Managing Payments: A Giant Balancing Act

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Doing things right and doing them cost-effectively is a giant balancing act. Ask any payments manager. The good news is that counteringbalance these twin goals, while difficult, is not impossible.

Keeping the scales from tipping in the wrong direction, however, requires first and foremost identifying what is “right” for your organization, then sizing up how your operation stacks against accepted best practices. After all, you can’t improve what you don’t measure.

For companies looking to benchmark— and improve— their performance, a balanced scorecard approach to managing payments should cover four critical steps in the payments process:

1. Making payments
2. Reconciling payments
3. Managing exceptions
4. Preventing fraud

1. Making payments: Maximize automation, optimize the payment mix

Automation. One of the key drivers of both operational and cost efficiencies is the degree of automation in the payment execution process. In fact, studies show that the average cost of manually processing a transaction is 44% higher than the cost of sending a transaction through an automated system. Manual processes cause poor data quality which reduces STP rates, resulting in increased overall costs and additional downstream inefficiencies, errors and problems.

The sad truth, however, is that despite advances in automation, most accounts payable departments are mired in paper and plagued by manual processes to one degree or another. They can, however, minimize these burdens by employing recognized best practices.

Best-in-class companies, for example, are using ERP systems, shared services centers and direct connectivity to their banks to increase automation along their entire payment initiation and execution continuum. They are leveraging technology and electronic file exchange capabilities to boost straight-through processing (STP), from the time a payment detail is entered into their payables systems until payments are sent to beneficiaries. As a result, these organizations have been able to reach 99% automation rates for the initiation of their ACH, wire, card and check transactions.

Focusing on a strong program of automation tools, in addition to supporting high STP rates, also gives companies more control over the timing of their payments. This helps them optimize their cash usage by avoiding late fees and penalties and also taking advantage of special terms and discounts, for example.

Payment mix. In addition to automation, the payment mix affects processing costs. From a payer’s perspective, ACH is an ideal low-value payment solution. It offers extremely low costs compared to checks, which can cost $3 to $10 per transaction. Purchasing and prepaid cards also are an effective and increasingly popular way to realign payment costs.

Just the same, and for a multitude of reasons, the more costly checks and wire transfers remain common payment vehicles. Surveys indicate that, despite a downward trend in usage, checks are still employed for well over half of the business-to-business payments that are made today. By analyzing the volume, cost and use of these instruments, companies can identify opportunities to migrate payments to more cost-effective ACH and card disbursements.

Best-in-class organizations are diligent about optimizing their mix of payments and maximizing electronic payments and processes to create a more controlled and efficient payment environment.

Well-oiled payment departments also employ a holistic approach to managing the payment mix that includes sending a single file containing ACH, wire, card and check transactions to their bank for the least-cost payment routing. Advanced analytical tools are available that take raw payments data from an ERP system and provide concrete recommendations on rebalancing the payments mix to optimize automation, flexibility and overall costs.

In addition, best practices include electronically attaching and matching remittance details to e-payments, something that prevents inquiries and dunning calls, as well as delays in crediting payments credited when vendors don’t know how to apply them.

Designing sound, efficient payment processes also involves building in contingencies, such as multiple communication links for network connections, multiple channels for delivering payment instructions to your bank provider and routine contingency testing.

Cross-border transactions. Frequently firms, even those that have achieved best-in-class centralization and automation rates for domestic payments, employ manual processes for cross-border transactions. Yet, they could automate this last mile by working with a global provider whose payment processing platform and capabilities provide one-stop ease and convenience for local and foreign currency transactions.

While practices and benchmarks vary from industry to industry and country to country, companies should view payment providers as a key resource when it comes to measuring their performance and identifying best practices for making payments.

2. Reconciling payments: Establish timely, automated validation

Reconciliations are another, often ignored, factor in the cost-effectiveness equation. Thus, no assessment of the effectiveness of payment processes would be complete without looking at the STP rates for, and frequency of, transaction matchings and reconciliations. Reconciliations provide timely recognition of breakdowns in the payment process and are a tool for preventing downstream customer service and fraud issues.

Auto-reconciliations. In today’s automated world, many companies are using their ERP system’s reconciliation module to auto-reconcile, ensuring that payments were executed when requested. Best-in-class companies achieve straightforward auto-reconciliation rates in the order of 99%, working with their bank providers to receive information in a timely and automated fashion. Auto-reconciliations lower AP departments’ costs and free up resources for more value-added business activities.

Bank-reconciliation services. Companies that don’t have in-house auto-reconciliation capabilities can typically enhance and speed up reconciliations by using services available from a banking partner or service provider. When moving in this direction, organizations should expect end-to-end reconciliations and establish service-level agreements that ensure the same quality and level of performance as could be achieved with in-house automated reconciliations.

3. Managing exceptions: Increase efficiency, reduce incidents

Even the most efficient payments operation, with 99% quality rates, will experience exceptions to the rule and need to handle inquiries and special requests from their customers, vendors and other beneficiaries. Customers, for example, may experience a bankruptcy and the payments they are unable to identify.

Overall, the difference between high- and low-performing operations lies in the volume of exceptions they must handle and their ability to mitigate potential negative impacts on suppliers, vendors and customers.

Bottom line, dealing with high exception rates diverts critical resources from core processes and strategic business issues to deal with customer and vendor calls that add no value to the organization and may, in fact, be damaging relationships with them.

In most cases, the source of above-average inquiry volumes can be linked to weaknesses in the two previous steps: making and reconciling payments.

When benchmarking payment processes, organizations must analyze the volumes and reasons for returned transactions, stop payments, and other payment and data remittance-related requests. They also need to identify sound policies and practices for managing these inquiries as quickly and efficiently as possible.

4. Preventing fraud: Reduce costs and risks

Last, but far from least, a payment audit must encompass issues around controls, compliance and fraud management.

In addition to measuring fraud-related incidents against norms, organizations need to determine if and where fissures in internal controls are leading to fraud losses. This includes examining everything from reconciliation processes to payment acceptance policies and separation of duties to bank account structures, or lack thereof, in promptness in reporting fraudulent items.

Working with their providers, firms can set guidelines for reconciling discrepancies and identify cost-effective and appropriate fraud-mitigation tools. Offerings such as positive pay services, reconciliation services, checkprint fraud features, and ACH UPIC and debit filters can all drive down the cost of fraud and protect accounts against it.

Striking the right balance

In the current economic climate, every dollar counts. Assessing current practices and comparing them to industry benchmarks is a critical starting point for improving cash management and performance. Engaging trusted financial and technology providers can ease benchmarking efforts and help build a benefits-based case for changing systems and processes.