

# Strategic Approaches to Managing Accounts Receivable and Accounts Payable

## TABLE OF CONTENTS

Improving Cash Flow with Effective AR and AP Management . . . . .	2
Strategic AR Management . . . . .	2
Strategic AP Management . . . . .	4
Conclusion . . . . .	5

## EXECUTIVE SUMMARY

Strategic management of accounts payable and accounts receivable—especially in uncertain economic times—can play a critical role in a company’s short-term survival and its long-term success. This white paper demonstrates how taking a strategic approach to these critical functions and looking at them as integrated processes occurring on an integrated continuum can pay off in significant benefits—including increased cash flow, reduced transaction and operating costs, time savings—even improvements in sales and revenue.

## **IMPROVING CASH FLOW WITH EFFECTIVE AR AND AP MANAGEMENT**

Taking a strategic approach to accounts receivable (AR) and accounts payable (AP) management is always advisable. In economically uncertain times, it is imperative. “We are in an interesting time, where very large companies typically have substantial liquidity and are having a difficult time getting historical rates of return on that liquidity,” says Jeff Minick, senior vice president and manager, commercial banking treasury solutions, Bank of America Merrill Lynch. “A majority of mid-market companies don’t have that luxury; therefore, they need to squeeze everything out of the cash they have.” The best way to optimize cash is to have very efficient payables and receivables. Without that, you have higher costs and more risk, neither of which is attractive to businesses, he adds.

Prioritization and resources are the two keys to strategic management of AR and AP, and the size of the challenge correlates with the size of the company’s staff. “The smaller the company, the more responsibilities each employee has,” Minick notes. “Efficiency is critical to survival. I often ask clients if they would rather hire another salesperson or another accounts payable clerk. Efficient payables and receivables processes allow them to hire more salespeople.”

No matter what the business climate, cash is always king, says Wayne R. Pinnell, CPA, managing partner of Haskell & White, LLP, a multi-office accounting and business advisory firm in Southern California. “That means businesses need to focus on cash flow and build their reserves,” he says. While capital markets are in the early stages of a recovery, having a good cash flow remains vital to long-term success. Strategic AR and AP management can have a significant impact on that success.

With sales down and operating expenses up, the only area that offers any potential for capturing incremental value or profit is in the middle space between the price of a sale and gross profit, says Patricia Sigmon, founder of LPS Consulting and author of *Six Steps to Creating Profit*. That means this is a C-level issue, not just an accounting exercise. “We don’t want to spend more money, increasing costs on collections, nor do we want to pay interest, penalties, or excessive expense on our payables,” she says. “From the initial point of sale, when AR can be designed to be most favorable, to the actual payment of all expenses, a senior ‘eye’ must be managing every piece of this puzzle for maximum profit intake.”

## **STRATEGIC AR MANAGEMENT**

Minick suggests approaching AR management as an integrated process occurring along a continuum: Marketing/pitch of product or service to be sold > Sale of product or service > Provision of product or service > Collection of funds.

Starting the AR process early—at the beginning of the sales process—can reap many benefits later. “We encourage our clients to get their salespeople to include terms and payment in the conversation,” Minick continues. “We’ve spent many years running conversion programs for our clients, where we attempt to get their customers to pay them electronically. If a business can negotiate to get paid electronically at the beginning of the sales process, it can save both time and money.”

Pinnell agrees that starting the AR process in the early stages of a new business relationship is critical. He recommends evaluating the customer’s AR exposure from the initial sale and establishing credit limits for all customers—and monitoring and adhering to them throughout the relationship. “Don’t be afraid to contact customers about past-due payments, as this may be the first sign that they are experiencing financial difficulties,” he advises. Failure to take prompt action can lead to a more significant loss downstream. If a customer’s financial situation changes, consider modifying the terms by changing to COD or COD+ (cash for a new order with payment toward outstanding balances), he adds.

A well-designed AR management strategy can have a positive impact on a wide range of other business functions, including sales and marketing, customer service, and operations. By speeding up the AR process, a business can make it easier to manage at all points in the continuum and account for their funds sooner, Minick says. It also provides the necessary tools to follow up with slow-pay customers. “In the end, a business’s grasp of liquidity will be better, enabling it to speed up product/service launches, gain a firmer grasp on how quickly a sale leads to revenue, and focus more time on other aspects of the business.”

### **Adopting a financial process optimization strategy**

Today, more than ever, organizations are leveraging business intelligence in order to optimize cash flow. “The key to capturing significant savings and ongoing boosts in cash flow is investing in financial process optimization, says Mary Driscoll, senior research fellow at APQC, a member-based nonprofit that specializes in benchmarking, knowledge management, measurement, and process improvement.

Treasurers at many companies tend to be focused on essential functions such as general accounting, cost control, meeting audit requirements, tax management, and closing the books—all of which are critical to the successful operation of the business, Driscoll acknowledges. “This [financial process optimization] can dramatically free up accounting staff from performing low-value transaction work that’s much better done with the aid of automation.”

Businesses benefit when in-house finance people perform the analysis needed to understand the payment patterns of key accounts and use that knowledge to optimize cash flow. Too often, companies lack that analytical bandwidth and end

up “on a back foot and at the mercy of frequent cash-flow squeezes,” Driscoll says. The reason is that even the most capable in-house accountants often lack a natural inclination to focus on cash in-flow optimization and the impact that strong working capital management can have on balance sheet strength.

“The first step [to implementing AR process optimization] is to figure out what the burning issues are,” Driscoll adds. “Are you spending too much? Do you need to bring down costs? Do you need to do a better job of leveraging the analytical talent you have on staff who are, unfortunately, bogged down in low-value, repetitive transaction processing tasks, such as manually gathering data from disparate systems to generate invoices from customers?”

---

## STRATEGIC AP MANAGEMENT

Cash management practices can play a critical role in both a company’s short-term survival and its long-term success. Maintaining sound reserves is a vital strategy in planning for a rainy day. It also provides the opportunity to make prudent, long-term investments in the business. “A vast number of the casualties of the recession were a direct result of insufficient cash reserves,” Pinnell observes.

Managing short-term cash provides businesses with a better idea of what debt facilities they truly need and how much financing to request to cover any seasonal activities, Minick notes. Having an accurate grasp of those two items can help speed the approval process when applying for loans and lines of credit.

### Look for ways to minimize finance charges

First and foremost, take advantage of discounts that are offered for paying early, and delay payment until the end of the allowable payment cycle on transactions that offer no discounts, Pinnell suggests. In the current environment of very low returns on traditional safe harbor investments such as Treasury bills, discounts offered for early payment often present an attractive alternative.

One of the easiest and most effective ways to optimize the AP cycle is to leverage credit cards as a payment vehicle, Minick says. No-interest credit cards can provide up to a 90-day, interest-free window in some cases. “Depending on card cut-off dates and how they match up with your invoice payments, you have up to 30 days before each new charge is included on a statement and another 30 days after that before the payment has to be made,” Sigmon explains.

“If you negotiate 30-day terms with your vendors, you can stretch the actual payment to 90 days.” In addition, many credit cards offer rewards programs, and accumulated points can be used for a variety of business uses, including travel and office equipment.

### Best Practices in AR Management

While there is no handy cookbook for end-to-end AR process optimization, organizations like [American Productivity and Quality Center \(APQC\)](#) and the [Institute of Financial Operations](#) offer a vast body of knowledge about performance levels and AR best practices.

APQC Open Standards Research has found that average cycle time to generate complete and correct billing data varies widely between top and bottom performers, from six days for the latter to just one day for top performers. Companies can improve their AR management performance by adopting best practices such as:

- Focusing on credit management
- Shortening payment terms
- Offering early payment discounts
- Eliminating barriers to payment; offer electronic payment options.
- Billing promptly and electronically, wherever possible
- Using new technology to automate the payment processing function or to improve existing automated processes
- Establishing a billing dispute resolution process
- Establishing a proactive collection process with early intervention and offering incentives to collections personnel
- Monitoring ARs on at least a weekly basis.

## **Automate the primary AP cycles**

Reducing transaction costs and automating AP processes can return significant savings for many businesses. According to research by Aberdeen Group, mid-market companies experience AP transaction processing costs 32 percent higher than industry averages, and they are twice as likely to make improper payments as their industry peers. Adopting best practices, especially process automation, is an effective way to address that disparity. Companies identified as best practice firms by Aberdeen Group reported invoice processing costs averaging 84 percent less than those of their peers with invoice processing cycle times averaging 59 percent faster. Industry best-in-class companies incurred an average cost to process an invoice of \$2.18 vs. an industry average of \$9.38; invoice processing cycle times were 2.8 days vs. 15.8 days.

Companies that fall into the industry best-in-class category tend to have a number of AP management strategies in common, according to Aberdeen Group's research:

- Enterprise-level visibility into AP processing  
(70 percent for best-in-class vs. 53 percent for industry average)
- Segmentation of vendor base for electronic and manual payments  
(80 percent vs. 47 percent)
- Use of automated invoice imaging and workflow solutions  
(55 percent vs. 49 percent)
- Ability to measure process cycle times (44 percent vs. 39 percent)
- Use of online/Web-based reporting (50 percent vs. 14 percent)
- Comprehensive AP automation (44 percent vs. 34 percent).

“Really, a more strategic approach to AP all comes down to deploying technologies that automate the primary AP cycles of receiving, coding, review and approval, and remittance to pay,” says Max Leisten, market director at SciQuest, a multinational provider of e-procurement solutions. He pegs typical processing cost-per-invoice (CPI) for manual AP practices as high as \$30–\$40, but says that with end-to-end application of technology across all the primary AP cycles, CPI can drop to about \$2. “That’s fairly dramatic data in an economy where every dollar counts,” he says.

---

## **CONCLUSION**

Managing both sides of a company's cash flow is important to every business in today's economy, and strategic approaches for improving AR and AP performance have a lot in common, especially the important roles technology and automation can play. At the same time, for these management approaches to be truly

strategic, they cannot be treated as mere accounting functions. C-level guidance and input is a must, and research shows that companies where management has visibility into AR and AP processes perform best in those areas.

In the end, strategic management of AR and AP is not just about saving money, it's about improving overall business performance by freeing up resources and time that can be devoted to a company's more mission-critical business activities.



Inc Magazine is not affiliated with Bank of America Corporation and is responsible for the content they present in this article.

"Bank of America Merrill Lynch" is the marketing name for the global banking and global markets businesses of Bank of America Corporation. Lending, derivatives, and other commercial banking activities are performed globally by banking affiliates of Bank of America Corporation, including Bank of America, N.A., member FDIC. Securities, strategic advisory, and other investment banking activities are performed globally by investment banking affiliates of Bank of America Corporation ("Investment Banking Affiliates"), including, in the United States, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Merrill Lynch Professional Clearing Corp., both of which are registered broker-dealers and members of FINRA and SIPC, and, in other jurisdictions, by locally registered entities. Investment products offered by Investment Banking Affiliates: Are Not FDIC Insured • May Lose Value • Are Not Bank Guaranteed. ©2012 Bank of America Corporation