Six steps towards receivables best practice

A SEPA migration plan is just an extension of most treasurers’ day to day job of driving efficiency in AP/AR. With the right banking partner, it is neither expensive nor disruptive and will generate significant value, especially in receivables. There is no longer any advantage in delay.

SEPA update

The SEPA timetable announced by the European Commission in late 2010 remains on track. This lays down a forced migration to SEPA-compliant credit transfers in February 2013 and to SEPA-compliant direct debits in February 2014. The drivers that created the impetus for SEPA remain. Just one example: there are around 50 billion euro-denominated ACH transactions a year but a single ACH can handle 20 billion transactions. So why waste the money involved in running 17 ACHs? While some details remain to be finalised, it seems clear that there is less than a year before treasurers will be affected by the SEPA project.

As Lars Schwabe, SEPA Product Manager in Treasury and Security Services at J.P. Morgan, puts it: “The path is clear. We are moving from the legacy environment into a new environment. A little more time may be given to some types of customer to adapt and some specific issues remain to be solved. But none of that negates the central point that this new system is coming into being within a fairly short time. There is no longer any advantage for treasurers to take a ‘wait-and-see’ attitude.”

In-country drivers

It is also important to appreciate that individual countries are pushing ahead with local policy and infrastructure changes, all consistent with SEPA, but all well in advance of the likely end-dates. Some treasurers have already been taken by surprise at the speed that countries such as Greece and Luxembourg managed the swift transition to mandatory use of BIC and IBAN.

A strict timetable is now also in place for this transition to be completed in Finland as the Finns are set to abolish use of the BBAN with a 12-month grace period ending in January 2012.

“Treasurers need to realise that they are as much impacted at country level as at regional level as SEPA migration proceeds,” says Schwabe. “It is very important that corporates with activity in euro-denominated AP/AR are prepared.”

In addition, in several Eurozone countries, financial stresses make it unlikely that governments will want to incur the costs of running local ACH schemes alongside SEPA. Again the implication is that the timelines for local regulatory changes will differ from the Europe-wide process and are likely to be faster rather than slower.
What to do next

Having recognised that SEPA-migration is a priority, treasurers must establish a migration plan. The right banking partner will already have an outline migration framework against which corporates can benchmark themselves. At J.P. Morgan, migration planning is broken down into the following stages:

- **Account opening (for new clients):**
  - Consider rationalising your accounts in Europe.
  - A single account is adequate for payables and receivables across all 17 Eurozone countries (17 Eurozone countries plus one Principality).

- **Counterparty IBAN collection:**
  - Is your counterparty account data largely in BBAN or IBAN form?

- **Counterparty bank capabilities:**
  - Are your counterparties’ banks prepared for SEPA?

- **Migration approach:**
  - Migrate payables before receivables?
  - Where is the greater volume and where is the risk to supplier and client relationships and also to operational continuity?

- **Review your formats:**
  - Is adoption of XML across treasury a plausible short or longer term strategy?

- **Review your channel:**
  - Consider a single optimal channel through to your banking partners for centralised processes.

- **Modify reconciliation processes:**
  - Review current reconciliation tools and consider how these might need to be adapted to leverage SEPA’s rich payment information.

At each stage, the client can break down the process further into a series of self-diagnostic questions, with the bank able to offer services to help with each. These questions focus the treasurer on key elements of the transition: if the company is organised by customer type does this change the process? Which countries are the priority? Which systems and processes need to be changed? Given a phased approach, what has to be done in what order? How many counterparties do they have and what level of counterparty data is already compliant? And so on.

Says Schwabe: “We have a checklist of critical questions that corporates can use to help with the self-diagnosis process. We want to help corporates understand the migration task and to break it down into manageable stages. Once this initial evaluation has been carried out, we then provide clients with a template that they can use to build a more detailed strategy.”

The choice of bank partners is crucial. The migration process for each corporate depends intimately on how well their bank(s) can support them through the change. Says Schwabe: “With J.P. Morgan the clients can send us the files in any format, legacy formats,
XML together with SEPA information in one batch file and we can take that file, convert as necessary and process it without delay. We really do understand the issues corporates face on this journey and we have developed tools to help support them on it.”

This contrasts with the ‘Big Bang’ approach adopted by some other institutions who have stated publicly that corporates wishing to migrate to SEPA with them have to use IBANs, XML and a single access channel.

Many corporates expect the migration process to be expensive and disruptive. In fact, although resources are required in treasury, accounts payable and receivable and in IT, the ability to phase the transition, and the capabilities of banks like J.P. Morgan to handle a mixture of new and legacy data and processes, means that migration can be achieved smoothly by treasuries of all kinds.

For the larger pan-European companies with multiple legal entities, the country-by-country approach makes sense, with a phased migration to IBANs, followed by centralisation in a single shared service centre. For the smaller European operator, it makes more sense to centralise immediately to gain the benefits of being able to negotiate on the basis not of country volumes with local banks in each country but of European volumes with a Europe-wide institution.

Obstacles exaggerated

In addition, some significant issues mentioned in this regard have been exaggerated. For example, one fear has been over the imposition of ISO 20022 XML. Because of the inclusion of XML in some of the SEPA proposals the belief has arisen that migration entails a complete ‘XML-ification’ of the back office. This is not the case. While IBAN will be mandatory, XML communication between bank and customer will not. Treasurers will have to enrich their databases to manage IBANs and exchange information with their banks via the web or SWIFT. But that communication does not have to be in XML.

Another hurdle has been the debate over direct debit mandates. A concern remains that migration to SEPA requires the replacement of legacy direct debit mandates with new, SEPA-compliant mandates in both B2B and B2C. Again, the situation is much more straightforward than it may seem. In B2B, replacement is necessary but simple since contractual interactions between companies are common and formalised. In the consumer space, there are a number of countries in which direct debits are not yet common and so the problem is manageable; in countries such as Spain, the Netherlands and Belgium, where take-up is high, existing B2C mandates are valid as SEPA mandates. The only significant hurdle is in Germany, but the market consensus is that a solution will be found that does not require the immediate replacement of legacy mandates with the SEPA version. In short, treasurers do not face a Europe-wide issue of mandate conversion if they decide to begin the migration process.

Spotlight on receivables

A potentially significant area for payback for the corporate treasurer converting to SEPA is receivables, especially in reconciliation. SEPA promises richer account information, a homogenised set of transaction data across Europe and the prospect of real-time reporting. However, in order to fully optimise the accounts receivables process, treasurers need flexible reporting tools able to make the most of the new environment as well as systems to help them migrate from paper to electronic collection and reconciliation. This is made even less straightforward as companies still usually have to collect through multiple locally-based entities, using a wider variety of collection mechanisms and systems.

“Treasurers are under increasing pressure to improve day sales outstanding (DSO), to release more cash trapped in the collections process, to improve the efficiency of the reconciliation process by replacing manual processes with automation and to gain increased visibility across all payment types and geographies,” says Jeff Hawkes, Head of EMEA Receivables at J.P. Morgan.

“The cost reductions and improvements in working capital management and forecasting that can be achieved by implementing best practice in accounts receivables (AR) have become the top priority in many corporate treasuries.”

In response to these needs, J.P. Morgan has developed Receivables Edge. This comprehensive receivables management system addresses the three overarching treasury concerns:

- **Operating efficiency:** reducing internal and external costs and outsourcing activities that are not core competencies.
- **Maximising working capital:** improving cashflows and visibility.
- **Risk and compliance:** manage the increasing regulatory burden around subjects such as revenue recognition and strengthen contingency planning.

**Receivables Edge**

Receivables Edge 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 is also positioned as a downstream tool for customer service and credit management as it contains a comprehensive suite of exception management, workflow management and reporting tools.

The system was designed initially to improve the efficiency of paper-based cheque systems. These are both slow and provide little visibility of future cash flows.
Receivables Edge allows cheques and any additional documentation to be scanned and imaged, both as images and using optical character recognition. All the information from the cheques and any accompanying invoices is captured by the system. Where cheque truncation is allowed, these scans can then be forwarded to the issuing bank for clearing.

This creates visibility where there was none and significantly speeds up the clearing process. Even where cheque truncation is not allowed, as is the case in some parts of Europe, and physical cheques must be delivered to the issuing bank, Receivables Edge creates pre-clearing visibility and a database of payment histories and behaviours that would have been difficult or impossible to create previously.

The system can also collect any form of electronic payment, whether ACH or wire, and integrate this with the cheque data to create a single database of payment information for the treasury available intra-day rather than end of day. The solution also provides local clearing capabilities in all countries in which J.P. Morgan has a European branch presence.

Automated reconciliation

Reconciliation is still one of the most difficult and manual processes in treasury. Receivables Edge has the ability to automatically match payments to invoices, greatly reducing the need for manual intervention. The system 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.

The reporting capabilities are also extremely flexible. Clients can produce their own reports by amount, date, payments from particular counterparties and other fields. “It gives treasurers a regional and global view of all their incoming payments. Tailored reports and analytics allow them to create delinquency reports, to spot customer segments that would benefit from being moved to direct debit and help in the important process of moving the receivables process from paper to electronic,” says Hawkes.

SEPA benefits match treasury priorities

Most companies with regional or global operations already have ongoing centralisation initiatives. They are already upgrading and rationalising ERP systems; they are already investing in new IT and reviewing their payment and collections mechanisms; and they are already looking at ways to reduce the complexity of their banking relationships.

SEPA migration fits perfectly within this overall strategy since the benefits it brings coincide with most treasurers’ wish-lists:

- **Reduction in complexity:**
  - Fewer bank accounts, bank relationships, legal entities.
  - One set of processes, one interface, one cut off time for 17 countries.

- **Long-term cost reductions:**
  - Prices based on European not country volumes.
  - Reduction in manual intervention in AP/AR processes.
  - Reduction in DSO.

- **Increased process efficiency:**
  - Promise of STP in reconciliation.
  - High levels of end-to-end automation.

- **Improvements in working capital management:**
  - Payment finality improves cash flow forecasting.
  - Real-time pan-European transaction information (subject to your banks’ channel capabilities).
  - Increased visibility of incoming payments.

These benefits can be realised without extensive disruption and without excessive costs. They should form part of any treasurer’s medium-term rationalisation plans. But they do require the choice of experienced pan-European banking partners that can cope with both legacy and SEPA environments simultaneously. And, given the importance of receivables in the migration process, treasurers should look carefully at the AR support and expertise of any bank on their shortlist.