THE GREAT LEAP FORWARD?

WHAT BENEFITS DO THE LATEST TECHNOLOGIES TRULY BRING TO COMPANIES' ACCOUNTS PAYABLE AND RECEIVABLES FUNCTIONS? **CHRIS HALL** OF BFINANCE FINDS OUT.

The automation, centralisation – and eventual outsourcing – of non-value-added treasury processes have long been main priorities for treasurers. By eliminating manual intervention and cutting costs, the treasury can bring benefits to the firm's bottom line and increase its focus on strategic tasks such as detailed evaluation of funding options, risk management policy and decision report for expansion into new markets.

Great advances have been made, such as payment factories which collate payment types (high and low value) from a different countries and business units then feed them into clearing systems worldwide via a bank-provided 'single pipe'. But these are rare and typically used only by the firms with the largest transaction volumes. Moreover, payment factories and their ilk are far from the final solution. Centralised accounts payables (A/P) and accounts receivables (A/R) structures still require manual intervention by bank and treasury staff.

STP is considered a holy grail for all parts of the financial services industry concerned with processing transactions, because of the potential benefits of speed and cost reduction through automation. But if we consider the order-to-payment process as effectively just one transaction between company A and company B, then straight-through processing (ie enabling an electronic transaction to be automatically booked, confirmed, settled, reconciled and entered in all ledgers) is some distance from reality.

The aim here is not to examine the potential for real-time processing of all payments, but to establish whether the treasurer can expect to reduce costs by eliminating delays, ie 'float', currently accepted as part of the business cycle.

The A/P and A/R functions of many large UK corporates remain swamped in paper and progress is often incremental. Let's look at the paper chain at its most primitive and compare this with how it could be. After undertaking the necessary price, service and quality comparisons, Company A raises an approved purchase order for a consignment of goods from Company B (an A/P forward entry may also be made at this point). On receipt of the order (perhaps by post or fax), Company B processes the order, making the necessary A/R entry and passing the order to the warehouse. At a given point dependent issues such as inventory and location, the delivery is made, accompanied by an invoice stating standard credit terms. These are noted in the A/P function and an additional item is included in Company A's regular cheque or BACS run. A remittance advice is then sent to Company B, which is reconciled in its accounts receivable ledger when the payment is recognised in the firm's regular bank statement.

Many will rightly point out that some of these steps are already automated, centralised or outsourced to an extent. Indeed, there are a number of cracks in the antiquated regime described above:

- **B2B portals.** A number of UK banks are offering business-to-business (B2B) marketplaces which clients can use to buy a wide range of business services – printing, IT, janitorial, plus larger-ticket items – in a secure environment. The bank guarantees the credit of all participants and in some cases will help set up an online tender.

- **EBPP.** Electronic bill presentment and payment (EBPP) services from banks are already cutting out physical paperwork. More rarely, they are being linked into firms' A/P and A/R systems, further reducing the scope for human intervention once a sale or a purchase is authorised.

- **'E-payments'.** B2B payments via the UK clearing system are slow to change, largely because collective bank action is required as well as individual, competition-driven, improvements. Save for costly automated clearing house (ACH) payments, processed by CHAPS, clearing times for payments in the UK remain stuck in a three-day cycle, for which government intervention would appear to be the only remedy. Software that automatically faxes remittance details to suppliers simultaneous to the release of payment instructions to the bank is common, but email remittance advice less so. On the business-to-consumer (B2C) side, increased use of credit cards over the internet and development of bill aggregation services for local authorities and utilities both serve to bring more payments online. For corporates, replacing multiple low-value payments with a single large value payment at a predetermined date could have considerable working capital and cashflow implications.
  Current bank pricing for processing of internet-based card payments means the benefits to cashflow might be outweighed by

'THE TREASURER MAY NEED TO ADJUST EXISTING SHORT-TERM FUNDING REQUIREMENTS TO ACCOUNT FOR SHORTER CREDIT TERMS FROM SUPPLIERS'

costs. But paperless direct debiting across the internet also reduces paper work and processing times.

- **Outsourcing services.** In this area, A/R has taken a different route to A/P. This is partly due to control issues – losing control of payments means losing control of costs. On the A/R side, outsourcing of the sales ledger has become familiar as a bi-product of factoring, and lockboxes are commonly used to outsource cross-border retail collections to the bank. But order-to-cash outsourcing specialists are also emerging, using technical expertise and economies of scale to take all collections processing off the company's hands. Outsourcing of A/P to third parties may lag A/R, but automation of payments is increasingly sophisticated. Several multinational firms with high volumes of mixed format, mixed currency payments have centralised their entire A/P function into a payments factory or hub, which effectively outsources much of the process by passing a single payments file to its bank. Similar direct file services are also available to UK corporates, whereby a mixed payment file of cheques, ACH payments, BACS etc is delivered electronically to a bank for further processing.

Within each step, different levels of automation have been achieved. For example, cross-border low value ACH payments suffer from different country formats and varying levels of payment detail / remittance information, in comparison with high value payments. But even when such issues are resolved, the problem of co-ordinating the whole order-to-payment process remains. The advances described above have not yet resulted in STP, nor have they enabled the treasurer to shorten the payment cycle sufficiently to bring true benefits in terms of reduced reliance on overdraft funding of working capital requirements

In this context, the key to STP is in implementing linkages between business units and trading partners via the current generation of web-enabled technologies. As such, treasurers are increasingly seeking out partners that are able to cut across product boundaries (that is, software, banking services, online exchanges) via alliances to provide end-to-end solutions.

Let's look at that same transaction, but with full automation to see how far things could change. Using password-protected authorisation, a procurement manager at Company A orders goods from Company B through an online trading portal (for which a bank or banks may be acting as a trusted third party 'guarantor'). The portal automatically sends a pre-formatted message to Company A's accounts payable ledger and schedules a future payment in accordance with Company B's credit terms. The trading portal also sends an order confirmation message to Company B's integrated enterprise resource planning (ERP) system.

This triggers an automated request to Company B's warehouse for the order to be made up and delivered. Meanwhile, an invoice is prepared for electronic presentment to Company A on receipt of the order. Assuming satisfactory delivery of the goods, Company A authorises payment electronically, through both a remittance advice to Company B and an instruction to its bank to release the previously scheduled payment. Alternatively, the remittance details are passed automatically via the bank.

While this model might not take into account all the practical realities facing individual companies, it does present a version of future cashflow cycles in which currently accepted practices are no longer appropriate. The following are among the changes to treasury practice that may follow full order-to-payments STP.

- **Control of access to B2B ordering portals.** Controls already ensure that payment instructions are not released without due authorisation. Payment cards used in the operating units have strict limits and access to the payments module of an electronic banking system are detailed in the treasury controls manual, but controls may have to be extended to use of B2B procurement portals and, eventually, service level agreements with outsourcing agents. The more automated the process, the weaker the treasurer's ability to manipulate the timing of payments according to unexpected changes in working capital requirements.

- **Review of working capital management.** With all processes in procurement cycle being squeezed, the impact of this streamlining on the flow of cash in, out and around the business could be significant. Attritional delays have traditionally been taken into account when putting together cashflow forecasts and credit terms, but current terms may no longer be appropriate as the cycle tightens further. The potential downside exists for the company that purchases more goods than it sells, and the treasurer may need to adjust existing short-term funding requirements to account for shorter credit terms from suppliers. On the other hand, there may be opportunities to manage work-in-progress and stock levels more effectively. These will have to be explored by the treasurer in consultation with operating units to maximise benefits.

- **Renegotiation of bank funding lines.** Overdraft lines put in place to fund traditional delays in the cashflow cycle may become redundant. Depending on whether or not the company is already cash positive or not, the framework for managing short-term funding or investment may need to be reviewed if the order-to-cash cycle improves. Certainly users of revolving credit facilities may be able to reduce the amount they draw down or alter their terms with the bank.

THE BOTTOM LINE. Although A/P and A/R may not be directly under the treasurer's control, it is an area where costs can be squeezed – particularly important. Potential cost reductions appear two-fold, lower transaction processing costs and reduced reliance on bank funding of working capital. Foreshortened credit terms and automated payment processes (linking purchaser, supplier and the banking system) may not guarantee value dates, but can bring more certainty than at present.

Moreover, it provides an opportunity to work with business units to derive greater operating efficiencies across the whole of the firm – therefore, demonstrating the value the treasury can add in terms of transaction costs and interest expense To realise such efficiencies, of course, the cost and resources of implementing STP solutions cannot be overlooked, nor can the need for standardised rather than as typically user-specific interfaces.

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