



## Red, White and Green

*The expanding government sector can bring profit to creative ISOs, processors and acquirers*

By Richard H. Gamble

**T**he federal government has served notice that it is raising the stakes for purchasing-card issuers that want its business. Ripples from its new request for proposal (RFP) are reaching suppliers, who must accept card payments and who will soon have to meet tougher data requirements and support more sophisticated procurement procedures. And that spells opportunity for ISOs, processors and acquirers that can help these suppliers deliver what the government expects—and increase their business in the process.

What's in play is SmartPay, the world's largest purchasing-card program—a \$14.5 billion behemoth administered by the General Services Administration (GSA). That program saves the government an estimated \$1.4 billion annually through lower procurement overhead. It also earns the government nearly \$100 million in rebates, reports Rick Malcolm, head of Visa's government card program. While 65 government agencies participate in the program, volume is definitely top-heavy. The top 20 agencies account for 96 percent of the card-based spending, the top 10 for 87 percent and the top five for 72 percent.

The SmartPay contract is coming up for renewal next year. In the RFP, the GSA describes what it expects from issuers for SmartPay2. "The government has signaled that it's looking for robust data mining to support improved strategic sourcing and control fraud and misuse," Malcolm observes.

The new RFP is creating a stir within the merchant acquiring community, says Aaron Bills, chief operating officer of 3Delta Systems in Chantilly, Va. "Increased p-card use is converging with improvements in the accounts payable and accounts receivable processes. The whole market is vibrat-

ing. We're seeing the agenda for B2B purchasing-card development for the next 10 years." P-card activity (use of cards for corporate and government purchasing) is now an \$18 billion market and growing nicely, he notes.

It's a good market for acquirers and processors but a specialized one, Bills says. Processors and ISOs wanting to enter the rich market of government suppliers must be able to make a sophisticated sale and support it with a flexible range of services, he says. "Government suppliers require a multi-faceted solution. You have to listen, understand the underlying business process and then wrap a somewhat customized solution around it." That's true of the B2B market but especially true for the government sector, he adds.

Acquirers won't be talking to mom-and-pop owners, but to a corporate controller, treasurer or CFO, someone who is not easy to see and who expects efficient, responsive presentations if meeting with a salesperson, Bills points out. Understanding interchange is critical, he adds. "You need to offer segmented interchange and explain pricing to people who will ask plenty of sharp questions." It also means that ISOs must approach sales prospecting differently. "You can't see most government suppliers from the street. It's not like walking into a dry cleaner. You have to learn to use the government Web site to identify contractors and find out where they are located."

### Reaching Level 3

The biggest issue is reporting line-item detail for everything that was purchased in a given transaction, known as Level 3 data. The federal government wants all that data, and quite a few government suppliers and their acquirers, processors and ISOs still can't deliver it. "The average processor or ISO is not set

up to supply Level 3," says Diane Merrigan, director of B2B market at Heartland Payment System in Princeton, N.J. "It can't be done on the normal merchant terminal. It can only be done on a virtual terminal or on special software." Most suppliers default to their primary bank for merchant services, she notes, even when that bank is not certified to provide Level 3 data.

The GSA wants Level 3 data on all transactions to go with the new data mining and analysis it is asking for in its RFP, both to enhance strategic sourcing and to curtail waste, fraud and abuse. An itemized hotel bill is a lot more revealing than a transaction total and date, notes Mallory Anderson, strategic implementation manager for government card services at Bank of America in Charlotte, N.C.

Falling short of Level 3 can be costly. Visa research among government purchasing agents found that they would do 25 percent to 35 percent more business with suppliers that provide Level 3 data, Merrigan reports. By capturing and reporting Level 3 data, suppliers qualify for a lower interchange rate and improve their chances of getting more business, she points out.

The federal government strategy of better management through better tools and data "will require more cooperation from suppliers and will present opportunities for ISOs and merchant processors to support the delivery of Level 3 data, which is becoming a requirement for core suppliers," Bills says.

How do suppliers capture that data? Typically, a government purchasing agent calls the back office of a supplier, Merrigan explains, where someone using a virtual terminal or appropriate computer software will type words in the fields provided, describing each item that is being purchased. They also can type in an order number or

contract number in the appropriate field. Level 3 data are attached to the transaction and come out on the cardholder's statement.

### Low attrition, low risk

What's attractive about capturing the business of government suppliers? Much lower attrition is one benefit, Merrigan notes. Heartland has specialized in B2B and B2G supplier services for eight years. "You have to understand this market deeply, including the supplier's workflow, and build a somewhat customized solution that reflects government requirements and the supplier's workflow. Both sides have a lot invested in the relationship and work to preserve it," she explains.

Low risk is another benefit. Even though a government purchasing agent calls the supplier by phone in the typical transaction, which means the card is not present, the risk is lower, Merrigan says, because this is repeat business and the two parties probably know each other. The tighter controls found in p-cards also limit risk, she adds. "These are businesses with stable contracts with the government," says Donna Embry, senior vice president for product strategy at Payment Alliance International in Louisville, Ky. "They're not likely to close up shop."

The profit margin is solid, but the front-end investment in staff training and the long sales cycle make profit anything but quick, Merrigan says. It's a labor-intensive business with lasting rewards for those who make the investment in fashioning complex solutions for complex business processes, she says.

"This is definitely not a feet-on-the-street market," Embry says. "It's a true relationship that involves managing portals and gateways. It's challenging, which creates real opportunities for creative ISOs and processors that can meet the challenge."

Not every processor finds the requirements so complex. In simplest terms, a government transaction is like any other on the Visa or MasterCard rails. Other than software to capture and report Level 3 data, a supplier to the government needs no different systems

or technology than a merchant selling to consumers from a mall store or Web site, says Vin Perrelli, chief operations executive for the U.S. at Global Payments in Atlanta. Global is processor to a range of government suppliers, and the suppliers are not making unusual requests for help dealing with their government transactions. "Their needs are very much like any other merchant," Perrelli insists.

The way a government, corporate or consumer transaction flows through the card-based payment systems is identical, but the business rules surrounding the payments are far different and must be accommodated, Embry says.

Size matters, says Jeff Pape, senior vice president for product management at U.S. Bank Corporate Payment Systems in Minneapolis. U.S. government transactions under \$2,500 are



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—Aaron Bills, COO, 3Delta Systems

likely to resemble consumer transactions, while larger transactions are likely to be tied to contracts, initiated by professional purchasing agents over the phone or Internet and subject to more complex business rules and processes, he explains.

For example, the government has long limited fuel purchases to \$75, but with today's high prices, the government is moving to boost the limit to \$150. Fuel providers must make changes in their systems and sometimes even at individual pumps to reflect the new cap, says Katie Buck, head of the government card services unit at Bank of America. Moreover, there is a move afoot to track the percentage of environmentally friendly fuel, such as ethanol, that government agencies buy. That, too, is data suppliers would need to capture and report, she adds.

### More buyer control

Government transactions are distinct in that many payments are initiated by the buyer, not the seller, and don't settle within 72 hours, Bills says. Large transactions are approved for payment only after the goods or services have been received and found to be satisfactory, he explains. Then the government approves payment by card where they used to settle by ACH transfer or check, he notes. "We're seeing an evolution in the B2B and B2G space of more buyer control over payment activity and timing," Pape agrees.

"The card is morphing into a payment mechanism that is embedded in procurement processes. The supplier needs help bringing card-processing technology in line with the buyer's business requirements, which may include traceable transactions, inter-

nal controls for Sarbanes-Oxley compliance and automatic reconciliation features. Only complex, integrated solutions can meet the test," he says.

ISOs and processors that capture government suppliers' business will find themselves on the leading edge, dealing with technology and services that they will be able to use down the road. "A lot of today's standard practices—online access and Level 3 data capture by merchants—started out as government initiatives and moved into the broader marketplace," Visa's Malcolm notes. Visa is now working on a new tool, to be announced later this year, being built for the new GSA requirements to support strategic sourcing. It will be available for use by state and local governments, as well as the private sector. **TT**

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