WRITTEN BY SPEND MATTERS™

A next-generation virtual card solution, exclusively by Mastercard

The virtual card market today

We all know the world is increasingly becoming more digital. As a finance or procurement professional, you see how digital promotes massive changes around the way you buy. Technologies including predictive analytics, data accuracy, machine learning, spend analysis, procure-to-pay, along with marketplaces and e-commerce are accelerating. Many organizations are also investing aggressively in digital technologies that they believe can enhance operating efficiency and cost savings while improving overall performance and competitiveness that affect purchase-to-pay functions.

However, one process that has been slow to change is supplier payments. While there have been significant inroads made in converting suppliers paid by check to electronic means, mainly ACH, wire and sometimes virtual card, businesses are still heavily reliant on paper-based processes and manual payment procedures. Paper checks continue to endure as a primary means of B2B payments, even after factoring in recent declines. The **2019 AFP Electronic Payments Survey** revealed that "check usage for B2B transactions declined to an all-time low to 42 percent, although it is still the most popular payment method for B2B transactions."[1] We can expect these trends to continue to be driven by the treasury's desire for electronic payments, and procurement and AP departments need to move away from manual processes in general.

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The fact that COVID forced many employees to work from home, including those responsible for paying by check (cutting, signing and mailing) and those responsible for receiving checks (collecting, sorting, depositing and logging) made many professionals realize there had to be a better way in today's digital age. These, among other considerations, increasingly lead procurement teams to explore virtual cards. Prior to COVID, the B2B virtual card market comprised nearly $200B of annual payment flows in North America. ***Mercator now estimates the virtual card market will grow to $500B by 2025.***

Virtual cards differ from their hard plastic cousin, the purchase card, in several ways. To start, virtual cards use a uniquely generated card number, expiration date and security code as a proxy to a traditional plastic card or paper check for a one-time, specific-amount payment. These layers of control provide businesses and their account holders with a high level of added security.

1 J.P. Morgan. 2019 AFP Electronic Payments Survey.
2 Source: Hackett Group.

Commercial cards were once the sole way to pay for travel and entertainment expenses. Use cases expanded over several decades as businesses paid suppliers for maintenance, repair and operations with hard plastic purchasing cards. More recently, businesses have sought to leverage virtual cards to pay their accounts payable.

Despite that initial push, virtual card payment volumes in B2B, relative to other payment types, are small. Today, Mercator estimates the market for all commercial card products (T&E, purchase cards and virtual cards) is just 2.3% of the total commercial addressable spend for North America. However, due to growing popularity with procurement teams, they forecast the virtual card market to grow at a 24% CAGR over the next few years from this relatively small base.

Challenges limiting virtual card adoption

Credit cards are universally accepted in B2C transactions, because unlike B2B transactions, there are no terms. You wouldn't think to go to your local coffee shop and, upon taking your coffee, offer to pay 60 days later. B2B merchants generally do not collect payment when their goods or services are provided. B2B buyers purchase items and negotiate payment terms with the supplier of 30, 60 or even 90 days. In that process suppliers finance the transaction and act like a bank for their customers.

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Extended payment terms and late payments create a long-standing point of friction with suppliers that is difficult to navigate. U.S. companies on average took 58 days to pay suppliers in the first quarter of fiscal 2021, up 5.5% from 55 days in the comparable period in 2020.[2] Payment term extensions are happening across industries because delaying payment is a powerful working capital tool.

Historically, buyers sent checks via mail and suppliers posted checks into their ERP systems against the buyer's accounts. Electronic payments have reduced check volume and suppliers accept ACH and wire payments (lower-cost alternatives) requiring them to reconcile payments, with invoices and cash received. This is no simple matter.

Purchasing cards and virtual cards give buyers another option to pay their sellers. There are significant benefits buyers realize when using virtual cards for supplier payments. With virtual cards, buyers can 1) potentially defer payment to when the card statement is due, which varies by customer and can range up to 60 days and 2) earn rebate income negotiated with their issuer. Additionally, using virtual cards, buyers can lower costs through automation by displacing check payments, simplifying reconciliation and capturing enhanced data for each transaction.

2 Source: Hackett Group.

Another challenge for suppliers is that virtual card payments often must be processed manually.

But from a supplier's perspective, virtual cards do little to solve their goals of getting paid fast and efficiently. Both fintechs and banks manage vast supplier enablement campaigns — asking suppliers to accept virtual cards for payment. Typically, suppliers are not offered payment acceleration at all, or if they are, it is usually limited; suppliers may receive an offer of payment 10 or 15 days sooner, for example. If they are on 60- or 90-day terms, 10 days will not change their working capital situation, especially if they have to pay a 2% or 3% merchant discount.

Another challenge for suppliers is that virtual card payments often must be processed manually. Currently, suppliers receive an email in their AR department indicating they have a credit card payment. The supplier has to click a hyperlink from the issuing bank, log in and manage credentials to that bank account to see the full number. They then can see a list of invoices that are being paid in a different portal. Next, the supplier must key that transaction into its own ERP system. Overall this is a highly manual and expensive process, and Mercator estimates that roughly 90% of virtual card transactions in North America are processed this way. Check, ACH and wire payments do not have a perceived pricing challenge, where card acceptance does.

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These challenges with supplier adoption create barriers for buyers as well.

In a 2020 AFP study on epayments, most practitioners cited major and minor barriers impacting their organization's use of electronic payments. When examining both the major and minor barriers, 79% of respondents cited a lack of supplier adoption.

Many AP automation platforms have added virtual card technology to help their clients pay suppliers. But according to Mastercard's own survey, 75% of U.S. corporations using card for AP payments do not feel they are realizing the full potential of this payment method. Further, 70% of companies believe they could more than double their spend on card if they were able to overcome resistance from suppliers.

So how is Mastercard addressing the challenges holding back virtual card adoption in B2B?

1 J.P. Morgan. 2019 AFP Electronic Payments Survey.
2 Source: Hackett Group.

A solution to accelerate supplier adoption

Mastercard is introducing Track Instant Pay — a next-generation virtual card solution that pairs sophisticated machine learning with straight-through processing to authorize instant payments to suppliers when they submit an invoice — automatically. Track Instant Pay is in essence an evolution of the virtual card, and an entirely new way to pay in B2B.

It is vastly more efficient and effective than checks, ACH, or even the traditional virtual card products in use today.

When suppliers submit invoices to their customers, Track Instant Pay uses machine learning to analyze the invoice data, identifying the few invoices that are likely to be rejected, thereby enabling the vast majority to be authorized for payment the day they're received. Funds are deposited automatically into the supplier's bank account in just a few short days — no emails to process. With Track Instant Pay, procurement teams can tell their suppliers, "We will pay you a few short days after you submit an invoice — automatically."

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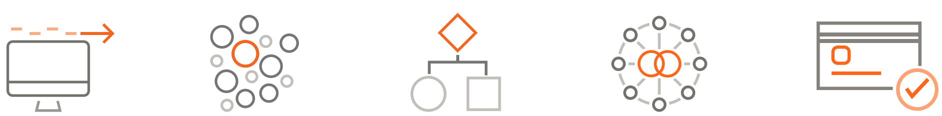
This solution is significantly different from other payment methods (e.g., check, ACH, etc.), where payment depends on lengthy, manual invoice approvals and payment processing. By leveraging the latest advances in machine learning, Track Instant Pay enables payment shortly after a supplier submits an invoice, safely and securely.

It's important to note that approval process, the buyer maintains their existing approval process, which Track Instant Pay sees the results of, and importantly, learns from.

Track Instant Pay does not remove any controls from a buyer's approval process; it simply allows the payment to run independent of that approval, under specific circumstances and with strong controls, backed by a powerful machine learning platform.

How Track Instant Pay works

Start	Next	Day 1	Day 3	End of grace period
Buyer sends new invoice to Instant Pay	Track Instant Pay analyses invoice data	Track Instant Pay initiates payment	Settlement is executed	



Buyer transmits new invoice data daily via a secure file transfer	Instant Pay's artificial intelligence analyzes invoice data and authorizes invoice for immediate payment	Instant Pay generates a VCN and transmits the VCN for straight through processing	Following Mastercard network settlement, funds are deposited in the supplier's merchant account	Buyer settles outstanding credit line with their issuer per their normal process and receives their rebate

2 Source: Hackett Group.

Paying invoices instantly and efficiently directly addresses traditional supplier resistance to virtual cards in the following ways:

1. **Suppliers get paid faster.** Track Instant Pay offers the maximum amount of payment acceleration of any payment method in the market. A supplier on 60-day terms can reduce their DSO by 57 days, drastically accelerating their cash flow and offsetting the cost of card acceptance. In terms of working capital benefit, there is a big difference between paying 2.5% for payment on day 60 versus paying 2.5% for payment on day 3. With cash in hand, suppliers can reinvest those funds back into their business, allowing them to improve the quality of their services and grow.

2. **Suppliers eliminate the cost of chasing collections on their open invoices.** A 2020 study of SME suppliers in the UK showed that the average SME supplier was chasing five outstanding invoices at any point in time, eating up 1.5 hours per day. Track Instant Pay eliminates these costs for the supplier — no need for them to call customers multiple times asking about the status of an invoice or spending time tracking the aging of receivables over a two- or three-month period.

3. **Suppliers eliminate the manual work involved with receiving and reconciling traditional virtual cards.** As noted previously, traditional virtual card transactions require a supplier to manually process an email to access their funds, creating significant friction. Track Instant Pay leverages straight-through processing for all transactions, meaning funds are automatically routed through the Mastercard network to the supplier's merchant bank account. What's more, Track Instant Pay provides rich remittance with every payment, far beyond what a supplier receives with checks or ACH, simplifying reconciliation.

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From a buyer's perspective, the attraction of Track Instant Pay is obvious. This program can convert a much more material portion of your spend from checks and ACH to virtual cards, where you earn a rebate rather than incurring costs. At the same time, you will have better line utilization and thus can optimize the use of the credit line tied to your virtual card program. Also, you will eliminate the AR/AP chase scenario, where suppliers spend an inordinate amount of effort chasing payment, and AP personnel spend the same amount of time researching and responding to supplier inquiries. In summary, with Track Instant Pay buyers can:

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- **Increase revenue** — convert check and ACH suppliers to virtual card, where you earn a rebate.
- **Manage working capital** — realize the benefits of using the credit line tied to your commercial card account and with the potential benefit of a grace period, which can defer a payment.
- **Automate processes** — automate manual processes and eliminate inbound calls and emails from suppliers chasing payment on their open invoices.
- **Enhance security** — unique, dynamically generated virtual card numbers, with layers of controls, secure your supplier payments and you no longer need to hold and safeguard supplier bank account information.
- **Improve relationships** — eliminate the friction created from long payment terms and enhance your corporate reputation as a valued partner.

1 J.P. Morgan. 2019 AFP Electronic Payments Survey.
2 Source: Hackett Group.

Summary

Mastercard's Track Instant Pay product can help buying organizations expand the reach of an existing virtual card program, or it can be a great way to get started with virtual cards for the first time.

Track Instant Pay has broad applicability across a large enterprise buyer's total supplier ecosystem given its rich value proposition.

We know investing in epayments takes a commitment and digital adoption isn't easy. Mastercard's Track Instant Pay can be part of a holistic payment strategy that helps you to automate and digitize your supplier payments.

The questions procurement should be asking around this topic include:

- How can procurement and treasury help support payment operations to drive more effective payment options to our total supplier base?
- How are we paying our suppliers today, and is it effective?
- On what terms are our virtual card payments accepted? How can we communicate with suppliers that Track Instant Pay will allow them to offset much of the MDR cost through cash acceleration, operational efficiencies through cash acceleration and operational efficiencies?
- How do we convey the value proposition around virtual cards, and in particular Mastercard Track Instant Pay, to reflect a fair payment method evaluation?

Mastercard's Track Instant Pay opens up a new value proposition for virtual cards.

Mastercard Track Instant Pay opens up a new value proposition for virtual cards. It takes the traditional analysis suppliers and AR teams use when comparing payment models from a purely operational and explicit fee conversation to one where working capital, collection costs and remittance data is front and center.

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2 Source: Hackett Group.