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CFO

THREE WAYS CFOs CAN BETTER ALIGN AP AND AR IN 2021

The working capital crunch today is real, and the COVID-19 crisis has put increasing pressure on CFOs to improve cash flow in a volatile, unpredictable environment. In 2020, Days Sales Outstanding (DSO) reached its highest point in 10 years and businesses had $1.2 trillion trapped in working capital, according to The Hackett Group. Supply chains cracked in a business environment that changed daily, and the move to remote work magnified existing back office inefficiencies. A record number of S&P 500 CFOs stepped down, according to the **Wall Street Journal**.

This has only forced CFOs to accelerate their focus on the basic working capital challenge: how do you collect payments sooner and extend outgoing payments terms as much as possible? Many find it impossible to answer that question because the accounts payable (AP) and accounts receivable (AR) functions work independently, with competing objectives and no ability to exchange key information or coordinate on a common working capital goal.

The problem often starts with the traditional challenge where AP and AR typically operate independently in ways that can lead to CFO headaches. For example, taking discounts for early payments to suppliers may reduce costs, but in a liquidity-strapped company, the benefits of delaying payment may outweigh the savings value from an early payment discount. Determining which strategy makes the most sense can be difficult without AP understanding how AR is approaching the working capital challenge.

To address working capital, CFOs must not only improve but also align the AP and AR processes. Without that alignment, information doesn't flow. And when information doesn't flow, cash doesn't flow.

Here are three ways CFOs can create better AP-AR alignment in 2021:

1. Breaking Down Silos with Supply Chain Finance

The silos that separate AP and AR block information flow and limit the agility that CFOs need in the 2021 environment. You can't respond to information that you can't see. CFOs need AP visibility to manage spending. They need AR visibility to find efficiencies and look for better ways to improve margins. They need both together to make hard decisions about strategic working capital priorities.

A supply chain finance (SCF) management program can break down these silos while introducing the flexibility to fine-tune working capital requirements in both AP and AR. With SCF, the CFO has the flexibility to drive a specific DPO with suppliers and a specific DSO with all customers, allowing the company to optimize working capital and increase liquidity.

On the AP side, SCF enables a CFO to get payments to suppliers on their preferred terms while effectively extending DPO. For the CFO, SCF gives them the flexibility to choose DPO based on a cost/benefit analysis of when and where it makes business sense to retain access to capital in exchange for the cost of the SCF option.

On the AR side, SCF can help strengthen relationships with customers, reduce the lag time associated with payments from them, and enable suppliers to better meet their customers' own need for longer payment terms. AR-based SCF allows companies to accelerate their receivables by 15, 30, 40 or even 60 or more days while buyers pay on their own preferred terms.

Taking it a step further, SCF can help reduce bad debt, reduce the administrative burden of accepting numerous incoming payments, and eradicate credit risk with some or all customer accounts. AR-based SCF also fosters cost savings by eliminating the burden of invoice production and distribution, credit issuance, collections and dispute management.

While supply chain finance gained popularity after the financial crisis of 2008, more companies had been turning to it. Corporate advisers and accountants have told the **Wall Street Journal** that the pandemic has accelerated the use of SCF. An estimated 23% of organizations relied on SCF to increase available cash to the business in the face of pandemic-driven economic headwind, according to a 2020 Gartner poll. Encouragingly, the rise of e-invoicing and P2P solutions has made SCF a viable option for mid-market companies with revenues between $100 million and $1 billion.

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2. Fix Inefficiencies with Automation

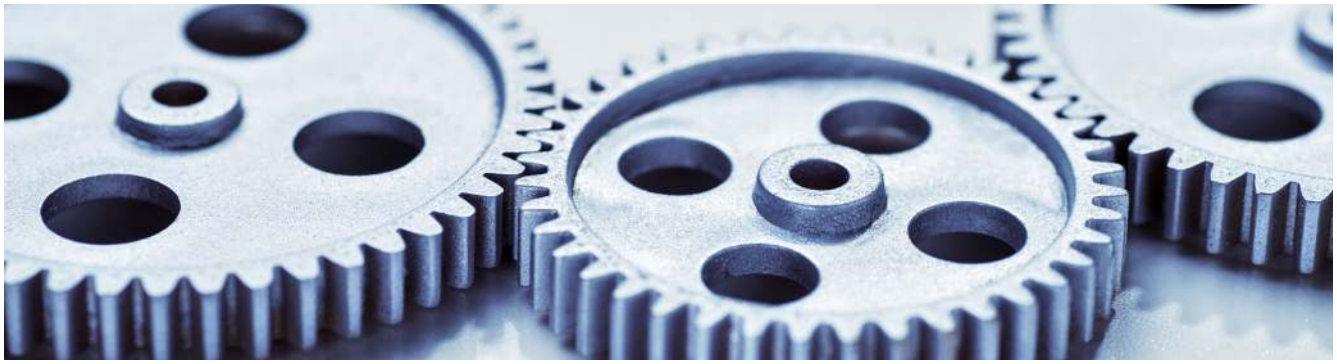
With an increased reliance on a remote workforce, the COVID-19 pandemic has elevated AP and AR digitization to be a top CFO priority. The increased need for credible, real-time data so that CFOs can make fast decisions on everything from credit exposure to liquidity needs and budgeting through better automation. According to an **Accenture** survey, 99% of CFOs want to use real-time data when making decisions, but only 16% believe they are fully capable of doing so.

Inefficiencies in outdated AP and AR processes obstruct the CFO's ability to accurately predict cash flow needs. **Forty-two percent** of B2B payments are still made by paper check, and the lingering preference for remote work in 2021 means that paper checks can sit for weeks in an office with limited staff. The pandemic has exposed finance teams to the bottlenecks that paper-based invoices create, highlighting opportunities for fraud, time lost and payment term issues.

Invoice processing remains a major area of inefficiency, especially among small and mid-market businesses that did not adopt cloud-based AP automation before the pandemic. Invoices come in through multiple channels, including postal mail, e-mail, FTP upload, EDI, invoice networks, fax and web entry. This creates complexity that adds time and expense to AP functions that are already labor-intensive. Forty percent of all Institute of Finance & Management (IOFM) members don't even track invoice processing costs, and AP professionals spend 84% of their time bogged down in manual processes. Inefficiencies like these lead to high processing costs, poor staff productivity, errors, lengthy approval cycles, and lost discounts.

The answer in 2021 is the same as it was before COVID-19 began: automation.

In addition to automating invoice workflows, automation and digitization of both incoming and outgoing payments eliminates paper checks and the attendant risks of errors and fraud. It also simplifies financial reporting and makes it easier to improve AP and AR workflows and spot weaknesses such as delinquent accounts.



Automation saves time and money. An AP department that manually processes 2,000 invoices per Full Time Employee (FTE) per year can process 23,000 invoices per FTE per year with automation, according to IOFM. Based on IOFM data, processing 5,000 invoices per month costs about $64,500 per year in processing costs in a manual AP operation. In a highly automated operation, the cost is closer to $8,500 per month — an 85% savings. For organizations that generate thousands of invoices a month, billing improvements can translate into millions of dollars that flow to the bottom line.

With automation, organizations gain greater control over the timing of invoice payments. In addition to "best-in-class" automation, users achieve over a 90% on-time payment rate and have complete, real-time visibility into early payment options and can utilize them when it makes sense. Eighty percent of suppliers offer early payment discounts and organizations with significant automation capture 74.2% of early payment discounts, while organizations with limited automation capture just 52.9%, according to IOFM benchmarks.

From a staffing perspective, automation frees up employees for more strategic, value-added activities, such as supplier relations, maintaining vendor master databases, moving more suppliers to electronic payments, and performing critical data analyses. While it is the case that automation can reduce FTE requirements within AP and AR, organizations should avoid the temptation to simply see automation as a way to eliminate FTE expense. Instead, businesses should utilize the knowledge and capabilities of existing staff and empower them with the challenge of moving away from rote AP and AR processes in favor of more impactful, strategic tasks.

In summary, the pandemic has accelerated the digitization of AP and AR departments. Transformative technology now represents the greatest challenge to today's CFO, according to a 2020 **study** by the IMA and the Association of Chartered Certified Accountants, yet less than one-third of CFOs are confident that their technologies are aligned with their requirements for ensuring the future success of the organization, according to Gartner 2021 report. Digitization is so important that **86%** of surveyed finance professionals see it as the missing link that will enable companies to rebound post-COVID in 2021 and 2022. Gartner calls digitalizing the "CFO Mandate for 2021," based on the **Gartner CFO survey**.

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3. Optimize through Collaboration with Strategic Partners

While technology can help with communication through better automation, misalignment or lack of integration between systems prevents the results. For instance, sometimes AR has information about changes in demand that AP needs to make decisions about ordering everything from raw production materials to back office supplies when systems are not aligned. As a result, even with technology, organizations can still get squeezed when DSO rises as customers take longer to pay their invoices, together with Days Payable Outstanding (DPO) coming under pressure from suppliers who are themselves trying to collect from their customers as soon as possible

For all its benefits, technology can only get you so far in optimizing internal operations. Automation alone can't *guarantee* an impact on DSO or eliminate the credit risk inherent in floating customer receivables. When you hit that wall, it's time to retain experts in each step in the supply chain finance process. You need a strategic partner if you want to optimize as well as automate.

Outsourcing lets you tap into the knowledge, experience and capabilities of an expert team. Organizations that have previously outsourced transactional AR processes, such as billing and collections, can expand toward a range of favorable outcomes, from enhanced customer experience to reduced revenue leakage. Vendor expertise will help you scope out your needs so that you hit your DSO target and have the confidence and that cash flow will be there when you need it.

By handing off tasks to a provider of managed services for customer onboarding, disputes, and collections, you can focus on core competencies. The result is improved overall working capital, due to shorter DSO and longer DPO, which makes possible a more predictable cash flow. You still have control, while your outsource partner takes care of the details.

CFO.com reports that business process outsourcing is part of an evolving corporate finance service delivery model. Forty-eight percent of CFOs and senior finance executives surveyed said they used business process outsourcing (BPO) or hybrid models, such as BPO hybrids. As organizations increasingly depend on automation to streamline their financial operations, having a strategic partner with the right human expertise will become even more important.

Each of the three approaches—finance management, automation and collaboration—contributes to successful alignment. Supply chain finance enables a cohesive strategy. Automation frees up time and money. Business process outsourcing optimizes benefits.

Together these approaches offer a way to boost cash flow and drive more value to the bottom line. That in turn better equips CFOs to fulfill the increasing demand for their expertise as strategic business advisors.

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