Bridging the gap

STEVE ELLIS AND **MARCUS HUGHES** EXPLAIN HOW STREAMLINING ACCOUNTS PAYABLE CAN BRING BIG WORKING CAPITAL AND PROCESSING BENEFITS.

Cash is king in the financial supply chain. Businesses typically focus on getting paid as quickly as possible, reducing days sales outstanding (DSO) and holding back on paying suppliers for as long as possible by extending days payables outstanding (DPO). However, a more collaborative approach can deliver benefits to both parties.

Executive summary

- Accounts payable automation can help to optimise working capital although paper invoices are still widely used.

CAPTURING DISCOUNTS Early payment discounts incentivise customers to pay early and credit terms like '2/10 net 30' can be an attractive proposition, allowing the payer to gain a 2% discount by settling an invoice within 10 days. This equates to an annualised return of over 36%, assuming the invoice is paid on the 10th day rather than at maturity 20 days later. Capturing these early payment discounts is therefore good use of a corporate's surplus cash.

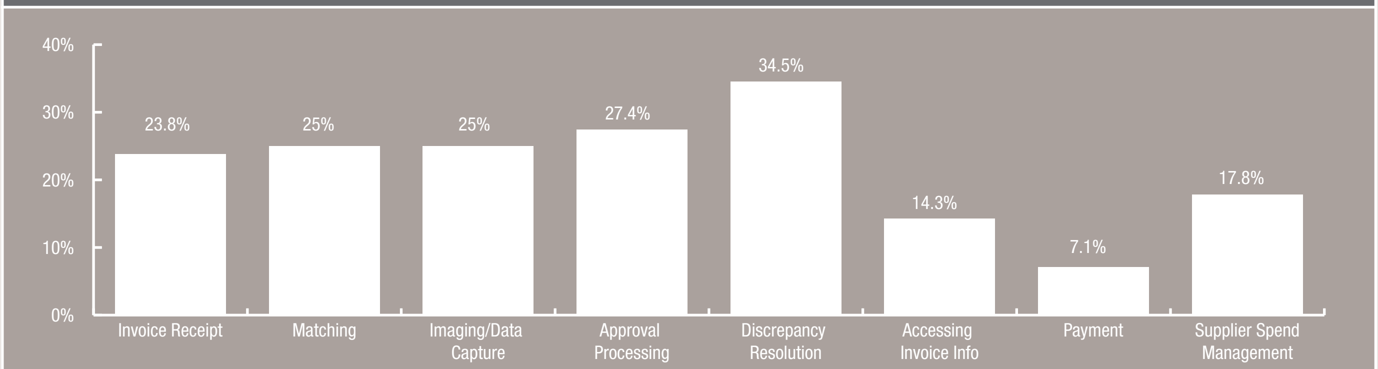
For corporates with credit capacity there is also an arbitrage opportunity. If you can borrow at around 6% a year and use the loan to capture the early payment discounts you can achieve a return in excess of 30% a year. This is more profitable than squeezing suppliers to extend your DPO and better for suppliers, who can benefit from enhanced cashflow.

Gartner predicts that by the end of 2009, at least 30% of the Global 2000 will have adopted dynamic early payment discounting as standard practice in accounts payable[1]. This suggests that corporates want to capture early payment discounts where available, but they will also proactively negotiate discounts even where such terms are not currently offered.

Some corporates remain reluctant to use their own cash resources or credit capacity to fund early payment discounts. In response, innovative banks are developing working capital management solutions to finance the supply chain. With such a solution, the bank bridges the funding gap, arbitraging the credit differential between the payer and the supplier. Subsequently, the cost of funds is reduced for the supplier, the payer pays less for the goods or extends the DPO, and both parties enjoy the working capital benefits.

Sadly, the working capital benefits associated with early payment discounts described earlier are out of reach for many businesses. Many organisations are not structured to achieve the approval of invoices in time to earn early payment discounts, because it typically takes 10 days or more to approve an invoice and release payment.

Chart 1. Pain points in the invoice receipt-to-payment cycle



Source: PayStream Advisors

ELIMINATING PAPER A recent study by consultancy Hackett-REL[2] estimated that poor visibility of payables and receivables is the cause of €500bn of unnecessary working capital in the financial supply chains of Europe's top 1,000 corporates. One reason for this inefficiency is the volume of paper. Gartner reckons that 90% of all invoices are paper.

Recognising that paper invoices are still widely used, corporates are adopting an evolutionary approach to invoice processing as they progress towards end-to-end e-commerce. This practical approach involves scanning all inbound paper invoices, data extraction, validation and matching, followed by timely electronic approval. An automated solution can reduce processing times from days to hours.

The solutions that stand out are those that successfully handle both paper and electronic invoices. Rolling out a new invoice management system is so much easier if suppliers can continue to submit invoices in their usual format, paper or electronic. This approach removes the barrier to supplier take-up which hinders other e-invoicing solutions that demand suppliers change their processes or submit invoices in a new format.

THE COST SAVINGS Benchmarking specialists estimate that the cost to process an invoice ranges from £2.50 to £7, and that a disputed invoice can cost as much as £50. Streamlining your invoice management can drive down the processing cost to less than £1 per paper invoice and even less for e-invoices. Productivity can improve by 50% to 80%, enabling a business to make large reductions in full-time equivalents or redeploy personnel to more productive roles.

As well as reducing accounts payable costs and improving controls and visibility, a streamlined approach can help to drive down the cost of goods and achieve better working capital management. This all means you can do more with less capital.

And as businesses are under increasing pressure to comply with industry regulation, streamlined invoice management can help enforce tight controls, with configurable entitlements, segregation of duties and a full audit trail. This control framework also reduces the operational risk of fraudulent invoices and invoices being paid twice.

At a strategic level, these best practices in streamlined invoice management help to optimise working capital management, enabling early payment discount capture to reduce the cost of goods. This collaborative approach to optimising working capital management can drive revenue and profitability, which ultimately enhances shareholder value, with bottom-line benefits for the entire financial supply chain.

Box 1. The pain points of automated accounts payable

A study by PayStream Advisors identified eight key pain points in the invoice receipt-to-payment cycle (see *Chart 1*). The four biggest are: discrepancy resolution, approval processing, imaging/data capture and matching. All can be eased through the use of an effective invoice management system.

■ **Discrepancy Resolution** The processes within an accounts payable function are labour-intensive, involving largely manual processes and a lot of paper. The heavy reliance on manual data input leads to frequent errors, costing time and money to resolve. An automated solution that scans the data down to line item, can remove this element of risk from the process.

■ **Approval processing** A powerful tool in unlocking value in the financial supply chain is the accurate and timely approval of invoices, which in turn can deliver benefits such as lower processing costs, improved visibility and control and audit compliance.

In streamlining accounts payable, all incoming invoices should be compared to business rules – for example, checking they are addressed to the correct legal entity or that local VAT rules are satisfied. If an invoice fails these tests, suppliers can be advised of the reasons for rejection so they can resubmit. Importantly, all disputed invoices should be captured in the system, enabling optimised VAT accrual management, with working capital benefits.

In organisations using multiple enterprise resource planning (ERP) systems, users may wish to access the invoice management systems via a browser. Alternatively, files of matched and unmatched invoices can be uploaded to the ERP system so that approval workflow can be completed in the host system.

■ **Imaging/data capture** Data, down to line item detail, can be extracted from invoice images using optical character recognition (OCR). The most sophisticated type of OCR, called freeform learning, identifies items wherever they are located on a document. OCR can also capture each supplier's international bank account number and bank identifier code or SWIFT address. This data can be used to update vendor files, so that euro payments qualify for lower bank charges.

■ **Matching** Invoice data can be automatically matched against the company's purchase orders and goods received notes. This reduces operational risk by verifying that goods invoiced have been ordered and delivered, cutting the risk of fraudulent invoices and duplicate payments. Data files of matched invoices and unmatched invoices can be uploaded, duly formatted, to your ERP system within a few hours.

1. *June 2005,* Dynamic early payment discounts will shake up accounts payable.
2. *International Payments Conference, March 2006.*

This issue will be discussed at *The Treasurers' Conference 2006.*

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