TSYS

White Paper

Implementing a Successful Commercial Card Program in Turkey

Avoiding Pitfalls: Lessons from the U.S. Experience

By Berrak Ciftci

EXECUTIVE SUMMARY

Turkey is a country known for its strategic importance and active economic and political roles on both sides of the European/Asian divide. The high activity level does not end with geopolitics, however; Turkey has a very active commercial cards and payments market.

The use of commercial cards to facilitate transactions between businesses is growing worldwide. For purposes of this report, commercial cards are defined as payment mechanisms used specifically for business-to-business transactions, including corporate travel and entertainment (T&E), fleet and purchasing cards. Visa's annual index for global Commercial Consumption Expenditure (CCE) — measuring business-to-business and government-to-business spend — reached $109.1 trillion in 2011, a 12-percent increase from 2010.[1] According to Tad Fordyce, head of Global Commercial Solutions for Visa Inc., "Underneath this growth lies a clear opportunity for issuers and corporations, financial and non-financial institutions, to optimize their commercial card programs, to capture more spend with electronic payments and, ultimately, to better meet the needs of their commercial and government clients."[1] According to a Visa survey, the Central/Eastern Europe and Middle East/Africa region, with 17.4 percent year-over-year growth rates in commercial spending, is second globally only to the Latin America/Caribbean region (19.4 percent).[1]

The U.S. is an interesting point of comparison, as it is the most developed commercial card market in the world. In 2011, commercial cards were used to purchase $374 billion worth of goods and services for U.S. businesses and government offices.[2] Mercator Advisory Group forecasts this market will see a compound annual growth rate (CAGR) of 18.4 percent from 2011 to 2015.[2] This growth rate is particularly impressive considering the maturity of the overall card market. The contrast in growth opportunities for emerging markets, which are largely still in nascent stages, is even more intriguing. While the emerging giants that Goldman Sachs refers to as the BRICs (Brazil, Russia, India and China) have accounted for most of the emerging markets' growth over the last two decades, the Next11 — yet another Goldman term — of the 11 developing economies beyond the BRICs, including Indonesia, Mexico and Turkey, are also being touted for their high-growth potential. According to Visa's CCE Index, Turkey's commercial consumption expenditure was rising steadily until the global economic slowdown of recent years — the figure of $1,100 billion in 2011 was just 10 percent higher than that of 2008 (See Graph A). Still, Turkey's CCE is not only one of the largest in the emerging payments market. It is also ranked seventh in Europe, just behind The Netherlands, and the country's growth in the commercial card market is consistently robust. In an interview with business journal *Para Dergisi*, Garanti Bank Payments System General Manager Mehmet Sezgin noted, "The most important reason for card use is the growth in commerce in recent years, coupled with the increasing tendency of enterprises to work more closely with banks. In the last five years, active commercial card numbers increased by 400 percent."[3]

This report looks specifically at the emerging opportunity to expand commercial card usage in Turkey. The paper begins by outlining key drivers of commercial card adoption in the U.S. market that could also help propel Turkey's commercial card market. The report then discusses three key insights for penetrating and developing a commercial card market in Turkey based on lessons from the U.S. market, as well as forecasting how it could evolve. The first insight entails understanding the opportunities

Types of Commercial Card Payments

Commercial cards come in many formats around the globe.

Common types of cards include:

Corporate/T&E*
- Provides a general credit card payment method for employees of businesses
- Covers employees' travel and entertainment expenses

Purchasing (P-Card)
- Allows organizations to make business-to-business (B2B) electronic payments for a variety of expenses

Distribution
- Helps distributors and suppliers streamline their sell-to-collect process, improving management of receivables, cash flow and risk

Payroll
- Provides an alternative to payroll checks on a reloadable, prepaid card

Small Business
- Offers higher credit limits than consumer
- Features looser restrictions

Fleet
- Enables payment, monitoring and managing of fleet-related expenses

Farm Card
- Allows farmers to pay after the harvest

**Travel & Entertainment (T&E) are corporate cards.*

and challenges of introducing commercial products in Turkey, based much on U.S. experience. The second involves identifying market opportunities by card type. The third relates to the importance of developing solutions specific to organization type, whether large or small businesses, government agencies or multinational corporations (MNCs).

THE MARKET OPPORTUNITY & DRIVERS FOR TURKEY'S CORPORATIONS

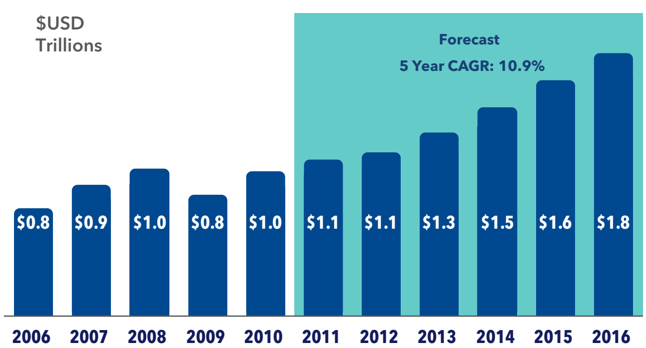
Changing Consumer Attitudes and Behaviors on Card Usage

The full benefits of a properly implemented commercial card program are currently under-realized in Turkey, and the timing is favorable for issuers to review their engagement in this realm. Penetrating Turkey's commercial market requires a continuing shift away from culturally-based attitudes that make some of the country's population predisposed to cash-based transactions. However, a burgeoning middle-class economy has helped spur more consumers to adopt cards in recent years. According to Interbank Card Center (BKM), a clearing house established by a consortium of Turkish banks, Turkish consumers are more apt to use credit cards than consumers in many other emerging markets. The report reveals that there were 54 million credit cards in December 2012, or 0.67 cards per capita,[4] compared with 0.015 in India, 0.2 in China and 0.8 in Brazil.[5] Moreover, Internet banking and ATM networks are already widely used by Turkey's consumers, suggesting that both the infrastructure and appetite exist for cards as a payment mechanism.

In line with fast-rising card adoption levels, Turkey's population is among the Next11's leaders in financial expertise and education. Consumer card default rates in Turkey, averaging less than eight percent from 2009 to 2012,[6] are low relative to other emerging economies — Brazil's, for example, has been more than 20 percent over a similar period.[7] Moreover, consumer banking has been revolutionized globally by the widespread adoption of smartphones and the ability to conduct basic transactions from virtually anywhere. The accessibility and efficiency of smartphones has led consumers to expect the same technological conveniences at their workplaces — often dubbed the "consumerization of IT." As a high-growth market, Turkey also has a population eager to replace cash and check payments with credit. According to the Central Bank of Turkey, Turkish households' purchases with plastic have climbed year-

Graph A

Turkey Commercial Opportunity



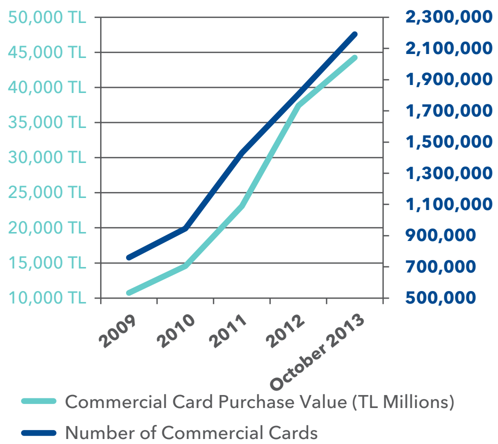
Source: Visa 2011 Turkey CCE report

over-year at a 19 percent CAGR from 2007 to 2012, as shown on Graph B. As commercial credit cardholders are consumers as well, increased financial awareness and higher expectations among Turkish consumers are likely to influence commercial card behavior.

From a relatively small base in 2005 Turkey has witnessed tremendous year-over-year growth in the usage of commercial cards. As businesses of all sizes increasingly recognise the value of moving to commercial cards continued aggressive growth will be realised. In fact, the growth of commercial card spend, at over 30 percent CAGR as shown in Graph B has outpaced consumer over a similar time frame.

Graph B

Growth of Turkish Commercial Cards



Source: BKM

Despite this impressive percent increase, however, there remains tremendous growth opportunity. As shown in graph C, the 23 Billion TL spent on commercial cards in 2011 represents a mere one percent of the total business-to-business expenditures.

A few factors are negatively affecting the adoption of commercial cards in Turkey. First is the market's overall unfamiliarity with the product. Second is the common perception among Turkish issuers that the functionality of commercial cards is still predominantly consumer-focused and lacks commercial-specific features, such as expense reporting or the integration of corporate spending policies. Third is that the currently available card products carry high fees, whether upfront, annual or monthly. Shifting to commercial card-specific technology and controls would help reduce fraud potential and, in turn, reduce card fees.

Pros and Cons of Issuing Commercial Cards Instead of Consumer Cards

Pros:
- Credit limits not subject to tighter regulations
- Lower risk / less bad debt
- Greater card usage
- Improved account performance
- Lower attrition
- Less sensitivity to price
- Analytics enable better controls

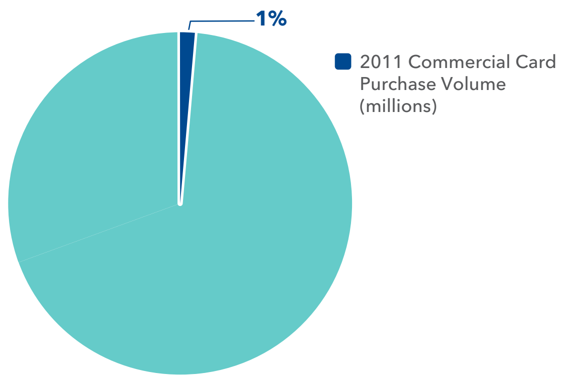
Cons:
- Lower interest income
- Increased costs (e.g. additional transaction reporting)
- Greater need for customer service
- Can be expensive and difficult to acquire new customers

The latent yet growing demand for commercial cards in Turkey amplifies the need for corporations to look anew at this opportunity and better understand how Turkish companies could benefit from greater card adoption. The volume of commercial card payment transactions has grown tremendously since 2002. As of August 2013, commercial credit card outstandings totaled 4.5 billion Turkish Lira.[8]

In the U.S., commercial payment cards provide efficiency and cost savings over paper payments such as checks. This opportunity for increased efficiency, automation and simplicity could be compelling to Turkey's large and mid-sized businesses.

Graph C

Share of Turkey's 2.2 Trillion TL Business-to-Business Spend on Commercial Cards



Source: Visa 2011 Turkey CCE Report & BKM

Potential Commercial Card Drivers in Turkey

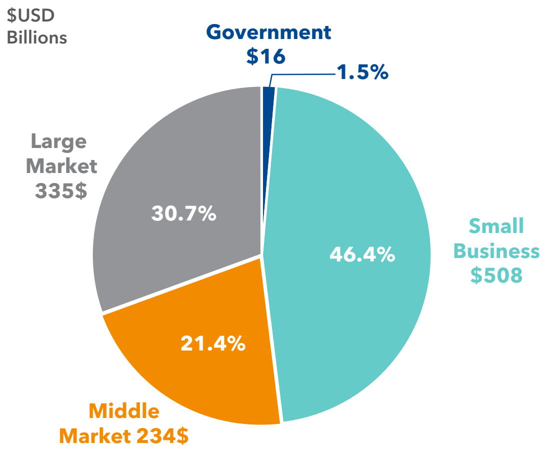
Turkey's commercial card market growth could be driven by the increase in MNCs in the country seeking efficiency, transparency and overall streamlined processes. According to the 2012 United Nations' *Global Investment Trends Monitor*,[9] while global foreign direct investment (FDI) decreased by eight percent in the first half of 2012 relative to the same period the year before, FDI in Turkey actually grew by 20.8 percent. For a variety of reasons — including Turkey's large market size, their burgeoning middle class and perhaps its seeking of footholds in anticipation of a possible EU membership — MNCs have sought to enter the Turkish market or expand existing market presence.

While MNCs and larger firms are suited to lead the charge in commercial card adoption because of their familiarity with the product, many of these firms are apt to be serviced by global banks. For regional and local issuers, there is great potential to bring scale to their commercial card programs through the small- and medium-tiered enterprises (SMEs). The sheer volume of SMEs accounts for the majority of opportunities in the commercial realm. As shown in Graph D, at $742 billion, small- and middle-market enterprises comprise 67.8 percent of the total market opportunity in business-to-business spend.

Regulatory pressures will provide a very potent push toward commercial cards for those smaller enterprises whose finances rely on consumer loans via credit cards.

Graph D

2011 Turkey CCE Distribution



Source: Visa 2011 Turkey CCE report

As of 2011, the Turkish government communicated its intent to introduce a range of new regulations that would impact the financial cards market.[10] New regulation introduced includes a single credit limit imposed on every individual consumer. No matter how many credit cards he or she holds, a single credit limit will apply across the total cards. Recent amendments announced by the Turkish Banking Regulation and Supervision Agency advised that those applying for a credit card will not be permitted to exceed twice the amount of their monthly income in the first year of ownership. In the following years they would be limited to a maximum of four times the cardholder's income.[11]

It is worth noting for this report that commercial cards are exempt from this single-limit practice in accordance with companies' business needs, and the anticipated impact of these regulations only serve to highlight the opportunity that commercial cards can pose for issuers as a strategic channel for growth going forward.

Another potential catalyst for commercial credit growth could be a change in how businesses perceive credit. Until recently, cultural norms in Turkey dictated that only a select few senior executives within an organization carried corporate credit cards. But that's changing as more companies begin to understand the value of cards. Turkey's adoption of commercial cards creates opportunities for corporations to realize significant improvement in a range of areas, including reduced costs, improved cash flow, less risk of payment fraud and greater satisfaction among buyers and suppliers. In addition, it offers all stakeholders the ability to capture and analyze more payments data, ultimately allowing for smarter decision-making and the improved financial health of organizations.

Driver #1: Reduced Costs

The continued growth of commercial card programs worldwide reflects the payment industry's trend toward the adoption of electronic payments and away from paper-based ones. Issuers have the opportunity to create new revenue streams by offering a commercial card program to Turkish businesses which also provides valuable cost-reduction measures. According to Paul Horn, the global product manager for Citibank's commercial cards, "It is estimated that (commercial) card programs can deliver savings of more than 75 percent in the administrative cost of procuring and paying for a good or service over the traditional purchase order-based process."[12]

Commercial Cards Program Benefits Across the Value Chain

Issuers
- Expansion into market with low penetration
- New revenue stream
- Data analysis and reporting

Suppliers
- Data analysis and reporting
- Decreased days sales outstanding (DSO) and improved cash flow
- Automation that reduces paper usage, increasing processing efficiency

Retailers
- Enhanced visibility
- Improved health of organizations' P&L
- Expanded credit/leverage float

Government
- Reduced leakage rates
- Improved compliance
- Disbursement of benefits/social schemes

Corporations
- Rule-based spending
- Increased visibility/reporting
- Greater efficiency of processes

Commercial card programs can reduce business costs in several ways. The automated billing procedures provided through commercial cards can reduce costly billing errors such as lost checks and duplicate payments. The data and analytics provided by a card program can help a business streamline its expenditure management. Loyalty and reward programs provide valuable benefits to companies and their employee cardholders. Denizbank's small business card in Turkey, for example, offers a loyalty program through which a defined percentage of every transaction is given as reward points.

Driver #2: Improved Cash Flow

Streamlining the payment process through a commercial card program enhances visibility into payments and expenses, especially for businesses with multiple vendors. According to Paul Horn of Citibank, commercial card programs increase "the ability to control the timing of electronic settlement, making cash flows more manageable and predictable, as well as improving transparency, auditing capabilities and forecasting."[12]

The ability of organizations to use commercial cards to extend credit to vendors or have more time to pay their own bills could be very appealing. Furthermore, just having a credit line could give businesses leverage to negotiate new and more favorable trade terms — another benefit corporations could tout.

Driver #3: Less Risk of Payment Misuse

Within the consumer payments market, card fraud is a major concern; however, it's less of a problem in the commercial space. Instead, businesses are more concerned about "misuse," which occurs when employees fail to adhere to company spending policies such as the allowed purchase types or the expensing limits on various purchases. When the right card procedures and policies are implemented, corporate card usage can actually help companies reduce employee spending misuse and promote adherence to company spending policies among both employees and third parties. As corporations continue to concentrate on areas they can most control in the short term, namely costs and wasteful expenses, they should increasingly look to the central function of commercial cards — controlling risk. Leading solutions already enable restrictions of purchases to select merchant category codes. For example, an employee who purchases office supplies could be restricted from using his or her commercial card at a restaurant or bar, and an attempt to do so would result in a failed authorization.

INSIGHTS FROM U.S. EXPERIENCE TO HELP ACCELERATE PENETRATION OF TURKEY'S COMMERCIAL CARD MARKET

The U.S. market's extensive and successful use of commercial cards provides a lens for examining how to propel commercial card programs within Turkey. The tipping point for commercial cards in the U.S. came in the early 1990s, when corporate executives realized the power of electronic payments beyond travel and entertainment (T&E). Automating business-to-business payments with purchase cards delivered cost savings and better control over micro-purchases — financial transactions involving very small sums of money. U.S. online payment provider PayPal defines micro-purchases as those valued at less than 6 U.S. dollars, or about 12 Turkish Lira.

The three segments of commercial cards in Turkey — corporate cards, small business cards and farmer cards — typically offer loyalty programs and have their own statement calculation method. However, whereas corporate cards are issued to companies, farmer and small business cards are issued to individuals. An important feature of farmer cards is a flexible payment option whereby farmers can delay paying until harvest time. In terms of number of cards, farmer cards predominate, followed by small business cards, with corporate cards making up the smallest portion.

Below are three insights gleaned from the robust U.S. commercial credit card market that could help FIs facilitate the growth of commercial credit in Turkey.

Insight: Identifying the Right Payment Opportunities by Payment Type

Both the public and private sector in Turkey could benefit from commercial card programs. However, corporations implementing such programs must understand the types of programs and cards that would best serve a particular segment. A report from Tower Group, *Global Commercial Cards Outlook*, points out that opportunities for prepaid cards for travel, procurement and fleets "are greatest in regions that are less credit savvy, both culturally and in risk determination."[13] Cards for lower-value and higher-volume payments could include purchasing cards (P-cards), prepaid, T&E and fleet cards. Today, much of the focus is on P-cards, but a significant opportunity exists across the spectrum.

Purchasing Cards (P-Cards)

P-cards present multiple features and benefits for corporations purchasing a high volume of low-value products and services. One primary benefit is automation of the purchase-to-pay process without the three-way match process. This is a manual process in which an invoice is received by a purchaser and matched to a packing slip and to a purchase order in the accounts payable process. In the event that any of the elements are not exactly in order, the invoice payment is likely to be delayed. Further, as mentioned earlier, P-cards provide tighter controls over miscellaneous and often poorly managed expenditures through Merchant Category Code (MCC) blocking, transaction limits, and pre-set daily or monthly limits. A non-traditional benefit is the ability to extend procurement categories beyond staples and the like to include temporary labour or car hire. Overall, the program's management information is invaluable for several departments because it drives significant cost reduction and efficiency gains within finance departments, and it helps secure better deals with key suppliers.

Despite these advantages, P-cards can pose challenges to businesses. For one, setting up such a program may require a business to significantly change its procurement and financial management protocols. Beyond the initial setup, corporations can generally use P-cards without any upfront costs, as these expenses are typically absorbed by the issuer. However, getting suppliers to accept them as a payment method may prove difficult, as less sophisticated suppliers or larger ones with deeply ingrained legacy accounting and inventory control systems are reluctant to overhaul their modus operandi.

Corporate/T&E Cards

Corporate/T&E cards can help companies ensure their employees adhere to corporate spending policies on expenses such as hotel stays, car hire, flights and meals. In 2011, Turkey's spending in Travel & Entertainment among middle- and large-market corporations and government was $13 billion.[14] This represents a significant opportunity for issuers to provide significant cost reductions to these markets.

In essence, Corporate/T&E cards act as a cost-reduction tool, while also allowing companies to keep better tabs on their purchasing deals with key suppliers such as hotel chains or airlines. This may even give a company's procurement professionals the insight they need to negotiate better deals. As discussed in another TSYS white paper, "when used correctly…data's largest value is its ability to provide companies with actionable insights that can lead to smarter decision making."[15] Furthermore, T&E programs provide spending analytics that can help companies quickly and easily spot travel spending abuse. Clearly, this presents an opportunity for corporations to provide value, increase customer loyalty and create new revenue streams for themselves.

Fleet Cards

Fleet cards, which help companies pay for vehicle-related expenses such as gasoline, are another emerging commercial card opportunity. They can be used to cover expenses from all types of company vehicles, whether passenger cars or trucks. The benefits of fleet cards have long been established — the availability of Level III transaction data, fleet-related point-of-sale security and controls, fuel discounts and line-item details that can be fed into management expense reporting systems. As fuel prices fluctuate wildly and fleet managers attempt to contain costs, Turkey still lacks fleet cards at present. The nearest application to fleet cards is putting a device on a car's gas tank. This device has a sensor that measures the volume of gas and calculates the funds to be subsequently collected from a commercial card. Issuers could set themselves apart from the market by streamlining the current cumbersome process, removing hardware requirements and providing more sophisticated reporting.

Corporations that offer a diverse range of card products — including P-cards, corporate/T&E and fleet cards — will be setting the foundation for future growth by gaining new revenue streams and building loyalty within the organizations that use them. But incorporating these card programs is not without hurdles, of course. Corporate executives in Turkey, for instance, may hesitate to provide their staffs with credit cards, as cards are widely perceived as being an elite executive perk. Issuers can address such concerns by communicating the benefits of commercial cards clearly, such as explaining how businesses can establish card-usage rules and addressing head-on the aforementioned perception.

Insight: Developing Entity-Specific Solutions

Within the U.S market, commercial cards are segmented to meet the needs of different types of entities, including small, medium, or large businesses, MNCs and the public sector. Each segment has different needs and expectations of a commercial card program. An organization's size — whether based on revenue or employee base — will also determine a program's design, such as its spending limits, the number of cards needed, business rules and even compliance requirements. MNCs have additional requirements related to accommodating multiple currencies and languages.[16]

The U.S. experience offers takeaways for creating commercial programs customized to the type of entity. For example, U.S. experience suggests that smaller businesses require fewer card features and controls. One could surmise that annual spending at a small business would likely be among the lowest. That said, small businesses collectively may generate a large percentage of a commercial card program's revenue considering that small businesses far outnumber large ones. As such, right-sizing and tiering commercial card programs by segment will be imperative, as the SME segment in particular has both unique reporting requirements and much greater price sensitivity. While SMEs' ability to access information is now greater than ever, they expect more from their banks in terms of greater ease of operations and data management and reporting. They have neither the staff nor the inclination to spend great quantities of time on esoteric activities that aren't part of their core competencies. So versioning — offering a silver-labeled solution to SMEs as opposed to platinum-label offerings the large corporations — is in order.

Within the U.S. mid-sized and large market, multipurpose cards are gaining favor because of their convenience. According to Mercator, "These firms tend to have more cardholders, varying aggregate spending, diverse travel expenses and increasingly benefit from historical spend analytics."[14] Corporations, for example, may want to set a card spending limit based on their internal expense policies — another benefit that commercial card programs can offer. As MNCs' presence in Turkey grows, so too will their needs for globally-focused cards and purchasing tools. Such cards must be "denominated in the local currency, globally accepted and include a program management tool in multiple languages that can effectively reduce administrative costs."[16]

In the U.S., card programs are developed around the various types of commercial segments and their distinct needs. This is a lesson that the Turkish market could follow as issuers form their growth strategies and identify the commercial card benefits that should be promoted.

CONCLUSION

Turkey's commercial cards and payments market is experiencing growth and offers significant potential for both corporations and issuers. This report identified three key drivers that could spur increased commercial card adoption in Turkey. The first is the ability to lower costs through card usage, the second is improved cash flow and the third is reduced payment card misuse.

Moreover, with the U.S. being one of the most developed commercial cards markets in the world, its experience offers several insights that may suggest how Turkey's market will mature.

Finally, as all content explored in the report suggests, the full benefits of a properly implemented commercial card program are currently under-realized in Turkey, but substantial change is underway.

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