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Overview of Payables Industry

Trends

Treasury Management
U.S. Bank

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Overview

Payments are no longer just a back-room "support" function. Increasingly, companies realize that payment processing is integral to the company's supply chain and bottom line results. To remain competitive, organizations require solutions that meet broader needs related to efficiently and cost-effectively processing payments and managing working capital for themselves and their suppliers.

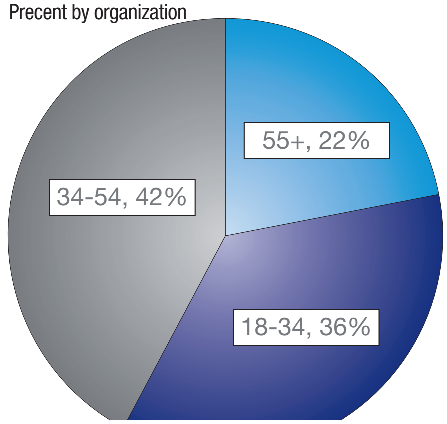
This white paper examines industry trends that have elevated the strategic importance of the payables function. It also explores how technology and workflow solutions have evolved in response to these trends to add value beyond payment processing and span the entire purchase-to-pay cycle for processing, payment, financing and fraud control.

Payables Trends

The economic downturn has increased the focus on Accounts Payable (A/P) departments due to their key role in companies' liquidity and working capital management. Additionally, as with any non-revenue generating unit, A/P is a target for cost reduction through process efficiencies.

Top Pressure for A/P Departments

Precent by organization



Source: Aberdeen Group, "E-Payables Benchmark 2009," September 2009

An E-Payables Benchmark Study conducted by The Aberdeen Group shows top pressures for A/P departments and illustrates how the financial crisis has increased the need for bottom line contributions from the traditionally overlooked Accounts Payable department. In this study, the pressure to contribute to working capital management as well as reduce operational costs increased year to year from 2008 to 2009.

Efficiency / Cost Reduction Initiatives

Accounts Payable departments have typically been viewed as 'cost centers' within the organization. Historically there has been little interest in investing in automation to cut costs in the paper-intensive domain of A/P processing, even when a good ROI can be demonstrated. With the recession causing companies to look to all opportunities for cost savings, there is increased impetus to implement efficiency solutions.

A/P departments can directly contribute to the bottom line with savings from process automation across the entire purchase to pay spectrum, migration to electronic payments, improvement in working capital management, and revenue from purchasing card rebates.

Migration to automated processes and electronic payments

Automating processes and electronifying payments present key cost reduction opportunities for organizations compared to the typical labor-intensive paper processes. As the following tables illustrate, there is a progression of cost reduction from laggard to best-in-class companies, as more electronic payments and automation is integrated into payables processing.

- Creating efficiencies in the time-consuming, traditionally manual areas of invoice processing/approval and payment results in significant cost savings. Aberdeen Group's September 2009 E-Payables Benchmark study, "Accounts Payable Rising," showed that best-in-class companies had high levels of A/P centralization, automation, and visibility, were able to achieve cost improvements, speed advantages, and accuracy improvements. The following table illustrates the significant difference in cost and time associated with automating invoice processing.

Maturity Class	Mean Class Performance
Best-in-Class (Top 20%)	• $3.53 to process a single invoice • 3.5 days to process a single invoice
Industry Average (Middle 50%)	• $11.19 to process a single invoice • 16 days to process a single invoice
Laggard (Bottom 30%)	• $35.56 to process a single invoice • 27.1 days to process a single invoice

- Efficiencies in payment processing yield similarly striking results, albeit on a smaller scale. Aberdeen's July 2009 study, "E-Payables: Electronic Payments, Reduce Your Processing Costs," measured best-in-class companies' payment processing costs:

Maturity Class	Mean Class Performance
Best-in-Class (Top 20%)	• $1.61 to process a single payment • 1.9 days to process a single payment
Industry Average (Middle 50%)	• $8.12 to process a single payment • 6.0 days to process a single payment
Laggard (Bottom 30%)	• $16.96 to process a single payment • 27.5 days to process a single payment

- In the past decade, top-tier financial institutions and technology vendors have expanded into the Purchase to Pay (P2P) cycle to deliver value from the purchase order through invoice processing and payment. These solutions are also referred to as Financial Supply Chain solutions (such as U.S. Bank's EIPP solution) and often can additionally incorporate an element of trade finance between buyer and supplier. Aside from automating processes and payments, financial supply chain automation solutions reduce costs further by providing visibility and self service to suppliers through a web portal. Trading documents such as POs, invoices and payment amounts/status are shared electronically through the portal. This transparency allows suppliers to view the status of invoices and payments, reducing or eliminating calls into A/P on these issues.

Payment Electronification

According to PayStream Advisors' April 2010 Report, "Electronic Payments, Streamline P2P, Reduce Costs," companies are looking to migrate to electronic payments for a variety of reasons that include:

- Cost savings from automation and payment cost differential between paper and electronic
- Improved cash forecasting
- Improved trading partner relationships
- Improved fraud control

Driven by cost efficiencies, revenue opportunities via rebates, and the opportunity for improved cash forecasting and visibility, the economic conditions have never been better to drive the payment shift.

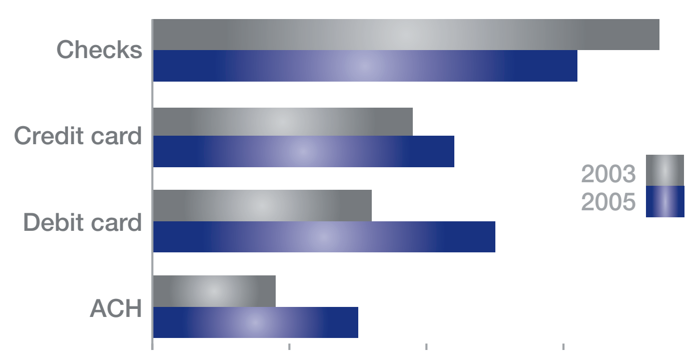
While there has been significant progress migrating paper to electronic payments, the vast majority of B2B payments continue to be made via check. It is estimated that almost 75 percent of B2B transactions are checks[1]. Some of the top barriers to shifting to electronic payments were identified in the April 2010 Paystream Research, "Electronic Payments: Streamline P2P, Reduce Costs."

In the short run, this evolution may have the effect of increasing companies' processing costs as they migrate their vendors to electronic payments (or are forced by trading partners to adopt new electronic payments and processes). In the long term, however, this migration will enable organizations to streamline procurement and accounts payables operations.

Each payment type brings unique benefits to the payors and payees, making it critical that organizations use

Barriers to Electronic Payment Adoption

Precent by organization



Source: "Electronic Payments: Streamline P2P, Reduce Costs," Quarter 2 2010, PayStream Advisors, Inc a strategic approach to segmenting their payables and targeting the appropriate payment types for each business purpose. Key factors in choosing the appropriate electronic payment option include:

- ACH payments have a low processing cost, mature integration into ERP systems, and ubiquitous acceptance through the banking system.
- Card payments are moving beyond T&E and MRO spend categories into larger dollar B2B supplier payments for three main reasons - the float and financing attributes of the cards, built in fraud control mechanisms, as well as the opportunity for rebates to buyers with larger programs.

Increase integration with banking partners

Technical integration with banking partners brings efficiencies, cost savings, and an additional level of control. Sophisticated payors are creating a link with their bank or third party provider to automate the process of payment file initiation and receiving information reporting while maintaining an audit trail.

- According to a 2009 Aberdeen study, 74% of respondents indicate that B2B integration and collaboration is a strategic initiative in their company. 37% of companies have increased their focus on B2B integration and collaboration during the recent economic downturn.
- Some large payors, with multiple banking relationships, are seeking “bank-agnostic” payment processes, such as sending standardized files directly through S.W.I.F.T. for delivery to multiple financial institutions. This allows organizations to replace multiple integration points with a single interface. Additionally, in light of the financial crisis and concerns about bank failure, this concept provides companies with confidence that a single point of integration can be used to reach multiple banks for “back up” purposes.

Focus on efficiency

Organizational structure changes, such as centralization of functions and/or outsourcing of non-core components, are being increasingly adopted in the effort to contain costs.

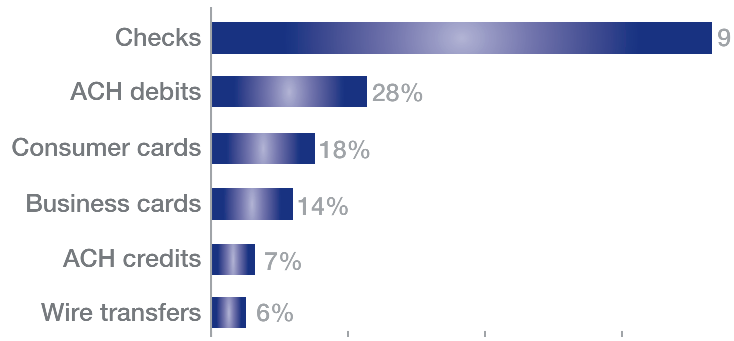
- Many organizations are consolidating their Accounts Payables functions across divisions and geographies. This enables the organizations to increase their visibility of vendor spend across business units and obtain processing efficiencies.
- Outsourcing is another trend largely motivated by cost control. Companies are outsourcing finance and accounting processes more rapidly today, according to the Everest Research Institute. Specific to payables, 20% of firms are outsourcing a part of their accounts payables process, with 15% looking to outsource in the near term. Celent research cites three primary drivers of this growth: 1) cost pressures, 2) the need to comply with regulations, and 3) increased focus on working capital management[2]. Financial outsourcing firms are seeing strong demand from the middle market and are targeting them with standardized solutions to minimize costs.

Liquidity Management / Working Capital Management

With credit availability still hampered by economic conditions, an organization's ability to maximize working capital has taken on increased strategic importance. According to Treasury and Risk's 2010 Strategic Treasury Survey, 54% of financial professionals cite the "laser focus on liquidity amid the recession" as the key reason the treasurer's position is being viewed more strategically. In a study performed by Cygnus Supply and Demand Chain in May 2010, executives put working capital management at the top of the list of areas to focus in the next two years, as shown in the graphic to the right.

Executive Focus for the Next Two Years

Precent of Executives



Source: "American Express/CFO Research Global Business & Spending Report" as referenced in "Striking the Right Balance: Finance Executives Combine Growing Optimism, Continued Financial Discipline," Cygnus Supply & Demand-Chain Executive, May 11, 2010.

Strategic Management of Days Payables Outstanding (DPO)

Companies are using a variety of approaches individually and in concert to manage DPO and contribute to their organization's bottom line.

- Trade Terms - Buyers seek to extend trade terms, often mitigating the negative effects on their suppliers by offering financing or promising immediate payment via cards.
- Discount Management - Savvy buyers are realizing the significant contribution of discount management, especially in a low interest rate environment. A standard discount of 2/10 net 30 provides approximately a 36% APY. Discount management is often a key component of Financial Supply Chain Automation solutions because the electronic exchange of documents and automated approval workflow allow invoices to be processed in time to take advantage of discounts.
- Financing considerations for both the buyer and supplier:
  - Supplier — Buyers are motivated to facilitate supplier financing for two main reasons- (1) to soften the blow of extended trade term policies, and (2) to manage risk in the supply chain as traditional sources of credit for trading partners becomes increasingly scarce and costly.
    - Typically offered in conjunction with a Financial Supply Chain automation solution, suppliers benefit from financing, often on an individual invoice basis.
    - Financing rates typically hinge on the buyer's credit rating, based on their promise to pay approved invoices, making it a more economical cost of capital for many small and mid-size suppliers.
  - Buyer — Buyers seeking additional extension of DPO beyond trade terms may use purchasing cards for their inherent payment financing capabilities or may seek payables extension financing through a Financial Supply Chain automation solution.

Visibility and Control

Risk management monitoring and fraud control remain key issues for A/P:

- According to the 2010 AFP Payments Fraud and Control survey, 73% of organizations experienced attempted or actual payments fraud in 2009.
- Internal fraud continues to be an issue with an estimated 7% of annual revenue or $994 billion lost to internal or occupational fraud in the U.S. each year[3].
- Duplicate payments occur for a variety of reasons, including clerical keying errors and inconsistencies in the vendor master file. The Institute of Internal Auditors estimates an average of .1% of payments are duplicate payments.

The fundamental foundation for sound risk management and control is transparency and near real-time access to financial data. Financial professionals are relying on a number of automation tools to increase visibility and control:

- Integration and automation of data feeds from their bank is a first step in providing companies with the information they need to manage liquidity and risk. However, this information simply details the movement of funds into and out of bank accounts and does not provide advanced notification of cash flows.
- Automating the Purchase to Pay Cycle allows organizations to gain visibility to the processes of invoice receipt and scheduled payment timing provides further cash forecasting and risk management benefits. Automation of the entire P2P, or financial supply chain enables financial professionals to have advance knowledge of events that will impact cash position and alert them to risks within the supply chain.

Globalization

As global trade becomes commonplace, companies' comfort level with conducting business internationally has increased. The U.S. is the world's largest exporter of goods and services with exports reaching $1.6 trillion in 2009[4].

Increased trade has also caused a shift from traditional trade services — including letters of credit that rely on banks to mitigate risks as third-party intermediaries between international trading partners — to open account trade. Global payables solutions often contain an element of trade finance between buyers and suppliers.

For More Information

U.S. Bank Payables Solutions complement the other treasury and payment solutions from U.S. Bank that businesses have come to trust. To learn more, contact your U.S. Bank Relationship Manager or Treasury Management Consultant.

[1] PayStream Advisors February 2010 survey

[2] “AP and AR Outsourcing: Not for the Faint of Heart” March 2007

[3] 2008 Association of Certified Fraud Examiners Report to the Nation

[4] National Income and Product Account Tables, Bureau of Economic Analysis