



Make your working capital work for you

Strategies for optimizing 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 numerous ways to free up working capital, this series focuses on four core strategies: accounts receivable, accounts payable, cash management and inventory.

This second installment looks at accounts payable.



Taking a strategic approach to accounts payable management

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

When it comes to working capital optimization, however, increasing payables should be a core strategy. To be sure, many businesses work this strategy by extending payables as long as possible to maximize free cash flow. Unfortunately, this approach is not always the right one. In some cases, delaying payment can erode supplier goodwill, resulting in slower delivery times, less willingness to fix defects, slower responses to queries and more onerous payment terms. On the flip side, paying early can sometimes yield substantial benefits in situations where suppliers offer discounts or rebates for early payment.

To effectively identify these opportunities and determine the right course of action when facing potentially conflicting outcomes, businesses must take a more strategic approach to accounts payable. The Accounts Payable team, along with the Purchasing and/or Procurement departments, must 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 optimizing payables and freeing up working capital to fuel growth.



Adopting best practices

While organizational change is rarely easy, fostering a working capital culture can yield sizeable benefits. For instance, refining your accounts payable processes can help enhance the accuracy of your cash flow forecasts, ultimately positioning you to improve liquidity, mitigate potential funding gaps and realize higher profits. Using

the insights gained from improved processes, you can also strengthen your own negotiating power, potentially partnering with major suppliers to share risk, extend payment terms, increase warranty periods or even hold some inventory on consignment.

Common risks

A 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 and set either longer or shorter payment terms with suppliers, depending on which are most favourable. These consequences can arise 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 over-extending 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
- Lack processes and systems to prevent late payments, under- or over-payments, duplicate payments or missed payments

While each business must adopt a customized approach to realize these goals, there are best 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 timeframe and with fewer resources, ultimately reducing enterprise costs.
- **Moving towards a paperless processing environment.** Although EDI (electronic data interchange) 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 eProcurement 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, 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.

Strategies for increasing payables



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

1. Vendor selection process

One of the first steps towards implementing a robust accounts payable system involves setting up preferred supplier lists to prevent maverick buying and position your organization to negotiate the most favourable buying terms. As part of the vendor selection process, there are several steps you can take to negotiate terms designed to optimize 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 as a way to induce suppliers to improve product or service quality, customer service standards and/or price
- If you are coming from a position of strength, negotiate longer payment terms
- Regularly seek opportunities to negotiate better pricing as well. Strategies might include asking vendors to match lower prices offered to your competitors or negotiating for volume discounts

2. Supplier master data set-up 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 account delinquencies which prevent you from taking advantage of available discounts and may even lead to disruptions in supply. To avoid these outcomes:

- 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. Document 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

Tracking key metrics

From a contractual review standpoint, many organizations use supplier scorecards to monitor supplier performance on a range of metrics, such as on-time delivery, defect rates and quality of service. In addition to alerting you to potentially floundering supplier performance, this type of scorecard system can also yield financial benefits by triggering discounts if suppliers fail to meet established SLAs.

Of course, supplier metrics are not the only ones organizations should track in an attempt to free up working capital. From an accounts payable perspective, it is also important to track days payable outstanding (DPO) to determine how well you are managing your cash flow. Beyond understanding the actions that drive DPO, finance departments should track any variance in this metric and follow up to ensure variances align with the company's cash management goals.



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. Failure to accurately manage payables, however, makes it harder to forecast and manage cash flows and anticipate short-term liquidity needs, putting many businesses on an unnecessary cash flow tightrope.

Lax procurement standards can also place the business at risk of over-spending or trading with unapproved suppliers. To prevent maverick buying or purchase control over-rides, you must track internal buyer practices to ensure buyers work with pre-approved 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
- Maximize your savings potential by exploring the viability of any available early payment discounts, volume rebates or trade spend initiatives, but 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
- Track payables outstanding by vendor and by payment terms
- 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
- When purchasing a new or riskier product, negotiate longer payment terms to increase working capital or ask to add the product to consignment stock rather than inventory as a way to maximize liquidity and reduce risk

The role of accounts payable in trade spend initiatives

Recently, businesses in many industries have begun to introduce trade spend initiatives as a way to strengthen partnerships between suppliers and retailers. Under these agreements, suppliers grant price concessions, rebates or marketing/advertising dollars in exchange for preferential product placing at the retail level.

In entering these partnerships, it is essential not to leave accounts payable behind. To get the full benefits of a supplier relations initiative, businesses must accurately track contract terms, communicate information about any special arrangements to staff and maintain management focus on working capital. The risk is that dollars negotiated by your purchasing team are lost through an inability to track the terms.

5. Invoicing process

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

- Set up a centralized processing office to ensure a standardized and consistent approach
- Refuse to pay inaccurate invoices (e.g. errors in quantities, amounts, address, etc.). These should be sent back to the supplier
- Process invoices on a timely basis and include a date stamp. Be sure to complete this process in line with defined internal service level agreements (e.g. process invoices within two days of receipt)
- Avoid paying invoices early; 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

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6. Accounting and reporting process

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. To bolster your accounting and reporting process, you need to:

- Validate supplier invoices against contract terms and their associated POs to ensure billing accuracy
 - 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 cut-off 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
 - Select a method of payment (i.e. cheque, EFT, credit card) that minimizes bank charges





Getting cash fit

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

Businesses that invest in EDI technology or improve existing electronic processes can further benefit by empowering fewer resources to manage the accounts payable process while simultaneously increasing processing accuracy, accelerating invoice processing and optimizing payment timing to take advantage of available 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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