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Accounts Payable Best Practices Pave Way for Financing Strategy

To make one of the few remaining potential sources of working capital available to their suppliers during the current credit crisis, many corporations must first evaluate how they can improve their accounts payable (A/P) processes.

Accounts payable financing, sometimes referred to as "reverse factoring," offers suppliers a source of asset-based funding for outstanding receivables that is flexible and cost competitive. It provides suppliers with immediate payment for receivables and buyers with greater control over cash flows.

With so many traditional forms of financing increasingly difficult to access due to the credit crunch, companies have been eyeing A/P financing as a possible working capital solution. However, in many cases, buyers find it challenging to support this form of supplier financing due to slow, paper-laden A/P processes.

A/P financing requires that a buyer has a streamlined A/P process from invoice receipt to approval. To make financing available to the supplier, a bank needs the approved invoice information from the buyer. If payment terms are 60 days, and it's taking a buyer 40 days to approve invoices, there's too little time for the bank to act on financing requests.

Laying the Groundwork

To lay the groundwork for an A/P financing solution, buyers need to introduce A/P best practices. The goal should be to leverage past investments in technology such as enterprise resource planning (ERP) systems while reducing time-consuming paper flow in the invoice approval process.

Some companies receive invoices in a decentralized fashion, and then manually capture the invoice information in a centralized environment, only to seek payment authorization back in their decentralized offices. Such processes are paper-driven and slow. Companies can work to re-map these processes on their own, or they can seek outside consulting advice. Similarly, they can invest in technology to streamline A/P processes, or they can outsource non-core processes such as capturing images of paper invoices and lifting data off those documents using scanners.

Here are some industry benchmarks companies can use when retooling their A/P processes to be "best in class":

- A/P employees should be able to process 25,000 to 30,000 invoices a year.
- The average cost of processing an invoice should not exceed a range of $1.50 to $1.75.
- Exception items should not go beyond 2%.
- Companies employing shared service centers should be processing at least 80% of all A/P activity through those centers.
- The average time to process an invoice from receipt to approval should not exceed three days.

Worth the Effort

All the work to streamline A/P processes and make A/P financing possible can pay off for both buyers and suppliers.

By utilizing an A/P financing solution, buyers are able to minimize borrowing by harmonizing and/or extending payment terms with suppliers. Reduced days payable outstanding (DPO) leads to working capital improvements for buyers. What's more, by enhancing the financial situation of its core suppliers, a buyer helps stabilize its supply chain.

In addition, for a buyer, A/P financing strengthens supplier relationships, generates possible pricing advantages and reduces transaction costs with open account payments.

From the supplier's perspective, A/P financing provides a new source of timely funding at attractive interest rates that makes cash inflows more predictable and reduces credit concentration issues. Resulting improvements in days sales outstanding (DSO) also generate working capital improvements.

Another Key to Success: Collaboration

Any corporation that is considering pursuing an A/P financing strategy should establish a cross-functional team early in the endeavor. The team should include representatives from A/P, Procurement and Information Technology.

This step is necessary so that each group can see the advantages of the strategy for them, so the overall effort can receive the organization-wide acceptance that will be necessary for implementation success.

Each area within an organization will view the merits of A/P financing differently. For example, A/P at the buyer may focus on the fact that suppliers will be able to access information about approved invoices sooner, thus reducing payment inquiries. Meanwhile, Procurement is more likely to appreciate the ability to negotiate purchases based on financial terms as well as volume.

Collaboration can also surface concerns and constraints that the team can tackle head on.

Learn More

By retooling A/P processes and establishing a cross-functional team, your company can prepare itself for A/P financing. To assist with this working capital solution, Deutsche Bank offers an easy-to-use, web-based A/P finance platform, db-SupplierFinance. To learn more, contact your Cash Management Sales representative.