



Winning the B2B Gold

The potential is huge, but it's a complex sale

By Richard H. Gamble

In the merchant acquiring world, business-to-business (B2B) transactions represent a “blue ocean of opportunity,” insists John Hayes, CEO of FTRANS Corp., an Atlanta A/R solutions provider. “Annual trade credit transactions, at more than \$18 trillion in volume, are more than 10 times the total dollar value of credit card transactions,” he notes. It’s a huge market with very low credit card penetration. Moreover, acquirers have a powerful ally in selling supplier card acceptance: large procurement organizations are asking—or telling—suppliers to start taking card payments.

Checks still dominate B2B settlement with a 74 percent share, down from 81 percent in 2004, but ACH transactions are growing faster than card transactions for B2B settlement. To expand their toehold in B2B payments, card players have revived EIPP (electronic invoice presentment and payment) ventures that seek to marry payments to electronic communication networks. MasterCard introduced a new B2B payments gateway in October, an electronic network that connects trading partners for settlement and settlement-related communication. First Data Corp. and Wells Fargo Bank quickly signed on as participants. American Express bought Harbor Payments and is using it as a foundation for the payments part of its new S2S (source-to-settlement) service, and JPMorgan Chase bought Xign, which now supports its B2B order-to-pay solution.

Opportunity for ISOs

B2B presents great opportunities for ISOs, says Aaron Bills, chief operating officer of 3Delta Corp., a B2B payments gateway, especially when the buyer and suppliers are local and the ISO can capitalize on its feet-on-the-

street presence. As issuers push p-card programs for smaller and smaller companies, more single-location or geographically focused companies will ask local suppliers to accept card payments.

A \$10 million business in a community of 100,000 inhabitants, for example, might launch a p-card program and decide to pay for legal, accounting, consulting, landscaping, cleaning and food service by card. A local sales rep

says. Many of the suppliers that sell to federal, state and local governments also sell to businesses, he notes.

For the supplier that also makes retail credit card sales, Level 3 data capture provides an ISO opportunity. Many such merchants process card transactions like a retailer and don’t get the benefit of the lower interchange for capturing and reporting Level 3 data, reports Greg Cohen, president of the



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who goes to Rotary and PTA meetings with managers of the buying and service firms could sign up the suppliers.

Selling card acceptance to B2B suppliers can be easy. Bills recalls one client who did high-end computer network engineering projects for customers that included 3Delta and three-letter security agencies in Washington. “He had multi-million dollar contracts and billed at a high hourly rate,” Bills reports, “but it hurt his productivity and his image to be the bill collector, so he started taking card payments. Now he’s happier and gets paid faster.”

An ISO might partner with an issuer to work on a buyer’s suppliers in a given area or might work directly with the buyer, Bills notes. “If I were an ISO, I’d go directly to the buyer,” he adds. ISOs can also find B2B prospects by poring over federal and state Web sites, which often will provide a wealth of information about supplier relationships, Bills

USA group for Moneris Solutions Inc. “This presents an opportunity for ISOs to work with the merchant and get all their business, even if only 10 percent of it is commercial,” he points out.

Helping suppliers get the lower interchange that goes with Level 3 reporting offers “a large opportunity to improve penetration,” notes Robert Ruark, merchant services executive at Bank of America.

Uncrowded Market

B2B suppliers are a ripe market opportunity for specialized ISOs and processors, Cohen says, because “the big guys—First Data, Chase Paymentech, Global, ourselves—offer Level 3 service but don’t really push it. A niche player that made it their special business could do very well.” Acquirers have done a “poor job” of signing up B2B suppliers, Cohen says, because they lack motivation. “It’s a tough nut to crack because

it costs more to enroll them, it's a long sales cycle and because the transaction volume is fairly light. Big mainstream players just see greener pastures elsewhere, so it's best tackled as a niche play, but for the right niche player, "there is a huge opportunity."

It's huge partly because it's what Cohen calls a "spider" play. A buyer sits at the center of the spider web, surrounded by its suppliers, who are surrounded by their suppliers and so forth, he explains. "As you sign up one buyer's suppliers, you can move on to their suppliers."

Only a handful of acquirers—fewer than five—really focus on B2B, reports Mark Abbey, partner at First Annapolis Consulting, Linthicum, Md. And that means an opportunity for an acquirer or ISO to build a strategy around B2B. But traditional retail merchant selling won't work. "Everything is different in the B2B world," he observes, "which creates opportunities for differentiation but also presents challenges for delivering what these suppliers need. There is a lot more educating involved."

New Strategy

Signing up a business supplier requires a whole new sales strategy. "It's a longer sales cycle—usually three to five meetings—and requires a deep understanding of how the supplier runs its business," notes Diane Merrigan, director of the B2B market for Heartland Payment Systems. "You have to deal with reporting, training, reconciliation and possibly integration with their ERP system. Many ISOs and merchant-level sales reps are not prepared to do this." Bills adds that you have to be able to talk with treasurers, CFOs and A/R managers on their level and fashion a solution around their concerns.

And you need a robust product offering. To succeed in the B2B space, Cohen notes, you need a three-part package: card processing, ACH processing and a recurring payment program for cards and ACH.

If you make the sale, it's harder to onboard a B2B supplier than it is to onboard a retail merchant, Abbey

says. They're likely to have order-entry systems that were not built to take card payments and have to be retrofitted to work, he explains.

Supplier Resistance

While some business suppliers like the value proposition of taking cards—quick cash, no invoicing and collection chores, happy customers—many resist what they think will be added cost. They suspect, Abbey notes, that taking cards would lead to adverse selection—that customers that stretch out their payments would continue to do so while customers that always pay on time would switch to cards and the supplier would have the discount to pay. "A lot of the hypothetical benefits from changing A/R behavior haven't panned out," he says.

Card settlement in the B2B world is usually driven by buying corporations adopting card programs to get process efficiencies and rebates and then pushing segments of their supplier base to accept card payments, Abbey reports. Issuers sign up buying companies and then take a dump of their A/P file to analyze their suppliers and start to market card acceptance to targeted suppliers, often aided by a mandate or strong pressure from the buying company, he explains.

Whether a supplier accepts card payments depends on things like profit margin, DSO, the cost of carrying receivables and what the supplier is selling. For example, a service provider like a consultant who has low fixed costs to cover is more likely to accept card payments, notes Drew Hofler, senior manager of financial solutions for Ariba Inc. And of course it depends a lot on how much pressure the supplier is getting from customers who want to use cards, he adds. Ariba, based in Sunnyvale, Calif., is a leading supplier of e-procurement systems.

The non-accepting supplier is seldom sold by an ISO cold-calling, Cohen observes. Usually it's in conjunction with issuers' sales to buying companies, which then identify the suppliers where they want to use the

card. Moneris partners with Harris Bank in the U.S. Harris is a big issuer of commercial cards, and when Harris sells a p-card program and gets a supplier list from their customer, it hands off the list to Moneris, which will work to sign up non-accepting suppliers, Cohen reports. The market is driven by buyers and issuers because they have the most to gain, he notes.

Crossing into A/P Land

B2B card transaction growth to date has been "strong but coming from a small base," according to Ruark, but future growth, especially when measured in dollar volume, may come from pushing the card for settlement of higher-dollar transactions, and that means overcoming resistance among both sellers and buyers.

The recent buyer/issuer initiative to move larger transactions onto card settlement increases the potential rewards for acquirers but also raises supplier resistance. Large transactions even pose a problem for buyers under traditional credit card rules. Buyers often don't want a supplier to be paid before a large order arrives and can be inspected. So, to attract more buyer business, card issuers are pushing programs that let the buyer wait, receive and inspect the order, receive the invoice and match it against purchase orders and receipt documents, and only then give the supplier a number to use to collect a card payment.

If buyer-controlled payment linked to an A/P process satisfies buyers, it creates real problems for suppliers. According to Hofler, "The two best selling points for B2B suppliers to take card payments are (1) the savings from not having to invoice, collect and otherwise process receivables and (2) payment within 48 hours of shipping." Moving to buyer-controlled card payments after invoice approval eliminates the process savings and significantly diminishes the value of quick payment, he points out.

Buyer-initiated payment after invoice approval means the supplier doesn't get paid in 48 hours, but many buyers will

expedite payment to suppliers who will accept card settlement, paying them quickly once an invoice has been processed and approved, Ruark says.

To find a workable solution, sellers and buyers have to rebalance value so that both are rewarded, Bills insists. "You can't build a buyer-centric solution on the backs of suppliers," he says. "They have to share in the financial and automation benefits." If suppliers are forced back into generating invoices and collecting delinquent accounts, if they have to work manually around systems designed for buy-

However, the supplier has no choice if the discount rate approaches or exceeds its profit margin, Merrigan notes. "Many suppliers are running on thin margins as it is, and to add a cost that slices further into profits may be fatal."

Find the Middle Ground

Failure to find a middle ground could push transactions away from card settlement. When push comes to shove, trading partners can and often do avoid card settlement for their mutual economic benefit. If two trading partners do \$1 million in p-card transactions a

decade," Bills predicts, and an opportunity ISOs won't want to miss.

Hooked on Trade Credit

While sellers and issuers appear to be driving the B2B card market, that's not true of the larger market, Hayes insists. "Contrary to popular opinion, the trade credit buyer is more often the reluctant party in using a credit card, not the trade credit seller," he says. "Our research indicates that buyers generally choose the payment method, and they have chosen to use credit cards only for small purchases. The credit card industry has not found a solution that is widely accepted for B2B transactions despite many years of trying," he notes.

Trade credit followed by check payments continues to reign because it is perceived to be free, flexible, easily obtained and leaves the buyer with greater control and leverage, Hayes points out. Less than 3 percent of B2B payments have migrated to cards, he says, because buyers are hooked on trade credit, which supplies a high percentage of their cash, and willing to swap only a small piece of it for the efficiencies of card purchases. For quite a few business buyers, using the card and having to pay the bank in monthly cycles means they have to pay sooner than they would under current trade credit practices.

So Hayes predicts that card settlement will never account for more than a modest slice of B2B payments. His idea is to offer, with Synovus Financial Corp., Trade Credit Express, a B2B supplier package that includes card acceptance, A/R outsourcing for process efficiency and A/R financing for liquidity.

Facility Robotics signed up last summer for Trade Credit Express, largely to get receivables financing, reports Vic Villalobos, president and CEO of the Atlanta firm, which does project work in the telecommunication industry. Getting cash within 72 hours of invoicing—and getting 90 percent of it for low-risk invoices—is better than waiting 30-45 days to get paid in full, he says. He prefers accepting credit



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ers and if they have to wait 30 days to be paid and still pay a discount, that “solution” won't fly, he predicts.

Offset the Difference

Suppliers could, of course, raise prices to offset the discount. B2B suppliers in the retail world—companies like Dell, HP, Office Depot, Office Max and Staples—already have raised prices by about 2.5 percent to offset the discount rate and accept card payments from any business that wants to pay that way, Hofler reports. But paying a price increase to move a transaction to card settlement defeats the goals of most B2B buyers, especially for larger transactions, and they won't like it if they're paying attention to prices, he agrees.

Supplier reluctance doesn't matter, says Debra Rossi, executive vice president and general manager of Wells Fargo's merchant payment solutions. "Large buyers are mandating card acceptance for transactions they select. A supplier's only choice, in many cases, is to accommodate the buyer or lose the business," she says.

month, Hofler illustrates, the supplier pays at least \$20,000 to the card infrastructure players and the buyer gets back no more than \$8,000 in rebates. That means the two trading partners are paying at least \$12,000 to card networks—money they could share if they disintermediate the middlemen and settle directly. A supplier could offer a 1.4 percent prompt pay discount to the buyer. The buyer would gain \$14,000 (\$6,000 more than its potential rebate), and the seller would still save \$6,000 compared to the \$20,000 it would pay for a card transaction, he explains.

As smart procurement operations sharpen their pencils, they usually find that they need buyer-financed trade credit, third-party financed trade credit and card programs to cut their best deals across the board, Hofler says.

But if the convergence of p-cards with the A/P process can be made to work, it opens up a new group of suppliers, many of which don't currently accept cards, and a new, larger group of transactions. "That will be the major opportunity over the next

card payments, which he calls “a lot simpler,” but concedes that his company does nothing to encourage customers to pay by card.

It would cost about the same to finance receivables with a bank line, but using TCE is more convenient, he observes. While Villalobos calls the FTRANS Web site “a good business tool,” he’s skeptical that he’ll save a lot of overhead on collections. “If there’s a dispute, we’re still involved,” he notes.

Ambitious Play for ISOs

But Hayes’ vision goes well beyond Facility Robotics’ application. He wants to sell a full A/R outsourcing package, and he wants ISOs to help him do it. It’s a chance for ISOs to dramatically expand the scope of their offering, earn residuals that will at least match the cut they get from credit card sales, and earn those residuals on a much larger base of transactions. His theory has yet to be tested. But it will work, he argues, because it will cost less than many small and mid-sized suppliers currently pay to run their internal credit operation. “When they see the savings, they are thrilled to outsource,” he insists. “They take no risk, get paid almost immediately, have no administration and no collections overhead to deal with.”

With a total payments solution, Hayes boasts, B2B suppliers can take card payments if that’s what their customers want, or they can continue to offer trade credit and take check payments and it all costs about the same and provides funds in about the same time. They can connect to a single solution and be relatively indifferent to their customers’ payment strategies and choice of instruments, he claims.

The savings from outsourcing can more than cover what banks charge for putting up the financing, what FTRANS charges from running the network and what ISOs might earn from selling it, he says.

“Where it doesn’t work,” he says, “is with companies that don’t need much of a credit operation or large companies that have the scale to operate efficient internal credit departments.”

Hayes considers the success of credit cards in the retail market to be an outsourcing play by retailers. “The bank card system has proven to be so economic that virtually all retailers, large and small, have chosen to outsource their internal credit functions to financial institutions that can operate credit systems on a larger scale, with greater expertise and better technology, and with a lower cost of capital,” he says. “We believe that B2B sellers will make the same decision if their customers cooperate and if the replacement cost is no greater than the current cost.”

However, card industry veterans like Cohen are not convinced that ISOs are right to sell a complete A/R outsourcing solution. “If you could get a few independent guys to champion it, it might work,” he observes, “but solutions that are overly complex usually don’t sell well through the ISO channel.” ISOs thrive on commodity products and services, he notes. A full back-office A/R outsourcing solution would be complex, more likely to be packaged with bank cash management and lockbox services, he adds.

An ISO could sell an A/R outsourcing solution, Bills agrees, but with caveats. He says it would take a special kind of ISO, one with a staff that is comfortable talking with treasurers, CFOs and A/R managers about their needs. “You have to listen deeply and then respond with a solution that fits their circumstances. It’s a long sales cycle. The relationship can be durable and lucrative, but it’s high-level selling. Pitching a commodity solution won’t work.”

Whether Hayes’ idea works, or even whether the current drive to capture larger transactions by tying card payments to the end of an A/P process catches on, the huge value of check payments still being made to settle B2B transactions will be the gleaming El Dorado that attracts innovative marketing attempts to expand card settlement. The ISOs and processors that learn the complex B2B market will be best positioned to catch the wave when or if it comes along. **TT**

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PCI Challenges

While a move into the B2B space could be profitable for ISOs, acquirers and processors, there are PCI (payment card industry) compliance issues that have to be confronted, notes Aaron Bills, chief operating officer of 3Delta Systems Inc. in Chantilly, Va. As buyers push into the first generation of accounts payable processing with card settlement, buyers are starting to deliver card account numbers to suppliers for one-time use, or else provide a “vendor card” assigned to that particular supplier, Bills says.

To use the card, the supplier necessarily has to see it in unencrypted format so it can be entered into the card processing system, Bills explains. “By participating in such an arrangement, the supplier is being asked to store card data in violation of the PCI requirements and prudent business practice,” he says. For example, faxing a card number to a supplier after an invoice has been approved violates PCI rules. “You can’t send or store unencrypted card data,” he says.

“What is a supplier supposed to do if it has been issued one or even multiple cards by 50 of its business customers?” Bills asks. “Keep them in a spreadsheet? A Rolodex? On Post-Its? Such practice imposes excessive administrative and security burdens on the merchant and won’t be viable in the long run without an automated solution.”