SoftCo
Smart Automation.

eBook

6 Procure-to-Pay Strategies to Boost Working Capital

www.softco.com

Table of Contents:

Invoice processing overview

An organization's working capital can be measured by comparing current assets against current liabilities. This formula tells us the short-term, liquid assets remaining after short-term liabilities have been paid off. This is important for performing financial analysis, financial modeling and managing cash flow.

Working capital is an accurate barometer for assessing the long-term financial health of a business. When not managed efficiently, however, companies often suffer from cash flow problems that significantly affect their ability to expand, improve processes or even operate their business.

Procurement and accounts payable teams need to work together to ensure that their procure-to-pay process is best placed to improve the buyer's cash conversion cycle without hurting suppliers' own cash flow needs.

The major drivers of a company's working capital are accounts receivable, inventory, prepaid balances, unearned income in current liabilities.

In general, the higher a company's working capital, the better. High working capital is considered a sign of a well-managed company with the potential for growth.

Benefits of Positive Working Capital

Improved Liquidity

Effective working capital management ensures that adequate cash levels are available for any potential upcoming opportunities or unanticipated scenarios. Positive working capital also gives organizations more flexibility, enabling you to satisfy customer orders, expand your business and invest in new products and services quicker.

Evades Interruptions in Operations

Optimum use of working capital management evades any future hindrances in business operations. A 'safety net' is available to protect against lack of production or delays in payment of suppliers.

Increased Profitability

Optimized working capital management is only achieved when areas including Accounts Payable and Receivable are operating efficiently. When this happens, organizations will always pay their suppliers per the agreed terms meaning they will capture early payment discounts and increase the income of cash.

Achieving the Correct Level of Positive Working Capital

Most businesses aim to achieve positive working capital on a consistent basis, however, it's important to note that there is a limit to how much positive working capital an organization should hold at any one time.

An extremely high figure is not always necessary. It can mean that there is more money within the company than needed in order to fulfill its operations. A high level of working capital may also indicate that cash is not being invested in the correct manner, or company growth is being neglected in favor of maximizing liquidity.

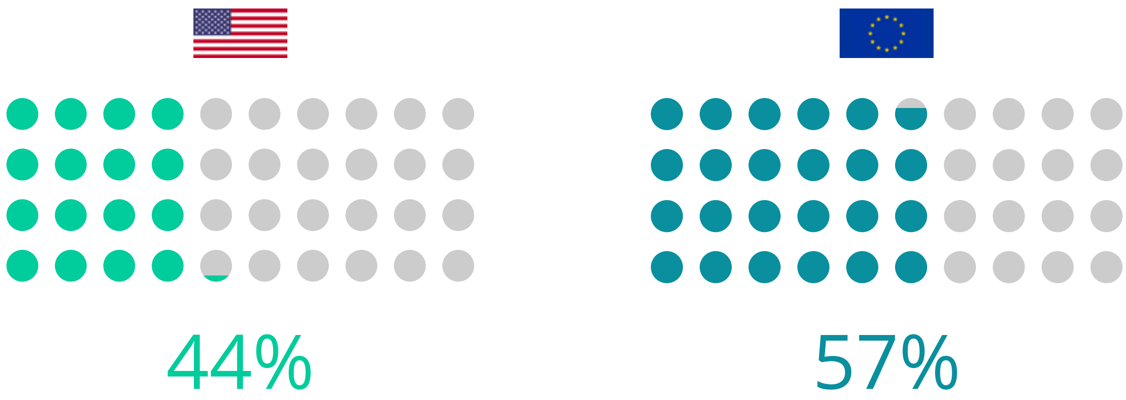
Having too much working capital in unsold and unused inventories, or uncollected accounts receivables from past sales, is an ineffective way of using vital resources. The key is to consistently maintain positive working capital, but avoid reaching too high a level that leads to waste and inefficiency.

An organization's procure-to-pay process can play a major role in helping to achieve the optimum level of positive working capital. Before undertaking strategical changes to your procure-to-pay process in a bid to optimize your working capital, it's worth taking a look at some current working capital trends in order to see where mistakes and gains have already been made.

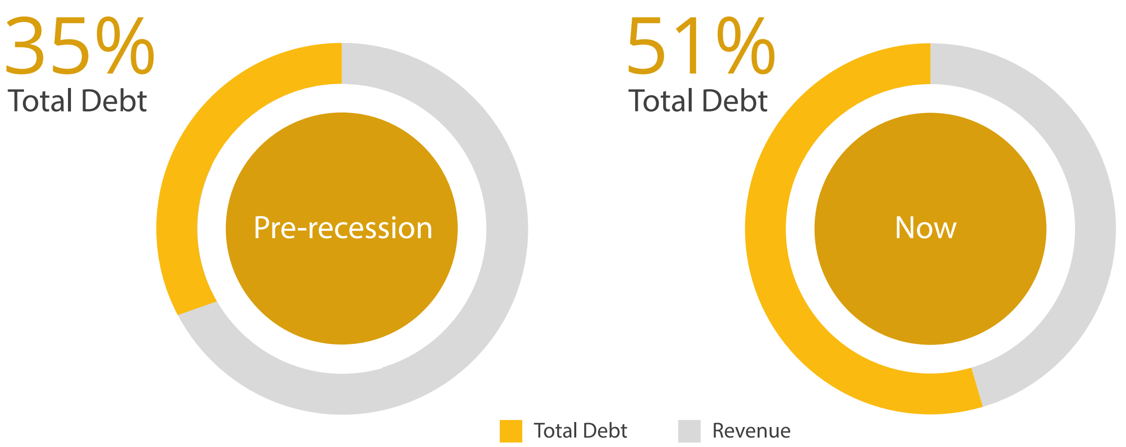
Working Capital Trends for 2019

Studies show that overall working capital performance has improved for the first time since 2014. Net working capital days, the number of days taken to convert working capital into revenue, were at their worst level in 2016, but **11 out of 17** sectors have improved their working capital performance since then.

If we look at working capital performance by region, however, focusing on the top 2000 companies in the US and Europe, the US is lagging behind its European counterparts. 44% of US companies have reported improvements in working capital performance, compared to 57% in Europe.

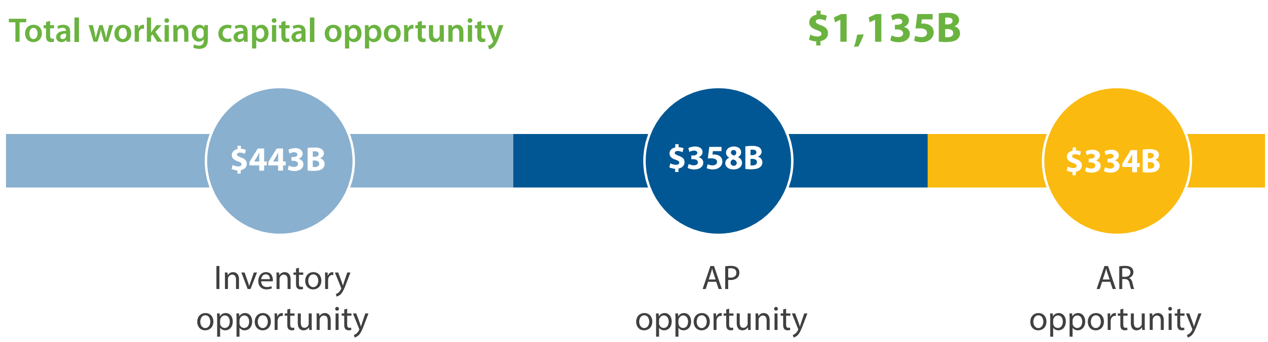


The reliance on debt as a source of working capital has been particularly visible in recent years, but rising interest rates and global political uncertainty have put paid to this trend, as many organizations begin to re-evaluate their financial strategies.



Charts show the total debt for all the companies included in the 2018 Working Capital Survey. as a percentafe of their total revenue. Data shown is from FY2008 and FY2017

Working Capital Opportunities



Inventories prove to be the biggest working capital opportunity, with 39% of total working capital tied up in this area. Payables and receivables also remain strong working capital opportunities, as organizations continue to reduce their reliance on debt and instead optimize their cash positions.

With inventory and accounts payable management pivotal in obtaining the optimum level of working capital, organizations are beginning to review and optimize their procure-to-pay process.

Strategies for Improving Working Capital in P2P

1. Effectively Manage Your Inventory

Close management of your inventory can have a major impact on your working capital management and affects both sales and procurement teams.

It is vitally important to consistently maintain an optimum level of stock.

Having excessive stock levels can place a heavy burden on the cash resources of any business in a number of ways. By ordering too much, you may be left with expired or out-of-season stock, if you don't manage to sell it in time. As well as creating a lot of waste, excessive stock levels drive up storage and insurance costs.

On the flip side, insufficient stock can result in lost sales and damage to customer relations. If you order too little, customers may become frustrated over time and start to look elsewhere.

In order to establish optimum stock levels consistently within your organization, you need to promote better communication and forecasting between departments. You can also apply a general rule to your inventory, whereby the oldest stock is sold first. Additionally, periodic inventory checks are useful in monitoring levels of different types of stock and alerting finance to any recurring overstock or understock issues.

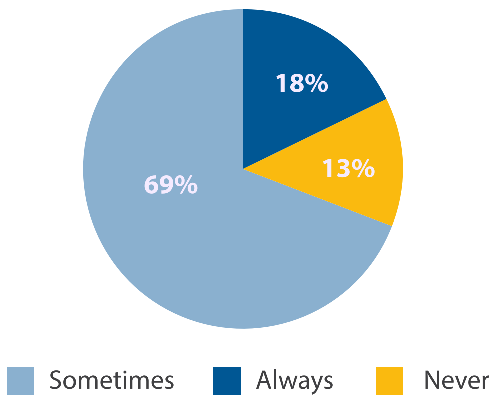
It is, however, just as important to monitor what you buy as much as you sell. Investing in a procurement automation solution can greatly boost working capital. Streamlining and centralizing the purchasing process enables a rigorous authorization process. This prevents maverick spending and ensures that stock is purchased from preferred suppliers only, who have been chosen based on quality of goods and favorable payment terms.

2. Negotiate Early Payment Discounts with Preferred Suppliers

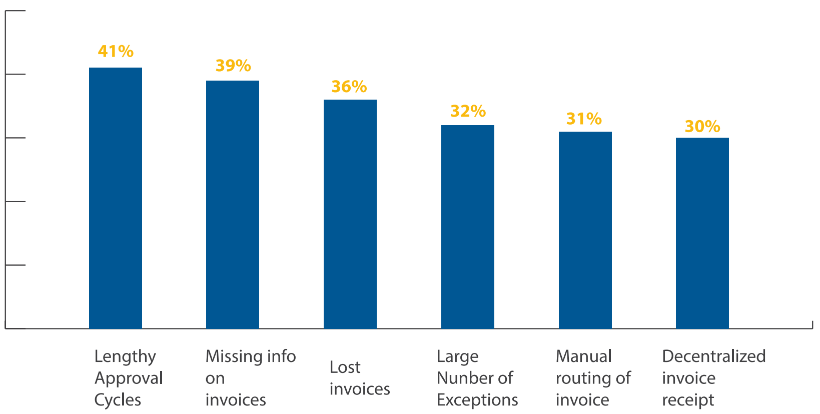
For purchasing organizations, the goal, generally, will be to increase their Days Payable Outstanding (DPO) in order to keep as much capital within the organization for as long as possible. Suppliers, on the other hand, hope to decrease their (Days Sales Outstanding) by speeding up the time in which customers take to pay debts.

An optimized working capital environment between both purchaser and supplier is where the cash conversion cycle needs of both are met however, this is not easily done.

One particular strategy that is helping to achieve this is early payment discounts. Suppliers set specific discounts on invoices in return for payment on specific dates. However, the number of organizations capitalizing on early payment discounts is still quite low.



A major reason why many companies miss out on early payment discounts is that their procure-to-pay process is littered with manual inefficiencies that greatly increase invoice-to-payment times.



An automated accounts payable solution enables businesses to accelerate their invoice lifecycle and capture early payment discounts more regularly than before. Depending on the size of your organization, the savings could amount to thousands, or even millions.

3. Automated Invoice Processing

The process of capturing relevant data from an invoice, matching the invoice to a GRN and PO, and sending the matched invoice for verification and approval, is often manual and time-consuming. According to PayStream Advisors, this process usually takes 45 days for industry novices and 23 days for mainstream finance teams. Costs can be as high as $14.38.

Imagine if there was a way to speed up these times to below 4 days ensuring that you can capture more discounts? What if you could reduce the cost of invoice processing to below $2.50 leaving you with additional cash flow?

Through Robotics Process Automation (RPA), global organizations are transforming invoice processing, and in turn, significantly boosting working capital. The three key areas of improvement for these organizations, as they affect working capital are:

Invoice Data Capture

This is the process of receiving an invoice from a supplier, extracting the relevant data, and entering it into an ERP or finance system. Traditionally, this process is expensive, manual and often leads to data errors.

With an automated solution, technologies like Optical Character Recognition (OCR) scan invoices that arrive in the form of paper, electronic files, PDFs or emails, and transfers the relevant data to a finance system, ready for matching.

Invoice Matching

Manually matching invoices, POs and GRNs can lead to a number of challenges. Incorrect data, missing or damaged documents, and compliance issues can often disrupt the invoice processing operation, increasing costs and time involved. This affects the organization’s ability to pay suppliers quickly and capture early payment discounts.

RPA can read relevant data from documents to automatically match them without any human interaction. As a result, employees save a considerable amount of, protect against human error, and greatly improve internal and external compliance.

Invoice Approval

Manual invoice approval processes involve a number of inefficiencies. Invoices can often go missing or spend longer than they should on someone's desk. With slow approval processing times, organizations will often miss early payment discounts or worse still, miss payment deadlines and end up having to pay penalty fees.

By setting up pre-configured invoice approval workflows in your AP solution, RPA essentially manages the entire process from there, in a much more efficient manner. Reminder notifications can be sent to speed up approval times and these invoices can usually be approved on the go, through mobile applications.

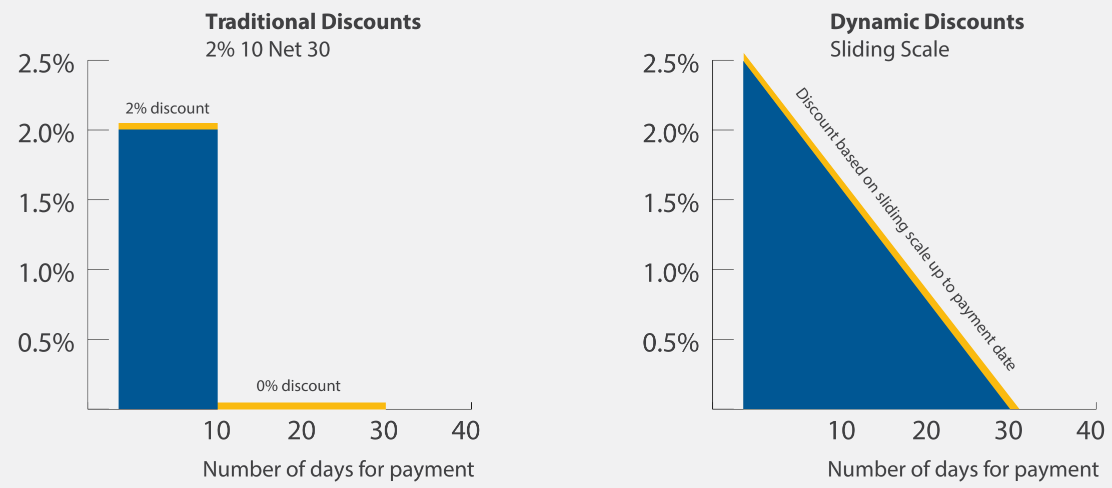
Balancing working capital, however, between buyers and suppliers, becomes more difficult for larger organizations and those that rely on more complex supply chains.

Large organizations dealing with complex supply chains and numerous suppliers often pay different suppliers under different payment terms. This is where a strategy called *Dynamic Discount Management* may be more beneficial than standard early payment discounts.

4. Dynamic Discount Management

Dynamic Discount Management (DDM) works off supply and demand to determine the price that customers pay. With static early payment discounts, rates and payment dates are pre-determined. With dynamic discounting, buyers and suppliers can collaborate on how and when discounts are offered and accepted.

Using a Dynamic Discount Management 'sliding-scale' discounting platform, the discounted amount is adjusted based on the actual pay date. Early payment discounts decrease as payment deadlines approach, enabling buyers and suppliers to set and select discounts according to their own business and financial requirements.



Such solutions give suppliers greater visibility over the status of invoices, which increases their ability to offer more tailored discount rates for particular invoices. They also act to greatly improve the health of supplier relationships and supply chain efficiency.

Some solutions allow buying organizations to choose between recurring or one-off discounts. Many give buyers the ability to segment suppliers and discount schemes according to supplier size, geography, spend, and other characteristics.

DDM solutions are designed to reveal every possible savings opportunity by allowing buyers to view discount terms and upcoming due dates at any time.

5. Payments

For a long time, checks were by far the most common form of payment between organizations and suppliers. Organizations are now starting to realize that by automating the payments process with electronic payments tools, they can significantly improve their cash flow and capitalize on savings.

Currently, 51% of B2B payments in the US are conducted via check, however, by 2020, this number is expected to drop to as low as 34% (Association for Financial Professionals). Today, 80% of organizations are making efforts to transition their B2B payments from paper check to electronic.

Electronic payments come in a variety of forms, with two of the most popular being Purchasing Cards (P-Cards) and Automated Clearing House (ACH).

Purchasing Cards (P-Cards)

One of the main reasons why P-Cards have become such a popular form of electronic payment is that they are particularly easy to implement. They are also one of the most widely-used tools for capturing discounts and therefore can be a particularly good source for generating working capital.

With a card payment, invoices can be paid and also discounts can be captured on the same day. Rather than having to adhere to typical 30-day invoice payment terms set by most suppliers, organizations are often able to hold onto capital beyond the usual 30 days, giving them more options over how to conduct their operations.

With a card payment, invoices can be paid and also discounts can be captured on the same day. Rather than having to adhere to typical 30-day invoice payment terms set by most suppliers, organizations are often able to hold onto capital beyond the usual 30 days, giving them more options over how to conduct their operations.

Furthermore, the costs associated with printing and mailing checks is completely eliminated with a switch to P-Cards.

Automated Clearing House (ACH)

The ACH Network is an electronic system that enables organizations to electronically collect payments for either single-entry or recurring payments. This is done by directly debiting customer checking or saving accounts.

The payments are created after the originator of the payment gives the organization permission to debit directly from their account. The originator's bank also takes the ACH transaction and batches it together with other ACH transactions to be sent out at regular times throughout the day.

The recipient's bank account receives the transaction, thus reconciling both accounts and ending the process.

Typically, ACH transactions cost the originator 29c. This figure is in stark contrast to the typical cost of $3 per check payment.

ACH is quite clearly a far greater source of working capital than paper checks, and organizations are beginning to realize this. As mentioned already, by 2020, only 34% of organizations will be using checks, however, ACH payments will have grown to 45% by this time.

According to data from The Association for Financial Professionals, an organization that sends 15,000 checks each month spend roughly $540,000 each year. In contrast, organizations that send payments through ACH are saving $487,800. These organizations are using these savings to re-invest back into the company.

**Assuming a company processes 15,000 payments a month.

	Cost to Process a Single Payment	Daily cost of:	Monthly cost of:	Yearly cost of:
Check	$3	$1,500	$45,000	$540,000
Purchasing Card	$1.50	$750	$22,500	$270,000
ACH	$0.29	$145	$4,350	$52,200

*Using median cost of $1.50

6. Procurement and AP Alignment

At present, one-half of organizations only capture early payment discounts some of the time and 16% never do. Organizations greatly improve their chances of receiving these discounts when their procurement and AP teams are tightly aligned. There are four key areas where the duo can work together to improve working capital:

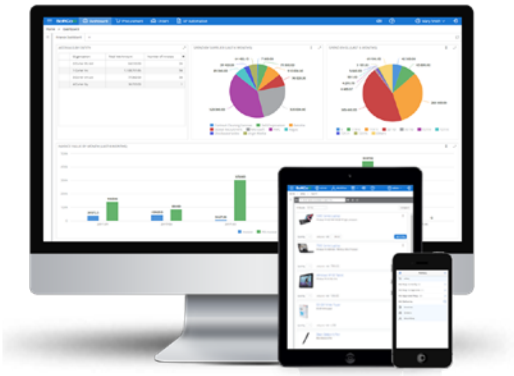
- When negotiating, procurement needs to be informed of a realistic invoice lifecycle time by AP so that the discount is actually achievable.
- Once a discount has been negotiated, procurement needs to communicate the terms to AP and facilitate them to ensure that they successfully capture the discount.
- AP can also have a hand in sourcing, a task normally left to procurement, by fuelling the process with insights into the budget and input on matters regarding the suppliers' accounting team.
- Procurement and AP are also a great pair when it comes to spend analytics, as both have a part to play in ordering, approving, and making payments. In order to make this partnership work, both teams are encouraged to develop common goals and find a way to track progress together.

References

PwC - Annual Working Capital Study 2018/19
Ernst & Young - Working Capital Management Report 2016
The Hackett Group - 2018 US Working Capital Survey
Levvel Research - 2017 AP & Working Capital Report
Association for Financial Professionals – 2017 Payments Fraud Survey

SoftCo

Procure-to-Pay Automation



- e-Procurement
- Accounts Payable Automation
- Payments
- Business Analysis
- Supplier Management
- Expense Management
- Contract Management
- eInvoicing
- ERP Integrations
- Compliant Archive

Trusted by over one million business users at large and enterprise organizations.

Request Demo

SoftCo

enquiry@softco.com

Dublin - Boston - Helsinki - London