Three steps to better receivables management

Multiple collection types, format inconsistency, and a lack of intelligible remittance data. These are all familiar challenges in the field of receivables management. But by eliminating paper, leveraging SEPA and automating reconciliation, corporates can streamline their receivables process, and wave goodbye to these unnecessary headaches.

A tricky discipline to master, the receivables management process is often riddled with inefficiencies. But as the treasurer’s quest for visibility and control over the company’s cash flows remains a priority, receivables is being highlighted as an area ripe for ‘reconditioning’. This is in no small part being driven by the realisation that reducing days sales outstanding (DSO) can help minimise the need for any form of alternative funding. And at a time when availability of credit continues to be squeezed, any improvement in working capital is very welcome.

Regulation is shining an additional spotlight on receivables today, as companies strive for transparency, standardisation and compliance. While regulation is often viewed as a cost burden by both providers and practitioners of payments, the benefits of some mandatory initiatives, such as SEPA, can add real value to a corporate’s internal processes. In fact SEPA promises richer account information, a homogenised set of transaction data across Europe and the prospect of real-time reporting, all of which can aid reconciliations, for example. But with the end-date for domestic ACH schemes of 1st February 2014 fast approaching, how can corporates embrace SEPA as part of a receivables management improvement programme?

The answer, according to Jeff Hawkes, Head of EMEA Receivables at J.P. Morgan, is by following a clear three step process:

1. Get rid of paper – and encourage your counterparties to do the same.
2. Leverage new electronic instruments.
3. Automate reconciliation.

Working through these steps will of course throw up challenges, and we will now explore the common hurdles that corporates face, as well as the best ways to overcome them.

Step 1: Migration away from paper instruments

Traditionally, the corporate treasury environment has been heavily paper-based. Although ‘go green’ initiatives are spurring on some forward-thinking companies to eliminate paper from their treasury function entirely, for the majority of corporates, the real driver remains operational efficiency. Looking specifically at receivables, cheques are a significant bottleneck. Receiving cheques hinders overall efficiency, reduces the amount of control that the collector is able to exercise, and elongates DSO. In addition, being a physical rather than an electronic instrument, cheques can be difficult to integrate into the company’s TMS.

Yet, despite drives by governments to migrate away from cheques, the antiquated payment instrument is still prevalent in a number of European countries. Take France for example: over the past decade, usage of cheques has fallen by 4%, but the total number issued on an annual basis in the country is still over three billion. According to the Comité consultatif du secteur financier (part of the Banque de France), the associated processing costs (borne by corporate treasuries as well as by processing institutions like banks) total circa €2.4 billion per annum. Countries such as Portugal, Italy and Ireland are also heavy cheque users. And despite the UK Payments Council’s best efforts, the UK remains a cheque ‘offender’, too.

But getting your own team to recognise the inefficiencies of collecting by cheque is not the toughest challenge – that should be a relatively easy win. It is persuading the customer to pay differently that is the key to achieving more efficient receivables management. “It’s about incentivising your counterparties to make the change, but it really has to be a sustained, comprehensive effort to get the best results,” says Hawkes. “Offer discounts over a given period for paying by direct debit, reward early payment, and perhaps even incentivise customers that include extra detail with their electronic remittances.” Making sure the payer fully understands what is expected of them, and that help is given in the migration to electronic payment is also essential. “Getting this right should ultimately lead to an improved biller-payer relationship as both parties will be able to benefit. The scope for success here depends to some degree on the bargaining you can leverage over your counterparties,” he adds.
Step 2: Leveraging new electronic instruments

SEPA migration is the second step for any company seriously considering receivables best practice today. Not only does SEPA offer companies standardisation and harmonisation – across everything from the process flow to the clearing cycle and reporting – it enables them to reduce their banking complexity and to reduce the need for manual intervention in AP/AR (and potentially to reduce headcount therefore). SEPA can also lead to a reduction in DSO; increase overall process efficiency; enable improved straight through processing (STP) – meaning a reduced margin for costly errors, and allow for improvements in working capital management. Moreover, where the B2B SDD scheme is being used, the fact that authorised transactions are irrevocable promotes significantly improved control over collections.

In addition, whether your treasury is centralised or decentralised, the SEPA Direct Debit (SDD) can be leveraged to your advantage. For the former, it enables the company to leverage a consistent direct debit format, for example. And for decentralised treasury departments that require access to multiple local ACHs, using the SDD actually puts the collector in control of dates because the collector initiates the transaction and thereby sets a value date of his or her choice.

Step 3: Automating reconciliations

Elsewhere, the fact that the SDD offers unique mandate references – which identify the payer – combined with the capacity for a richer payment narrative with SCTs (140 characters compared to 60 or so for legacy schemes), means that treasurers will be able to achieve far greater automation in their reconciliations process. This is the third step to better receivables management as it vastly reduces the inefficiencies associated with manual reconciliation.

SEPA: Worth the effort

But somewhat inevitably, with the benefits of SEPA come challenges too. Migrating legacy direct debit mandates to the SDD schemes and BIC and IBAN data collection, for example, are frequently cited by corporates as hurdles that are slowing their progress towards SEPA. The requirement to use XML-based formats has been off-putting for some companies too – in particular those treasuries that operate on a decentralised basis and have domestic formats entrenched in their systems (and psyche).

Hawkes believes, however, that some of the obstacles have been exaggerated. “The discussion around ISO 20022 XML is a case in point,” he says. “Because of the inclusion of XML in some of the SEPA proposals the belief has arisen that migration entails a complete overhaul of the back office. This is not the case. While IBAN is mandatory, XML communication between bank and customer is not.”

In addition, clients can continue to submit their transactions using legacy formats, provided their banking partner is supportive. “At J.P. Morgan, we will be offering clients a transaction conversion service. This means that clients can submit in the legacy German direct debit format, or pretty much any proprietary format they choose, and the bank will turn that into a compliant SDD transaction. And it’s the same story for SEPA Credit Transfers (SCTs),” Nevertheless, Hawkes does see a true challenge for corporates in mandate management.

Mandate management

Many legacy direct debit systems operate on a debtor-based mandate flow. But the SDD is based on a creditor-driven mandate flow. In practical terms, what this means is that the creditor is responsible for storing the debtor’s original mandate, together with any information regarding amendments relating to the mandate or its cancellation. All of this data must be SEPA-compliant. So the mandate held must contain information (in XML format) such as the BIC and IBAN codes, a creditor ID and a unique mandate reference.

“In other words, a lot of legwork is required of the corporate,” says Hawkes. “What we will be able to do at J.P. Morgan is to take the legacy mandate information from the client – whether in electronic or paper form – and convert that to the required SEPA-compliant format. So we will provide the BIC, the IBAN and the unique mandate reference.”

Turning to the storage of converted mandates, the SDD Rulebooks offer the possibility to issue e-mandates, meaning that dematerialised copies of mandates can be stored. There are some clear advantages to managing e-mandates over paper ones. Flexible and rapid accessibility is one, but lower storage costs also come into play. Also, the integrity of the mandate can be maintained without so much concern for damage, misplacing or ageing and illegibility. Nevertheless, the e-mandate solution is only an optional service offered by banks to their customers. J.P. Morgan is one of the banks offering this service.

“J.P. Morgan’s Mandate Management service can host all of the dematerialised mandate documents for you and provide an online interface which places you in control of changes and updates,” says Hawkes. “Legacy mandates are dematerialised, converting the data to be SEPA-ready, and appending the unique identifiers required by SEPA regulation. The solution also allows for fully automated end-to-end processing of e-mandates including issuing, amendment and cancellation of such mandates while eliminating the need to deal with a multitude of local, technical or organisational barriers.”

In addition to providing access to a suite of mandate status reports detailing returned or rejected transactions, a full audit trail is available through J.P. Morgan’s Mandate Management solution.
But what about electronic collections that fall outside of the SEPA remit? How can payers be easily identified in those instances and how can accounts receivable (AR) entries be closed without manual intervention to achieve straight through processing?

Says Hawkes: “The problem that clients face on the receivables side is that they are not in control of what information comes in, or what format it arrives in. As such the ability to even marginally improve the level of automated reconciliation on the receivables side can have huge operational and cost benefits.”

While some corporates will be able to achieve automation by having enough sway with their debtors to dictate the way a payment is received, others will not. Using Virtual References is a very effective way of achieving improved automation without exercising any clout. J.P. Morgan’s Virtual Reference solution is designed for customers that receive a large volume of ACH or wire transactions and require an automated process to identify payers. Here’s how it works:

1. J.P. Morgan provides you (the creditor) with a set of Virtual References. Millions can be assigned and each one is a unique identifier.
2. You then assign a Virtual Reference to each of your payers – or to an individual invoice depending on how you wish to use it.
3. Your vendor or customer uses the Virtual Reference number when making a payment where J.P. Morgan is the designated beneficiary bank. As the Virtual Reference is effectively no more and no less than an ACH routing instruction, it is validated by the clearing house, eliminating mistyping or misinterpretation of additional reference data.
4. The deposit is credited to your appointed collections account and the Virtual Reference used is quoted.
5. By using J.P. Morgan ACCESSSMOnline or host-to-host, or Receivables EdgeSM you can then proceed to download data and initiate automatic reconciliation.

Depending on the individual set-up, electronic or paper receivables reports can also be seamlessly delivered back to the client’s ERP system for straight through processing.

“Rather like a parcel sent via a courier service can be tracked with a code, the Virtual Reference solution allows you to not only know who has sent that payment to you, but also lets you know when it has arrived in your bank account – even intraday. Automatic A/R matching and closure of AR entries can then be performed via J.P. Morgan technology, such as Receivables Edge. This can really take the pain out of the receivables reconciliation process and greatly reduce error rates,” explains Hawkes.

Adding value through Receivables Edge

Virtual References represents just one facet of J.P. Morgan’s Receivables Edge, however – the technology has a lot more to offer treasurers looking to improve their receivables management. It is a web-based collections tool that consolidates Lockbox, ACH, EDI and wire information into the same browser for the purpose of cash and exception management.

Receivables Edge in the US, which we intend to replicate in EMEA, contains matching logic to draw comparable information from different types of incoming remittance and pass it back to the user in a consistent way. “If clients pay a different amount, or in the wrong
currency, or pay two invoices at once with the reference for only one, then the parsing algorithms can still match payment to invoice, minimising manual intervention,” Hawkes explains.  The solution provides local clearing capabilities in all 32 SEPA countries.

“The reporting capabilities are also extremely flexible, giving treasurers a regional and global view of all their incoming payments” he continues.  Clients can produce their own reports by amount, date, payments from particular counterparties and other fields.  “Delinquency reports could for example be created to help identify customer segments that would benefit from being moved to direct debit — and help in the important task of moving the receivables process from paper to electronic.  Therefore, the three step process for improving receivables management essentially turns into a virtuous circle when everything is in place,” notes Hawkes.

Keeping the wheels turning

As with all projects though, implementation is one thing and ongoing management is quite another.  In order to keep the circle ‘virtuous’ rather than ‘vicious’, Hawkes has some parting advice for corporates: “Embrace metrics to constantly measure improvements in the management of your receivables.  Not only will this help you and your team to see the progress that is being made, but it will help to secure and retain buy-in across the organisation.”

Metrics to use could range from a reduction in DSO, to visibility over cash, the accuracy of cash flow forecasting, reduction in manual intervention and/or reduction in headcount, as well as the reduction in borrowing costs or simply the accessibility of timely reporting.  With the right receivables management programme in place, these numbers will speak volumes throughout the corporate entity, and crucially, at the bottom line.

J.P. Morgan has a unique status in treasury and cash management.  We are a full service provider offering traditional transactional capabilities, liquidity and investment management, and global trade services across the entire financial and physical supply chain.

We understand you select a banking partner based on a variety of individual requirements, our continuing investment in quality treasury and supply chain solutions demonstrates our determination to help you succeed.  Operating within a diverse financial infrastructure requires practical answers on a global scale, but delivered with local expertise.

Industry regulation, the economic climate and evolving technology present the treasurer with opportunities – and challenges.  We understand how to help you take advantage of both.

This is our business.

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