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OPTIMIZING REVENUE SHARING

INSIGHTS ON WHAT DRIVES YOUR REBATE

Advancing Commercial Card and Payment Practices Worldwide

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Optimizing Revenue Sharing

Insights as to What Drives Your Rebate
Third Edition | October 2018

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Acknowledgements

The original revenue sharing report was compiled in 2006 by an NAPCP best practices task force comprising Purchasing Card issuers and program managers representing various sectors. This is the third edition of this report.

Anti-Trust Guidelines and Non-Disclosure

In the spirit of compliance, fairness and legality, this paper will help the management team of a card program to realize its best potential for obtaining an optimized incentive without compromising any laws or agreements. This paper purposely avoids giving specific information to remain in compliance with legal advice acquired by the NAPCP, which states that an individual or organization that provides a forum for sharing proprietary information is engaging in the restraint of free trade and is in violation of anti-trust regulations. In addition, contractual agreements usually prohibit disclosure of the terms of the contract by either party. Non-disclosure agreements are legally binding and will not be breached here. The NAPCP encourages and endorses all efforts, including message boards, to keep specifics of an individual organization's revenue sharing program confidential.

Executive Summary

Financial incentives, often referred to as revenue sharing or rebate, were broadly brought to the negotiation table by card issuers as an inducement to large Commercial Credit Card programs (Purchasing Card, Travel Card) in the late 1980s. Since then, eligibility requirements have been extended to encompass a wide variety of card programs. No two card programs, however, are the same, so the contractual agreement with the issuer will have many different facets. Participation in revenue sharing arrangements is not automatic—some programs will not meet the minimum qualifications of the card issuer's profitability model and will not qualify for an incentive at all.

Revenue sharing programs are generally quoted in the form of basis points, often tiered, and based on program charge volume. Schedules often include additional incentives for increases in volume. A revenue sharing schedule that includes more narrow bands of incremental charge volume may lead to a larger incentive when compared to schedules based on broader bands, particularly meaningful when the program has growth opportunities. Signing bonuses, as well as milestone bonuses should be asked for if not offered.

While revenue share is tangible and often substantial, it is essential to view it in the context of the entire value a program can bring to the organization. The cost savings a Purchasing Card delivers over the traditional payments processes is generally recognized to be $70 per transaction. Process efficiency far exceeds the value revenue share brings to the organization. Even so, revenue sharing programs offer significant sums paid to the end-using organization—this report explains the many considerations that must be examined to optimize the value offered by revenue sharing opportunities.

Program management practices have impact on optimization of revenue sharing potential. The most significant thing a program administrator can do to increase revenue share is to increase charge volume. Evaluating appropriate payment methods for various suppliers, or supplier types, and recommending card payments as appropriate is key. Policy should be established to direct purchases having certain characteristics to the

Purchasing Card, enforcing the policy drives volume. Recognition that employees making purchases also make the decision on how the supplier will be paid compels the organization to educate employees on the benefit of the program. The program administrator should review purchasing activity regularly and educate employees to select the most appropriate payment process.

Some Purchasing Card revenue sharing agreements include a provision for increased incentive for expedited payment. An evaluation of the financial benefit of accelerating payment in relation to the cost of the funds utilized to make the payment should be done.

Participation in a consortium, also known as a cooperative, may offer opportunities for enhanced revenue share opportunities. These are programs offered by a card issuer to a group of like-entities that are anchored by one contract. These groups mainly exist in the government sector (state, counties, cities, school districts, higher education and special districts). The revenue share opportunity is usually more attractive as it enables each member of the group to receive a revenue share based on the aggregate spend of the group.

Card issuers track certain measurements of financial efficiency about their clients' programs. Program administrators who understand and monitor these indices will have a better understanding of their card programs' profitability to their issuer. These metrics include charge volume, speed of payment, spend per card issued, average transaction size, and degree to which cards are underutilized. Purchasing Card contracts usually contain provisions defining which party absorbs the cost for fraud and employee misuse. Some issuers absorb these losses, while others will offset the incentive earned by the organization.

Gaining an understanding of what makes a card program profitable to the card issuer allows end-user organizations to feel confident they understand the landscape as they negotiate with their issuer. An overview of interchange, merchant discount fee, and other elements that drive the economics to the issuer are presented in the report. There are three main drivers of card issuer profitability: 1) charge volume, 2) speed of payment and 3) bad debt. Other cost factors impacting the card issuer's profitability include transactional costs, implementation costs, account management, customer service, investment in technical resources, user conferences, program rewards and overhead. Cost of funds to pay the merchants prior to being paid by the end-user is a substantial element of the issuer's cost structure.

Large ticket interchange has an impact on revenue share. Major networks have implemented a large ticket interchange program for high dollar transactions on P-Cards. This means lower revenue for the issuer and perhaps little to no revenue available to share with an end-user organization in the form of rebate. Despite that fact, the efficiencies gained by paying with a P-Card far outweigh the loss of revenue share.

Credit card interchange in the world marketplace is under scrutiny. In some countries outside the United States, regulations have been put in place to restrict interchange rates. These global trends, including pressure to lower or regulate U.S. interchange rates, could affect revenue share in time.

Because revenue sharing is easy to quantify and can be used to evaluate proposals submitted by various card issuers, its overall value to an organization is often exaggerated. The more significant value of a program is derived by the cost reduction for processing payments via a Purchasing Card, as opposed to other payment methods. Other value-added services, such as customer service, reporting and Web-based tools should also be considered as part of the financial package offered by an issuer. Nevertheless, revenue sharing does represent hard dollars and will directly affect your organization's bottom line and should be considered in context.

Introduction

Financial incentives, often referred to as revenue sharing or rebate, were broadly brought to the negotiation table by card issuers as an inducement to large Commercial Credit Card programs (Purchasing Card, Travel Card) in the late 1980s. Since then, eligibility requirements have been extended to encompass a wide variety of card programs. No two card programs, however, are the same, so the contractual agreement with the issuer will have many different facets. Participation in revenue sharing arrangements is not automatic—some programs will not meet the minimum qualifications of the card issuer's profitability model and will not qualify for an incentive at all.

Card managers should anticipate that their eligibility to participate in their chosen issuer's revenue sharing program will depend almost entirely on a combination of at least two of these four factors:

- Dollar volume
- Speed of payment (sometimes referred to as file turn, days receivables outstanding, client-held days)
- Average transaction size
- Large-ticket spend (charges meeting the qualifications established by the card associations and eligible for reduced merchant fees)
- Number of cards issued

While some of these aspects, such as file turn, are highly manageable, other aspects, such as a vendor's participation in a large-ticket program, are not. In the revenue sharing optimization exercise, the more controllable the eligibility factor, the better the ability to manage its outcome.

This report will discuss best practices in Purchasing Card program administration to manage these variables for the purpose of optimizing the financial benefit, including revenue sharing, to the organization.

Focus on the Big Picture

As we examine this subject, the reader should consider a few important facts that will help in understanding the environment of revenue sharing. Organizations, whether non-profit or profit seeking, want to realize a sufficient bottom line to maintain the operation of their business. This report addresses the question: "How can I improve the financial success of my card program?"

The answer depends on many factors, including program characteristics, costs/savings, efficient work flow, employee satisfaction and relationships with providers. Included in the cost/savings arena, an administrator will usually look at the potential of revenue sharing from his or her issuing bank. However, if not taken into context with all the factors that make a program successful, one can easily lose sight of the many ways a program contributes to the financial results of the organization. It is important not to focus solely on the incentive. Largely, the cost of traditional report-oriented procurement processes has been tabbed at about $90, while the average cost associated with Purchasing Card transactions is estimated to be about $20, which leaves a net savings of approximately $70 per transaction.[1] This figure alone demonstrates that an organization's savings from operating more efficiently by utilizing a Purchasing Card is far superior to the revenue sharing amount. This report will examine the many considerations that must be entertained by a program administrator and his or her

[1] RPMG Research Corporation, *2017 Purchasing Card Benchmark Survey Results Report: Market Trends and Best Practices*

management team in order to optimize the financial benefit from a Purchasing Card program, including any financial incentives offered by the issuer. While a cursory review of this report will provide the reader an overview of the issues, reading the report in its entirety will provide the most comprehensive understanding of a pragmatic approach to revenue sharing.

NAPCP Resources available to members—Calculate process cost for your organization, go to https://www.napcp.org/ProcessCosts. Report—Cost Savings: Purchasing Cards vs. Traditional Purchase Orders in the Government Sector: www.napcp.org/CostSavings.

Savings Resulting from Implementation of an Effective/Efficient Card Program

The concepts of effectiveness and efficiency in a card program are repeated throughout this report. An optimal incentive will naturally fall into place when a card program is administrated soundly. When such an approach is put into practice, the usage rate of cards typically improves, as does employee satisfaction with the program. Regardless of the incentive amount, card programs that cannot maximize usage and effectiveness through technology, corporate culture, staffing and progress will not be able to achieve an optimal threshold of incentive. In some cases, the program characteristics may be such that the card issuer is unable to offer a financial incentive. Even in those cases in which the program characteristics preclude an offer to share revenue, the principles of effective and efficient program management may still afford opportunities to the end-user organization to reduce cost and improve controls. Since each issuer's revenue sharing details will vary, an organization should use the incentive schedule offered to them as one of several components in achieving the overall program's goals.

To put process cost savings and revenue share value into perspective, the average value of process cost savings is $70 while the value of revenue share is $5 on a transactional basis. This is based on industry averages and details can be found at https://www.napcp.org/page/RevShareVsSavings.

Fair Profit and the Parties in the Commercial Card Supply Chain

To continue to provide a service or goods, a business has to make a fair profit. When we speak of allowing a fair profit for the parties involved in the Commercial Card supply chain, an explanation of those parties is in order.

The following parties play a role in the Commercial Card process:

- **Merchant acquirers** set suppliers up to accept Purchasing Cards. They provide equipment or software that allows the supplier to process transactions. They facilitate payment flow, including depositing funds into the supplier's bank account.
- **Processors** provide various services to the card issuers, which may include card production, statement printing, authorization and data delivery.
- **Networks/Schemes** facilitate the movement of transactional data between the issuer and acquirer. Organizations in this role include Visa, Mastercard and American Express. These are also **referred to as bank associations.**
- **Card issuers** work directly with end-users to set up the program, issue cards and provide the electronic invoice. The card issuer uses the services of the networks and processors to facilitate card issuance, provide authorization and provide data. Many financial institutions are issuers.

We see that while a credit card transaction might be perceived as simple by those not familiar with the process, a transaction may go through many different operations and be handled by multiple entities before it is complete. Due to the nature of technology, information flow and areas of specialization, a transaction takes an amazingly circumventive route in a short period of time.

Since there are many entities involved with a card transaction, the task of determining what constitutes a fair profit becomes daunting. What is important to remember is that it is natural and a good business practice for an issuer and the parties involved in the supply chain to seek a fair profit. An ageless quotation sums up this approach concisely:

Any business arrangement that is not profitable to the other person will in the end prove unprofitable for you. The bargain that yields mutual satisfaction is the only one that is apt to be repeated. – B.C. Forbes

If a company were to be squeezed so tightly so as not to be able to earn a fair profit, all parties in the transaction would lose. Meaningful services or technological advancements may suffer if a provider, and/or the parties involved in a transaction, cannot realize a fair profit. Profit allows a company to invest in the business and provide technological and process improvements that, in turn, will improve working and business relationships for the future. Program managers should seek to efficiently direct their card programs to achieve the most symbiotic relationships that continue given all market forces.

Revenue Sharing: Part of a Comprehensive Package

When seeking responses from issuers during the Request for Proposal (RFP) process, program management should conduct a comprehensive analysis of the proposals made by potential issuers. While cost/incentive is a large factor since the incentive most likely covers the costs of the card program, other factors should weigh in the decision. Those factors include:

- technological capabilities of the issuing bank
- experience and expertise
- customer service support for both cardholders and program staff
- proximity or availability of the bank's staff/support
- financial stability
- cost and ease of changeover (if applicable) or implementation
- length of contract

This list reminds the decision makers that, regardless of the amount of incentive given back to the organization, an issuer who does not address each of these items satisfactorily will never be able to help a program grow to achieve its maximum incentive. The incentive offered to an organization may also be a part of a more comprehensive financial package, including value-added services.

Organizations should invite multiple issuers to the table. This not only aids when comparing capabilities (e.g., reporting capabilities vs. rebate offered), but also provides the opportunity to leverage one issuer against another due to competition.

Other types of financial incentives may also be offered or pursued by the organization. For example, issuers may be prepared to offer a signing bonus to close an agreement. Likewise, an incumbent issuer may offer a business retention bonus to avoid the costly process of replacing a defecting customer. Organizations should be mindful that when a signing bonus is offered, the rebate may be less. If switching card issuers, conversion assistance may be included to help offset associated costs.

Incentives Linked to Program Growth

Revenue sharing schedules often include additional incentives for increases in charge volume. Milestone bonuses should be asked for, if not offered. These incentives will allow programs that experience growth during the term of the contract to share in the larger pool of revenue. The appropriate time to address this issue is during contract negotiations. Many times, program managers underestimate the growth potential of a new program and sub-optimize the revenue sharing opportunity. A revenue sharing schedule that includes more narrow bands of incremental charge volume may lead to a larger incentive when compared to schedules based on broader bands.

For example, if a card program had a revenue sharing grid that looked like this:

Turn:	*5 days*	*10 days*	*15 days*	*20 days*	*25 days*	*30 days*	*35 days*
$10M	1.65	1.60	1.55	1.50	1.45	1.40	---
$20M	1.80	1.75	1.70	1.65	1.60	1.55	---
$30M	1.95	1.90	1.85	1.80	1.75	1.70	1.65

The program would see better results upon payout if they were to negotiate an incentive schedule with smaller divisions that looks more like this:

Turn:	*5 days*	*10 days*	*15 days*	*20 days*	*25 days*	*30 days*	*35 days*
$10M	1.65	1.60	1.55	1.50	1.45	1.40	---
$15M	1.73	1.68	1.63	1.58	1.53	1.48	---
$20M	1.80	1.75	1.70	1.65	1.60	1.55	---
$25M	1.87	1.82	1.77	1.72	1.67	1.62	1.57
$30M	1.95	1.90	1.85	1.80	1.75	1.70	1.65

These tables are for illustrative purposes only. They are not representative or suggestive of actual incentive schedules.

While the result is the same in both tables, the increments in dollar volume are smaller. Therefore, if a program were to reach $18 million in the first scenario and paid within 20 days (a factor of 1.50), they would realize a benefit of $270,000, while in the second scenario (a factor of 1.58) they will have gained an additional $14,400—all because they have smaller increments in their schedule. This concept applies no matter the size of the program.

Be cautious in using revenue sharing in regular budget projections, however, since unforeseen circumstances and varying market factors could vary the size of the check from year to year.

Optimizing Revenue Sharing Potential through Program Management Practices

Some of the variables that enter into the equation of how much revenue an issuer is willing to share with an organization fall under the purview of the program administrator. The program administrator and the organization's management team share in the responsibility to structure and monitor the program for financial efficiency. Financial efficiency includes not only minimizing the organization's payment processing cost, but also managing the program characteristics to minimize risk and overhead incurred by their own organization as well as the issuer. Financial efficiency also includes optimizing the organization's use of their financial resources. Some revenue sharing arrangements increase incentive in relation to speed of payment. Organizations should evaluate the net financial impact resulting from payment acceleration.

Increase Charge Volume

Possibly the single, most important characteristic of a program that affects revenue sharing is total charge volume. Programs with charge volume below a certain threshold often do not generate enough revenue and still maintain a target return for the issuer that an incentive may not be offered at all. This position is certainly understandable. The revenue realized by the issuer, the acquirer, the association and third-party processors comes almost exclusively from the merchant's discount fee. Issuers must recover the costs associated with servicing a program. Issuers' expenses include the issuance of cards, assuming a limited level of risk, mailing monthly statements, providing customer support and account management, providing data feeds and reports, holding client conferences, etc.

Program administrators and the organization's management can influence this area in a number of ways:

- If the organization has a policy to direct purchases and payments having certain characteristics (such as all purchases under a specified dollar amount) to the Purchasing Card, that policy should be enforced. Violators should be identified and the opportunity cost, at least in terms of processing savings missed because of their actions, should be noted.
- Some organizations do not adopt a policy directing all purchases in a certain domain to the Purchasing Card. Instead, an alternative means to make purchases exists along with the Purchasing Card. Employees making purchases also make the decision of how the vendor will be paid. In some cases, the employee may be more comfortable with one payment tool or another and fail to choose the Purchasing Card when making an eligible purchase. This will result in missed opportunities to increase revenue sharing. To direct future purchases to the Purchasing Card, the program administrator should review all purchasing activity regularly and educate employees to select the most appropriate payment process.
- In addition, many issuers and the bank associations have knowledgeable resources available to assist clients with program expansion initiatives. These resources can often share best practices from other programs in expanding card use. Many users have found unique applications and uses for Purchasing Cards and possibly may have worked with the same suppliers used by your organization to negotiate card acceptance. They want to help!
- Participation in professional organizations, such as the NAPCP, can facilitate an exchange of successful approaches to program expansion employed by program managers in other industries and organizations.

Evaluate Options to Accelerate Payment

Some Purchasing Card revenue sharing agreements include a provision for increased incentive for expedited payment. Program administrators should evaluate the financial benefit of accelerating payment in relation to the cost of the funds utilized to make the payment. In some cases, the increase in revenue share may not be cost-justified. (Please note that if your organization has an internally approved methodology to perform cost/benefit analysis, you should follow that methodology.)

Example: 5 days versus 15 days

<u>Assumptions</u>

- The end-user spends $12,000,000 annually via its Purchasing Card program
- Cost of capital is 9% annually
    - o Depending on the organization, they may choose to view cost of capital as their current borrowing rate or, if they do not borrow to fund operations, they may choose to use some other factor as their opportunity cost. Regardless, personnel from the Treasury function will be able to advise the appropriate rate to be used for this calculation.
- Incentive offered for 15 days is 65 basis points (bpts)
- Incentive offered for 5 days is 80 bpts

Daily interest on $12,000,000 at 9% APR $2,958.90

Annual Revenue Sharing Comparison:

15-day payment terms (65 bpts)	$ 78,000
5-day payment terms (80 bpts)	$ 96,000
10-day difference in revenue sharing options	$ 18,000

Conclusion: The organization would spend an additional $29,589 ($2,958.90 x 10 days) annually in interest expense to increase the revenue sharing amount by $18,000. Fifteen-day payment terms are financially advantageous in this example.

Benefits of Joining a Card Issuers' Consortium

A consortium, also known as a cooperative, is a program offered by a card issuer to a group of like-entities that are anchored by one contract. These groups mainly exist in the government sector (state, counties, cities, school districts, higher education and special districts). The revenue share opportunity is usually more attractive as it enables each member of the group to receive a revenue share based on the aggregate spend of the group. Consequently, most entities receive a larger revenue share than what they would under an individual contract. Everyone in the group benefits, including the card issuer who only has one primary contract with the "anchor" to maintain, and short-form "Participation" agreements for each member. They also have the unique benefit of bringing everyone in the consortium together for training, updates and collaboration as needed.

Monitor Key Measures of Efficiency

Card issuers track certain measurements of financial efficiency about their clients' programs. Program administrators who also monitor these indices will have a better understanding of their card programs' profitability to their issuers.

Factors that make a card program profitable to an issuer include low risk, low overhead, a customer who consumes few resources and one that pays promptly. Metrics that support these characteristics are:

- Charge volume—The most basic factor affecting revenue sharing is charge volume. Most program administrators monitor the number of transactions and charge volume. These indices are usually compared to a business plan or historical performance to identify trends and variation.
- Speed of payment—Payment terms are usually specified in the terms of the contract. Some issuers may improve their revenue sharing offer in exchange for accelerated payment. Conversely, penalties are usually stipulated for late payment. Issuers typically measure payment performance by some variation of an average collection period calculation. In its simplest form, the average collection period is the accounts receivable balance divided by average daily charges. There are a number of variations to this measurement—some issuers consider charges as receivable when they post to the cardholder's account. Other issuers consider an amount receivable when it is billed to the organization. Some issuers use a weighted daily average, others use the simple calculation described earlier. There are also other terms used to describe this measurement, including "file turn" and "client held days." Regardless of the variation used, program administrators should be aware of how this is calculated and be able to evaluate the benefit of accelerating payment. This can usually be accomplished by weighing the improved incentive in relation to the cost of funds to increase payment from 15 days to 10 days, or from monthly payment to weekly payment or even to daily payment.
- Spend per card issued—Each card issued carries a certain amount of overhead to issue and support. This includes establishment of the account, manufacture and distribution of the card, mailing or electronic delivery of monthly account statements, etc. Each card also carries a certain level of risk to the issuer. From the card issuer's perspective, then, it is important for each card issued to produce enough revenue to cover the variable costs of issuance. While each issuer uses cost models unique to their own situation, tracking of the charge volume per card issued will help the organization identify trends that affect profitability. The program administrator should be able to see the utilization of cards issued to employees, the impact of adding infrequently-used cards and general purchasing trends.
- Average transaction size—Issuers are interested in the average dollar value of a transaction (sometimes referred to as "average ticket"). Generally, the larger the transaction amount, the lower the overhead in relation to the revenue-generating portion of the transaction. In short, larger transactions are more profitable to the issuer. While issuers may target increased transaction size as a program objective, other factors might influence an organization's efforts to impact this index. For example, the traditional domain for Purchasing Card programs has been high volume, low dollar-value transactions. Some organizations, for control purposes, restrict high-value purchases from the Purchasing Cards. Transitioning larger purchases to the Purchasing Card without thoroughly reviewing the adequacy of controls may result in added exposure to the organization. Program administrators should evaluate the overall cost benefit and assess the adequacy of internal controls to accommodate higher-value purchases when deciding to proactively increase average transactions.
- Underutilized cards—Cards that are seldom used may not create enough revenue for the issuer to recover the marginal cost of supporting that card. In addition, every card issued carries a certain level of risk for

unauthorized use. An excessive number of infrequently used cards distort other program metrics, such as spend per card issued. Program administrators should monitor the percentage and number of cards unused during an appropriate period (e.g., six months) and require justification for those cards. While underutilized cards may be a symptom of issuance to employees whose job responsibilities no longer include procurement on a regular basis, it may also indicate an employee who continues to be engaged in purchasing activity, but who has migrated to alternative payment methods, thereby eroding potential total charge volume. Program administrators should be alert for this possibility if buyers within the organization make the settlement method decision.

Track Incentive Earned

Most program administrators monitor various statistics about the program to report the financial benefit to management. With respect to revenue sharing, the most fundamental of monitoring activities is to track revenue sharing earned as the fiscal year or contract year progresses. Revenue sharing represents hard dollars and will flow directly to the organization's income statement. This fact should be presented to management regularly as support of the program's value to the organization.

In addition to validation of the program's value, tracking the incentive may be necessary to accrue revenue sharing on the organization's general ledger during the year. Tracking revenue sharing as it is earned also helps the program administrator validate the accuracy of the calculation performed by the issuer.

Managing Other Areas for Efficiency

By controlling other areas that increase costs for the card issuer, program administrators can also reduce these expenses for their own organizations. Purchasing Card contracts usually contain provisions defining which party absorbs the cost for fraud and employee misuse. Some issuers absorb these losses, while others will offset the incentive earned by the organization. In either case, program administrators who utilize the control features of Purchasing Cards and who have implemented audit routines for early detection of unauthorized card use will minimize this expense. Practitioners interested in learning more about prevention and detection of unauthorized use are referred to the NAPCP Report *Fraud Prevention and Detection: Establishing and Maintaining a Purchasing Card Program with Adequate Management Controls to Prevent Fraud, Misuse and Abuse, NAPCP Edition 2.3, June 2017*.

Disputed transactions are also an indirect cost that is shared by both the issuer and the end-user. Disputes can involve several processes, which increase administrative cost for the issuer and the end-user organization. Disputes are sometimes initiated for situations that could easily be resolved by dealing directly with the vendor. By controlling the number of unnecessary disputes, a program administrator can help contain this expense for both their issuer and their own organization.

Considerations Affecting Internal Treatment of Incentive

Many organizations use revenue sharing as an incentive to end-users to maximize use of the card and credit the user's department for their share of the incentive. This treatment is quite effective because there is a tangible cost-reduction benefit to the end-user's department. Depending on the amount of revenue sharing, however, it may be material enough that the organization may need to accrue it during the year.

Some organizations, however, take a different approach to the accounting treatment and do not distribute the incentive to the users, but rather record it at a higher level in their consolidated ledgers. This approach simplifies the accounting entries and allocation models that need to be maintained to redistribute the incentive on a pro-rata share.

Revenue sharing may also be a means of funding the ongoing management of the Purchasing Card program and its pursuit of realizing the potential the program offers an organization. Effective Purchasing Card programs don't manage themselves; organizations are wise to invest in the continued professional development of those responsible for program management.

Guidelines to Maximize the Efficiency of a Card Program

In their *2017 Purchasing Card Benchmark Survey Results Report—Market Trends and Best Practices,* Mahendra Gupta and Richard Palmer identified some common elements in the way high-performance programs are administered. "Larger organizations and those with significant levels of Purchasing Card spending commonly have contractual incentives provided by their card issuer to promote greater Purchasing Card use (also known as rebates or refunds). The majority of respondents (84 percent) indicate that Purchasing Cards are 'moderately' to 'extremely' valuable with regard to providing rebates and incentives."

Some consideration of the lesser known ideas to maximize efficiency should also be considered, such as:

- choose the same issuer for all card programs (Purchase, Fleet, Travel)
- monitor program statistics for trends, opportunities and goal setting
- travel policy that mandates Travel Card use (e.g., limit personal card use)
- acquire and maintain upper management support
- communicate in a way that promotes and educates
- set appropriate staffing level that allows strategic thought

The last item is often dismissed as unnecessary to maximize the efficiency of a card program. However, allowing enough resources to manage the card program can, in addition to supporting the day-to-day operations, facilitate program management's ability to identify opportunities for program improvement. A card program that does this will excel in both its ongoing growth and its value to the institution. The Purchasing Card program manager should take advantage of the issuer's training and networking opportunities to convert that knowledge into gains.

What Makes a Card Program Profitable for a Card Issuer?

Card Issuer Revenue – Interchange

For the networks of Visa and Mastercard, the merchant discount (also referred to as merchant fee) includes interchange and is paid by the merchant to their acquiring bank. Although interchange is obviously a factor in the price that acquiring banks charge merchants, other costs such as the processing, equipment rental, risk, etc. are also considered when developing this fee. There is no interchange component of the merchant fee for American Express. However, a merchant still pays a merchant discount fee in conjunction with card acceptance.

The merchant discount fee is the amount charged to the supplier/vendor when they accept a credit card for payment. For example, if a credit card is used as payment for a $100 purchase at XYZ Inc., the merchant fee for XYZ Inc. may be 3 percent. This means the merchant will receive $97 for the transaction and the acquirer will receive $3. If the interchange is 2.5 percent, the acquirer will pay $2.50, which will go to the card issuer, and keep $.50 for processing the transaction.

The merchant fee varies by merchant, industry, transaction type, etc. Although merchant fees are highly negotiable, interchange, a significant portion of the fee, is not often negotiable. While this may appear to be a negative for the merchant, some of the benefits to the merchant include: the merchant can now be paid in two days (after the date of the transaction) vs. 30-plus days with a traditional payment vehicle (e.g., check, wire, etc.); reduction in bad debt; the elimination of billing and receivable management; and minimization of cash handling and employee theft.

The portion of the fee that flows back to the issuing bank is what funds annual revenue share (rebate). The issuer determines the amount available to distribute to end-user organizations in the form of a rebate. The higher the fee, the more available for rebate.

Currently, the interchange rates for credit cards are not regulated by the government in the U.S. or Canada. However, this does not hold true for Europe. As of April 20, 2015, the European Council adopted regulation capping interchange fees for payments made with consumer debit and credit cards. PSD2 legislation includes regulations on multilateral interchange fees also known as the interchange fees regulation (IFR). This regulation will ultimately ban suppliers from imposing surcharges on customers for the use of certain payment cards and will limit the fees for transactions based on such payment methods. The IFR was bundled into the directive and capped interchange fees for consumer credit cards excluding Commercial Cards as referenced in Chapter I, article I, section 3-a. Commercial Cards are exempt until June 9, 2019, where a formal review of the regulation will take place. The commission will submit a report on the application of the regulation including the effect on the market of the exclusion of Commercial Cards, comparing the situation in those Member States where surcharging is prohibited with those where it is permitted. Corporate Cards (Travel Cards) are not necessarily exempt from the IFR. Typically, these types of Commercial Cards are individual liability cards and are in some cases being ruled as “consumer cards,” which subjects them to interchange capping. In Canada, Visa and Mastercard voluntarily reduced their credit card fees to an average effective rate of 1.50 percent for the next five years. The new reductions would be implemented no later than April 2015. As a result of these changes, card issuers’ margins are even smaller. This has led to a reduction in, and in some cases, elimination of, revenue sharing in programs outside the U.S.

The Durbin Amendment, part of the Dodd-Frank Wall Street Reform and Consumer Protection Act in the United States, set caps on swipe and/or interchange fees for debit card transactions. Currently, it does not appear that regulation of credit card interchange will follow.

Card Issuer Profitability – Key Drivers

There are three main drivers of card issuer profitability: 1) charge volume, 2) speed of payment and 3) bad debt. Each of these drivers has an impact on the card issuer’s overall profitability. The following is a brief overview of these drivers.

Charge Volume

Charge volume is the most visible driver of Commercial Card profitability. At the most basic level, as charge volume increases, profitability increases. However, as charge volume increases, so does the likelihood of an increase in late payments and credit losses (i.e., default).

The easiest way to maximize your Commercial Card incentive is to increase your charge volume. Some best practices for increasing charge volume include: enforcing a mandate to use the card; run a spend analysis to identify additional spend, which can be moved to a credit card; and include language in your RFPs that stipulates your suppliers must accept credit cards from you as a form of payment.

Speed of Payment

The level of impact speed of pay has on Commercial Cards' profitability varies based on current interest rates. The higher the interest rates, the greater the impact speed of pay has on the profitability and vice versa.

Typically, after a credit card transaction is approved, the merchant is paid by the card issuer within two days. The card issuer must then incur the cost of floating these funds until they receive payment from the end-user. The difference between the card issuer receiving payment within 20 days vs. 30 days can be significant (e.g. +/- 2 basis points per day, depending on interest rates). As a best practice, you should negotiate a speed of pay incentive with your card issuer. This should be a win/win for both sides.

Bad Debt

Bad debt on a Purchasing Card is less likely than bad debt on a Corporate Travel and Entertainment Card. However, bad debt still exists. The cause of bad debt on a Purchasing Card can be a result of:

1. *Organization Bankruptcy* – If an organization goes bankrupt, the card issuer is at risk of losing all outstanding balances.
2. *Employee Misuse* – This is defined as employees using their Purchasing Card for unauthorized purchases that do not benefit the organization. Most card issuers offer a level of indemnification for this type of misuse. However, this loss can negatively impact both the organization's incentive and the card issuer's profitability.
3. *Fraudulent Charges* – These are defined as charges which are incurred by an unauthorized person. Fraudulent charges may or may not be deducted from your financial incentive depending on your contract terms. However, similar to employee misuse, these charges can have a direct impact on the card issuer's profitability.

Other Card Issuer Costs

Other cost factors impact the card issuer's profitability. Like any business, card issuers incur various costs that deduct from the revenue and may ultimately impact the amount of any financial incentive you may receive. Below is a summary of other costs incurred by card issuers.

A. Overhead

Transactional Costs

Each credit card transaction has costs associated with it. When a card is "swiped" or "read" (magnetic stripe vs. chip) at the point-of-sale, there is a cost to verify the validity of the card and then either approve or deny the charge. There is an additional cost to capture and process the data from the transaction. During the RFP process, an organization should ask if the process/capture of data is done by the issuing bank or third party. If the latter, will it be costlier?

Implementation

If you are implementing a new Commercial Card program or expanding an existing program, the card issuer may provide implementation resources. These resources are very valuable to the success and the growth of a program, as they set the foundation. Implementation resources are typically utilized one time per account, making this a one-time expense to the card issuer.

Account Management

As a Commercial Card customer, your card issuer will provide account management resources. The level of resources will vary depending on the size and complexity of the program. For example, a smaller, non-complex program may only require 30 percent of an account manager's time. At the same time, a larger, more complex program may require 100 percent of an account manager's time. Account management resources are an ongoing cost to the card issuer.

Customer Service

For issues with a specific credit card account (e.g., lost card, billing error, etc.), the cardholder can directly call the card issuer's customer service call center. Typically, these call centers are open 24/7. This represents an ongoing cost to the card issuer.

Technical Resources

One of the major benefits of a Commercial Card program is the technology. It is imperative that card issuers continue delivering cutting-edge technology solutions. This is a key factor in helping companies optimize their expense management processes. Consequently, card issuers continue to invest significant capital into technology.

User Conferences

Based on customer feedback, card issuers may host a number of user conferences. The purpose of these conferences is to introduce new products and services, demo new technology, share best practices and discuss future enhancements. While these conferences are a great benefit to Commercial Card customers, the cost is borne by the card issuer.

Rewards Program

In today's environment, Purchasing Card programs usually do not offer personal rewards programs—this will depend on the card issuer. However, if an organization uses a One Card solution, rewards may become a factor. Reward points may be applied incorrectly if a transaction is not labeled correctly (i.e., Purchasing or T&E). This could lead to additional costs for the card issuer and a greater deduction from the organization's incentive. While a rewards program would have little to no impact on the cost, it is worth considering what role a rewards program will play in your program if you use a One Card solution. Typically, if an organization receives rewards, they receive little or no rebate.

B. Cost of Funds

Provider's Perspective

One of the costs an issuer incurs in providing Purchasing Cards is the cost of funds to pay the merchants prior to being paid by the end-user. The issuer experiences an outlay of funds as they pay the merchants or suppliers, which typically happens within roughly two days of the transaction being processed. The end-user ultimately pays the issuer, but there is a lapse in time between when the issuer pays the merchant and ultimately receives payment from the end-user. For example, if the payment term is 15 days, payment will be made an average of 30 days from the transaction date. As a result, the issuer incurs a cost of carrying the payments made to the suppliers while not yet receiving payment from the end-user organization. The more quickly the end-user pays, the shorter the time the issuer has to bear the cost of carrying the payments to the suppliers, which drives down the cost.

As a result, speed of payment by the end-user should be negotiated as part of the contract. Many issuers will take this into consideration as they structure the revenue sharing programs they offer their clients by offering a tiered structure whereby the quicker the payment, the larger the revenue share offered.

Impact of Issuer's Borrowing Rates

The issuer's cost of borrowing may increase, driving up its cost to carry the payments to suppliers, eroding its profitability. As a result, some issuers include a clause in the revenue sharing program that allows them to adjust the incentive as their borrowing rates fluctuate.

C. Financial Risk

There is always risk for the card issuer whenever it implements a Commercial Card program with an organization. However, it is incumbent on the card issuers to take the appropriate actions to minimize their risk as much as possible.

How Card Issuers Minimize Risk

The first step a card issuer takes to minimize risk is reviewing a customer's credit history. Credit to organizations is only approved after an assessment of financial history, current financial health and anticipated future financial performance. The better the financial history of both the organization and the industry in which it is engaged in business, the more favorably the issuer will view the financial risk. While no credit extension is 100 percent risk free, issuers will typically reward companies having favorable financial risk assessments with larger lines of credit and more generous payment terms.

After credit is granted, unforeseen events (e.g., bankruptcy, natural disaster), whether within the organization's control or not, may negatively impact the organization's ability to pay the issuer the balance due on card transactions.

To mitigate risk, card issuers vary the contract terms depending on the risk assessment. Variables include:

- frequency of invoicing
- frequency of payment
- collateral requirements (letter of credit, funds on deposit with issuer)

- amount of credit extended
- incentive penalties for increasing average days sales outstanding (negative float for the issuer)
- compensation schedule for up-front bonuses if spend thresholds are not achieved

Large Ticket Interchange and Its Impact on Incentives

As we have seen, the majority, if not all, of the revenue an issuer receives from Commercial Card programs comes from interchange. In an organization's desire to maximize the use of Purchasing Cards, many have asked issuers and the bank associations to develop an incentive for merchants to accept Purchasing Cards for high dollar value transactions. Both Mastercard and Visa implemented a large ticket interchange that has been successful in moving these high dollar transactions to Purchasing Cards. However, one must be mindful that lower interchange means lower revenue for the issuer and perhaps little or no revenue available to share with the end-user organization. Organizations must recognize the fact that enticing merchants to accept the Purchasing Card for high-ticket items may mean not receiving incentive payments on those transactions. Revenue sharing represents but a small percentage of the overall savings from use of a card; acceptance with no revenue sharing is still probably a lot better than no acceptance at all.

Discounted Interchange

There are programs whereby the bank associations/schemes have entered into lower interchange agreements with specific merchants to gain a greater acceptance of their networks at those merchants. Additionally, the bank associations/schemes may charge merchants a lower interchange rate in exchange for passing along more detailed transactional information, commonly referred to as Level 2 or Level 3 data. Examples of this are prevalent in the travel and entertainment sector where hotels, airlines and gas stations, to name a few, will pay lower interchange in exchange for passing along detailed transactional information. This is not unlike the existing large ticket interchange rates that have existed for years. Similar to large ticket interchange, some issuers may reduce the amount of revenue sharing they provide back to the client for spend that qualifies for discounted interchange rates. Be sure to ask the issuer what specific interchange rate types you will receive your revenue sharing payments on and whether there is language in the contracts that can change over time with regard to what transactions qualify for what rebate.

Global Perspective and Credit Card Interchange Under Scrutiny in the World Marketplace

Revenue share outside of the U.S. is not widely available. As we have discussed in this report, issuers derive revenue from, among other things, interchange. Interchange has been a controversial issue in the United States and around the world. After successfully defending the interchange system in the United States against anti-trust charges, the major bank associations operating in the United States have been able to set default interchange rates in response to market forces. Outside the United States, however, such as in the European Union and Australia, regulation has been put in place to restrict interchange rates.

The controversy around interchange arises, at least to some extent, from the conflicting impulses of cardholders and merchants. Assuming that an increase in interchange does not decrease merchant willingness to accept a particular payment card system, end-users want higher interchange rates because higher interchange rates translate into lower fees, lower interest rates, more rewards and more benefits. Merchants, on the other hand, have the opposite desire. Assuming that a decrease in interchange does not decrease consumer willingness to use a particular payment card system, accepting merchants prefer lower interchange rates because lower interchange rates usually result in lower acceptance costs for merchants.

In this report, we do not attempt to discuss the value versus the costs of card acceptance. We merely want the reader to understand that there is an ongoing debate within the U.S. on whether what is happening overseas will impact interchange in the United States. In addition, merchants continue to pressure the industry for lower fees. The bottom line is that the issuing banks, who count on interchange for a significant portion of their revenue, are concerned. If issuers believe the interchange model will change, they will see it as a risk when proposing incentives over time. The longer the time, the greater the risk. If interchange is reduced as a result of pressures from merchants or regulators or if it is ultimately capped through regulation, the issuer will have no recourse but to reduce their costs by reducing benefits—either rewards or refunds. Organizations with card programs must consider the world events when negotiating with issuers and they should be prepared to share in the risks associated with interchange and the impact on the capability for the issuer to offer incentives.

Summary

Because revenue sharing is easy to quantify and can be used to evaluate proposals submitted by various card issuers, its overall value to an organization is often exaggerated. More significant savings are usually realized by the cost reduction for processing payments with a Purchasing Card, as opposed to other payment methods. Other value-added services, such as customer service, reporting and Web-based tools should also be considered as part of the financial package offered by an issuer. Nevertheless, revenue sharing does represent hard dollars and will directly affect your organization's bottom line but should be considered in context.

The source for revenue sharing comes from fees paid by the merchant on purchases involving credit cards. Some merchants may be reluctant to accept Purchasing Cards for some transactions, particularly if they involve negotiated pricing that did not consider the form of payment as a factor. In addition, the fees paid by the merchant in large dollar transactions may result in an unacceptable erosion of profit for your suppliers. The bank associations have developed a program to accommodate higher value purchases, with a significant reduction in fees paid by the merchant. These reduced fee transactions, however, may result in no incentive available to the end-user organization. Administrators of multinational programs should be aware that the fee structure outside of the U.S. may differ from domestic rates and may be limited by government regulation, resulting in a decreased pool of funds available for revenue sharing. End-users should consider that all parties involved in the Purchasing Card supply chain rightfully expect to earn a profit for their efforts.

With respect to revenue sharing, the amount of charge volume will be a primary determinant. Programs that do not generate enough revenue to cover the costs to issue cards and to support the program will usually not qualify for revenue sharing. There is typically a direct relationship between charge volume and revenue sharing percentage. Therefore, the most significant thing a program administrator can do is to increase charge volume.

There are other activities that can help reduce the issuer's cost and indirectly affect the amount of financial incentive. The speed of payment, for example, will affect the issuer's profitability. Program administrators should engage in a cost/benefit analysis to determine whether payment acceleration would result in a favorable cash flow.

Other areas that affect the financial efficiency of a program include the minimization of unauthorized use, minimization of disputes, minimization of overhead to support the account and the elimination of seldom used cards. Attention to these factors is also important to the end-user organization and represents effective program management.

Simply stated, the larger the card program and the lower the issuer's cost to support that customer, the greater the opportunity to improve revenue sharing. The concepts of efficiency and effectiveness in managing a card program should be the focus of program administrators.

Appendix – Glossary of Terms

Acquirer	A financial institution or other entity that signs up merchants to accept credit cards and provides related services to the merchant.
Basis point (bpt)	1/100th of a percentage point.
Card issuer	The institution issuing a credit card. In the case of an American Express CPC, American Express is the issuer. For Mastercard and Visa branded cards, any association member financial institution, bank, credit union or organization that issues, or causes to be issued, plastic cards to cardholders.
Client held days	A measurement of timeliness of payment.
Credit card processor	A company that performs authorization and settlement of credit card payments, usually handling several types of credit and payment cards (such as Visa, Mastercard and American Express).
Discount/ merchant fee	Fee paid by the merchant to the merchant bank or other contracted party for processing the merchant's credit card sales (transactions).
Discount rate	The percentage rate that a merchant institution charges the merchant giving deposit credit for handling merchant sales drafts or electronic sales transmissions. The discount fee is the currency amount charged.
File turn	A measurement of timeliness of payment.
Incentive schedule	A document, typically part of the contract with the issuer, that outlines the various components and performance thresholds that guide the calculation of the revenue shared with the end-user organization.
Interchange fee	A fee paid by the acquiring bank/merchant bank to the issuing bank. The fee compensates the issuer for the time after settlement with the acquiring bank/merchant bank and before it recoups the settlement value from the end-user.
Large ticket interchange	Typically, a lower interchange fee charged to merchants for transactions which exceed a high dollar amount (e.g., $10,000) and, as applicable, meet other requirements.
Network	The bank association's role in the credit card transaction flow. The network routes transactions presented for authorization to the appropriate issuer's (or processor's) system and routes the approval back to the merchant.
Processor	A provider of back-office services that performs varied functions on behalf of the acquirer or issuer, including authorization of credit card transactions, switching of card transactions from the merchant's terminals to the correct card system, printing of statements, etc.
Ticket	A transaction.

Other Related NAPCP Resources (www.napcp.org)

Benchmarking Report, Measuring Your Program's Success—Tips for Sharing Program Performance
www.napcp.org/metricsreport2016

Calculate process cost for your organization, go to www.napcp.org/ProcessCosts.

Cost Savings: P-Cards vs. Traditional Purchase Orders in the Government Sector
www.napcp.org/processcosts

Fraud Prevention and Detection: Establishing and Maintaining a Purchasing Card Program with Adequate Management Controls to Prevent Fraud, Misuse and Abuse
www.napcp.org/FraudPrevent2017

◆ Gaining Management Buy-In for Your Commercial Card and Payment Strategy
www.napcp.org/ManagementBuyIn

◆ NAPCP Global Provider Directory (annual NAPCP guide of industry product and service providers)
www.napcp.org/providerdirectory

Purchasing Card Best Practices: The Key Elements of Building a World-Class Program
www.napcp.org/BestPracticesReport

End-User Perspective on Supplier's Acceptance of Card Payments, in partnership with Accenture
www.napcp.org/suppliereconomics

The One Card Solution
www.napcp.org/2016onecard

Trends in Commercial Card and Program Management, collaboration between NAPCP and TSYS
www.napcp.org/trendses2016

Other Resources

For interchange rate schedules, go to: http://www.napcp.org/?page=Interchange

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Membership in the NAPCP gives you access to the educational and networking resources you need to build and manage a world-class Purchasing Card (P-Card) program. As you learn best practices and communicate with other P-Card professionals willing to share success stories and methods, you will discover new ways to expand your program and reap the benefits of economy *and* efficiency.

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