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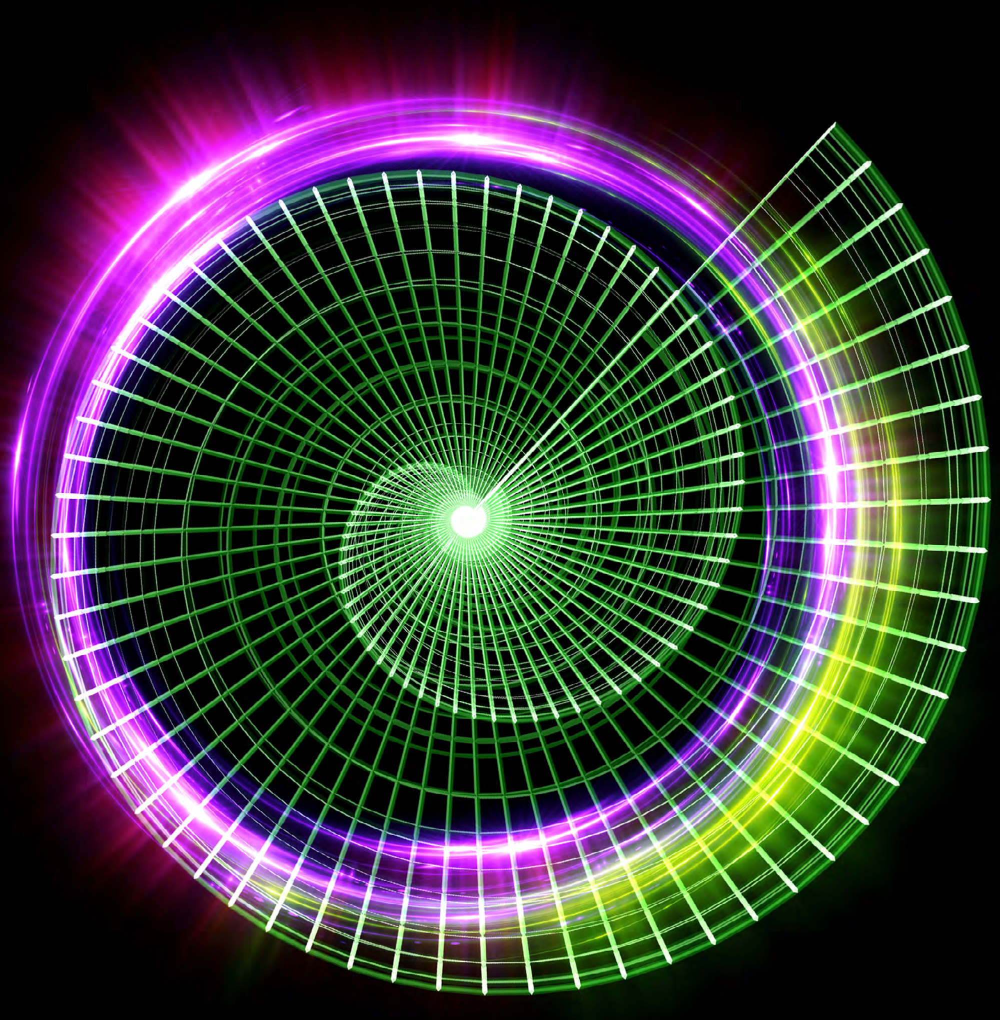
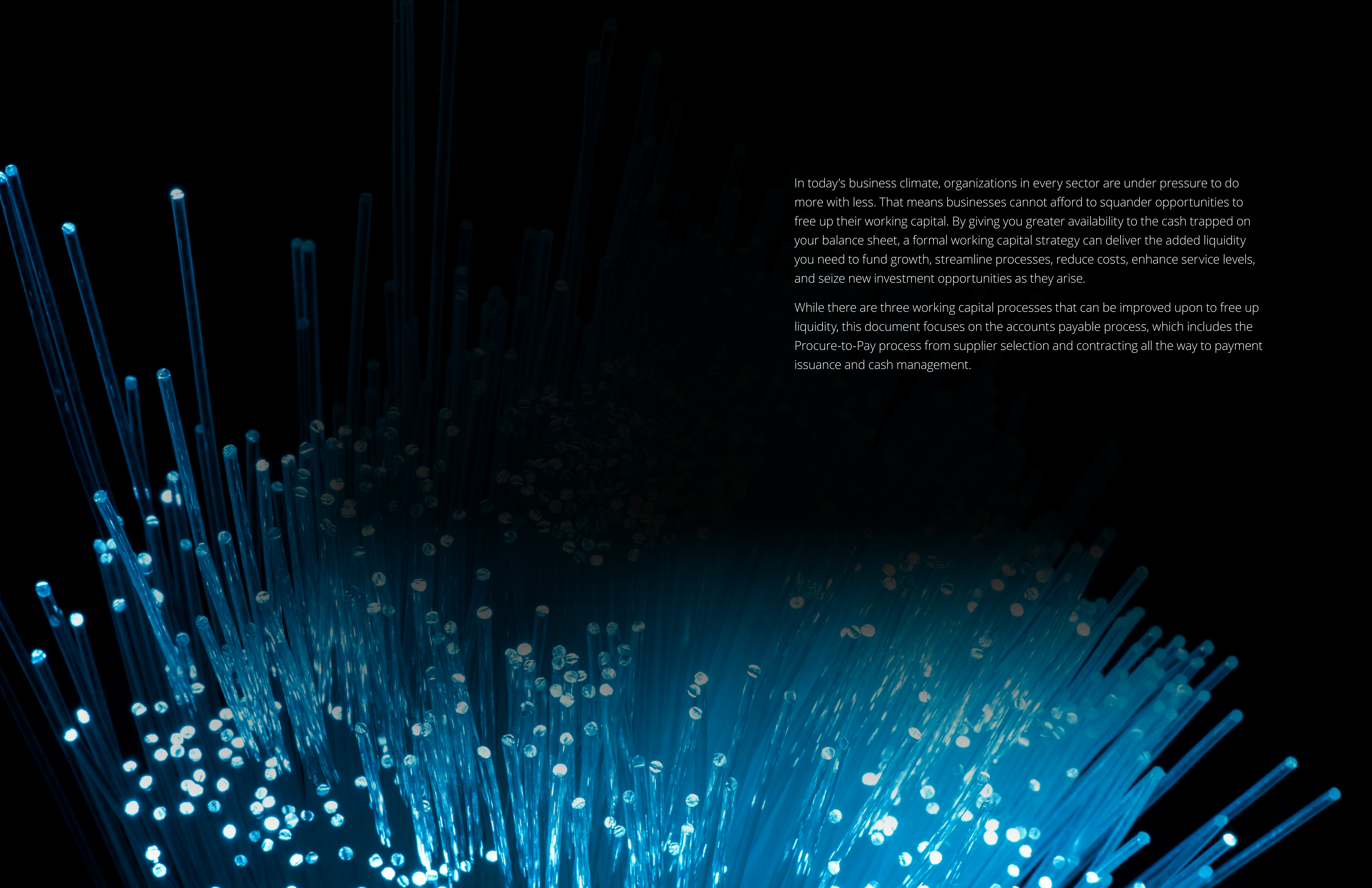


Make your working capital work for you

Strategies for improving your accounts payable



In today's business climate, organizations in every sector are under pressure to do more with less. That means businesses cannot afford to squander opportunities to free up their working capital. By giving you greater availability to the cash trapped on your balance sheet, a formal working capital strategy can deliver the added liquidity you need to fund growth, streamline processes, reduce costs, enhance service levels, and seize new investment opportunities as they arise.

While there are three working capital processes that can be improved upon to free up liquidity, this document focuses on the accounts payable process, which includes the Procure-to-Pay process from supplier selection and contracting all the way to payment issuance and cash management.

Taking a strategic approach to accounts payable management

Because accounts payable is a back-office function, it doesn't always take center stage as businesses look to grow or build competitive advantage. In fact, accounts payable process enhancements often take a backseat to management's competing priorities.

When it comes to working capital improvement, however, increasing payables should be a core strategy. To be sure, many businesses work this strategy by extending payables as long as possible to increase free cash flow. Unfortunately, this approach is not always the right one and typically not sustainable. If continued for long periods of time, consistently paying late can erode supplier goodwill and result in slower delivery times, less willingness to fix defects, slower responses to queries, and more onerous payment terms during future contract negotiations. On the flip side, paying early can yield benefits in situations where suppliers offer discounts or rebates for early payment; however, it also reduces overall cash balances and could lead to increased debt needs.

To effectively identify these opportunities and determine the right course of action when facing potentially conflicting outcomes, businesses should take a more strategic approach to managing accounts payable. The accounts payable team, along with the purchasing and/or procurement departments, should collaborate with senior management to inject a working capital culture throughout the company. This is about more than ensuring invoices are received and processed in a timely fashion; it's about adopting a management focus that emphasizes the importance of improving payables and freeing up working capital to fuel growth.

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Adopting leading practices

While organizational change is rarely easy, fostering a working capital culture can produce sizable benefits. For instance, refining your accounts payable processes can help enhance the accuracy of your cash flow forecasts, free up cash, and ultimately position you to improve liquidity, mitigate potential funding gaps, and increase capital available to fund other strategic initiatives.

Common risks

Failure to adopt effective accounts payable processes can hamper a company's ability to process invoices on a timely basis, take advantage of available discounts, set favorable payment terms with suppliers, make payments on an optimal basis, and ultimately enhance working capital and liquidity. These consequences can arise in many instances, including when businesses:

- Rely too heavily on error-prone manual processes to approve requisitions, scan supplier invoices, and issue payments;
- Fail to issue purchase orders for each new order;
- Do not confirm if order deliveries match contractual terms or cannot easily access vendor contracts;
- Lose access to early payment discounts by overextending payment cycles or simply accept discounts without calculating the cost of capital outlay;
- Neglect to take advantage of maximum savings through volume rebates or trade spend initiatives;
- Incorrectly load supplier and/or contract information into master data files; and/or
- Lack processes and systems to prevent early payments, incorrect payments, duplicate payments, or missed payments.

While each business must adopt a customized approach to realize these goals, there are leading practices that can guide the way. Some strategies include:

- Centralizing accounts payable processing and reporting across the enterprise through a shared service environment to ensure all staff members adhere to common practices and standards and measure their performance against established business metrics. This has the added advantage of enabling you to accomplish more tasks in a faster time frame and with fewer resources, ultimately reducing enterprise costs.
- Moving toward a paperless processing environment. Although electronic data interchange (EDI) is not for everyone, businesses that automate their accounts payable systems by enabling electronic communication with vendors gain significant functionality advantages and savings through available discounts or rebates. With an e-procurement system, for instance, you can communicate electronically with vendors and customers to automatically generate purchase orders (POs) for each new order, electronically validate and accept invoices, approve requisitions, track goods received, and pay invoices on a timely basis. Depending on the level of automation you select, you may even be able to scan invoices automatically, track delivery receipts, and resolve disputes electronically rather than through manual follow-up.
- Adopting more robust governance practices, which can reduce the risk of manual error and strengthen internal controls around accounts payable processing and contract review.
- Setting up supplier portals so that suppliers can electronically track the status of orders, delivery schedules, potential product shortages, and payments received. In addition to reducing time spent on these processes, these systems also cut down on manual errors, thus improving order accuracy.
- Creating management workflows to enhance the efficiency of your accounts payable processes. Management workflows can help you identify and resolve system bottlenecks and streamline process handoffs to improve liquidity management in the most effective manner possible.
- Strengthening purchasing approval processes by defining the level of management authority required to make various-sized purchases.
- Instilling a cash culture throughout the organization by educating stakeholders on how their actions affect working capital and incentivizing them to make decisions to improve working capital and cash generation. Ensuring communication and awareness among the groups is occurring allows the company to work more seamlessly toward improving working capital performance.
- Developing key working capital metrics to monitor performance. These metrics can provide visibility into different aspects of the working capital processes and alert management when performance is going offtrack. These metrics should go beyond the high-level calculations, such as DPO, to provide greater clarity into the various operational and strategic aspects of working capital.

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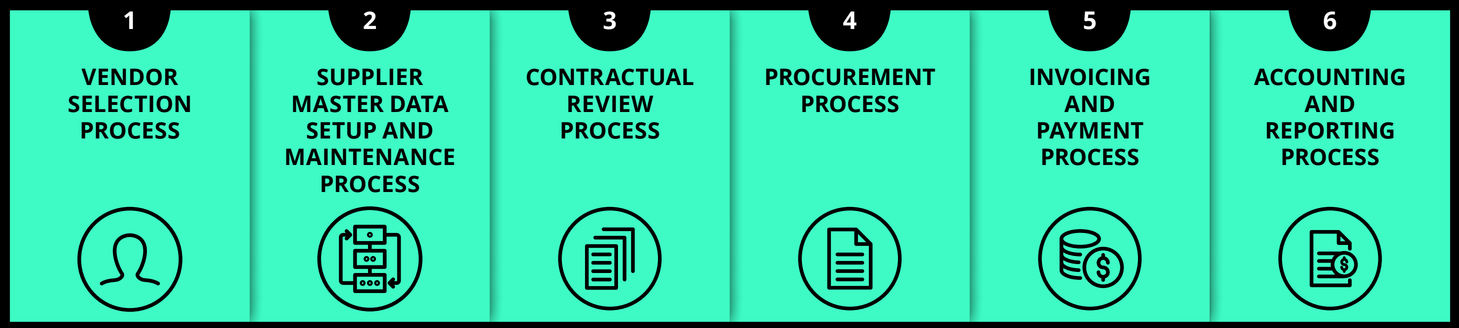
Strategies for increasing payables

There are six main activities within the accounts payable function that, if improved, can help you free up cash and strengthen your working capital:



1 VENDOR SELECTION PROCESS

One of the first steps toward implementing a robust accounts payable system involves setting up preferred supplier lists to prevent maverick buying and position your organization to negotiate the most favorable buying terms. As part of the vendor selection process, there are several steps you can take to negotiate terms designed to improve your working capital:

- **Establish priorities for the vendor negotiation process** and ensure key personnel and decision makers are involved (e.g., Chief Financial Officer and Chief Procurement Officer).
- **Develop supplier performance scorecards for strategic vendors** and leverage these scorecards during negotiation to induce suppliers to improve product or service quality, customer service standards, and/or price.
- **Incorporate working capital metrics into the pricing model.** Negotiate longer payment terms (if you are coming from a position of strength), if possible, but understand any trade-off in terms of pricing.
- **Understand the impact of discounts on working capital and cost of capital.** EBITDA savings might be generated by utilizing discounts, but what impact does making earlier payments have on working capital?
- **Regularly seek opportunities to negotiate better pricing.** Strategies might include asking vendors to match lower prices offered to your competitors and negotiating for volume discounts.
- **Evaluate usage of financing tools** such as supply-chain financing to drive longer terms with vendors.

2 SUPPLIER MASTER DATA SETUP AND MAINTENANCE PROCESS

Once you have negotiated terms with vendors, it is essential to properly capture and maintain this data. Inaccurate entry of this data can result in more than payment errors; it can also lead to unnecessary early payments and/or account delinquencies that prevent you from taking advantage of available discounts and may lead to disruptions in supply. To avoid these outcomes, several steps can be taken, including:

- **Ensure all service-level agreements (SLAs) are accurately reflected in your purchasing and payables systems.** Among other things, supplier master data should indicate product/service details, quality standards, delivery timelines, supplier responsibilities, and any regulatory compliance mandates that apply.
- **Regularly update payment terms** and the availability of volume discounts, trade credits, or other ongoing or periodic rebates. If supplier contractual terms change or are renegotiated, the supplier master data must also be changed to keep pace.
- **Properly store your supplier contracts.** Contract management systems can help streamline this process and simplify information searches.

3 CONTRACTUAL REVIEW PROCESS

To prevent inaccurate or even fraudulent vendor billing practices (which may result in overpayment or duplicate payment), it is essential to regularly review vendor contracts:

- **Assign responsibility for data to a central master data team** that can check for completeness, accuracy, and compliance with standard terms. This team should also periodically review vendor performance to ensure vendors continue to meet their contractual terms.
- **Include supplier contract clauses** that pass accountability for fines and penalties to vendors where they are found to be underperforming in some respect.
- **Complete periodic and timely vendor contract reviews,** in addition to reviewing such contracts against industry standard terms.
- **Ask your legal team** to check vendor authorization limits, assess the appropriateness of contractual terms, and confirm compliance with regulations.

4 PROCUREMENT PROCESS

Some businesses work with hundreds, and even thousands, of suppliers. Even if your environment is more streamlined, it can be challenging to keep track of all the invoices you receive and reconcile each invoice to its associated PO. Lax procurement standards can place the business at risk of overspending or trading with unapproved suppliers. To prevent maverick buying or purchase control overrides, you must track internal buyer practices to ensure buyers work with preapproved vendors and stay within authorized spending limits. Here are some strategies to consider:

- **Issue POs for each new order** so you can validate any orders received, lock in payment terms in advance, and track invoices against existing POs to ensure suppliers bill in accordance with agreed-upon terms.
- **Increase your savings potential** by exploring the viability of any available early payment discounts, volume rebates, or trade spend initiatives. However, keep in mind that you don't need to accept all early payment discounts. If you don't have the cash on hand or the capital outlay exceeds the benefit of the discount offered, it may make sense to pay later.
- **Set clear accounts payable metrics** (such as frequency of invoices that match POs, percentage of invoices paid to terms, and percentage of negotiated discounts captured) and adhere to them across the organization.
- **Negotiate longer payment terms** when purchasing a new or riskier product to increase working capital. Alternatively, consider asking to add the product to consignment stock rather than inventory to maximize liquidity and reduce risk.

5 INVOICING AND PAYMENT PROCESS

Properly managing the invoicing and payment process is yet another way to improve liquidity. Here are some strategies to consider for improving processing:

- **Set up a centralized processing office** to ensure a standardized and consistent approach.
- **Implement controls** to minimize unauthorized payments and monitor early payments.
- **Validate supplier invoices against contract terms and their associated POs to ensure billing accuracy.** Refuse to pay inaccurate invoices (e.g., errors in quantities, amounts, address, etc.), which should be sent back to the supplier, and restart the payment clock once the discrepancies are resolved.

- **Process invoices on a timely basis and include a date stamp.** Be sure to complete this process in line with defined internal SLAs (e.g., process invoices within two days of receipt).
- **Avoid paying invoices early unless the benefit outweighs the capital cost of doing so;** without risking key supplier relationships, you should pay invoices only when they are due.
- **Conduct a management review of the AP aging listing** to determine appropriate follow-up actions.
- **Develop appropriate channels and processes for exception reporting and handling.**
- **Implement an EDI system that allows vendors to submit invoices electronically** while enabling you to track invoices against their associated POs, validate, and approve payments, and maintain accurate payment records.
- **Limit the frequency of payment runs** to reduce the ability of making suboptimal early payments.

6 ACCOUNTING AND REPORTING PROCESSS

Before you can actively manage payables, you need assurance that your accounting reports are up to date and that your financial records fairly reflect current accounts payable balances. Without this data, many businesses lack visibility into how much, how often, and when they pay their suppliers. This can hamper you from choosing the most advantageous payment terms or selecting appropriate timing in which to pay vendors. Additionally, failure to accurately manage payables makes it harder to forecast and manage cash flows and anticipate short-term liquidity needs, putting many businesses on an unnecessary cash flow tightrope. To bolster your accounting and reporting process, you can undertake several actions, including:

- **Track payables outstanding by vendor** and by payment terms to ensure an accurate AP aging report.
- **Improve real-time reporting capabilities** by automating reconciliations and ensuring they remain current.
- **Follow up on and resolve unreconciled items on a timely basis.**
- **Have the same individuals prepare and review all reconciliations,** to reduce the likelihood of overpayment or duplicate payments.
- **Post journal entries** before reporting period cutoff dates.
- **Apply payments to each invoice** on the date they're made to maintain system accuracy.
- **Properly track all payments made,** not just vendor payments.

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Getting cash fit

By improving accounts payable governance and controls, setting up clear management processes, and consistently tracking key metrics, businesses can streamline their processes and inject a working capital and cash culture into the enterprise. Approached effectively, this can strengthen corporate cost management, reduce process complexity, reduce the risks associated with routine transaction processing, and enhance vendor contract compliance.

Businesses that invest in improving existing processes and technology can benefit by empowering fewer resources to manage the accounts payable process while simultaneously accelerating invoice processing, improving invoice and payment processing accuracy, and improving payment timing to take advantage of beneficial discounts.

With proper executive-level support, these steps can help you do more than simply maintain operating margins. They also support greater liquidity, which can lead to stronger bottom-line performance.

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