CFO

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The CFO's Guide to Automating Accounts Receivable

Electronic invoicing is changing the AR landscape

Introduction: CFOs Look for Innovative Improvements to Accounts Receivable

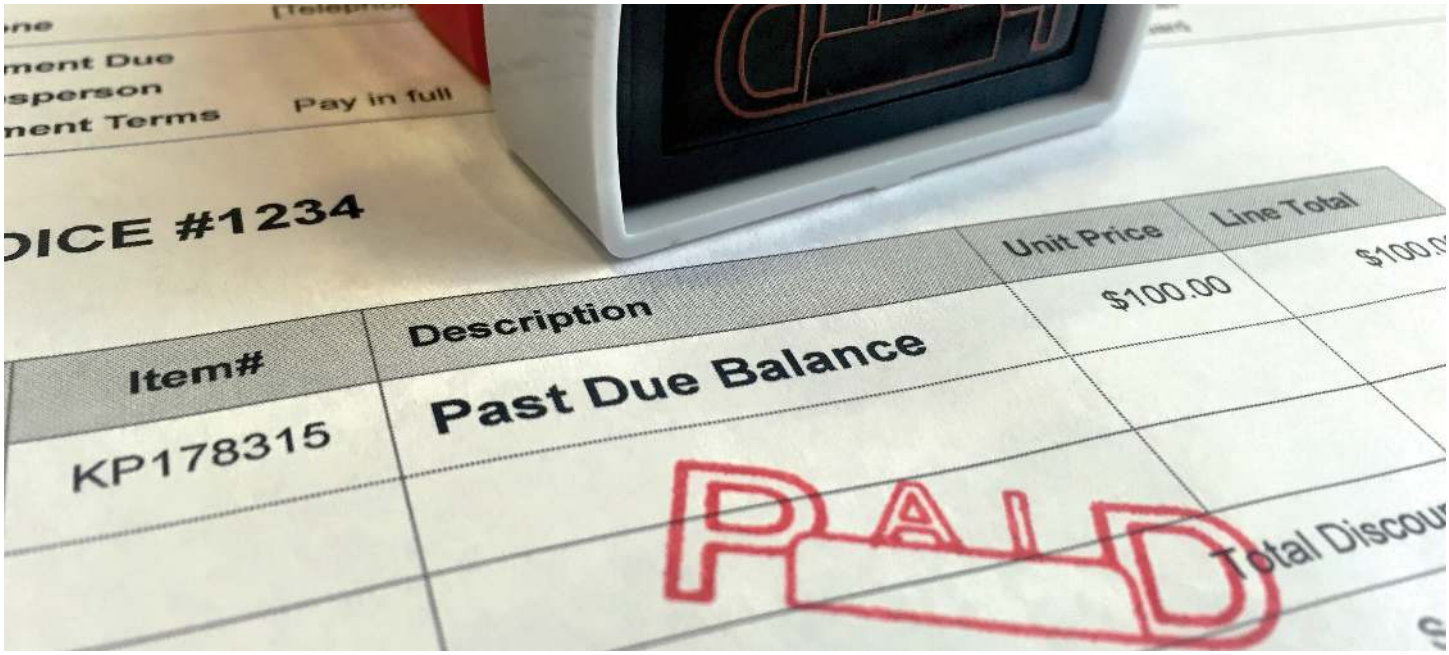
Accounts receivable (AR) is a top concern for today's chief financial officers. And that's no surprise, considering how improvements in AR performance lead to getting paid faster and more efficiently, which is directly connected to healthy cash flow and increasing working capital.

Financial processing issues can be even more acute for companies with networks of dealers, distributors or vendors, as well as for group purchasing organizations, because national account customers can often pay inconsistently and past terms.

This e-book explores AR problems—the areas where performance tends to suffer and considerations for CFOs to take into account when evaluating potential changes. More importantly, it shows how electronic and outsourced solutions can improve performance and lead to both strategic and bottom-line benefits for CFOs. It also reviews the current thinking from CFOs on AR-related issues, as shown in studies by the Association for Financial Professionals (AFP) and the Institute of Finance & Management (IOFM)—industry groups that represent finance executives and help set standards of excellence in their field.

Avoiding Inefficiencies: Common AR Performance Pitfalls

Studies have shown that CFOs believe their most important role is managing cash and working capital. To help themselves in that role, especially during periods when revenue growth is difficult, CFOs naturally will turn to improving the effectiveness of their accounts receivable department. One of the chief benchmarks of AR performance is Days Sales Outstanding, or DSO, and most of the CFOs surveyed for the Institute of Finance & Management's 2015 AR Automation Study reported that reducing DSO was their highest priority. Other surveys of AR departments have shown that DSO is considered the top measurement of performance and that the top priority in 2016 is improving DSO.



In the U.S., most companies require 30-day payment terms. But in reality—according to the 2015 IOFM study—most companies have an average DSO of more than 30, including 13 percent of companies with a DSO of more than 50. Companies that do not receive payments on time can suffer from anemic cash flow, which makes strategic planning, forecasting, and overall business growth more difficult.

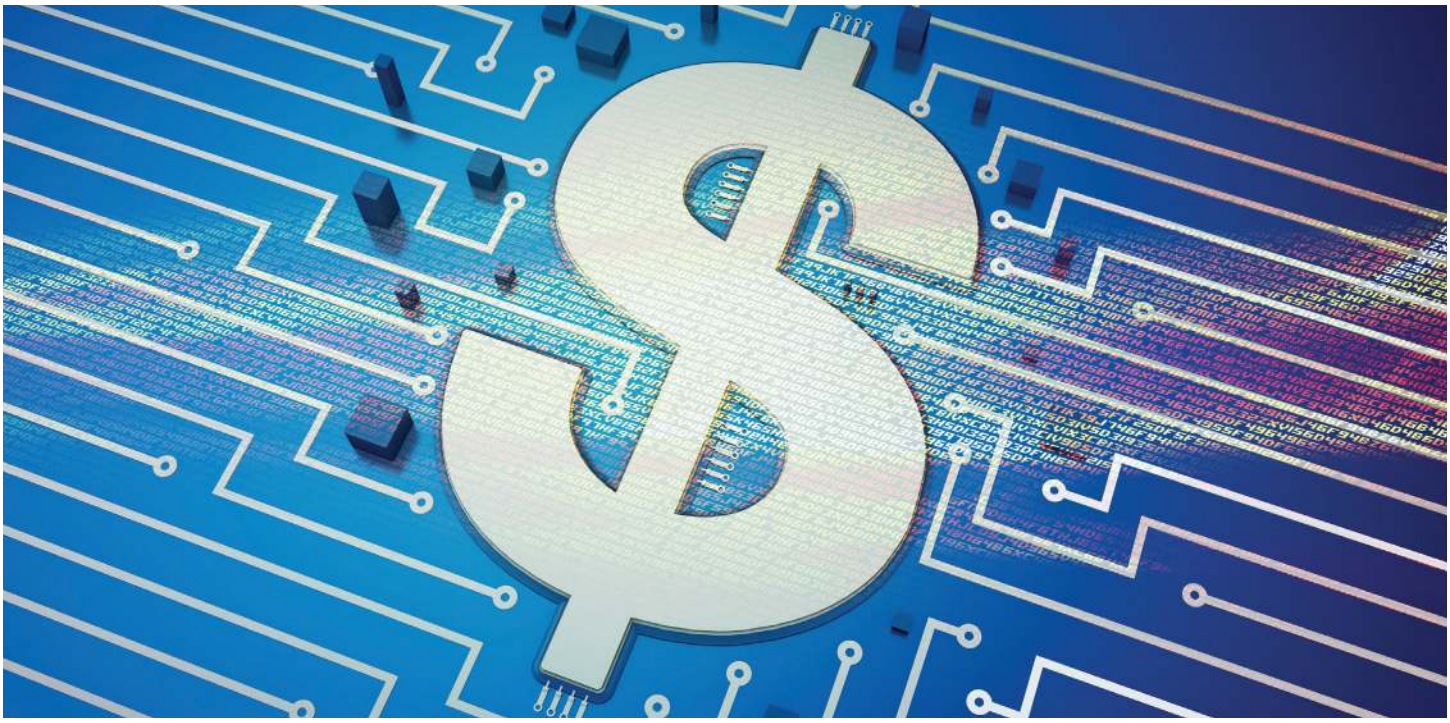
Best-in-class electronic receivables generate an exception rate of 1 percent to 2 percent, compared to the 5 percent to 20 percent exception rate for paper-based receivables.

—IOFM

Where does AR typically lack? Inefficient processes is the most notable area in 2016. Many companies fail to establish a centralized billing system, relying instead on their distributors or dealers to perform AR duties. This arrangement can leave distributors, dealers and vendors to chase payments from their national account customers instead of focusing on business growth. Managing invoice exceptions can take weeks, driving up DSO. According to the IOFM, paper-based receivables generate an exception rate of 5 percent to 20 percent, depending on the industry and complexity of the receivables, compared to 1 percent to 2 percent for best-in-class electronic receivables. About three-quarters of all reconciliations for inaccurate payments requires a manual re-keying of the information.

Manual processes also add time. Paper payments—the traditional paper checks with invoice stubs paid through the mail—always had to be manually keyed before reconciliation. But even the advent of electronic payments has not eliminated re-keying. Of the companies surveyed for the 2015 IOFM study, 51 percent received emailed remittance data that had to be re-keyed. With mailed remittances, 49 percent of them have to be re-keyed.

Many AR systems also suffer from a lack of customer and sales analytics. Without the technology needed to



analyze purchasing and payment patterns, many companies are falling behind their competitors. And without the needed technology, there can be no data-based real-time insight or analysis, resulting in a limited strategic role for AR in the organization.

Delays caused by paper invoicing represent about 60 percent of all AR costs, in addition to the expense of processing paper check payments as compared to an all-electronic payment solution. Many companies simply write off any disputed amount when a short-payment situation arises in their paper-invoicing systems because it is cheaper than their reconciliation process. For invoice disputes and other payment disagreements, 21 percent of the companies in the IOFM 2015 study lose at least $250,000 per year. That includes 5 percent of the companies that lose $2 million or more per year and 3 percent that lose $1 million to $2 million.

Innovative Solutions: How CFOs Should Use Automation to Make Improvements

The most obvious benefit for CFOs who automate financial processes—and eliminate paper invoices and reduce manual input—is lower overhead expense. Less re-keying is required, and less staff time is spent tracking down and reconciling invoices, especially with the errors inherent in manual processes.

The ultimate goal of automation is straight-through processing with virtually no human intervention. According to the 2015 IOFM study, less than half of surveyed companies post the majority of their receivables cleanly—straight through, without human intervention. Only 13 percent reported that more than 90 percent of their receivables post without human intervention.

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—2015 IOFM Study

The IOFM survey also showed that only one in four respondents receive remittance data through an electronic file that is automatically reconciled. But 69 percent either already receive most of their payments electronically or expect to within three years.

While e-mailed invoices are an improvement over mailed invoices because of their instant delivery, e-mail

is a minor step toward automation. For more efficiency, invoices should be delivered via a secure website, cloud-based portal, or direct data feed that provides the recipient with tools to manage the invoices. These options allow the recipient to drop the invoice directly into an accounts payable workflow—instead of turning an electronic invoice into paper to manage it. The recipient can make payment approvals electronically, and both the buyer and seller can track invoices and manage disputes electronically, avoiding a costly, manual reconciliation process.

The biggest challenge for corporate controllers is a lack of visibility into the AR and AP processes.

A common mistake that a company can make when trying to improve its financial processes is adopting the easiest solution rather than one that adds value for customers. For example, a company's IT department, when tasked with creating a more efficient way to get invoices out to customers, may choose a solution that creates e-mailed, PDF-format bills. But later on, that company will likely discover that most of its largest customers prefer to receive their bills via other means, such as direct data feeds.

The best full-service outsourcing solution should offer a billing process that is most efficient for the company—adopting the company's preferred type of billing output—while at the same time offering the flexibility to deliver invoices in the format that is most efficient for each customer, such as PDFs, electronic data feeds, or secure websites. Tailoring billing to customers' own business processes makes it easier for them to pay and to pay promptly. Customers who receive their invoices by direct data feed are most likely to pay on time, reports Mark Brousseau, editor of special projects for IOFM.

"If (an invoice) starts life electronically, it's much more likely to end up as an electronic payment," Brousseau says.

A key strategic benefit to automating the financial processes is the added analytical tools that the CFO and company managers can access. In a 2014 survey by the Association for Financial Professionals, corporate controllers reported that their biggest problem was their lack of visibility into AR and AP processes. As

more and more processes are automated, including electronic billing and invoicing, ever-more advanced analytics will be possible, including advanced payments modeling to help CFOs better predict and manage cash flow and working capital.

The 2014 Association for Financial Professionals Inc. survey, as well as a 2013 survey by Deloitte, has shown that both CFOs and treasury functions are playing more of a strategic role within the organization and will continue to do so in the future. One key driver of this transformation is automation. The measurement of sales, payments, and cash flow made possible by automation will shift AR into a strategic organizational role. Analytics, including predictive tools and real-time information, will help make that shift. When receivables visibility is improved—so the CFO can know with more certainty when invoices have been approved for payment and when payments will be made—it opens the door to financing options. The company can offer supply chain financing alternatives, or early payment discounts, knowing precisely what their effect will be on AR.

A qualified third-party partner can demonstrate how it will better manage the credit and collections

For a company with a dealer/distributor/vendor network, an emerging option is for the solution provider to make payments to the dealer/distributor/vendor in a regular, predictable manner on behalf of the purchaser. In this model, the provider is responsible for collecting payment from the purchaser. This outsourced credit service, known as "channel finance," removes the costs of issuing and maintaining purchaser credit, completely eliminates customer default risk, and frees up working capital for the seller and its sales network.

Part of the CFO's role as a leader is to anticipate how AR should change as the company grows. It is important to evaluate AR as a whole—its combined costs and functions-and not just the silos that appear to be the most troublesome. Many legacy automation providers are only able to address portions of the AR process; the most innovative providers can manage the full process from order receipt through cash application.

A company that partners with a properly qualified third-party provider can expect to receive benefits beyond lower direct overhead costs. The CFO should evaluate service providers' proficiency in core competencies that deliver all forms of tangible and intangible value to AR. For example, does the service provider have the expertise to take over credit and collections, and can it demonstrate that it will deliver better performance? How will it better manage the collections process, and how will it measure and demonstrate improved performance? How will it improve efficiency in billing, and how will it measure that efficiency? What analytics and forecasting capabilities does the solution offer, and how will the solution contribute to AR's strategic value to the whole organization?

Technology is another key area where the service provider should be able to demonstrate a clear advantage over a company's existing systems. The CFO should evaluate how the service provider's technology expertise and implementation stacks up against the company's internal IT team, which typically focuses its resources on technology in the company's core competencies instead of back-office functions. It is critical for the CFO to weigh the organization's best interests at the highest level and lead the push to AR automation, for benefits that extend beyond the remit of the typical IT team.

Bountiful Benefits: The Evolution of Electronic AR Solutions

Electronic solutions will inevitably replace printed-paper invoicing. IOFM's 2015 study showed that 54 percent of the organizations surveyed had implemented electronic invoicing, with 4.8 percent planning to implement it in six months, 1.6 percent planning to implement it in 12 months, and 27 percent planning to implement it at some undefined point in the future. Only 12.7 percent of the respondents had no plans to implement electronic invoicing. As the adoption of automated AR solutions increases, so will the opportunities to use the data in new and interesting analytics. Electronically tracking the payment process allows companies to check into altered payments and evidence for why payments were altered and how they were approved. Applying analytics to every step of the payment process will help the CFO manage the company's cash flow and understand buying patterns for improved financial forecasting.

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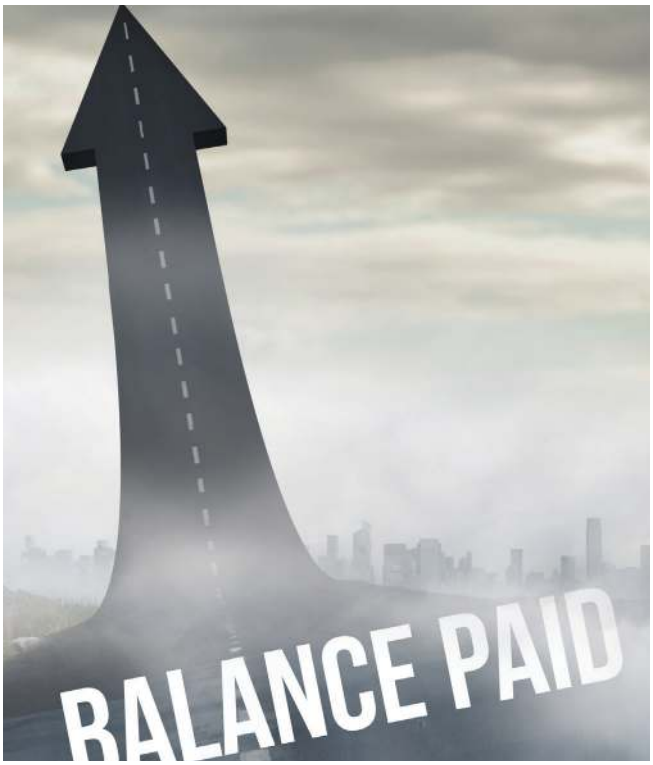

Automating financial processes will also allow CFOs to grow revenues without adding overhead. Companies can reallocate staff (those that were previously devoted to re-keying and other manual processes) to other value-added initiatives to better accommodate customers, who are increasingly expecting to connect their own paperless AP systems with their suppliers' electronic AR systems.

With cloud-based solutions, the company is not required to make a large investment in equipment or bespoke software. Cloud-based solutions also make it easier to adopt the most advanced software, along with the knowledge of how to use it and access to constant platform upgrades.

The working capital benefits of improving financial process performance should be a key incentive for CFOs. Automated solutions can accelerate payments, shrink DSO, reduce bad debt and even remove credit default risk. Outsourcing credit and collections activity to a well-qualified provider opens up the company's resources to focus on its own business growth.

Advanced solutions help companies stay ahead of their competition and open avenues to more innovation with payments—allowing discounts for early payments; helping distributors and dealers receive payment in full for approved receivables; and bringing in third-party financing alternatives for receivables. Channel finance solutions can take lag time away from national account payments to dealers/distributors/vendors or GPOs.

Conclusion: An Innovative Approach to AR

For CFOs, improving financial process performance is an essential piece of their most important role: managing cash and working capital. The headaches of high average DSO, costs associated with chasing invoice or payment problems, and credit and collection duties—can be resolved by qualified third-party service providers, which can elevate AR departments to higher levels of electronic billing, invoicing and payments.

As more companies automate invoicing and payments, they can apply innovative emerging financing solutions that use approved receivables to shorten or eliminate payment gaps. This is especially true for companies with networks of dealers or distributors and those with national account buyers. Automated financial processes will also yield advances in analytics. While increased adoption of electronic and outsourced AR solutions is inevitable, the CFO who takes a strategic approach with these solutions will achieve better cash and working capital management and, ultimately, bottom-line performance benefits.

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