



Check Float in Today's
Business Environment

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The value of check float on enterprise cash conversion has been steadily diminishing. New strategies are emerging that take advantage of technology to increase efficiency while optimizing working capital.

2 : **Executive Overview**

There are many myths and misunderstandings that persist about check float and its current value in enterprise cash conversion. While most organizations recognize the potential cost savings in moving from paper to electronic payments, many hesitate because of the perceived potential for lost check float.

The erroneous perceptions about check float that exist today can be traced back to the 1980s, when many of today's financial executives were just entering the industry. In those days, interest rates were sky-high and check float was king. Fast-forward thirty years and the financial environment is very different. In 2011, interest rates are low and dramatic efficiencies have been realized in the postal, banking and Federal Reserve systems, minimizing the value and number of float days. As a result, companies can no longer collect the same levels of interest by holding payments longer. In short, check float is not what it used to be.

While float should still play a role when considering payment methods, its effect has been greatly minimized. In most cases, the cost savings from paying electronically exceed the money you would earn from check float at today's interest rates. In addition, there are new electronic payment methods that allow you to reap the benefits of electronic payments and still keep payment float.

History of Check Float

Float is defined as the "time lapse between issuing a check and debiting of its amount from the check issuer's account, or between depositing a check and crediting of its amount to the check depositor's account."¹ Check float has been a staple in the cash management toolbox of American business for decades.

The 1980s: The Heyday of Check Float

During the 1980s, check float was a very important source of funds for most businesses. Several factors combined to create this condition:

- Interest rates were double digit for almost the entire decade. In December of 1980, the prime rate was 21.5% and the federal funds overnight rate was 18.9%. The decade closed with the prime rate still hovering in the 10% to 11% range and the federal funds overnight rate at 8.45%.
- Mail service was inefficient. It often took the postal service four business days to deliver a letter.
- Most accounts-payable checks were sent directly to the business, which received and processed its own checks. It typically took at least two business days to process a check and deposit it in the bank.
- After the check was deposited, three days were usually required until the funds were debited from the payer's account.

As a result, a business in the 1980s could expect to receive approximately nine days of "free money," at very favorable interest rates, on an accounts-payable check.

2011: A Very Different World

The payment and cash management landscape is very different today. Dramatic changes have taken place in the intervening years. Interest rates are exponentially lower than they were forty years ago. In August 2011, the prime rate was 3.35% and the federal funds overnight rate had dipped to a miniscule 0.1%.

3 The U.S. Postal Service is much more efficient. The addition of more automation and the implementation of zip-plus-four have accelerated the delivery of mail. Furthermore, most companies now use post office lockboxes to receive vendor payments. Lockbox mail is processed seven days a week and typically receives expedited treatment. For example, banks often assign unique five-digit zip codes to lockbox mail, which allows quicker pickup from regional post offices. This eliminates additional sorting and transporting and can cut a day (or even two on weekends) off payment delivery and deposit time. In fact, lockbox mail seldom sits at the receiving post office more than a few hours.

The Federal Reserve System, which is both the payment system regulator and the largest processor of checks, has also become much more efficient in check processing. The measures taken to combat check float include the closing of country bank routing numbers, which had delayed payments, and the establishment of a series of regulations focused on providing customers quicker access to funds deposited in a bank. The most significant change was the adoption of the Check Clearing for the 21st Century Act (Check 21) in October 2004.

Check 21 allows the recipient of an original paper check to create a digital version of the check and to process it electronically. The passage of Check 21 was greatly influenced by the 9/11 terrorist attacks. Before Check 21, the banking system was dependent on air, truck and rail systems to transport paper checks. The 9/11 attacks brought the transportation system to a halt, leaving \$47 billion worth of checks floating in financial limbo for days. Because of Check 21, most checks are now processed electronically and 80% are cleared on the same day.

These are some results of the changes that have taken place between the 1980s and now:

- Mail float has been reduced from four business days to two.
- Vendor processing float, which was approximately two days, has been eliminated.
- Payment system clearing float has been reduced from three business days to one.
- Overall, that means that the nine days of float enjoyed by payers in the 1980s has been reduced to three days.

Yet, despite the efficiencies obtained by converting from paper checks to images (because of Check 21), banks are still assigning check clearing float of three days on paper checks, meaning the vendor still does not have use of its funds for three days after the check is deposited.

Figure 1. Check Float 1980 vs. 2011

	Interest Rate	Mail Float	Check Processing by the Vendor	Payment System Clearing Float	Total Days of Float
1980	18.9%	4 Days	2 Days	3 Days	9 Days
2011	0.1%	2 Days	0 Days	1 Day	3 Days

Automated Payment Systems Gain Traction

Electronic payments improve efficiency and dramatically cut costs, especially when paying established vendors with regularly occurring invoices. At today's interest rates, the cost savings realized with electronic payments generally outweigh the money earned on check float. In addition, the use of the Automated Clearing House (ACH) electronic payment system also improves cash forecasting and provides better fraud control.

Here is how electronic payments through the ACH system typically work:

1. On the due date, the payer originates the ACH payment with an effective date of +1.
2. On day two, the money leaves the payer's account and the vendor receives credit for the payment.
3. The vendor gets use of the payment the same day it is received, because banks cannot legally assign float on electronic payments.

4 While the use of electronic payments continues to grow in the U.S., the majority of business-to-business payments to vendors are still made by check. According to a survey by the Association of Financial Professionals (AFP), the typical organization makes 57% of its business-to-business payments by check,² despite the fact that the cost of paying by check continues to rise. The cost of an average accounts-payable check now regularly exceeds \$3 when you take into account the cost for check stock and toner, postage and envelope, labor for printing, bank fee for disbursement, and other transaction costs such as fees for clearing a check and reconciliation. When you consider that the average accounts-payable check in the U.S. is \$10,000, the cost of paying by check greatly exceeds any return gained through check float.

In addition to check costs rising, so is check fraud. The U.S. Secret Service reports that check fraud is growing at a rate of 11.9% a year and that the annual loss to check fraud in the U.S. is \$5 billion. In fact, the chief of the agency's Financial Crimes Division calls check fraud "the number one way criminals today are attacking our financial systems."³ In addition, a 2011 survey by the AFP reported "checks were the dominant payment form targeted by fraudsters, with 93% of the affected organizations reporting that their checks had been targeted."⁴ In contrast, the same report stated that ACH fraud was much less prevalent, particularly when companies follow best practices and consistently execute their own business rules.

The reason that many companies give for the slow adoption of ACH is a hesitancy to give up check float. Many organizations are still paying by check because they believe that check float is of high value to them.

Paymode-X: Taking Electronic Vendor Payments to a New Level

Paymode-X is an electronic settlement network that optimizes electronic payment processing. The largest and fastest-growing network of its kind, Paymode-X has more than 150,000 participating companies, with approximately 2,500 new vendors joining each month. Each vendor's banking information and remittance preferences are authenticated and maintained on Paymode-X, simplifying the payment process. This allows the payer and the vendor to save time, money and resources.

The Best of Both Worlds

Paymode-X delivers the best of both worlds: the economy of an electronic payment system and the ability to control payment timing. Because payers incur no fees when making a payment using Paymode-X, they save on average \$3 per payment versus printing, mailing and processing a paper check. Paymode-X also lets payers optimize working capital through payment scheduling. Payers in the network can realize all the benefits of electronic payments yet still control the settlement date. As a result, they can still have use of their money for as long as or longer than they would with a paper check.

Here is how it works:

1. The payer uses their AP/ERP system to determine the desired timing of the disbursement, based on their knowledge of the payment due date and the certainty of the electronic payment timing. This allows the payer to equal or even increase the float anticipated when paying by check.
2. The payer delivers the payment instruction to Paymode-X, specifying the timing determined in their AP/ERP system.
3. The payment is automatically deposited to the vendor's account on the date specified by the payer, and the cash is immediately available to the vendor.

Figure 2. Paper Checks vs. Paymode-X

	Cost per Payment	Float for Payer	Bank Float Incurred by Vendor
Paper Checks	\$3+	3 Days	3 Days
Paymode-X	None	Controlled by Payer	None on ACH Payment







5 A Win-Win for Payers and Vendors

Both payers and vendors can benefit by transmitting ACH payments through Paymode-X. Because there is no bank float on electronic payments, terms can be negotiated between the payer and vendor for a win-win for both sides. A good example of this is a practice common in the automotive industry whereby payers and vendors often share the float when making ACH payments through Paymode-X.

Here is an example:

- The payment terms are 2/10 net 30.
- The payment is sent to the Paymode-X network on Day 30, with an effective date of Day 34.
- On Day 34, the vendor receives the ACH transaction and funds are available that day.
- The payer receives three days of float.
- The vendor receives use of funds in four days, which is a two-day improvement when compared with a paper check (because there is no check-clearing float).

Figure 3. Sharing the Float

	Day 1	Day 2	Day 3	Day 4	Day 5	Day 6
Check	Check in Mail 		Check in Lock Box 	Bank in Clearing Float 		Funds Available to Vendor 
Paymode-X	Payment in Paymode-X 			Funds available to Vendor 		

In this example, the Paymode-X payer sends the remittance notification to the vendor on Day 30, with a payment date of Day 34. The payer benefits from three additional days of fund usage. The vendor receives its payment, and use of its funds, on Day 34, two days earlier than with a check payment.

When Does It Make Economic Sense to Cut a Check?

Even in this day of low interest rates and improved postal and banking efficiencies, check float still needs to be a consideration in enterprise cash management. It can fill the cash flow gap and provide free financing so that you don't have to draw on your line of credit, move investments to cover payments, or change your capital structure or equity line.

The following chart provides a quick look at the number of days of check float that would be required to break even at five different interest rates, if you calculate a total cost for each check of \$3.12.

The average number of days of float created by mailing a check is typically three days.

AP Check Amount	Interest Rate				
	5%	4%	3%	2%	1%
\$ 2,000	12 days	15 days	19 days	29 days	57 days
\$ 4,000	6 days	8 days	10 days	15 days	29 days
\$ 6,000	4 days	5 days	7 days	10 days	19 days
\$ 8,000	3 days	4 days	5 days	9 days	15 days
\$ 10,000	3 days	3 days	4 days	6 days	12 days
\$ 50,000	1 day	1 day	1 day	2 days	3 days

- 6 Consider this example: Company X's typical AP check is for \$8,000. Using the chart above, at 5%, Company X is able to break even by gaining as much from the three days of float as it will cost them to cut a check. At 1%, it would take a full 15 days of float simply to offset the cost of the check. As the chart illustrates, only at significantly higher dollar amounts per check does check float begin to create a positive return.

If a check is below the break-even value (three days), you should be making payments electronically. If the amount is high enough to produce a positive cash result after expenses, you should consider cutting a check. Better yet, use an advanced ACH network such as Paymode-X, where you can get the efficiencies and protections that come from the use of electronic payments and still assign a settlement date that allows you to keep the float.

Conclusion

Thanks to enormous efficiency gains made by banks and the postal service, and to the concurrent plunge in interest rates, the value of check float is not what it once was. But check float still has a role to play and should be considered when analyzing your cash conversion cycle.

Electronic payments are steadily becoming the preferred way of doing business. That's because electronic payments boost efficiency and reduce risk for both the payer and vendor. For the payer, electronic payments also eliminate operational costs, reduce bank fees and remove reconciliation costs. For the vendor, benefits include automated cash applications and receivables processing, reduced banking fees, and improved working capital. According to the AFP, the typical organization has reduced the level of paper checks for business-to-business payments from 74% in 2007 to 57% in 2010. In the future, it is likely that rather than simple acceptance of electronic transactions, organizations will refuse to do business any other way.

Paymode-X allows you to take advantage of the value-added benefits of electronic payments—such as lower costs, increased efficiency, improved cash forecasting and reduced fraud—while continuing to manage payment timing to your best advantage.

References

1. BusinessDictionary.com.
2. On Association for Financial Professionals, "2010 AFP Electronics Payment Survey," November 2010.
3. www.stopcheckfraud.com.
4. Association for Financial Professionals, "2011 AFP Payments Fraud Survey," March 2011.



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