Optimize Working Capital, Courtesy of AP

Underwritten by

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January, 2013
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In the present business environment, an increasing number of enterprises are looking to implement working capital optimization strategies in order to improve balance sheets as well as fund investments and fuel growth. Accounts payable (“AP”) represents one of the main opportunities to optimize working capital. However, it is not easy to accomplish this in a sustainable manner without some level of automation in the AP process. This report explores the opportunities that exist within AP to impact working capital management.

The economic conditions over the last few years have made one thing crystal clear: cash is king; and, it is likely to maintain that status for many years to come. The financial crisis and overall economic downturn that began in 2008 resulted in a liquidity shortage that made it more difficult for enterprises to maintain direct access to credit. Since then, lenders have established more stringent lending criteria and have kept a closer watch on their clients’ balance sheets. Now, as businesses begin to restore their focus on growth, the challenge is finding alternative sources of cash to fuel that growth. This situation forced many enterprises to reevaluate the importance of working capital management as a mechanism for unlocking cash and, as a result, reduce their reliance on third-party financing to fund operations and investments. In order to gain access to this source of cash in a manner that is sustainable, finance leaders must make improvements in the three major areas that drive working capital, accounts payable (“AP”), accounts receivable and inventory management.

The focus for this report is AP and how working capital can be improved through this business process. Often, enterprises utilizing the AP method will decide to withhold payments for lengthy periods of time and aggressively push for extended terms. However, there is a danger that this becomes a standard practice which can harm supplier relationships and potentially disrupt the buying organization’s business operations. A more sustainable approach that will yield more benefits in the long-run is to streamline the larger procure-to-pay process and, more specifically, streamline the AP process to ensure greater efficiency and visibility across the department. Real-time visibility and accuracy into current and future liabilities gives AP more control and precision around the outflow of cash, thereby improving the management of working capital. But streamlining AP operations is a challenge, especially when an AP group is operating in a manual and paper-based environment, making it extremely difficult for AP to be a source for working capital improvements.
The Challenge for AP

In many enterprises, AP is not broken, per se, but it does need to be fixed, especially if AP is expected to focus on optimizing working capital. AP is generally one of the last departments in an organization to benefit from any sort of automation. This is evidenced by recent Ardent Partners’ research (figure 1), which shows that in 2012, the average enterprise received approximately 71% of its invoices in a manual format (i.e., paper, PDF, email, fax). This sort of manual AP environment is not only costly and inefficient, but it also limits control and accuracy over payments and accessibility to data (e.g., invoice and payment related information), all of which are necessary in order to get a good grasp on working capital and understand the various levers that can be used to optimize it.

A paper-based AP process can be more error-prone and time-consuming than an automated one, resulting in lengthy invoice processing times, duplicate and late payments, overpayments and a number of other unnecessary inefficiencies. In addition, manual processes also make it difficult to take advantage of early payment discounts and to get an accurate picture of accruals due to the poor level of visibility into the AP process and the related data. Manual processes are resource-intensive and require AP staff members to complete tactical tasks such as entering data and responding to supplier inquiries as opposed to focusing on more strategic activities. A manual environment restricts AP’s ability to support and add value to the treasury, in fact, it can lead to improper cash flow analysis and inaccurate cash flow forecasts by the treasury.

Optimization through Technology

AP’s ability to add value to the strategic objectives of the business is greatly enhanced through the usage of technology. Leveraging technology enables AP to process invoices and payments in a more efficient and accurate manner while exercising greater control in the outflow of cash. Automation also captures real-time invoice and payment data allowing for more accurate forecasting and analysis of cash flow.

Establishing a working capital focus throughout various operational processes, including AP, takes diligence and a well-designed and detailed strategy. Enterprises must understand that the right capabilities must be in place in order to successfully execute an optimization strategy. One of the most utilized mechanisms is process automation (figure 2) as shown in Ardent Partners’ research.
Commercial card products and payment automation are the most popular mechanisms currently being used by enterprises to manage their working capital. These solutions allow organizations to have more control and visibility into the payment process. For example, purchasing cards (“p-cards”) offer lower processing costs and greater spend visibility than paper checks, and have the literal extra bonus of paying buyers a percentage of card volume via a rebate program. Using a p-card can save time by eliminating the need for a purchase requisition or purchase order. P-cards can also aid in the management of cash by offering short-term credit to the buyer while paying the supplier immediately without the need for an invoice. Other commercial card products such as “cardless” payment accounts or single-use accounts offer similar benefits.

As shown in the chart above, AP process automation and payment automation are also key mechanisms that many organizations use today to optimize working capital, and that many others plan to adopt over the coming year. Additionally, it seems that enterprises have begun to realize that getting their suppliers onto an AP platform and enabling them to submit eInvoices and accept electronic payments is an important part of improving the management of working capital. On-boarding suppliers is a crucial first step in removing paper and automating the transactions between a buyer and seller, thereby drastically improving connectivity, control and visibility into payables.

**Technology Considerations**

It is clear that there is considerable interest in automating the AP process, but what are some of the important factors to consider when going down this road? There are a number of different ways to automate the AP process and, depending on a specific department’s requirements and the solution selected, all or part of the AP process can be automated. However, according to research from Ardent Partners, best-in-class AP groups are more likely to automate the entire AP process, which consists of the following major phases (1) **Receive** – how an enterprise receives invoices (2) **Process** – how an enterprise validates and approves the invoice, and (3) **Pay** – how an enterprise manages and executes payments.
Automating the entire process can be achieved by utilizing a single end-to-end solution or by combining different services and solutions together. Typically, an end-to-end solution will have the following features, which play a role in providing the level of control, visibility and accuracy within the AP process that is required to have a significant impact on working capital:

- **eInvoicing** – Ability to create and submit electronic invoices or purchase order flips
- **Scan and capture** – Allows invoices that are submitted in paper format to be converted into an electronic format
- **Automated routing and approval workflow** – Configurable business rules that automate matching, validation and routing of invoices and payments
- **Payment automation** – Ability to manage and execute various forms of payment, including checks and electronic forms such as commercial cards, ACH/EFT or wire transfers
- **Connected supplier network** – Improves connectivity between trading partners, although not offered by all end-to-end solutions
- **Self-service supplier portal** – Not part of all end-to-end solutions, a supplier portal provides real-time visibility into invoice and payment statuses

In addition to the above functions, certain providers have the ability to offer automation around capturing early payment discounts and various financing options that can further support a working capital optimization strategy. These are typically accessible to those that have leveraged technology to a significant degree, and as a result, can maintain a higher level of visibility, transparency and efficiency in the process.

- **Dynamic Discounting** – Allows buyers and sellers to dynamically alter the standard terms of payment. These solutions enable buyers to offer early payment discounts to suppliers based on certain requirements. Buyers manage their discount offers according to cash positions, allowing them to generate higher yields on available cash.
- **Trade Finance: Supplier** – Once an invoice is approved, the lender pays the supplier early, minus a financing discount; the buyer then pays the full invoice amount on an agreed upon billing cycle. By leveraging this type of facility, the buyer can extend days payable outstanding and maintain a more consistent cash flow.
- **Trade Finance: Buyer** – The lender establishes a line of credit for the buyer that is designed to extend payment terms. Financing is based on the receipt of the buyer’s approved invoices and the supplier’s offer to sell the invoice. The supplier is paid on the “net due” date and the buyer then pays the full invoice amount plus a financing fee on an agreed upon billing cycle.

Although technology is a significant enabler and helps to establish a strong foundation, in order for AP to support a working capital optimization initiative and ensure that it becomes a long-term, sustainable process, collaboration between AP and treasury must be encouraged and policies and procedures must be established. This includes monitoring AP metrics (such as invoice cycle times...
and percentage of invoices received electronically) and establishing policies around payment methods and discounts, supplier enablement and the usage of financing instruments.

**Best-in-Class AP Operations**

Best-in-class AP departments have successfully elevated their function to become a more strategic component of financial operations. These leading groups have achieved optimal levels of processing efficiency and are able to align systems and processes to ensure a high level of visibility and control. By taking a holistic approach to the process and leveraging technology to a higher degree than their peers, they have been able to automate a larger portion of their processes and increase their focus on strategic activities.

As shown in Table 1, organizations that have achieved best-in-class performance are able to process an invoice at a cost less than $2. On average, these organizations receive 67% of their invoices in some electronic format. Also, best-in-class companies are able to process a much higher number of invoices per full-time equivalent (FTE) — over 4,000 per month — which has a large impact on costs and efficiency. Additionally, an essential component of capturing early payment discounts is the ability to process invoices in a timely manner, and have them ready for payment in time. Best-in-class AP departments report invoice processing cycle times of approximately 3.8 days versus almost 15 days for their competitors.

**Table 1: Best-in-Class AP Performance**

<table>
<thead>
<tr>
<th>Metrics</th>
<th>Best-in-Class</th>
<th>All Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost to Process an Invoice</td>
<td>&lt;$2</td>
<td>$23</td>
</tr>
<tr>
<td>Percentage of Invoices Received Electronically</td>
<td>67%</td>
<td>13.3%</td>
</tr>
<tr>
<td>Number of Invoices Processed per AP FTE / month</td>
<td>&gt;4,000</td>
<td>1,400</td>
</tr>
<tr>
<td>Invoice Processing Cycle Times (receipt to approval)</td>
<td>3.8 Days</td>
<td>14.8 Days</td>
</tr>
</tbody>
</table>

It is due to this higher level of efficiency and the visibility that is created through automation, which enables best-in-class AP groups to influence and support working capital optimization strategies.
Recommendations

Ardent recommends the following strategies and approaches for AP departments that wish to improve their performance, and position themselves to add significant value to working capital optimization efforts.

- **Migrate off paper, by any means necessary** – Removing paper from the AP process should be a top priority for AP leaders. Take whatever method is most accessible and appropriate for your organization. One approach to consider is the multi-solution or portfolio approach to removing paper. In this strategy, groups may utilize eInvoicing and put in place strategies to maximize the number of invoices received in this manner, while also deploying scan and capture capabilities to handle those suppliers who continue to send paper invoices. Establish migration goals and track the percentage volumes for both manual and electronic invoices and payments to ensure that targets are met.

- **Develop a supplier enablement strategy** – One of the biggest challenges to a successful AP automation initiative is enabling a majority of the supply base to submit eInvoices and/or accept ePayments. Therefore, once a solution is selected, it is important to develop a plan to enable as many suppliers as possible in the shortest timeframe available. A strong and well-managed communication campaign can make the difference between a small percentage or a sizeable majority of suppliers being on-boarded. The execution of the communication is as important as the message itself: make sure that the right suppliers receive the right message.

- **Build an electronic payments strategy as part of the overall AP transformation** – An AP transformation effort should also include a plan to migrate from manual and paper-based payments. Electronic forms of payment or ePayments (e.g., card products, ACH/EFT, wire transfers) offer significant cost savings versus manual methods as well as improved security, more precision and visibility into payments, all of which are a necessary part of optimizing working capital. A supplier enablement effort should also include a strategy around improving the acceptance of various forms of ePayments among the supplier community.
ABOUT ARDENT PARTNERS

Ardent Partners is a Boston-based research and advisory firm focused on defining and advancing accounts payable, procurement and supply management strategies, processes and technologies that drive business value and accelerate organizational transformation within the enterprise. Founded by Andrew Bartolini, Ardent also publishes the CPO Rising and Payables Place websites. Register for access to Ardent Partners research at ardentpartners.com/newsletter-registration/.

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Vishal Patel is a recognized expert in the world of accounts payable and supply management. He has worked closely with accounts payable and procurement groups for most of his career, researching best practices and advising clients on how to utilize technology to improve organizational performance. Vishal is the lead analyst for Ardent’s ePayables (Accounts Payable automation) coverage and is also responsible for the oversight of certain AP solution selection and benchmarking projects.

Vishal joined Ardent from a technology provider, where, as Director of Business Development, he helped establish and grow the company’s US business by helping corporations de-couple their marketing supply chains and drive significant savings. Earlier in his career, Vishal was a Research Director in the Global Supply Management research practice at Aberdeen Group where he led and supported the coverage of many key areas including contract management, commercial cards, ePayables and complex category management.

Vishal has been named a “Pro to Know” by Supply and Demand Chain Executive and holds a B.S. in Finance and International Business from The Pennsylvania State University and an M.B.A from Babson College. He welcomes your comments at vpatel@ardentpartners.com or +1. 917.470.9522.

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