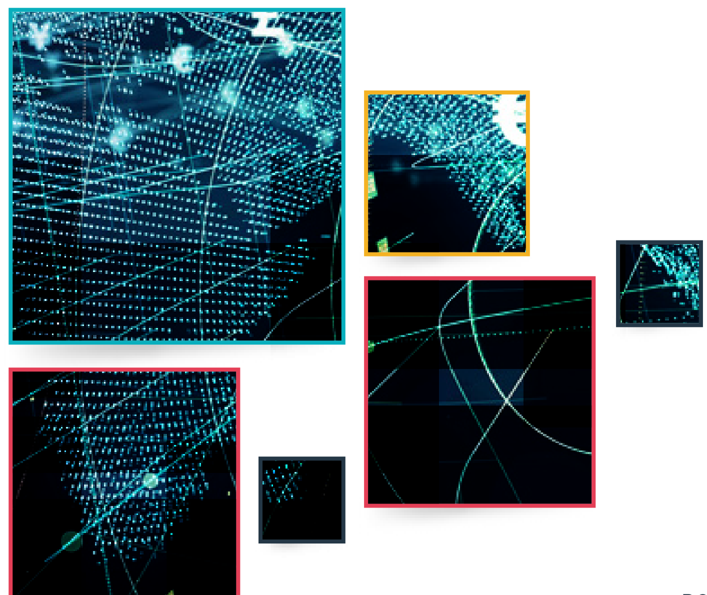
Transforming Payments

Improving Cashflow in AP & AR



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Introduction

Payments connect companies both internally and externally. Internally, they connect various departments, with each part of the cash conversion cycle (CCC) overlapping and impacting others. Externally, they connect different organizations to one another, as one company's Accounts Payable (AP) is another's Accounts Receivable (AR).

Each of these internal and external parties involved in the CCC and payments has its own areas of concern, its own key performance indicators (KPIs), and its own priorities and perspectives. Sometimes, their priorities and metrics fail to support each other. At other times, they may directly clash.

This ebook is for the various internal groups involved in payments and cash conversion, from AP and AR to Treasury and Finance. It will delve into the "why" and the "how" of cooperation and seeking win-win solutions. Four key drivers emerge as points of focus and consideration as the various Finance groups seek to align properly and take internal and external implications into account:

Cashflow management: Managing cashflow properly is a core need for Treasury. AP and AR are deeply involved in cashflow, and Treasury must coordinate with them to ensure the company's cashflow needs are consistently met.

Financial performance optimization: Financial performance is a major operational focus for AP and AR. Treasury must consider it on the financial side, but it is less of an operational concern there.

Graceful scalability: Your company needs to be able to handle its own growth safely and effectively. Automation and efficient processes that reduce errors and defects are important prerequisites to managing ramped up volumes without adding staff.

Stewardship – protecting the most liquid assets: Treasurers are considered the stewards of the organization's most liquid assets, but every area and every employee involved in payments is an important part of this protection. Fraud is a growing concern, and payment security and controls must be a priority for all payment area.

As we consider the need for cooperation in transforming payments and improving cashflow, these four drivers will be key points to bear in mind.

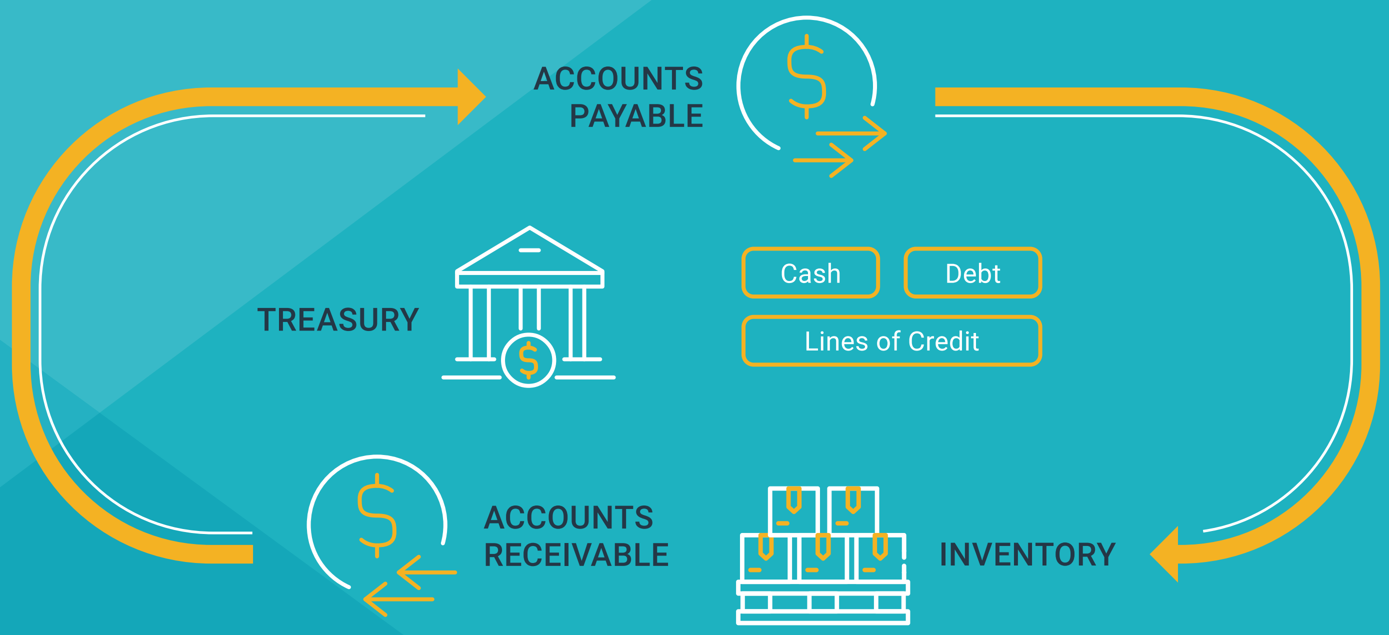
Payments connect companies both internally and externally.

Connected world

The CCC is the cycle of purchasing inventory, selling it and collecting the receivable to reinvest in inventory. It is described as the measurement of time from payment to collection, calculated by adding days sales outstanding (DSO) to days inventory outstanding (DIO) and subtracting days payable outstanding (DPO).

Internally, the CCC connects every department involved in procure-to-pay, inventory and order-to-collect. Treasury, while not operationally involved, sits at the center of the cycle with an eye to its funding and impact on liquidity. The various groups' actions and processes impact each other, each needing information from others. AP and AR, for example, must share information about their forecasts and monthly targets, while Treasury must provide liquidity to fund AP and AR throughout the month.

Each group's actions and inactions have implications for overall organizational liquidity and financial performance. Impacts on the company then return as repercussions to the individual departments. Competing KPIs are not just an inconvenience to other areas, but ultimately a self-inflicted wound on one's own area. Taking an "end-to-end" view of payment and cashflow processes is vital.



Externally, the CCC also connects companies to their vendors and customers. The end-to-end view, then, must be extended to an “end-to-end to end-to-end” (or E2E^2) view, considering not only the overarching internal process, but also how payment processes impact external parties. Buyers must consider whether their payment processes are breaking their external partners, damaging relationships or using capital inefficiently.

Optimizing part of the process suboptimizes the whole. A process that has been narrowly optimized may seem effective when viewed without reference to its broader and longer-term repercussions. Zooming out and considering the larger picture, however, typically reveals that narrow optimization is ineffective for the company’s overall goals.

It should be noted that this is not a plea for central planning. Individual activities can (and often should) be planned within their own groups. They simply need to be optimized for overarching targets that consider the larger mission and concerns of the company.

With so much interaction between groups whose concerns and individual goals differ so greatly, a coordinated effort to improve communication and cooperation and to promote an E2E^2 mindset is necessary. For a department to thrive, the company must thrive. In order for a company to thrive, the department must recognize its impact on other departments, on the overarching organization, and on external partners. Each group must work with the others to optimize the entire CCC and payments processes.

While there are a multitude of departments and external parties involved — and it’s important that each of these groups be heard and their concerns and issues addressed as needed — AP, AR and Treasury are likely to be the central internal groups concerned. For Treasury, the relevance is less in its own operations and more about addressing its liquidity concerns with AP and AR, helping bring other groups together, and spearheading initiatives and changes. For AP and AR, changes in perspective and operations can have positive impacts across all other areas involved. The following pages will focus on key drivers, needs, and options for transforming payments in AP and AR, with an eye to Treasury’s concerns related to liquidity and cashflow.

Accounts payable

Challenges in cashflow timing

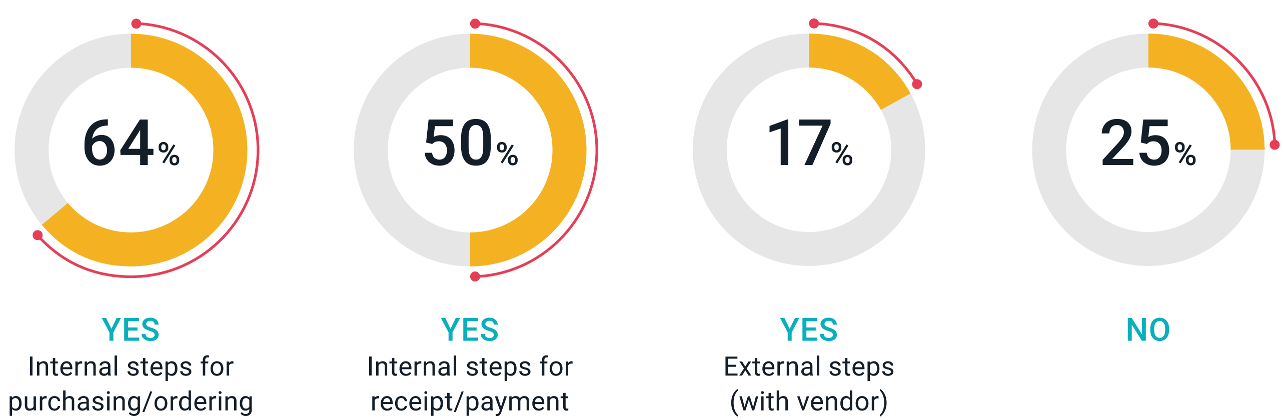
There is a reason the CCC is measured in days: timing is vital for cashflow. Many of the factors involved in AP are related to timing. Optimizing the timing, however, is not simple.

In its efforts to manage payment terms, AP has an awkward balance to maintain. Internally, there is pressure on AP to preserve the company's liquidity by staying over a minimum DPO level. Barring certain situations where early payment discounts might make it worthwhile for the company, paying early is typically something AP should avoid. On the other hand, however, AP must consider the need to maintain a healthy supply chain and good vendor relationships, particularly in times when suppliers face greater restrictions in accessing capital.

Vendors also need liquidity. In many cases, vendors are smaller organizations than their buyers and operate with less margin. This means both that their need for liquidity is sometimes urgent and that it's highly important to them to know when they will be paid.

With traditional payment terms, balancing internal liquidity needs with the vendor's needs can be difficult to maintain during regular economic conditions and impossible to maintain when there are strains that impact both the buyer and the supplier. Traditional terms operate in lockstep, meaning that the only way for AP to preserve its organization's liquidity is to pay later, leaving suppliers with the short end of the stick. If pushed too far, this can disrupt an organization's supply chain, turning a win-lose scenario into a lose-lose.

Do you have an end-to-end view of your accounts payable processes? (Select all that apply)



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Challenges in financial performance

Financial performance is another area of challenge for AP, with defects, scalability, financial return, and fraud as central players. Inefficient and manual processes can interfere with AP's operational efficiency, increasing costs, creating vulnerabilities and reducing returns.

Defects are one major area of concern. With manual processes, errors are both inevitable and difficult to fix. When exceptions are managed via phone calls and emails, they can take quite a while to resolve, consuming valuable staff time and creating problems in supplier relationships.

Manual processes also negatively impact scalability. Scaling up with manual processes typically means either adding staff or rushing through processes without the appropriate steps. Rushing AP processes increases defects and susceptibility to fraud, while adding staff is a major cost. In addition, even if staff can be added, there is little flexibility to scale up and down as needed on an ongoing basis.

Third, financial return and rebates are an area of growing consideration for AP. While typically thought of as a cost center, AP departments do have opportunities to take advantage of rebates to create a financial return for the company if the payment methods that offer those rebates are well suited to both buyer and supplier.

Finally, the proliferation of touchpoints and unenforced controls in manual processes result in more vulnerability to fraud. Criminals continue to innovate and find new and improved ways of stealing, making the security of payments an increasing concern for AP, Treasury and management.

Considering solutions for AP

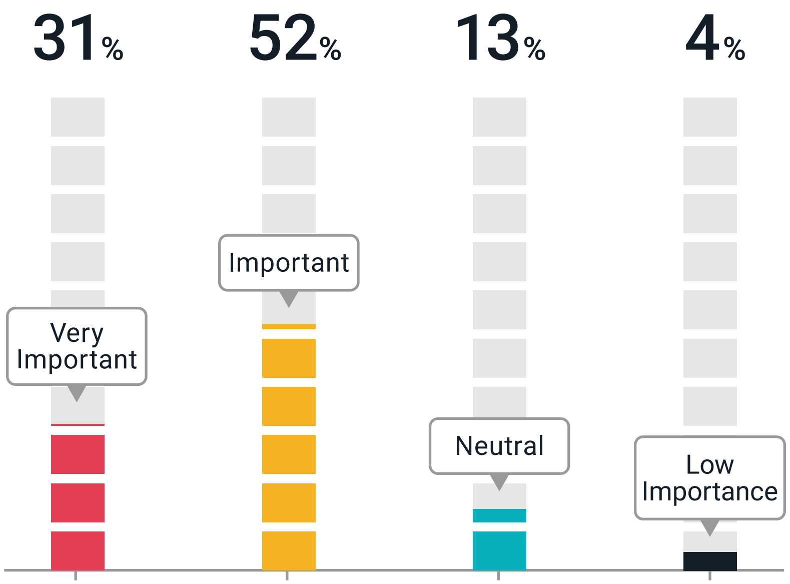
Many of the issues above, whether related to cashflow or financial performance, can be significantly improved by transforming payments and adopting more modern processes. This may involve automation, supply chain finance or more innovative payment methods.

Automation

In terms of efficiency, scalability and security, manual processes are typically a major impediment. Reducing the manual intervention required to approve and send payments by automating AP processes can decrease errors, decrease susceptibility to fraud, and improve the flexibility and scalability of your AP department. This can be seen in four main areas:

1. Automation allows AP to approve payments earlier in the process, broadening the options for when payments can be made since they are no longer approved late or processed just in time, as can sometimes be the case with manual.
2. Reducing defects through automation also lowers the associated inconvenience and cost of manual resolution.
3. Automation makes it far easier to scale up and down without staffing changes.
4. Fewer touchpoints result in fewer opportunities for criminals to insert themselves into the process and allow for system-enforced controls.

Our desire to move toward full-electronic processing is best described as:



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Reverse factoring
For many companies struggling with the need to support their own cashflow without undermining their supply chain, the solution is to disconnect from the win-lose model entirely. This can be accomplished by adopting options such as reverse factoring, a type of supply chain finance that inserts additional capital into the equation. With reverse factoring, the buyer leverages their superior credit to obtain third-party financing for the supplier. The supplier can take their payment early from the third party for a discount, while the buyer is able to hold onto their cash longer, paying the third party back later than with traditional terms.

Virtual cards
Virtual cards are another option that can help AP disconnect from the traditional payment terms model, while also helping with the financial return issue. Virtual cards are a payment method comparable to a credit card, with two major differences: First, there is no physical credit card, just a number; second, the number is generated for one payment only. Each virtual card is generated for a specified vendor and payment amount and cannot be used if those parameters are not met. This makes virtual cards an attractive option for security reasons.

In addition to the security element, virtual cards are another method of disconnecting from the win-lose model. They allow suppliers to be paid earlier, while the buyer is not required to pay until later. This supports supply chain stability and internal cashflow and liquidity needs.

Rebates are another attractive feature of virtual cards for buyers. This allows AP to achieve a financial return. The vendor pays a fee, which can be a concern for adoption, but the ability to receive payment early is often well worth the fee to suppliers.

BENEFITS
- Source of revenue
- Frees up AP staff
- Better visibility
- Security

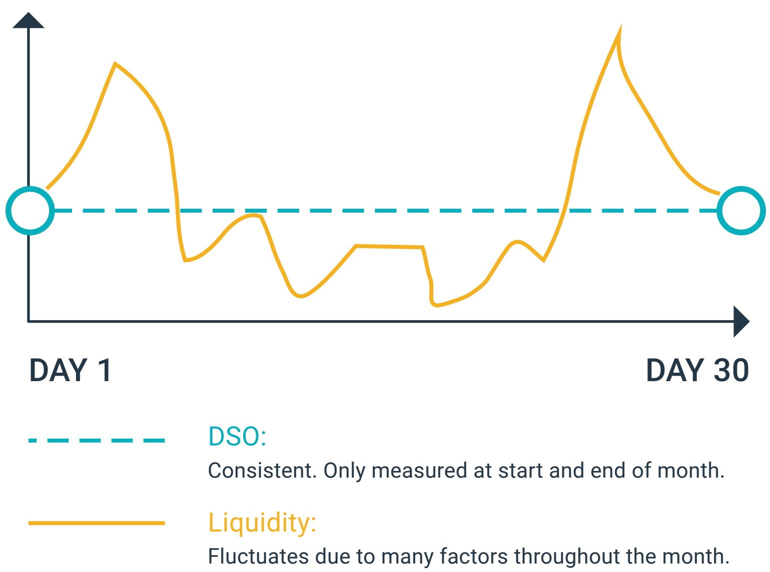
BENEFITS
- Gets paid sooner
- Security
- Better visibility
- Better reconcilliation

Accounts receivable

Challenges in cashflow & liquidity

AR, dealing with the inverse of the process AP controls, has concerns and challenges that also revolve around cashflow timing, liquidity and efficiency, but in different ways. As a primary gateway to the inflow of cash, AR's operational efficiency and its choices are vital to the ongoing health of the organization.

DSO & consistent liquidity
AR's key metrics center around DSO and keeping it sufficiently low. However, the way DSO is calculated is not aligned with liquidity. Typically, DSO is calculated monthly rather than daily. As a result, AR is incentivized to ensure that payments are received by the end of the month. As long as everyone pays by month-end, DSO looks good on paper.



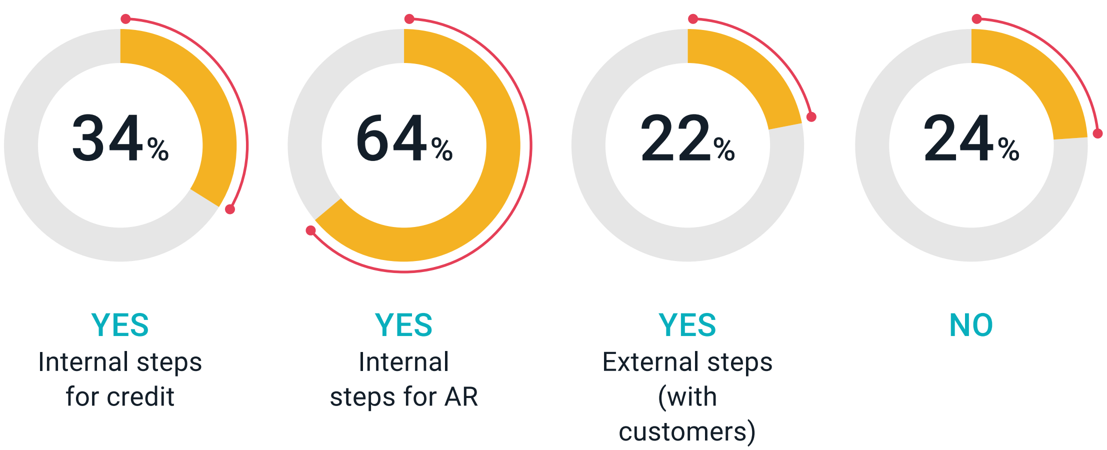
This metric is useful for measuring efficiency of the process, but it isn't meant to optimize for cashflow liquidity over the course of the month. This is a major concern for Treasury, but it may not be on AR's radar if its collection is only measured on DSO. To optimize collecting receivables for consistently good cashflow and ideal liquidity, AR must look beyond its internal metrics and work with Treasury to understand the organization's needs.

Cost of capital
The assets tied up in receivables do no immediate good for the company's capital situation — and capital has a cost. When the company needs an infusion of cash, some options for obtaining that capital may be costlier than others. Converting receivables to cash earlier than AR might otherwise be incentivized to do may sometimes be the best option. AR once again needs to work with Treasury to understand the company's capital needs and determine when it is optimal to convert receivables to cash.

Achieving better visibility
A third area where AR must cooperate with Treasury is in helping achieve improved visibility. Clearly, AR’s status, decisions and plans have a significant impact on liquidity. To make optimal decisions regarding cash management, then, Treasury needs information from AR. Specifically, Treasury needs high-quality forecast information from AR in a timely manner.

Assignment & application
While AR may not always be aware of the issues stated above, the challenges of assignment and application are a pain point most AR departments know all too well. As payments are received, they must be both assigned to the correct customer and applied to the correct invoice issued to that customer. With manual processes, this can be a slow and frustrating task. Payment information is often poor or missing, and manually reaching out to the customer for additional detail takes time and can cause important customer relationships to deteriorate.

Do you have an end-to-end view of your credit and accounts receivables processes? (Select all that apply)



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Considering solutions for AR

All of the challenges and issues above contribute to the need for more modern processes and the need to partner with other areas to ensure overarching goals are met. Consider the following areas where AR can seek to move forward.

Cooperation

AR's operations clearly have a significant impact on the organization's cash. With internal metrics that, while useful, typically fail to take the larger picture into account, cooperation with other areas in the organization — especially Treasury — is vital for AR to perform its function optimally. This cooperation takes work and initiative from both AR and Treasury, as well as any other groups involved, and can be broken into several steps and concepts:

Comprehensive KPIs: Competing KPIs must be driven out, and overarching KPIs must be established that address the larger needs and goals of the organization. Work to understand each other's perspectives and find KPIs and objectives that align with goals without interfering with other areas. Consider goals for liquidity and efficiency for cash and operations.

Information & forecasting: AR and Treasury must work together on improving forecasting. This requires Treasury to provide feedback to AR on accuracy, while AR must work on providing information more frequently and looking to improve the quality of that information.

Efficient processes

To improve the quality and timeliness of the information AR provides Treasury and to drive out inefficiencies that cause internal strain and relationship deterioration, many AR departments may need to move away from manual processes. Shifting to digital and automated processes allows AR to receive, assign and apply payments faster with fewer defects, delays and frustrating manual resolution processes. Some lockboxes, for example, auto-assign and auto-apply payments, making AR's role far more efficient.

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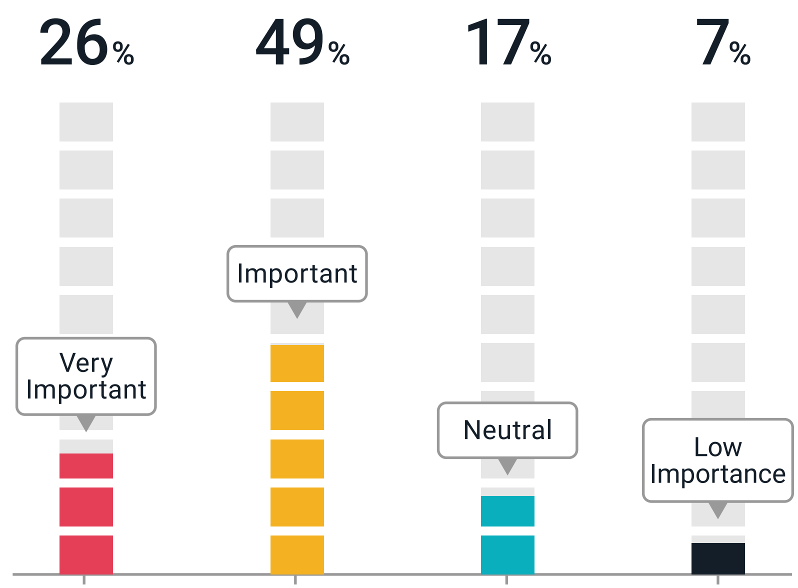

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Improving efficiency through modernized processes also improves the speed at which AR can obtain and share forecasting information with Treasury, as well as the accuracy of that information. Better visibility within AR, with sufficient communication, leads to better visibility into the entire organization's liquidity status.

Conclusion

The importance of cashflow and payment processes to a company's overall success must not be underestimated. As companies seek to bolster their liquidity management and efficiency, payment transformation should be a priority.

This is a broad task, however, stretching across multiple areas. AP, AR and Treasury must all be deeply involved in these efforts, and any party within the organization looking to transform payments must take a comprehensive view.

Breaking this comprehensive view across two parallel lines can clarify what is needed where:

Flow of liquidity:
The actual transfer of value is one of these parallel lines. This line can be traced across the entire CCC, with the receiving of payment in AR, the sending of payment in AP, and Treasury's efforts to oversee the internal management of the liquidity being exchanged. The counterparty AP and AR departments (vendors and customers) should also be factored in as an organization considers its overarching flow of liquidity and how to optimize it.

Flow of information:
In parallel to payments, information about those payments is also flowing. This information needs to be accurate, sufficiently detailed and shared with all relevant parties in a timely manner. Again, external parties must be considered as companies assess and transform their information flow processes.

With connections both internal and external across the CCC, and both value transfer and information to consider, companies must ensure they understand all the connections before acting. Consider, too, the possibility of adjusting how these connections themselves work and delinking from the win-lose payment models by adopting supply chain finance programs or payment methods such as virtual cards.

Finally, look to reduce inefficiency and increase scalability and security across the CCC with these three measures:

Streamlining: Complexity obscures information, makes security more difficult, and lengthens the time and manpower required to accomplish tasks. Reduce the complexity of payments and streamline the process to allow for improved visibility, scalability, security and efficiency. This is likely to involve digitalization.

Automating: Adopting automation in various parts of the CCC can speed processes, reduce defects and free up staff for more strategic tasks. Not all tasks can be automated well, but automating those portions of the CCC that are prime candidates for automation can make a massive difference to efficiency and quality.

Eliminating: When changing processes, keep in mind that there may be some steps that should simply be eliminated. Transforming and modernizing a process does mean transferring a manual process to a digital process without adjustments. Some steps may be rendered unnecessary, and this is a good thing. Keep what is necessary or wise, but consider the possibility of eliminating some steps if possible.

Throughout the process of considering and transforming payments, remember that payments are inherently a point of connection, both internally and externally. Whichever part you play in the process, work to understand the other perspectives involved, seek cooperation and move towards win-win scenarios that support overarching organizational goals, departmental needs and external partnerships.

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About the firms

Esker is a global cloud platform built to unlock strategic value for Finance, Procurement and Customer Service professionals, and strengthen collaboration between companies by automating the cash conversion cycle. Esker's solutions incorporate AI technologies to drive increased productivity, enhanced visibility, reduced fraud risk, and improved collaboration with customers, suppliers and employees. Esker operates in North America, Latin America, Europe and Asia Pacific with global headquarters in Lyon, France, and U.S. headquarters in Madison, Wisconsin.

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Strategic Treasurer was founded in 2004 by Craig Jeffery, a financial expert and trusted advisor to executive treasury teams since the early 1990s. Partners and associates of Strategic Treasurer span North America and Europe.

This team of experienced treasury specialists are widely recognized and respected leaders in treasury. Known for their expertise in treasury technology, risk management, and working capital as well as other cash management and banking operations, they efficiently identify issues, creatively explore ideas and options, and provide effective solutions and implementations for their valued clients.

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