Commercial Payments

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About This Series

Through this series of whitepapers, we examine the dynamic and growing commercial payments sector. This issue provides insight into the challenges and opportunities of large corporate's accounts payable and receivables processes. For this series Mastercard has partnered with RFi Consulting (RFi), an independent consulting firm focused on the financial services sector and with a strong specialisation in the payments industry.

Introduction

A series of in-depth interviews with three leading large corporates, operating across Australia and New Zealand, revealed common challenges which significantly impact their use of payment methods and those of their customers. First, this paper will explore how organisations seek to improve rates of straight-through reconciliation (STR) in accounts receivable through automation of the statement-matching process, and therefore significantly reducing the entries left to manual reconciliation.

Second, we cover the initiatives being used to extend Days Payable Outstanding (DPO) to increase working capital, whilst at the same time meeting supplier needs. Furthermore, businesses report that their most labour-intensive pain point in accounts payables is reconciliation arising from incorrect capture of payment information due to manual processes.
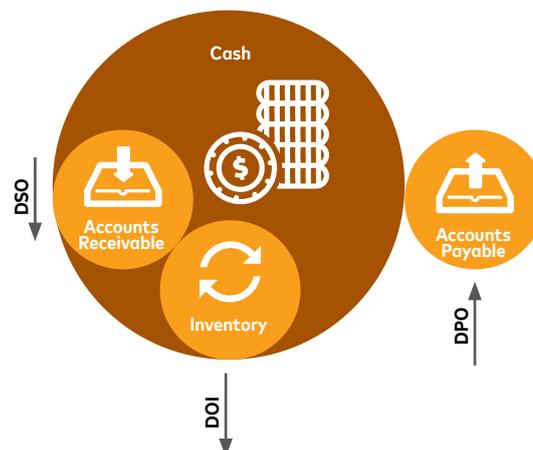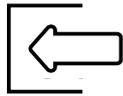
Accounts Receivable (A/R)

It is important to note that there are two reconciliations required in an organisation. First, "financial reconciliation" which focuses on balances and net credit and debit movements across the accounts from electronic bank statements. Treasurers use this information to build an accurate picture of liquidity and working capital, investment opportunities and funding requirements for the day. Anecdotally, corporates indicate that rates of financial reconciliation are generally very high. However, the same can't be said for the second component of "operational reconciliation".

Operational reconciliation refers to reconciliation of collections generated by the order-to-cash cycle of the business. In the case of the corporates interviewed, the process was managed with the assistance of their enterprise resource planning (ERP) systems. This level of reconciliation is more detailed and requires additional information for example: transaction references, remitter identification and remittance information delivered via the payment networks and banks. Auto-reconciliation rates reported, ranged from 15% to 30% for operational reconciliation which then requires significant manual intervention to complete the task.

As the corporate clients we interviewed primarily operate in the business-to-business market, they reported the vast majority (~90%) of payments they received are made by direct deposit (EFT). However, with direct entry the remitter behaviour is key; companies which look to improve STR educate their remitters on what information and references should accompany payment. This is because ERP systems are designed to scan reconciliation reports provided by the bank and match deposits against outstanding payments.

Improving STR rates not only **yields process efficiencies and savings** in AR, but also helps **reduce days sales outstanding (DSO) and freeing up customer credit lines** for more business.

In the consumer space, the auto-reconciliation feature permitted by the Customer Reference Number in the BPAY system has seen widespread adoption across the major billers, however BPAY usage in commercial B2B payments is much less utilised.

Additionally, companies noted that often customers send partial payments or pay on account periodically (normally monthly) rather than paying against each individual invoice. This leads to additional time and effort spent reconciling a single payment against multiple invoices, as automatically matching against invoice amounts in these cases is typically not possible and therefore requires (costly) manual intervention. Indeed the respondent companies were keen to move away from payment on statement and to adopt payment against individual invoices, but claimed old habits take a long time to change across the customer base.

The challenge with the reconciliation of direct entry payments is exacerbated due to the limited data fields that are currently available to accompany such payments. This problem is widely recognised in the industry and the New Payment Platform is expected to provide a solution with the implementation of "data with payment" by the end of 2017. However, as previously highlighted, the system capability will only provide a benefit if the data is correctly populated.

The interviews also revealed that very few credit card payments were received by corporates. Where they paid by card, customers did so primarily for cashflow purposes. It should be noted that all the respondent companies surcharged on all card brands, despite the benefits of improved STR, which accepting transactions through an e-commerce gateway might offer. As the majority of customers indicated reluctance to pay the surcharge they therefore reverted to EFT. It was also noted, that certain companies and sectors, for example government agencies, are not allowed to pay surcharges on payments by policy.
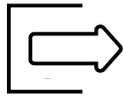
Accounts Payable (A/P)

The research revealed significant inefficiencies in the procure-to-pay process of the companies interviewed, especially in those organisations where automation of the payment process was limited and integration with the ERP system had not yet occurred. However, where this had taken place, there seemed to be a reasonable level of satisfaction with the status quo, with companies trying to move as many payments as possible to EFT; these were primarily sent in batches electronically via file transfer to their bank via the ERP system.

Reluctance to change may have arisen due to centralisation of the accounts payable process with staff dedicated full-time to the task of processing payments. As a result, there may have been limited consideration of alternatives. That being said, whilst there is still a focus on increasing their Days Payable Outstanding where possible, the success of this strategy is limited by the relative bargaining power (and size) of the company versus the vendor and standard industry practise. DPOs varied greatly between the companies and vendors with a range between 7 days and 120 days. However, the average appeared to be 45 days.

Virtual and Procurement Cards offer the benefit of **extending Days Payable Outstanding (DPO)** whilst offering **supplier improved terms.**

One of the respondent corporations was piloting, and another investigating, using virtual card services. In both scenarios, the primary drivers were to improve cashflow whilst maintaining or improving supplier relations. This is achieved through offering suppliers' different terms depending on the method of payment, for example giving them a choice between accepting virtual cards on 3-7 day terms or EFT on 45-60 day terms, with the merchant service fee being the cost to the suppler for almost immediate cash.

As typical, the company must pay off the cards two weeks after the statement or they achieve an interest-free period (or DSO) of up to 55 days. Virtual card payment is particularly attractive to smaller suppliers, who tend to be cash hungry.

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In terms of **Accounts Receivable**, corporates strive to improve STR rates which not only yields process efficiencies, but also helps **reduce days sales outstanding** (DSO) and frees up customer credit lines for more business. Whilst in Accounts Payables, **Virtual and Procurement Cards** offer the benefit of **extending Days Payable Outstanding** (DPO) whilst offering **supplier improved terms**.

In the case of one company, being a transport and logistics business, payment is often required up front in order to facilitate release of goods and services. As a means of counteracting this issue, a third-party service is used, which provides real-time payments and payment guarantees, but this adds a signification additional transaction fee, regardless of payment amount. The use of a virtual card payment or the real-time nature of New Payments Platform, could potentially achieve the same aim and be more cost effective.

Businesses report their most labour-intensive pain point in accounts payables is reconciliation arising from payments being rejected due to incorrect entry of account or BSB number, or mismatches of invoice and payment amounts. This was mainly for one-time vendors and on-the- spot payments due to capturing errors. In these situations, the payment will be reversed and manually reconciled after the fact.

Next in the series: Trade and International Payments

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