WHITE PAPER

RECEIVABLES AND PAYMENT SERVICES

TRAVELING ON THE SAME PATH: THE CONVERGENCE OF AP AND AR

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Traveling on the Same Path: The Convergence of AP and AR

There is an increased trend toward the convergence of accounts payable (AP) and accounts receivable (AR). From working capital improvements to greater negotiating power with suppliers, companies can achieve significant benefits by taking a joint approach to AP and AR.

Companies have begun to realize that bringing these two areas together can lead to significant benefits. While the financial crisis kick-started a greater emphasis on working capital with companies looking to reduce their external borrowing needs and make better use of excess cash, companies still have ways to go in improving the cash conversion cycle (CCC). According to The Hackett Group's 2015 U.S. Working Capital Survey, "The cash conversion cycle once again remained flat in 2014, only improving one day since 2007. Cash on hand continued to increase, improving a total 74 percent over the same period. Even though revenue has increased 39 percent , debt continues to be a source of investment, increasing an alarming total 62 percent over the same period." Increasingly companies are converging their A/R and A/P processes across their people, process and technology in order to improve efficiencies and more effectively drive free cash-flow.

In the past, AP and AR were managed separately. After all, making payments and collecting receipts are processes which sit at the opposite ends of a transaction and which require very different skillsets. Making payments involves labor intensive tasks such as matching purchase orders, invoices and internal approvals and keying information into the relevant systems. The collections process involves dealing with payments in multiple formats as well as chasing overdue payments and resolving disputes. As a result of these differences, a company's AP and AR functions historically were rarely spoken about in the same breath. But more recently, AR and AP departments are converging.

At the same time, the arrival of new technologies has prompted many companies to make and receive payments using a more diverse range of payment instruments. This has created new opportunities for AP and AR teams to collaborate and learn from each other in order to benefit the organization as a whole.

This white paper explores the reasons why and how companies are approaching AP and AR more holistically, the benefits of doing so – and the challenges companies may encounter.

Why is a holistic approach to AP and AR the new way forward?

Companies are taking a more holistic approach to AP and AR for a couple of reasons. One is the increasing importance that companies are placing on working capital management. Working capital can be optimized in three ways: reducing inventory held, reducing days sales outstanding (DSO) and increasing days payables outstanding (DPO).

In the 1980s and 1990s, many companies focused on optimizing their inventory levels by adopting just-in-time models. A few years later, the focus moved to AP and AR: companies began improving working capital by delaying payments or by speeding up collections. Some companies discovered that by optimizing both DSO and DPO they could effectively operate with negative working capital, with their payables extending beyond the receivables the company was collecting.

Today, many companies have achieved optimum inventory levels, not withstanding minor adjustments. However, AP and AR typically continue to be ripe for improvement – and the greatest benefits can be gained by addressing both of these areas together. As a result, more companies are now giving a single person within the organization responsibility for AP and AR.

At the same time, the evolution of newer payment methods has led many companies to revisit the instruments that they use to make and receive payments. By bringing together perspectives from AP and AR, companies may be in a better position to understand the different types of payment technology available and learn from other companies' practices.

How can you're AP and AR teams improve their performance through collaboration?

The responsibilities of both AP and AR teams are becoming wider than in the past. On the one hand, AR teams are increasingly required to deal with electronic payments – particularly as more suppliers are pushing to make business-to-business payments using corporate cards in order to take advantage of attractive rebate arrangements. Meanwhile, suppliers are increasingly being asked to take on some of the AP responsibilities previously handled by their large corporate customers – for example, by inputting invoices directly into their customers' portals.

As a result, AR teams are gaining greater exposure to electronic payments, mobile payments and buy-side portals – so it makes sense to align these teams more closely with AP in order to share knowledge and benefit the whole organization. For example, a member of the AR team might observe that the company is receiving more requests to accept payment using credit cards, and might suggest that the AP team could look into the benefits of making more credit card payments. Or the AR individual might be required to input an invoice into a specific portal and might wish to consult the AP team for information about the portal and how to use it.

A further consideration is that some of a company's vendors may also be customers of that company, and vice versa. In such instances, there may be opportunities to harmonize terms across the different relationships. Let's say that Company A is looking to sell goods or services to Company B – and at the same time, Company A is a customer of Company B. If Customer B asks for unlimited liability, Customer A might be in a position to point to the existing contract and say that unlimited liability wasn't granted in the previous arrangement. In this way, an informed overview of both transactions can lead to more informed and effective negotiations.

Better information can also be useful in other circumstances. If a vendor is negotiating a contract with a new customer, the customer might claim that a certain point in the contract is not typically seen within that industry. The vendor might be able to counter this argument by stating that the disputed clause is common practice among its own suppliers – but a certain level of cooperation between the vendor's AP and AR teams is required in order to get to this point.

How does the convergence of Accounts Payable and Accounts Receivables look in practice?

With greater levels of interaction already taking place between AP and AR – and a growing focus on working capital management – organizations have inevitably begun to explore the benefits of bringing these areas closer together. But what does the convergence of AP and AR look like in practice?

Unifying the reporting lines

One key difference lies in the reporting lines for the two areas. Rather than having two separate lines for AP and AR, companies are increasingly appointing a single department head to own the two organizations to help drive working capital improvements. With people from both groups reporting in to him or her, this person would be in a better position to improve cash flow by taking a holistic view of both areas. The growing use of shared service centers is a strong enabler of this model: AP and AR are now typically incorporated within the SSC, so the director of a shared services center is a good example of a department responsible for both functions.

Establishing processes

Convergence is also taking place at the process level, particularly as AP and AR teams begin to approach their core activities in a more sophisticated way. Where payables are concerned, the focus used to be on receiving invoices from a vendor and paying them. While this might have included the use of electronic hubs, electronic invoices submission and automated workflow approval processes, the overall process remained the same.

Today, this is beginning to change. When they receive an invoice, the most sophisticated companies are now offering their vendors a set of options. These options might include receiving payment in 45 days by check – or ideally by ACH or electronic payment, which reduces the company's costs dramatically. Alternatively, the company may offer to pay in 30 days at a discount of 50 basis points or 1% of the original price – or the company might offer to pay within five days using a virtual card, with the vendor paying the relevant interchange fees. Some are providing vendors with dynamic discounting options which can improve both parties' working capital position.

Fact: Today, many companies have achieved optimum inventory levels, not withstanding minor adjustments

The same trends are likewise affecting accounts receivable. As well as invoicing their customers as quickly and efficiently as possible, and resolving any disputes in a timely manner, companies are also exploring the use of the same types of dynamic discounting techniques in order to get paid sooner. While AP and AR processes are still clearly different, both functions are focusing on the common goals of improving straight through processing rates and migrating from paper to electronic transactions.

Leveraging technology and workflow

Whether a company is sending or receiving an invoice, there is much to be gained by using electronic processes that will achieve this as efficiently as possible – and technologies are increasingly being developed which address both of these areas at once. Likewise, technology is emerging which can help companies both offer and receive dynamic discounting in order to optimize both AP and AR.

AP and AR or Billing Systems are becoming more collaborative as well. There are many instances where buying companies require their vendors to enter all the invoice information into their buy-side presentment system. The vendors have been forced to hire additional staff to perform the AP data input function for their customers. Customers requiring this function of their vendors have effectively offloaded the wage cost of hiring data entry clerks to their vendors' collection departments. This aspect of the convergence has led to innovation by technology companies that allow for automated data exchanges between their (vendors) billing or AR systems and these buy-side presentment systems. This automated data exchange eliminates the time, effort and cost of the vendors' collection personnel performing AP data entry tasks for their customers.

Workflow technology can also be used to support both areas of the business. For receivables, the process of collecting an invoice is a matter of workflow: once an invoice is sent, the company needs to stipulate how long it will wait for a particular customer to pay based on credit ratings and predictive analytics. On the basis of this information, the company makes a determination on whether to contact a specific customer at a particular point. The payables process likewise comes with its own workflow: when an invoice is received, AP needs to determine whether the invoice matches the PO and the receiver before submitting it for approval and handling any exceptions or disputes.

With a single stakeholder looking at both areas and realizing that similar process efficiencies can be gained in both of these areas, there is a growing demand for technology which can not only facilitate the use of dynamic discounts but also support dispute management processes.

Fact: Convergence is also taking place at the process level, particularly as AP and AR teams begin to approach their core activities in a more sophisticated way

Are you ready to overcome the challenges of a siloed AP and AR function?

The benefits of a collaborative approach can be significant. However, heads of shared services centers – and others with responsibility for both AP and AR – face a number of different challenges as they work to manage both areas successfully.

Some of these are the perennial challenges of AP and AR, such as moving from check to electronic payments, or introducing greater efficiency in the area of collections. Paying vendors as late as possible can be difficult, particularly across a diverse vendor base – some vendors may accept card payments, some may wish to be paid later and some may wish to be paid earlier. In some cases the vendor will be smaller than its customer; in other cases, the vendor will be the stronger player in the relationship.

At the same time, the AR team will be working to collect invoices as quickly as possible. This brings its own challenges, such as receiving payments in multiple formats and re-keying remittance data. Sometimes the vendor will have greater negotiating power; on other occasions the customer may be in a stronger position to dictate terms. Meanwhile, companies collecting payments from thousands of customers will need processes in place to identify accounts which are at risk of late or non-payment.

Other challenges may arise as companies bring these areas closer together. These might include working with the right number of vendors in order to automate processes across both areas. The more vendors a company works with, the more phone calls and integration points the company will have to manage – so getting this balance right is key.

At the same time, it's important to make sure that whichever vendors the company partners with are going to be there for the long haul. With so many new players and new technologies in the market, a further challenge is learning how to cut through the noise and focus on the core challenges around business-to-business receivables and business-to-business payments.

What does the future hold?

As more companies begin to approach AP and AR in a holistic way, technology vendors will develop a greater range of solutions which are designed to support the convergence of these areas. Companies tackling this area now may already be able to see significant benefits, from greater efficiencies to improved negotiating power. In the future, further opportunities for improvement will arise.

In conclusion, AP and AR may have been managed separately in the past, but companies are increasingly recognizing that one person's payment is another person's receivable. A collaborative approach to these areas can enable companies to gain the greatest benefits – and create a combined operation which is greater than the sum of its parts.

Fact: A collaborative approach to these areas can enable companies to gain the greatest benefits

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