COMMERCIAL CARDS

Turn of a Friendly Card

Citi® Optimized Pay Reimagines AP

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Citi Optimized Pay is an innovative card-based early payment tool aimed at removing friction from AP processes while lowering bank charges and building working capital strength. In a conversation with Tom Alford, Deputy Editor – TMI, Ritesh Jain, B2B Product Head, EMEA Commercial Cards Treasury & Trade Solutions, Citi, explains how this solution is revitalising the world of card-based supplier payment programmes.

There is no question that robust working capital management is important for the success of any business, but the ways in which it can be improved have come under close scrutiny over the past few years. A number of approaches have been put forward, with optimisation of AP by extending payment terms often cited as a key step.

But in the real world, extending terms can come into direct conflict with the need for supply chain resilience. Paying suppliers later can have a disruptive impact on their cash flow cycle, which can lead to supply chain interruptions. Extending terms unfairly also has legal and regulatory implications in some jurisdictions, and most large companies these days actively seek to avoid the negative publicity brought about by the exposure of unfair corporate payment practices.

Meeting these competing demands is a challenge. The idea that card payments can solve the issue has been mooted many times over the years. Certainly, a credit card can be used very effectively by individuals as a way of deferring payment to the issuer until next month. In the business world, T&E and P-cards (commercial cards) are in common usage for the same working capital ends, often with longer terms available. But stretching the commercial card concept into the AP realm has never really taken off, despite its well-understood capacity to pay suppliers early while delaying buyer cash outflows.

Understanding the barriers

So, if conflicting working capital management priorities are satisfied by card payment programmes, and the practice is well appreciated and understood, why have they not been more widely adopted for AP? The answer, says Jain, has three components.

The first and main barrier is cost: cards are seen as expensive payment tools by most suppliers. The supplier taking the card can often be charged anywhere between 2.5%-3.5% of the payment by their merchant acquirer.

Resistance is compounded by the lack of clarity around the exact cost of each transaction. Card payments have a complex pricing structure. The structure is governed by Payment Networks such as Visa and Mastercard, explains Jain. Indeed, cost varies by context: payment through a point-of-sale (PoS) machine, via an e-commerce site, or over the phone, for example, attract different tariffs. The level of data reported by the merchant to the issuer also impacts the cost, as do cross-border versus domestic transactions.

The high cost, and the uncertainty and lack of transparency around it, erects a natural barrier when buyers approach their suppliers to take this payment form. To further dissuade, the actual cost for the supplier is determined not by the issuer (such as Citi) nor by the network operator (such as Visa or Mastercard) but by third-party acquirers that sit in the middle of the transaction. The end-cost is therefore the sum of the complex input costs and the inscrutable margins of each acquirer.

Another barrier to adoption is the burdensome supplier onboarding process. A supplier prepared to accept the cost of card payments will need to engage with an abundance of documentation, including the contract and the KYC certification (occasionally even proof of business ownership), to set up a merchant account. "It certainly can be rather onerous," states Jain.

And assuming a supplier tackles these hurdles, they must then take on the administrative and compliance obligations of handling card numbers, he continues. PCI (Payment Card Industry) Data Security Standard compliance alone carries requirements such as encryption of cardholder data, managing firewalls, updating antivirus software and assigning unique IDs to each person with computer access. "In addition to these compliance costs, the typical AR department will not be set up to process card payments, and will require outlay on setting up the necessary systems," he says.

Having assessed the high cost levels, onerous onboarding, and operational outlays (of the otherwise conceptually robust card payment) as the main barriers to mainstream adoption as a working capital solution, Citi was driven to devise a response. Thus Citi Optimized Pay was born.

Collaborate and solve

Citi Optimized Pay is a collaboration between Citi, Mastercard and Visa, and Swedish fintech Billhop, which is regulated by the country's Financial Supervisory Authority. It solves the problems of adoption, and has proven its workability by some considerable degree.

Traditional card payments require a buyer to provide their card details to the supplier, which will then charge the card but with all the attendant pain points for that to happen. With Citi Optimized Pay, the buyer uses a card account but the payment is routed via the Billhop platform. The payment instruction is converted into a bank transfer, with funds deposited directly into the supplier's own bank account.

What is being offered by the partners is, in effect, a payment translation service, explains Jain. The initial form of payment, the card, is being translated into a bank transfer. The starting point means the buyer retains all the benefits of card payments, but the end point means the supplier does not have to endure the typical cost, onboarding, and operational pain points associated with that mechanism.

> *"Use it when you need it. If you decide it's not the **best approach** for a particular invoice or in a particular month, you can route that payment through your normal bank account"*

Having initiated that payment (as part of a standard ERP payment run, if required), the 'black box' of the Billhop platform executes the payment instruction by charging the buyer's card account. It then converts this card transaction into a bank transfer. The pre-agreed fee associated with the solution is then charged as a separate line item on the buyer's card account. All the supplier sees at its end is its own bank account (which can be with any bank) being credited with that payment.

By re-wiring the mechanics and leveraging technology, Citi has been able to cut the fee to half of that of a typical commercial card payment. And by converting the payment to a bank transfer, there is zero onboarding documentation or extra engagement on the part of the supplier to be paid in this way.

Real-world proof

The partners naturally believe they have a practicable solution for a common set of problems in the uptake of commercial cards as a working capital management tool. But while reimagining the fundamentals is all well and good, the acid test comes only with client adoption and endorsement. Jain confirms that live use of the system to date has indeed secured the real-world seal of approval.

The Deputy CFO of a large, global corporate met with Citi to explain that, as part of the company's finance KPIs, operating account cash balances had to be maintained to preserve certain banking covenants. This placed working capital as a key lever to success. With most of its suppliers already on 60-day terms, DPO extensions were considered neither feasible nor fair.

The senior executive was quick to spot an interesting opportunity. A number of the company's suppliers offered a 2% early payment discount if the invoices were paid within 10 days instead of the usual 60 day terms.

The company saw that if Citi Optimized Pay was used to pay a supplier on day 10, it could afford multiple benefits for both itself and its suppliers:

a) Suppliers would be paid on day 10, significantly improving their cash flow from the previous routine of being paid on day 60. Importantly, this did not come at any incremental cost to suppliers, outside of the 2% discount they'd already contractually agreed to provide.
b) Even though the suppliers would be paid on day 10, there was no cash flow on that day from the company's bank account. In fact, the company calculated, that using Citi Optimized Pay to pay invoices on day 10 actually improved their DPO, as payment terms were now available via the card account.
c) Finally, there was an opportunity for the company to earn money on their invoice payments. As the solution only costs 1.5%, the difference of 0.5% (2% early payment discount - solution cost of 1.5%) was a direct upside.

"The advantage of DPO improvements and the capacity to earn on early payments is complemented by the fact that there is no effort required on the part of the supplier at all," confirms Jain. "And because of that, within the first week of going live, our first client had more than €1m of approved invoices processed through Citi Optimized Pay."

Adding value

Once a buyer has identified and understood the value of the solution, all that is required is for it to execute its payments, says Jain. There is no need to negotiate contracts with suppliers already offering early payment discounts. As far as they are concerned, they are simply receiving a bank transfer in early settlement of their invoices, as per their established contractual agreements.

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Buyers may need to discuss the mechanism and terms with those suppliers not already offering early payment discounts, just to see if they will be interested in taking part. And while some may have been deterred by the "fairly intensive engagement" required to take part in buyer-led SCF programmes, he reiterates the fact that, because suppliers do not have to do anything to take advantage of this fully bank-agnostic programme, Citi Optimized Pay can be a really good complement to SCF. Specifically, for suppliers who find it onerous to comply with extensive documentation requirements for SCF programmes, Citi Optimized Pay can be a practical alternative.

The solution is highly flexible in its deployment too. In another use-case scenario, Citi explored its potential with a client that makes ongoing commercial rent payments. Although the client had an agreement that offered a 5% discount for paying quarterly rather than monthly in advance, its working capital needs meant it was unable to leverage this offer.

Citi suggested using Citi Optimized Pay to make the quarterly advance rent payments, knowing that the 5% discount would give it arbitrage over the solution's 1.5% rate, and that it could offer terms that would require settlement only at the end of the quarter. "It gave the client an average DPO improvement of 53 days, a significant 3.5% upside on its costs, and again, meant no engagement necessary on the part of the supplier," says Jain.

Naturally, Citi is working with other clients to explore further AP categories where discounting arrangements exist, including a rising number of major global corporations. The annual insurance premium payment has been revealed as an example, with discounts often offered over monthly payments. Some utilities also extend discounts for upfront payment, as do businesses providing annual maintenance contracts. It is easy to see how the concept could be applied to an ever growing list of categories.

Having witnessed the system in action, Jain believes that the benefits of Citi Optimized Pay will make sense for an increasing number of corporate buyers as a payment tool. The lack of effort required for their suppliers to also enjoy the advantages, across a broad spectrum of AP scenarios, is further enhanced by the knowledge that neither party is compelled to use it for every invoice payment. "Use it when you need it," he comments. "If you decide it's not the best approach for a particular invoice or in a particular month, you can route that payment through your normal bank account."

The solution gives options, and in delivering an innovative take on the commercial card concept, Citi and its partners have removed the main barriers to its adoption. But as client use cases to date demonstrate, Citi Optimized Pay is more than just another payment option: it is a working capital optimisation solution.