing insights to program managers looking to expand into Canada.*

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