


Purchasing Cards



Corporate procurement cards have been developed as a mechanism for streamlining the clerical processing of low value transactions.



CIPS members can record one CPD hour for reading a CIPS Knowledge download that displays a CIPS CPD icon.

Background

“Corporate procurement cards have been developed as a mechanism for streamlining the clerical processing of low value transactions. They can substantially reduce the associated administrative costs and they free up buyers’ time to spend on more useful activities¹”. As the definition above indicates, they are widely used, in the main for low value, low risk orders. There are, generally speaking, two types of usage: a) purchases from existing contracts; or b) ad hoc purchases.

A list of typical low-value items might be as follows:

- Computer consumables and equipment
- Stationery and printing
- Safety equipment
- Cleaning services and materials
- Office furniture and related consumables
- Training and seminars
- Catering supplies and services
- Transport, travel and fares
- Building services
- Ad hoc printing requirements
- Mechanical plant spares
- Books and journals

CIPS suggests that purchasing cards may deliver greatest value when used for high volume, low value supplies (from call-off contracts for example). For purchases from new ad hoc suppliers, purchasing cards avoid the time and cost of the customer establishing the supplier on their finance systems and the supplier opening an account for the customer. They are also useful when used like an ordinary credit card, instead of petty cash, for ad hoc purchases at retail outlets as deemed appropriate by the buying organisation. Purchasing and supply management P & SM professionals should determine how, and in what ways, their own organisation should use purchasing cards to support their purchasing and supply chain strategy.

Numerous estimates have been put forward for the cost of raising an order and paying an invoice. Much depends on the nature of the order, ie whether it is a call off order for instance, and more importantly, the salary levels of the person carrying out the process. Nevertheless, CIPS believes that a reasonable estimate for the cost of raising a typical low value, simple order and paying the corresponding invoice is approximately £50. As, typically, 80% of an organisation's orders are low value and this represents less than 20% of expenditure, purchasing cards can significantly reduce the overall costs of an organisation's transactions or at the very least, ensure a more effective reallocation of resources.

Low value orders generate large amounts of paper in the form of requisitions, orders, goods received notes, invoices etc., and are moreover expensive to process owing to the labour-intensive nature of such processing in many organisations, particularly those which do not have a suitable IT system.

The CIPS position

CIPS is expressing beliefs on purchasing cards as it takes the view that purchasing cards can add value to most organisations' P & SM processes and as such are a very useful tool in the P & SM professional's armoury.

Purchasing cards are in fact a payment mechanism, which can be incorporated into a purchasing process. CIPS also believes that each organisation should decide how purchasing cards best fit into their overall purchasing strategy.

CIPS views, opinions and beliefs are highlighted and expanded at appropriate points within this Guide; a list of the broad practice statements which underpin the text is as follows:

- CIPS suggests that purchasing cards deliver greatest value when used for high volume/low value procurement
- CIPS takes the view that when used appropriately, purchasing cards can be an effective way of keeping transaction costs to a minimum
- In addition to reduced transaction costs, CIPS has identified a number of other benefits associated with the use of purchasing cards
- The level of benefit to be gained from the use of purchasing cards is closely linked with the maturity of the P & SM strategy and its supporting systems
- CIPS believes that the decision as to who within the organisation should be card-holders lies with the P & SM professional
- CIPS believes that the implementation of a purchasing card system should be preceded by a BPR (Business Process Engineering) initiative
- CIPS considers that purchasing cards are an appropriate payment mechanism for eCommerce transactions
- CIPS considers that purchasing cards can be an effective tool for the P & SM professional wishing to develop and improve relationships with internal customers.

What are the benefits of using purchasing cards?

The most often quoted attraction of purchasing cards is the reduction in order processing costs.

Various organisations and consultancies such as Arthur Andersen and Ernst and Young have calculated the cost of making a purchase – these figures do not differ markedly from the figure of £50 quoted by CIPS.

How much of this cost is avoided by using a purchase card depends on the extent to which organisations employing cards are prepared to change their systems. If it is still necessary to raise a requisition and produce and issue an order, then there might be little saving in the costs associated with these transactions. However, there will be a saving in the costs associated with the clearing of invoices as the purchaser will now receive only one effectively consolidated invoice a month. This can represent a significant saving if the card is used for the purchase of the low value items which, as indicated earlier, can represent 80% of the total orders issued, yet only 5% of the total spend value. If it is assumed that each low value order causes a low value invoice when a purchase card is not used, then consolidation on a monthly basis should represent a considerable saving.

Without an IT system, low value orders are difficult to control or monitor centrally although many organisations are less concerned with control or monitoring than they are with simply coping and avoiding cost. Goods are often received before the order has been issued owing to those requiring the goods or services arranging delivery first and then taking steps to raise an order as an afterthought.

Another reason can be the long processing lead times in some organisations. In general little value is added by purchasing departments and releasing time from the processing of low value

orders means that staff can devote more time to large value purchases which have the potential to yield greater value in terms of cost savings, improved service and quality.

CIPS believes that there are significant potential advantages to be had by implementing purchasing cards, of which reduced process costs are just one aspect.

They include:

- Devolving the transactional, ie order processing, part of the purchasing cycle to card holders, e.g. end users, other colleagues or internal customers
- Improved liaison between an organisation's P & SM professionals and card holders, leading to improved relationships (a counter-argument might be that the reverse might turn out to be the case if Finance rather than Purchasing is the main channel for transactions)
- Greater compliance with contracts (if implemented within a clear, effectively communicated procurement policy and procedures for instance, the card holders may only use the cards with certain suppliers, or within a closed e-procurement system which can significantly reduce maverick spend)
- Reduced bureaucracy, if implemented properly (individual invoices are no longer processed)
- Environmental benefits such as reduced paper work
- Released time, across the purchasing cycle, for work which adds greater value to the organisation
- Suppliers being paid promptly by the card-issuing bank, typically within three days as opposed to 30-60 days, particularly important now that Late Payment legislation is a factor to take into account.
- Improved relationships with suppliers due to prompt payment reduced paperwork and enhanced contract compliance
- More effective expenditure analysis from management information (providing the relevant systems are updated with enough detail of what has been purchased via the card)
- Improved audit control.

It is important to stress, however, that the impact of the above advantages depends upon the maturity of the P & SM strategy as well as its supporting systems within an organisation.

What problems might be encountered?

Cultural issues

Changing the manner in which processing of low value orders is undertaken within the organisation so that requisitions and orders are no longer necessary can require a considerable cultural change in the organisation; this can be one of the main impediments to the use of purchase cards and is an issue of which the P & SM professional needs to be aware. Resistance to the introduction of cards in organisations can be because of a lack of trust, usually but not always in the Finance department, which can have concerns about 'lack of control' associated with the use of purchase cards once they are issued.

Verbal Orders

Particular concerns are often expressed about the use of purchase cards to order materials or services over the telephone. Of course it is perfectly possible to order in this way and for an organisation to be bound, irrespective of whether or not a purchase card has been involved in the transaction. There does not need to be a paper order or any written record of the order. It is often not realised that the use of a purchase card does not make verbal ordering easier, nor does it alter the legal position with respect to the order.

Cashflow

An organisation may experience an adverse cashflow as it will often find that it has to pay earlier than was previously the case. It has been suggested that this adverse cashflow could be the equivalent of a financing charge in the range of 0.25% to 0.6%. This must be offset against

the advantages of streamlining the process and possible benefits from rationalising the materials and supplies purchased as well as the supplier base. It also needs to be seen in the context of the modern move to improving the rate at which small suppliers in particular are paid. Purchasing cards may be seen as a way of paying small suppliers on time which is increasingly being seen as social obligation of big business and government departments and which is moreover now the subject of legislation.

Fraud

Some Finance departments are anxious that the card number, when given over the telephone to support a legitimate purchase, could be used by unscrupulous and dishonest suppliers to bill for goods and services not ordered. In fact there is no more risk of this than if the card were used in person, nor is there any more risk than in circumstances where private individuals use their private credit or charge cards.

There is also some concern in some organisations that their own individuals abuse the opportunity which the cards present, either by purchasing more than they otherwise would or by using the cards fraudulently themselves. Dealing with the possibility of fraud by card holders, it is possible to specify what may be purchased with the card so that attempted purchases of materials and services which are not authorised will not be accepted by the card issuer at the time when the supplier seeks authorisation from the card supplier. There are also ceilings imposed by the card issuers on the total monthly spend which an organisation may make. In addition, there is a limit imposed on the amount which may be purchased in any month by a particular card.

Some organisations which have adopted purchasing cards also insist that the staff using the card maintain records of every transaction so that they might at any time be audited. In some cases, organisations restrict the card to the purchasing department so that those with a requirement still have to raise a requisition which has to be sent to the purchasing department. The purchasing department then telephones the supplier and quotes the card number. This can then be followed by a purchase order. Receipt of the goods or service can be recorded, so providing an audit trail. The advantages of this approach have to be offset against the increased bureaucracy.

Transaction Fees

Some suppliers complain that the transaction fee that they must pay to the card-providing bank (approximately 2% of transaction value) is excessive. This fee may, however, be offset by greater market share (as a result of end users complying with preferred supplier contracts) and prompt guaranteed payment.

Insufficient number of suppliers accepting the card

This has been advanced by many organisations as a reason for not using purchasing cards. However, it has been claimed that the benefits accruing to a purchaser from the use of cards more than outweighs the extra effort required to recruit either extra suppliers or existing suppliers to support the purchase card concept.

Some other limitations of purchasing cards are as follows:

- They could lead to a headcount reduction which needs to be carefully managed if problems are to be avoided
- Cardholders will require training and support – this obviously represents a cost to the organisation
- There may be increased workload for card users

- Some organisations may require each purchase coding to a different budget line resulting in less of a reduction in bureaucracy than initially envisaged
- Management information on purchasing card transactions may be too generic for some buying organisations
- Ad hoc suppliers may not wish to accept purchasing cards unless higher volumes are committed
- Some small suppliers do not accept purchasing cards.

How should a purchasing card programme be set up

Introducing purchasing cards is similar in many respects to introducing any other form of change into an organisation. Support from the top management in an organisation is usually essential to resolve the cultural difficulties identified above. An education programme within the organisation will be required; this is best done on a pilot basis initially so that any difficulties can be identified and resolved before the concept is extended to the organisation as a whole.

To facilitate the adoption of the purchase card and to familiarise staff with its use, some organisations start to use the card only with those suppliers who have an established track record of accepting them. This gives the purchasing organisation an experienced supplier with which to deal and thus the opportunity to sort out any difficulties before rolling out the process to suppliers for whom cards are a new experience. An important benefit for the supplier is the opportunity to build a relationship with the purchaser which might stand the supplier in good stead in the future.

It is the responsibility of the P & SM professional to decide who, in their organisation, should be card holders. Maximum benefit is obtained when cards are given to the users of the goods and services to be purchased. However, in some cases it is appropriate to give the card to the person who is responsible for purchasing within a given budget centre, if for example the individual end users rarely make a purchase. It is the responsibility of the organisation using the purchasing card to decide what it considers to be low value. In some organisations this can be as little as £50, in others it can be £5,000. Equally, it is the responsibility of the buying organisation, in particular the P & SM professional, to determine what categories of expenditure, and credit limit, each cardholder should have.

CIPS encourages P & SM professionals to endeavour to negotiate appropriate transaction fees for their suppliers whilst selecting the most appropriate card-providing bank. CIPS suggests also that Business Process Re-engineering should usually be a prerequisite to the introduction of purchasing cards. That is, questioning existing processes and replacing them, as appropriate, with new processes. For example, the organisation may decide that there should be no need for line item detail when using purchasing cards for low value orders. In some cases, Business Process Re-engineering, coupled with closer working relationships with suppliers, can in itself deliver many of the benefits attributable to the introduction of purchasing cards.

It is also the responsibility of the P & SM professional, in liaison with colleagues in Finance and Internal Audit, to determine who, in the organisation, should receive card statements and the arrangements for verifying and paying these card statements. If suppliers are VAT-enabled they should no longer need to submit invoices to the buying organisation, as they are not required for VAT purposes. However, proof of delivery is still required for internal control purposes. At present, the capability of suppliers to transmit electronic VAT data is still patchy and as a consequence, many purchasers' systems have to accommodate both (ie electronic VAT data and paper invoices) methods.

CIPS recommends that the buying organisation approaches their local Customs and Excise office in order to agree an appropriate percentage of VAT to be reclaimed each year against purchasing card transactions. CIPS suggests that it is the responsibility of P & SM professionals to decide what management information is required by their organisation in respect of purchasing card transactions and to agree with the card-providing bank on the provision of such information.

Many purchasing organisations see the cards as an opportunity to rationalise their supply base and to direct the delegated purchasers using the cards to designated suppliers with whom preferential terms of supply have been negotiated.

A frequently used approach is to negotiate a framework agreement for a range of supplies with a supplier having a range of outlets across the geographic area of interest to the purchaser. A part of the agreement includes the option to use the purchase card. As the only means of payment at the disposal of the delegated purchaser in the purchasing organisation is the card, the delegated purchaser is constrained to use the designated supplier.

This means that the supplier base can be fully researched and rationalised, and discounts or better prices and other terms obtained, as well as simultaneously eliminating much costly processing of paper.

Suitable materials for such an approach include hand tools, stationery, workwear, building materials and anything for which there are outlets dealing with a satisfactory range of the requirements. Purchasing cards can also be used for the provision of services such as the hiring of temporary staff.

To summarise, a simplified list of measures that might be taken when contemplating the adoption of purchasing cards is as follows:

- Carry out an analysis of existing low value transactions
- Identify those areas/departments which might benefit from the introduction of purchasing cards
- Set initial savings targets
- Set up a project team, ensuring the support of senior management
- Identify areas of implementation
- Select suitable suppliers
- Draw up new procedures for the use of procurement cards, with an emphasis on simplicity
- Put new training programmes in place; this may include suppliers
- Implement
- Monitor and evaluate, expanding to other areas if appropriate.

What other methods of handling low value orders are there?

Corporate purchasing cards are only one way of dealing with low value orders. Among the strategies available are the following:

Reduced order frequency

How low value orders may be handled depends on whether they are for frequently required goods or services or whether they are for infrequent requirements.

Infrequent requirements can be further subdivided into those which can be purchased from the same source or outlet such as stationery and those which can only be purchased from different outlets.

Framework agreements and call-offs

The importance of grouping purchases on the basis of the frequency with which they are purchased or the similarity of the outlets from which they can be obtained is that such purchases lend themselves to being bought by means of framework arrangements.

Such an arrangement does not usually specify the volume of any goods or services to be purchased. Rather, it covers the specification of the goods or services, the terms and conditions on which they are to be purchased, the prices or rates to be paid, the period for which the contract is valid, delivery and packaging details and any other data which might be described without reference to specific quantities. The contract will specify how quantities of the goods or services are to be ordered and by whom. The contract will be made legally binding by payment to the vendor by the purchaser of a nominal sum (often as little as £5) which acts as consideration for the vendor's promise to deliver in accordance with the terms in the contract. Actual requirements are ordered by means of call-off or framework orders which are issued by specified personnel in the purchaser's organisation as and when the requirements arise. Under the conditions of the framework or call-off contract, the vendor is now legally obliged to arrange delivery.

Framework or call-off contracts or agreements can be used in conjunction with purchasing cards for payment purposes. Some organisations insist on suppliers using this means of payment in order to avoid the costs of processing large numbers of invoices. Framework or call-off contracts or agreements can also be used in conjunction with electronic forms of ordering and payment.

Accumulating requisitions

One method of handling frequent low value orders which does not involve framework contracts or agreements is to accumulate requisitions, ie holding requisitions until there are sufficient to place a large value order. This is often done by assigning a certain day of the week for the purchase of certain requirements. As an illustration, Monday might be the day for purchasing all computer consumables.

This obviously slows down the purchasing process but it might lead to better deals being negotiated or tendered. In some cases, accumulating requisitions can lead to one quite large order being placed with a supplier, thus avoiding the placing of several small orders and their associated invoices.

Limiting the choice of supplier

Reducing the choice of supplier can be a way of reducing the number of invoices provided suppliers agree to invoice using a consolidated invoice. This does not reduce the number of requisitions or necessarily the number of orders unless the requisitions are accumulated as described above.

Amend re-order algorithms

Sometimes a large number of orders and resulting invoices are caused by re-order algorithms being set at too high a level with the result that stock is not allowed to fall sufficiently before a re-order requisition is triggered.

Increase and/or rationalise stock holdings

This is often a concomitant of the need to change the re-order algorithm, stock holdings could be increased so as to avoid the need to re-order as frequently. It might also be possible to

rationalise stock holdings by, for example, holding stock at fewer locations and thus needing to raise fewer orders for stock replenishment purposes.

Reduce the supplier base

This is another way of reducing the number of transactions. By avoiding multi-sourcing of supplies, fewer orders will be needed and thus fewer invoices will be generated.

Performance pricing/self billing

This is a way of reducing the number of invoices. Suppliers are paid in relation to the output of the purchaser, for example an automobile manufacturer might pay so much per vehicle produced. If the amount paid is directly related to the amount of supplies consumed in the purchaser's production, then the process is usually called self-billing.

The advantages for suppliers are speedier payment and reduced administrative costs such as postage, stationery etc. The key advantage to the purchaser is the reduced workload normally associated with normal invoicing.

Key issues are supplier selection, briefing and gaining the support and understanding of staff within both the supplier and the purchaser, keeping to the system (the supplier not to raise invoices, the purchaser to pay the correct sum as agreed) and handling the VAT issue; although the last factor has now been addressed by Visa with their line item detail approach (see below).

Payment in cash

This approach is usually not favoured by Finance and Audit departments but it is often used for minor items of a very infrequent nature and for purchases which need to be made in extremis. It suffers from all the disadvantages of local purchasing and is also open to fraud (or at least the suspicion of fraud) even though staff using cash are obliged to obtain receipts.

Payment by cheque

Basically, a cheque system is a way of avoiding an invoice, it does not avoid an order. Control may be exercised by limiting the number of cheques which may be issued to any member of staff and by limiting the maximum value of the cheques themselves. Members of staff can be obliged to maintain a record in the cheque book or elsewhere of the reasons for the purchase, what was purchased, the supplier and the value of the cheque. Random reviews of these records could be instigated.

An innovative method of making almost immediate payment by cheque for small value purchases was first introduced some years ago by Kaiser Aluminium (USA). In essence, each low value order was accompanied with a blank cheque which the vendor completed with the amount (up to a pre-agreed limit) to be charged and then paid the cheque into his/her account.

Purchasing cards and electronic procurement

EDI (Electronic Data Interchange) is an electronic messaging system which pre-dates electronic commerce and electronic procurement by means of which orders and invoices may be transmitted to trading partners. It is also possible to transmit price and stock information. Benefits include cost savings, reduction in lead times, use of approaches such as Just In Time (JIT) and better customer service. Usually, in view of the set-up costs incurred, EDI is conducted between purchasers and suppliers who expect to enjoy a long-term trading relationship with

each other. A significant disadvantage of EDI is the wide range of standards which apply; these vary from one sector of industry to another.

Whilst not obsolete, EDI has certainly lost ground to e-procurement for which CIPS believes that purchasing cards are an appropriate payment mechanism, especially if the transactions are taking place in a safe environment such as an extranet. As e-procurement develops, so will methods of payment. As organisations become more confident in the use of e-procurement, they will affect increasingly high value and high risk orders over the Internet. CIPS believes that any purchase transaction of a high value or high risk product or service, whether or not ordered over the Internet, or paid for via a purchasing card, must also have been subject to an appropriate procurement process.

Such a process must involve at the very least:

- a verification of the supplier's status (supplier appraisals are undertaken)
- the product or service being purchased is checked to ensure it meets the requirement
- value for money being ascertained on the basis of whole life costs
- agreement being reached on the terms and conditions of business.

Conclusion

CIPS advocates the use of purchasing cards for those purchase transactions which are high volume (ie from a call-off contract) low value, low risk and also for ad hoc low value low risk purchases. However, it is the responsibility of the P & SM professional to work with colleagues in the relevant departments, to determine how purchasing cards should best support their purchasing and supply chain strategy. If implemented appropriately, purchasing cards can be another way in which the P & SM professional can develop relations with internal customers and end users and thereby promote the P & SM function. Purchasing cards are an appropriate interim step towards e-procurement. CIPS encourages the appropriate implementation and use of e-procurement systems and suggests that, at present, purchasing cards are a suitable method of payment in e-procurement environments. However, CIPS will continue to monitor the development of eCommerce payment mechanisms, and will review this position accordingly.

CIPS Group Easton House, Easton on the Hill, Stamford, Lincolnshire, PE9 3NZ, United Kingdom
T +44 (0)1780 756777 F +44 (0)1780 751610 E info@cips.org

CIPS Africa Ground Floor, Building B, 48 Sovereign Drive, Route 21 Corporate Park, Irene X30, Centurion, Pretoria, South Africa
T +27 (0)12 345 6177 F +27 (0)12 345 3309 E infosasa@cips.org.za

CIPS Australasia Level 8, 520 Collins Street, Melbourne, Victoria 3000, Australia
T 1300 765 142/+61 (0)3 9629 6000 F 1300 765 143/+61 (0)3 9620 5488 E info@cipsa.com.au

CIPS Middle East & North Africa Office 1703, The Fairmont Hotel, Sheikh Zayed Road, PO Box 49042, Dubai, United Arab Emirates
T +971 (0)4 327 7348 F +971 (0)4 332 5541 E mena.enquiries@cips.org



*Printed on stock containing
50% post consumer
recycled content*

www.cips.org

CIPS™ is a registered trademark of the
Chartered Institute of Purchasing & Supply