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MERCATOR ADVISORY GROUP

PERFECTING SUPPLIER ENABLEMENT OF COMMERCIAL CARDS

A Mercator Advisory Group Research Brief Prepared For VISA

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Introduction

Mass-scale adoption of commercial cards for use in corporate payables has been hampered by pricing and technical acceptance requirements. Despite more than 20 years of effort led by major issuers and the branded networks, adoption of commercial cards for business-to-business payables is only at about 2%, according to Mercator Advisory Group estimates. Issuers, buyers, and financial technology firms (fintechs) across the spectrum of cards and digital payments are now trying several new approaches to this challenge. One is to use virtual card accounts as the catalyst because virtual card accounts fit the rapidly advancing digital world of payables.

Since the Great Recession of 2008–2009, virtual cards—primarily single-use-accounts (SUA)—have quickly increased in usage and popularity among corporate buyers. Adoption has been spurred by competitive pressure from issuing banks striving to increase clients' spending on their commercial cards as well as by buyers' improved understanding of how card payables benefit them. To promote wide acceptance of virtual cards as an e-payables tool, issuers typically fund implementation that includes both initial supplier enablement and ongoing optimization. Nonetheless, suppliers' acceptance of commercial cards, virtual and otherwise, remains difficult to achieve, especially for higher-value, direct spend payments.

The commercial card industry is at a crossroads. Issuers and buyers are pursuing multichannel efforts to promote acceptance of card-based e-payments solutions in the face of intense technological change, varying regulatory environments, and new business approaches designed to eliminate paper as a B2B payables choice. In this research brief, Mercator Advisory Group recommends ways to enhance suppliers' recognition of the value proposition of accepting cards. This depends on improving supplier enablement for commercial cards, defined here as the identification and enrollment of suppliers into a card-based program.

Paths to Supplier Enablement

Understand the Challenge

The commercial card industry is an integral and growing part of the broader business-to-business (B2B) payments landscape. Mercator Advisory Group estimates that the overall noncash value transfer between U.S. businesses in the B2B payments ecosystem was close to $24 trillion in 2015. This includes payments by check, ACH, cards, and wire. With the ongoing shift away from cash and checks, vast opportunities still exist for growth in cards as payables tools.

For issuers, the U.S. commercial card market remains the most lucrative because of its interchange rates. In other markets, such as the European Union, Australia, and Malaysia to name just a few, regulators have imposed rate caps and interchange is substantially lower than in the United States. So the value proposition differs by market for issuers. Interchange remains a double-edged sword since it is a major driver on the buyer side given the potential for revenue share (or rebate) associated with interchange, but it is the primary obstacle to supplier acceptance of card payments. One way to look at this age-old conundrum is by comparing the effect of scale. Substantial reduction in interchange may bring an issuer lower gross revenue per dollar spent on the issuer's cards (and a lower percentage rebate for the buyer), but it is somewhat offset by improved overall spend volume, increasing the benefit to all parties. The increased spending volume results in large part from suppliers being more open to card accounts because virtual card payments reduce acceptance costs.

Fundamentals

The advent of a potpourri of commercial card products, especially the more nuanced single-use account, has provided more choices for suppliers but made it more difficult for them to understand the potential benefits of each product. This difficulty complicates buyers' efforts to foster supplier adoption of e-payables. Virtual card accounts are central to the growth prospects for commercial cards over the next five years at least and must be clearly defined even to suppliers that currently accept traditional cards.

To gain key supplier acceptance of virtual card accounts, Mercator Advisory Group recommends that issuers review and revamp their approaches to supplier enablement starting with the fundamentals (outlined in Figure 1).

Figure 1: The Fundamental Steps of the Supplier Enablement Process

Source: Mercator Advisory Group

Spend Analysis

A preliminary step is to analyze suppliers' spend in the buying organization's accounts payable file. Qualifying suppliers as targets for enablement typically begins by gathering data from the buying organization's previous 12 months of invoiced payments spend. Relevant details for each supplier include spend, industry type, payment terms if available, and whether the supplier is already enrolled in a card network and card enabled. This step eliminates certain suppliers—one-time purchases, employees, ineligible transaction types (e.g., tax payments), and independent contractors. To ensure optimal matching results, the file should be formatted to align with card network requirements. Depending on the corporate client's level of systems sophistication and data management, completing this step may take some time. Matching tools can then be employed to drill down for more specific campaign targeting.

Supplier Matching

Next, the payment service provider (PSP) conducts a review of the assembled information to prepare the file for a matching process. The branded networks have tools available (for example Visa's Supplier Matching Service and spend analytics) to segment the file of suppliers that accept cards and thus identify opportunities to move B2B spending from checks to cards. Some issuers have an internal acquiring bank business from which to draw merchant analysis data as well. Other resources include independent sales organizations (ISOs) or merchant services providers (MSPs) with which to partner to improve supplier enablement results.

Once the matching analysis is complete, the direction for the campaign should be clear given current acceptance rates along with details such as enhanced data availability (Level III data, which implies supplier pricing advantages), Merchant Category Code (MCC), and average transaction size (ATS).

Targeting

With the completed matching, PSPs can provide a customized spend analysis identifying supplier targets for the card program. One point to consider: A supplier that accepts cards can be segmented into a pool to determine if it is suited for virtual card processing in addition to or replacing traditional purchasing card (P card) spend. Since P cards historically have been used for low-value (<$5,000), high-frequency purchases, some of this spend may be better suited to remain on P cards or ghost cards given suppliers' preferences with regard to days sales outstanding (DSO). Although the benefits of virtual cards are numerous, depending on buyer-supplier processing agreements, there can be a timing advantage to the immediacy of processing certain payments initiated via a phone order or e-commerce portal without requiring an approved invoice.

Supplier Campaigns

Supplier campaigns are designed to encourage suppliers to sign up for the buying organization's commercial cards program. Campaigns to promote acceptance of virtual cards typically detail their specific value-add for suppliers. The results of all the preliminary work will feed into the strategic campaign launch phases. Some PSPs and buying organizations may elect to start a campaign with a pilot launch focusing on a small number of suppliers before ramping up to a larger number of targeted suppliers. This allows the buying organization to become familiar with the new payables process.

Outreach to targeted suppliers can be through email, traditional letters, outbound calls, and even social media. The goal is to introduce the single-use account program and its benefits to the buying organization's suppliers. Communications should outline how the program works and explain the enrollment process. This is where buying organizations can contribute great value. Best practices indicate that the greater the upfront participation of buying organizations (including senior leadership reaching out to suppliers), the better the success in motivating increased spending on virtual cards.[i] Knowing the supplier's decision makers and making sure they understand the importance of the program will help to gain attention. Letters to the supplier should be customized using the buying organization's letterhead and preferably signed by an officer of the company.

Communication with suppliers should identify the benefits for both parties and clearly state why the buying organization is asking the supplier to make this change. A frequently asked questions (FAQ) document regarding the SUA program may be helpful. In a phone call campaign, a call script should communicate program benefits, outline how the program works, and instruct the supplier on the efforts involved.

Messaging tone matters. Both the carrot and stick approaches are used by buying organizations. The carrot approach involves positive persuasion via data and pricing implications. The stick approach essentially demands the acceptance of virtual cards, the negative consequence of noncompliance being removal from strategic supplier lists or renegotiation of preferred pricing terms. The success of these approaches varies by industry sector and company size, so careful consideration should be given to avoid causing friction in a company's supply chain.

In addition to external communication, the buying organization's internal team also needs some education. Team members should have a clear understanding of the SUA program as well as the communication materials being sent to the suppliers. This is valuable preparation given the tendency for suppliers to contact buyers directly with questions surrounding the program. Note that all responses to suppliers' inquiries should be consistent with the information or messaging provided throughout the supplier campaign.

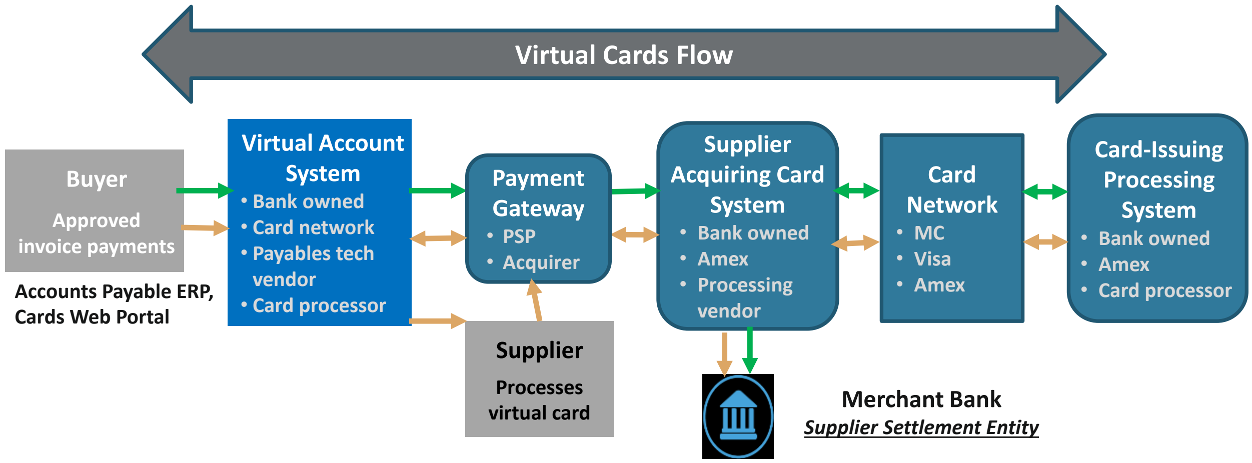
During the targeted supplier phases, it is important to track and review results on a regular basis. There is also benefit to implementing a follow-up phone campaign for key suppliers who have not yet responded to initial notification of the SUA program or who have declined to accept it. Once a supplier has decided to accept single-use accounts, confirmation should be sent per the buying organization's instructions. If a supplier needs to be enabled, the commercial card acceptance process will be initiated. Campaign strategies should be adjusted if necessary as each phase of the launch proceeds. Regular review and analysis of the individual campaign results will provide insight into both successes and failed attempts. Future targeting strategies can also be adapted from ongoing analysis of results, resulting in increased adoption in subsequent campaigns.

Supplier Management

Acceptance Setup

Traditional supplier acceptance begins with an acquiring entity (a bank or a non-bank-sponsored acquirer) that will conduct a business risk review, determine the discount rate (supplier bottom-line pricing per transaction), set up the necessary supplier payment acceptance equipment, train users as necessary, and then set up the merchant bank account. If a merchant accepts credit cards, that merchant can also accept virtual cards. Card network clearing and settlement flows remain basically the same, the major processing changes affecting the buyer side's front end. In the case of a pull payment (supplier initiated), the supplier will receive the SUA and process it as required, whereas in a push payment (buyer initiated) the supplier does not process a payment, instead receiving notification of the transaction once it is settled. Figure 2 illustrates the flow in each virtual card scenario.

Figure 2: Virtual Card High-Level Process Flow



Supplier-Initiated Payment (SIP). Buyer-approved payment is requested through the virtual account system interface. Single-use account (SUA) is securely communicated to supplier through virtual system via email or other method, then retrieved (pulled) and processed by supplier using a business-as-usual card payment method. Normal card network authorization and settlement flow with potentially a separate remittance file sent to supplier from virtual account system.

Buyer-Initiated Payment (BIP). Buyer-approved payment is requested through the virtual account system interface; then the account is pushed through the network authorization and settlement flow directly to supplier bank settlement account, bypassing supplier handling for payment processing. A remittance file can be sent separately or else potentially synched with settlement data for straight-through receivables posting.

Source: Mercator Advisory Group

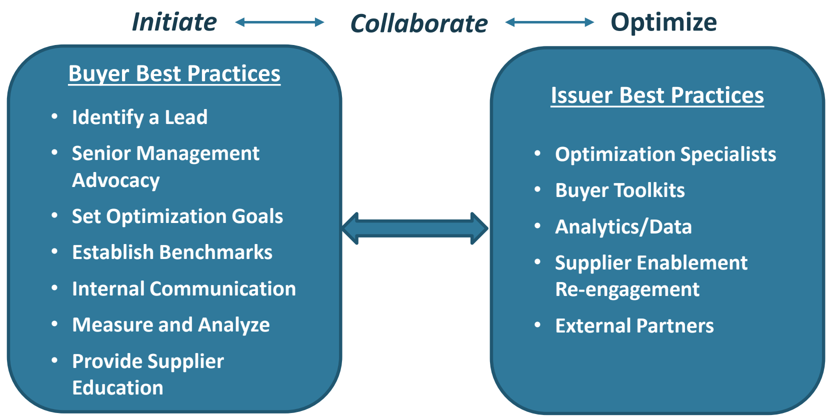
The incremental work to enable acceptance of virtual cards that is necessary for suppliers who already accept cards may be minor or it may be more complicated, depending on the setup. If there is no change in acquirer and the merchant already passes Level III data, then only setup is needed and training the supplier about receiving the SUA via a secured method and processing the payment (as in the case of a supplier-initiated payment). Depending on the front-end system, some work may be needed for separate remittance data transmission. If the acquirer is new or the supplier is not set up for Level III data inclusion, then some incremental work is involved.

Ongoing Management

Continued effort is needed after the initial strategy phases are complete if the enablement process is to be successful. Metrics typically addressed at the beginning of a campaign should continue to be applied as benchmarks. Regular monitoring ensures that virtual card programs continue to perform at an optimal level—that is, achieve expected spending levels (though unfortunately, underperformance of commercial card programs seems to be the rule rather than the exception[ii]). Most issuers refer to this effort to gain the greatest possible spend effectiveness as an optimization program.

Optimization efforts need to be spearheaded by the buying organization, but issuing banks can benefit as much from successful programs as their clients can and therefore should have resources aligned with this goal. Since commercial card programs' tenure from a contractual standpoint typically ranges between three and five years, it is in the issuer's best interest to provide ongoing collaboration, the level of which will of course vary by program size. Issuers should be open as well to utilizing external enablement partners to provide industry supplier analytics and to assist in ongoing supplier re-engagement. Figure 3 summarizes the best practices for implementing shared optimization efforts on the part of both issuers and corporate clients.

Figure 3: Optimization Requires Ongoing Collaboration



Source: Mercator Advisory Group

Overcoming Initial Objections

Pricing

Getting started with cards enablement for B2B payments creates a lot of friction, none more than the merchant/supplier perception of high acceptance costs. The almost universal first reaction by suppliers to a request to accept cards is "They are too expensive." Overcoming this knee-jerk reaction is not easy. Industry participants have gotten better at countering this negative response through improved targeting, industry educational efforts, and data and analytics that explain more clearly how suppliers benefit from acceptance of virtual cards.

Suppliers typically assume that the standard rate for accepting card payments is 3–4% of the transaction. The cost is referred to as the merchant discount rate (MDR) and is defined by the contract with the supplier's chosen acquirer. For the highest level of interchange assessment on standard rate for commercial large-market credit cards,[iii] the three basic cost elements are as follows (not including further markups by the acquirer):

Interchange Standard Rate (highest-level revenue to issuer)	2.65% + $0.10
Acquirer Assessment (cost from network)	0.30%
Network Assessment (revenue to network)	0.15%
Gross Minimum MDR	3.1% + $0.10

The network interchange assessment schedules are a bit complex but clear enough for suppliers to see that lower acceptance costs are possible depending on data richness, virtual processing method, and higher average transaction amounts. Suppliers need to understand these rates and the hard cost advantages of accepting virtual card solutions. Enablement communications should describe these nuances in an easy-to-digest manner. Issuers also need to understand that the interchange they receive is a negotiable item and suppliers can benefit by having reduced interchange passed on as lower MDR.

Table 1: Commercial Card Interchange Variations, United States (Illustrative Example)

Assessment Category	MasterCard	Visa	Supplier Assessed Cost (per $100)	
			MasterCard	Visa
Not Large Ticket; No Enhanced Data	Data Rate I 2.65% + $0.10	Commercial Card Not Present 2.65% + $0.10	$2.75	$2.75
Inclusion of Level III data	Data Rate III 1.80% + $0.10	Commercial Level III 1.85% + $0.10	$1.90	$1.95
Large Ticket	Varies by transaction amount, but Large Ticket I is 1.25% + $40 Minimum amount $7,225.01	Visa Purchasing Large Ticket is 1.45% + $35 No minimum amount if Level III data is supplied and meets CPS criteria	Transaction size $10,000 = $1.65	Transaction size $10,000 = $1.80
Proprietary Straight-through Payments Option	MasterCard Payment Gateway™ (MPG) varies by transaction amount; transactions between $7,255.01 and $25,000 have a rate of 1.20%	Visa Straight Through Processing (STP) Fee Program varies by transaction amount; transactions between $7,000 and $14,999.99 have a rate of 1.30% + $35.00	Transaction size $10,000 = $1.20	Transaction size $10,000 = $1.65

Note: This table is for illustrative purposes only since rates vary by business class and can also be negotiable between network participants.

Source: Mercator Advisory Group estimates; MasterCard U.S. Interchange Program and Rates (April 2016); Visa USA Interchange Reimbursement Fees (April 2016)

Virtual card use in the payables process generates higher average payment value than traditional plastic P cards do primarily because of the reduced risk in this solution. Buyers ease up on transaction limits and are willing to expand payment into a broader array of invoice types and values. The virtual card system, typically integrated with the buyer's enterprise resource planning (ERP) software or automated payables solution, can digitally generate a single-use account number that specifies payment amount, date range, and merchant type, with multiple approval layers and audit trail. This contrasts with physical plastics distributed to employees, which contain open credit lines and are therefore more easily subject to misuse. The virtual account number can also be set up for settlement from a supplier's bank account with no manual processing, eliminating potential merchant mishandling and possible payment manipulation. These factors appeal to buyers' confidence that large-ticket payments (that is, payments greater than $7,500) are indeed safe with virtual cards. As such, suppliers' awareness of the nuances of interchange assessment is a key selling point for acceptance. Large-ticket interchange rates vary by transaction size but as an example, a $100,000 payment transaction (with Level III data) would produce a supplier interchange fee of 1.15%, which is substantially lower than the assessment rate of 2.65% for a low-value card-not-present transaction. Virtual card acceptance also carries greater potential for incorporation of Level III data in the supplier transaction record even for low-value payments, currently also allowing for reduced interchange assessment.

Improved Working Capital

Another important topic to address with suppliers to promote enablement is optimizing working capital. A universal concern is cash flow, and typically the smaller the supplier, the larger the concern. All firms follow a "working capital cycle" known as the cash conversion cycle (CCC), in which they purchase or produce inventory, hold it for some variable period of time, and eventually sell it and receive payment. The CCC is essentially a yardstick to gauge a company's working capital policies and their effectiveness, which differ across industry segments and subsegments.

Reducing a supplier's days sales outstanding (DSO) also reduces the CCC, improving cash flow. The question becomes: How much leverage does any given supplier have over the elements of the CCC? One can review a company's financial statement to extract the relevant information and compare CCC results with those of different competitors within an industry segment. In cases where it is viable to do so and data capabilities are available, enablement teams should customize supplier data to illustrate the point. Suppliers may have some leverage over more efficient inventory, but typically this is more a function of sales effectiveness. Buyers have leverage over DPD and will pull that lever when possible. Suppliers have the most leverage over DSO, but it can come at a high cost, and these costs (e.g., certain supply chain financing variations) can be compared with the benefits of cards.

Reduced Processing Cost

Manual processes such as keying-in card payment information, handling check-based payments, and reconcilement of remittance data increase suppliers' end-to-end handling costs. Moving to virtual card acceptance pushes suppliers further toward efficient digital processes. Most suppliers do not know their line-item processing costs. Results in one broad study of end-to-end processing of receivables indicate that 40–60% average savings are available through digital change.[iv] Increasing awareness of these costs and efficiencies to suppliers builds the business case for accepting virtual cards

Fewer Disputes and Chargebacks

Suppliers also should be informed about the benefits of virtual card systemic controls, which can greatly reduce fraud and mishandling of payments. These solutions are appealing to suppliers because they reduce the frequency of disputes and chargebacks and facilitate straight-through processing.

Conclusions

Commercial card products have historically had limited business growth in the business-to-business payables space because of several sources of friction:

- The traditional model did not fit well into corporate payables systems.
- Suppliers perceived transaction pricing as too expensive.
- Suppliers considered the efforts necessary to support acceptance too complicated.

This trend began to change with the introduction and increased understanding of virtual card account payments. By 2015, however, cards-based share of B2B electronic payments had achieved only about 2% penetration in the United States, and even less in all other markets. The U.S. in particular remains very dependent on checks, with roughly 50% of B2B payments made this way in 2015. So a vast e-payment opportunity still exists, as do challenges in promoting acceptance.

Efforts by commercial card issuers to expand supplier enablement continue on a number of fronts, from traditional approaches to new technology and business models. It's best to start with fundamentals—understanding the buyer's supply chain relationships and then overcoming suppliers' initial objections to card acceptance, primarily their perception of a high cost of transactions. Issuers can achieve greater market share for their cards through a combination of efforts such as pricing flexibility, custom data to clearly describe reductions in both hard and soft acceptance costs, and simpler educational messages built into initial enablement campaigns as well as program optimization.

Opportunity exists across the globe for both displacing checks and achieving organic growth in the massive B2B payments market. The commercial card industry has proved over time that it can innovate and adapt card products very well. The next five years should clearly reveal whether the convergence of enablement best practices, next-generation technology, and flexible business arrangements will result in virtual cards gaining the massive scale associated with double or triple its current market share.

Endnotes

[i] Richard Palmer and Mahendra Gupta, RPMG Research Corporation, *2015 Electronic Accounts Payable Benchmark Survey Results*, August 2015

[ii] CPI, RPMG research, http://www.commercialpaymentsinternational.com/conferences/global-commercial-cards-payments-summit/program/day-2

[iii] MasterCard and Visa Interchange US Region, https://www.mastercard.us/en-us/about-mastercard/what-we-do/interchange.html, https://usa.visa.com/dam/VCOM/download/merchants/visa-usa-interchange-reimbursement-fees.pdf

[iv] APQC, Accounts Receivable Performance, http://www.versapay.com/wp-content/uploads/2015/04/Doing-OK-Is-No-Longer-Good-Enough.pdf

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