Are you receiving me?

The accounts receivable function may not traditionally be associated with excitement, but get it wrong and it could cost the business dearly. Streamlining this process, especially on the collections side, should be on the agenda now and should remain there. But is there more to it than the application of technology?

A sale is not a sale until it's paid for; so goes the traditional credit controller's mantra. No matter how successful every other function is in the business, although accounts receivable (AR) is shown in the balance sheet as an asset, the money still has to be collected. In the B2B space, better collection means lower debtor default and lower days sales outstanding (DSO – the average number of days that a company takes to collect revenue after a sale has been made) means the business is stronger in terms of working capital and can extend credit lines to customers, driving up sales; the reverse is true if the process fails.

According to a May 2013 HSBC Global Connections report, on average global companies had $3.1 billion of cash trapped in internal working capital which, it stated, could be unlocked by reducing DSO "to within the median range for their industry". But research from working capital consultancy REL found that converting sales into cash is getting harder, with cash conversion efficiency in Europe deteriorating three years in a row from 13.4% in 2009 to 10.6% in 2012. Almost certainly connected to this is Experian's quarterly Late Payment Index finding, issued in November 2013, that the UK's largest firms are paying overdue bills three days later than at the same point a year earlier and some 15 days later than the country's smallest businesses.

An easy fix?

The problem with AR, and collections specifically, is that it is subject to a strong cultural and human element – even within large and sophisticated client businesses. Finding improvements will never be easy. Fragmented or missing remittance data, part payments, disputed invoices, persistent use of cash and cheques, variable payment behaviours, almost zero standardisation of remittance formatting – all

these things conspire to make the job more difficult. Being able to reduce DSO is not simply a matter of brow-beating debtors into paying on time and supplying accurate remittance data, not least because such an approach can harm commercial relationships.

In its research paper, 'Buried Treasure: Uncovering cash from your accounts receivable process', REL points out that a backlog of receivables is, in fact, "really the result of internal processes that need to be optimised". Asking how to prevent bad debts, reduce billing errors, and minimise payment disputes, it argues, "is much more promising than asking what it will take to get a particular customer to send a cheque".

Too much, too soon

With the choice of cash, debit and credit cards, direct debit, direct credit, ACH in US, giro in the Nordics, RiBa (Ricevuta Bancaria) credit transfers in Italy, Direct Entry in Australia, wire transfer (local and international), electronic bill payments via Internet banking and online payment services (such as PayPal and WorldPay) – and a whole host of other regional and local possibilities – the distribution of remittances across multiple formats and channels can make collection and reconciliation even more difficult than it already is.

But as the green shoots of economic recovery show signs of emerging, surely the worst is over and the need to tighten up AR will recede? Not so, says John Salter, Managing Director, Cash Management and Payments, Lloyds Bank Commercial Banking. "Just because things are getting better, don't take your eye off the ball; the risk element has not gone away." Empirical evidence, he notes, shows that as many companies emerge from recession, many over-trade by launching too quickly into new markets, delivering too many new products too soon or taking on contracts beyond their capacity. "If they over-trade, they could go bust."

Reconciling differences

One of the most difficult aspects of the receivables process to improve is the reconciliations process. This difficulty is often linked to the fact that a collection is usually initiated by the debtor and one of the challenges here is that their remittance data is sometimes incomplete or incorrect. There will always be a certain number of exceptions generated including part payments, credit notes and disputed invoices. But even with correct remittance data there may be problems such as insufficient funds being available to settle. Of course, there is a need to avoid upsetting customers with bad debt notices if there is a perfectly reasonable explanation for late or part payment but if an invoice looks like it is not going to be paid on time, the business has to make some firm decisions, especially if it is to prevent a delinquent account turning into a bad debt.

Following the release of the Experian quarterly Late Payment Index, mentioned above, Ade Potts, Managing Director for the firm's SME division, said that to increase the chances of getting paid faster, credit monitoring was a good first port of call. "This will help to differentiate between those debtors that are unable to pay, those that have the means to pay but have a track record of paying late, and those that are willing and able."

Indeed, unless a business has a ready source of receivables data to give it advance warning, even a small percentage of exceptions experienced within a large global corporate receivables programme can soon become very costly.

Seeking a solution

A review of the receivables management process should be seen as a way of enabling the business to focus on the core pillars of its incoming capital. Finding improvements must start with an exploration of how a business is currently being paid by its customers. It will thus be necessary to consider whether or not that model is business- or industry-specific, how well it works and precisely what problems it creates. Asking what the business is trying to achieve by changing the process, and if that process can even be changed, is also essential.

A typical large mainstream retailer, for example, will take notes and coins as part of its collections process because many of its customers still use cash. Gareth Lodge, Senior Analyst at Celent, told Treasury Today in a June 2013 interview that "by the number of transactions, cash is the dominant payment type in every country in the world. It is, in fact, typically more dominant than all other payment types put together". Not least of the worries with cash-handling is staff security.

It's true too that some businesses still take (and make) a lot of cheque payments (particularly in the US and India) but cheque payment has an attendant security/fraud issue and extra processing requirement even if US-style lock-boxes are used. Both cash and cheque also typically require in-country banking support which adds to the cost. If payment format is linked to a cultural norm (or habit) it may be possible to change that process slowly over time, perhaps with certain inducements (a discount for those that opt into e-billing for example). Forcing change without a thorough analysis of the needs of the customer-base to help understand their motivations could backfire in terms of increased customer churn.

If change amongst debtors is not immediately possible, receivables and collections improvements may still be implemented but the response to questions asked regarding existing payment norms should be used to find the most appropriate course of action in terms of moulding internal processes to meet that need. For Salter, as an industry advisor, he believes that "it really is a case of understanding by industry, by customer within that industry, by geography, how they operate today".

Automate and be done?

Although technology is often seen as the answer to every problem, if the underlying processes are poor, simply automating them will not help. But success with a broad scope of automation is possible. Thomson Reuters received Highly Commended in the Best Process Re-engineering Solution category in the 2013 Adam Smith Awards with its consolidated receivables project. This has delivered a global end-to-end solution enabling automatic allocation of customer payments to customer open AR accounts based on remit information that uses a unique number (similar to a barcode) and also auto reconciling of bank statements to general ledger accounts.

For many firms, direct debit is nirvana in terms of collections. Filipe Simão, Head of Client Advisory, Cash Management, BNP Paribas, is positive about SEPA Direct Debits (SDD) because "never before has the industry had a uniform, standardised way of collecting cross-border". Being able to centralise all DD activity certainly removes the need for in-country collection accounts which will reduce cost and improve efficiency.

The slow uptake of SDD to date is no mystery, being in part due to the greater difficulty in migrating from existing direct debit

systems. With the SEPA credit transfer (SCT) process, moving from a third party local scheme to SEPA is a technical exercise, requiring the conversion of a database of beneficiary account numbers into BIC and IBAN numbers and the capacity to generate XML-formatted payments messages. "SDD is much more complicated because of the way mandate management works," says Simão. The SDD mandate flow differs from what is in place in most countries, he explains. With SDD, the mandate and its lifecycle will be managed by the creditor. This requires the set-up of new systems and processes and is a migration that cannot be automated to the same degree as SCTs.

In its defence, SEPA is complemented by the B2B SEPA Direct Debit scheme which, if used, removes the risk of rejection of a transaction. Because it requires the debtor's bank to ensure the collection is authorised (by checking the collection against mandate information) the debtor cannot later claim a refund. "This helps tremendously with treasury forecasting because you know the direct debits are not going to bounce back," notes Simão.

Another solution in the B2B collections and reconciliations space, he notes, is the concept of the virtual account. Set up and allocated individually to a corporate client's counterparties for the sole purpose of handling incoming payments, these "dramatically improve the reconciliation rate because we know that whenever a settlement is made using a virtual account number, it relates only to a specific client and counterparty".

As a variation on this theme, collections via in-country accounts for exporters can be handled through a remote collections process allowing exporters to be paid locally without having to hold and manage a local account. An overseas counterparty pays into an account held by its creditor's bank; the bank then credits its client's home account.

There is no panacea

So why don't all businesses just centralise and automate their various AR and collections processes? Firstly, Salter warns, "anything can look good on paper; it's the execution that's the challenge". Indeed, one of the major hurdles is the simple fact that payments and collections will always involve people and people "do not always act rationally". With direct debits, for example, he notes "it is fascinating how companies are happy to collect their money by DD but don't want another business debiting their own accounts directly". Intellectually the systems work, but in practice problems exist because "companies are run by people". As a result the level of automation is not where he feels it should be.

Secondly, some processes cannot be automated. A major UK-based high street retail client of Lloyds, when discussing working capital drivers, put receivables top of its fix-list, ahead even of payables and inventory. Many of its customers use cash, something that cannot be changed overnight. But by changing the way cash was collected and reported across all branches, its receivables could be better managed. Even something as simple as altering the time the courier arrives to collect the cash meant it could move the receivables book forward gaining one extra days' value of cash in bank which, given the sums involved, gave it "significant uplift".

Surely an electronic alternative to cash would work? Marcus Treacher, Global Head of eCommerce for Payments and Cash Management at HSBC, predicts that smartphone contactless payments "will have a huge impact in terms of cost reduction on the cash cycle and more efficient receivables handling for bank processing centres and large retailers such as supermarkets". But Celent's Lodge counters that payments behaviour is driven by habit and convenience. "Anyone developing alternative payment systems has to compete with that." That goes for both B2C and B2B.

A simple solution

There are fundamental principles of improvement that may be applied in terms of what a company does, why it does it and how this fits its operating model from an order-to-pay perspective. Individually, companies can tackle the problem and realise some major improvements. But there is no one-size-fits-all solution: invoices are not standard; customers may not behave as you wish them to; cash and cheque are still endemic; direct debit is feasible only if the business can handle the exceptions – the list goes on.

With customers tending remittance data through different channels, it becomes a demanding task to manipulate the data into a coherent format for ready-use as business intelligence. BIC and IBAN validation services are available for bank account numbers, and data other than the invoice number can be used by receivables systems to reconcile outstanding invoices (such as invoice amount or due-date). Customers can also be requested to quote a structured reference that includes a checksum digit (an error-detecting code) that will immediately highlight a discrepancy.

If it is possible, digitising, and by extension standardising, remittance information would be a major improvement in the straight through flow of remittance data – and Thomson Reuters has proven that it can be done. Outsourcing some or all AR processes to a bank or to another third-party provider with a broad global footprint and economies of scale in terms of technology (notably around auto-reconciliation and matching) and AR expertise, can deliver benefits but at a cost and with some inevitable loss of control.

The obvious way to remove customer error is for the creditor to take control of collections initiation (using direct debit in particular), says Simão. In the B2C space, electronic bill presentment and payment (EBPP) enables bills to be created and sent by the creditor, and paid by the debtor through their electronic banking account; they cannot change remittance data which resolves the reconciliations problem. In the B2C sector generally there has been a lack of integration of these systems so consumers have to login to a separate EBPP website for each of their suppliers, although Belgium's Zoomit (which requires a one-off registration on the creditor's website) and the multi-channel SEPAmail (developed in France but designed with the SEPA zone in mind) claim to address this issue.

For Salter though there is one significant improvement that can be applied that does not add cost, does not rely on technology nor cause any loss of oversight. "If you really want to improve your receivables, train your sales people," he states. At the front line, if sales people can encourage customers to use the preferred payment option, half the battle is won. "Good receivables always start with the sale, not with the back office trying to drive a change of process." This logical approach harks back to the opening statement that a sale is not a sale until it is paid for; it may not be popular with sales people but it must be a change for good the if it removes problems downstream and provides clear, timely and useful information that keeps a company liquid and, ultimately, afloat in a sea of uncertainty. ■