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It Pays to Pay Well:

How to Optimize Your Vendor Payment Strategy

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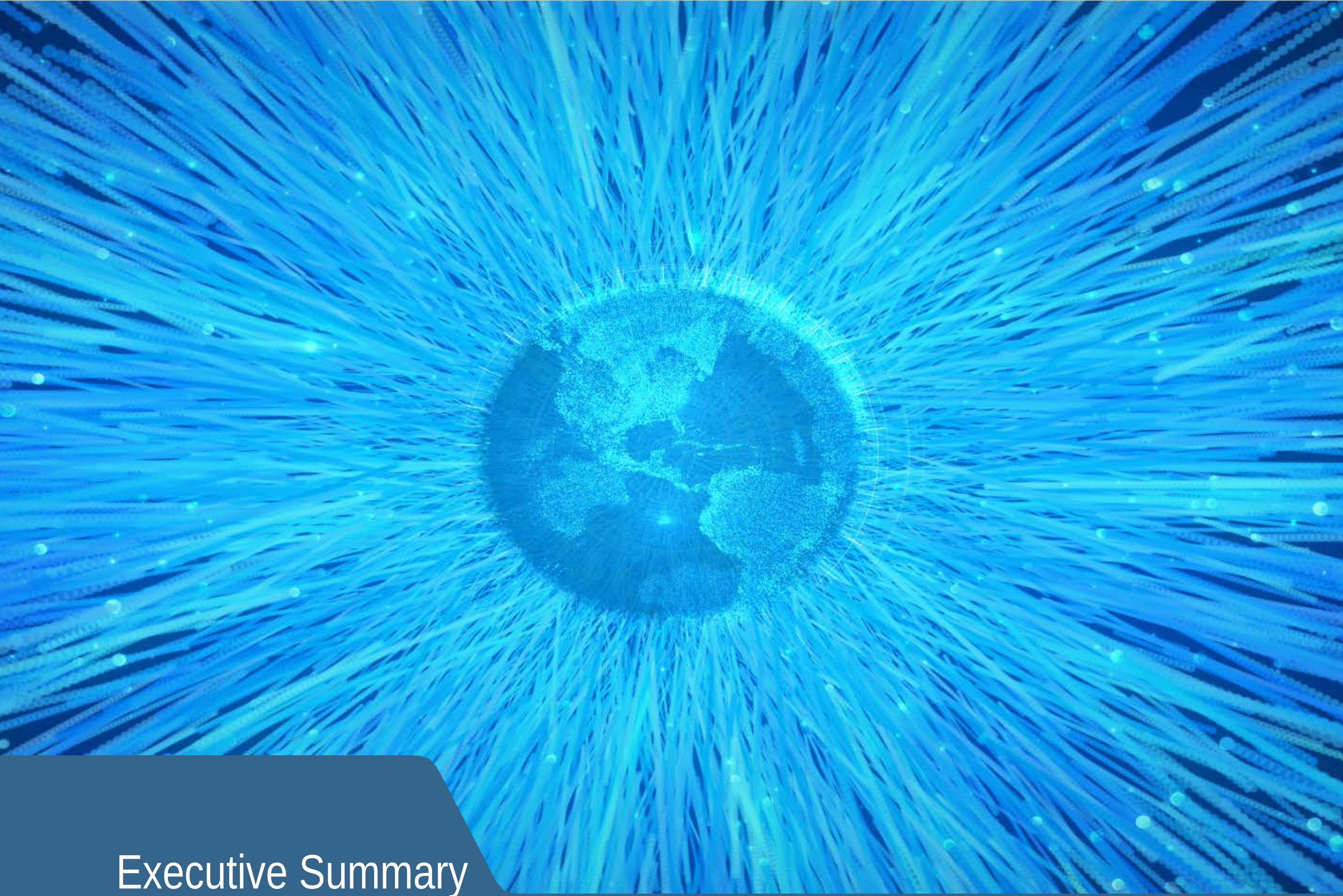


Executive Summary

The world has never been more focused on business-to-business (B2B) payments, as accounts payable and finance leaders are transforming the way they pay their vendors and leave the world of manual processes and paper check payments behind. For far too long, the automation and optimization of B2B payments was overlooked by a majority of businesses. But the pandemic and the challenging business environment it helped create (including much greater economic uncertainty, increased global supply chain risk, heightened inflationary pressures, and labor shortages) has caused more CFOs and finance executives to manage cash more tightly. This, combined with the emergence of more flexible ways to automate payment solutions, has drawn new attention to the business-to-business (B2B) payment process and increased the number of finance teams focused on optimizing it.

Ardent Partners research has shown that the typical AP organization continues to rely on older, inefficient, manual, and paper-based processes which leads to both higher invoice processing costs and vendor payment processing costs. Today, the average cost to process an invoice is $9.25, while a payment is $8.64. This indicates that significant room for improvement exists across the board. At the same time, the AP leaders and their teams managing paper processes realize that serious work needs to be done to lower costs and shorten processing times.

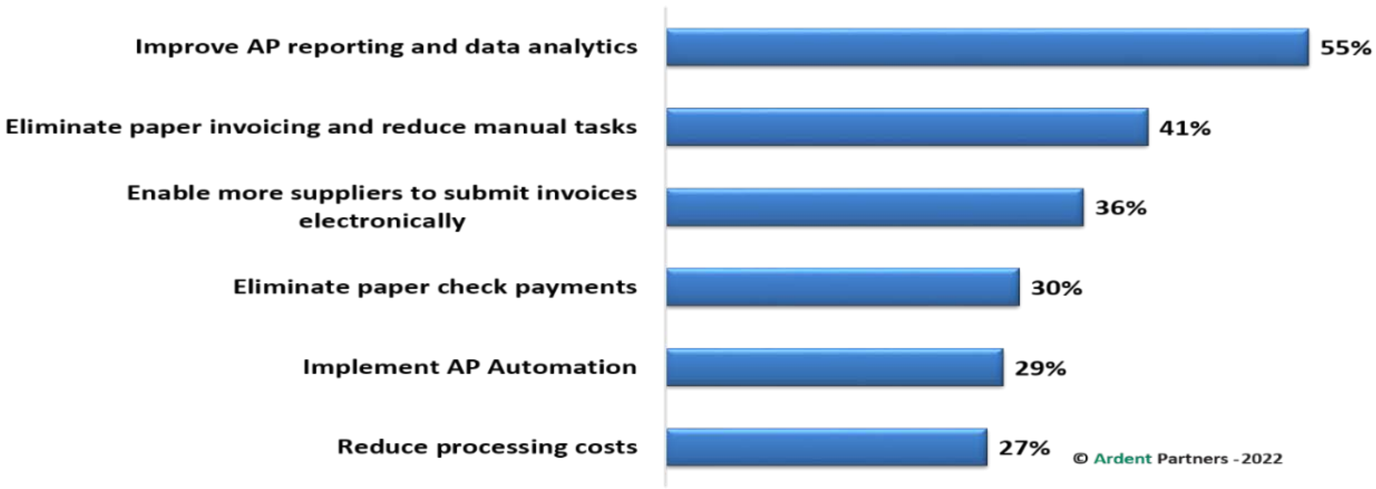
More broadly, when Ardent Partners recently asked 187 AP and finance professionals to list the top priorities on their annual agendas (see Figure 1, below), four of the top six priorities named directly help teams to increase their invoice and payment efficiencies. For example, eliminating or reducing inbound paper invoices and the manual tasks required to process them (41%) and eliminating paper checks (30%) with internal strategies that leverage automation solutions can help reduce costs and time significantly. Likewise, an external strategy to increase the number of suppliers who submit their invoices electronically (36%) provides a strong investment case and proven results.

It's reasonable for us to expect that global endemics, as well as financial, social and geo-political uncertainties will be omnipresent throughout the year. On top of everything else, new challenges such as rising price inflation and an increasing cost of capital are important considerations for CFOs and Treasurers as they develop and execute the strategies designed to optimize cash. And as the momentum for B2B payment automation continues to grow, the groups that fail to more closely examine and improve their vendor payment processes will cost their organizations precious time and money and cause them to potentially fall behind the competition. The fact that paper payment processes expose businesses to greater security and fraud risks and make them a generally less-attractive trading partner to their vendors should also fuel greater investment in this area over the next few years.

Why it Pays to Pay Well

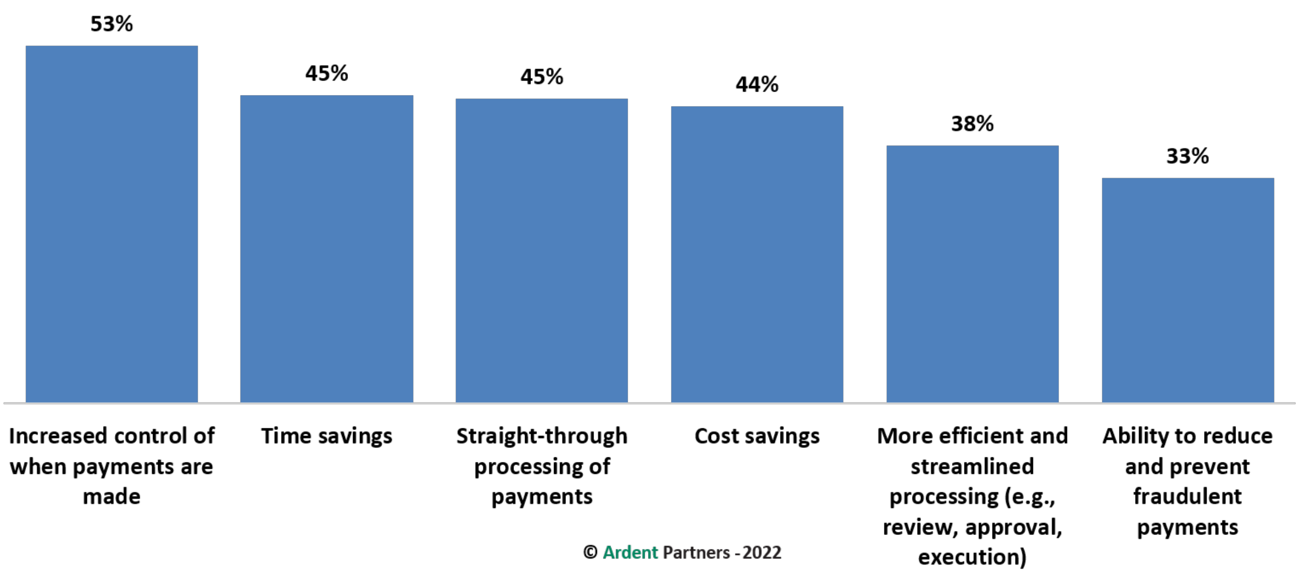
Businesses in general and AP teams in particular stand to gain much from digitizing B2B processes and payments, not least of which are the improved visibility into payment data and better control over payment scheduling and execution. In fact, out of 187 AP leaders surveyed, 53% noted increased control of payment timing as the top benefit

Figure 1: AP's Agenda in 2022



gained from electronic payments (see Figure 2, below). With a paper check, the buyer has no idea when or if the vendor received the payment until the check is deposited. Electronic payment methods allow for buyers to schedule the delivery of payment down to the minute in some cases, and receive instant notification that the funds have settled in the vendor's account. Time savings (45%) and straight-through processing of payments (45%) tied for the second biggest benefit of ePayments, followed right behind by cost savings (44%). Payment review, approval, and execution are more streamlined overall when paying suppliers electronically, as the actions taken are all digital and do not require manual "touches" and are not subject to the delays inherent in a manual process. This results in huge efficiencies from a process standpoint, and leads directly to cost savings. The data is indisputable, **paying well means paying electronically**.

Figure 2: Top Benefits of Paying Suppliers Electronically



Why it Pays to Pay Smart

While there are clear benefits to electronic payments, a majority of businesses have not yet unlocked the full value. The first step in driving greater value from a B2B payments program is to deploy scalable solutions that automate the process. Paper-based payments worked fine once upon a time, but just as new technologies have obviated other legacy business processes (the paper invoice, the rolodex, etc.), new ePayment solutions and processes have made it strikingly less economical, not to mention riskier to pay vendors with paper checks. Electronic payment methods are not new, but recent developments and innovations in the market, combined with an increased recognition of the emerging business value of digital payments, have pushed AP organizations to look at new ways to drive financial value

When it comes to selecting the "right" electronic B2B payment solution, businesses have many options and factors to consider. Unfortunately, this is not a case of "select one and be done." They need to develop an electronic payment strategy that encompasses not only their needs and wants, but also the needs and wants of their vendors. Factors such as supplier size, location (domestic vs. international), payment timing, payment amount, cash requirements, working capital objectives, rebate targets, and more, will require businesses to utilize multiple payment methods. Suffice to say, this is not an area where one (technology) size fits all.

Mitigate Fraud

In good times, business professionals that manage cash must be vigilant to outside threats and the risk of fraud. When times get tough or when big market shifts occur, criminals typically emerge to try to exploit the situation. Since early 2020, fraud has been on the rise as the criminal element saw opportunities to take advantage of the pandemic. Incidents of Business Email Compromise (BEC), in particular, increased significantly. Conducting more business outside of the office and operating as virtual teams translated into greater IT and data security risks. With so many new and susceptible entry points, last year was the largest on record in terms of payments made by mistake to fraudsters. Firms with a formal vendor payment strategy that includes proper financial controls are positioned to minimize critical vulnerabilities and mitigate loss due to payments made to fraudsters posing as legitimate vendors.

Today's supply chain challenges have highlighted the importance of establishing and maintaining good working relationships with your vendors in order to ensure business continuity. Understanding how and when your vendors prefer to be paid is a critical part of designing and executing a successful vendor payment strategy. Expanded collaboration between trading partners can unlock financial value for both parties and help strengthen, and even expand the working relationship.

Improve Cash Management

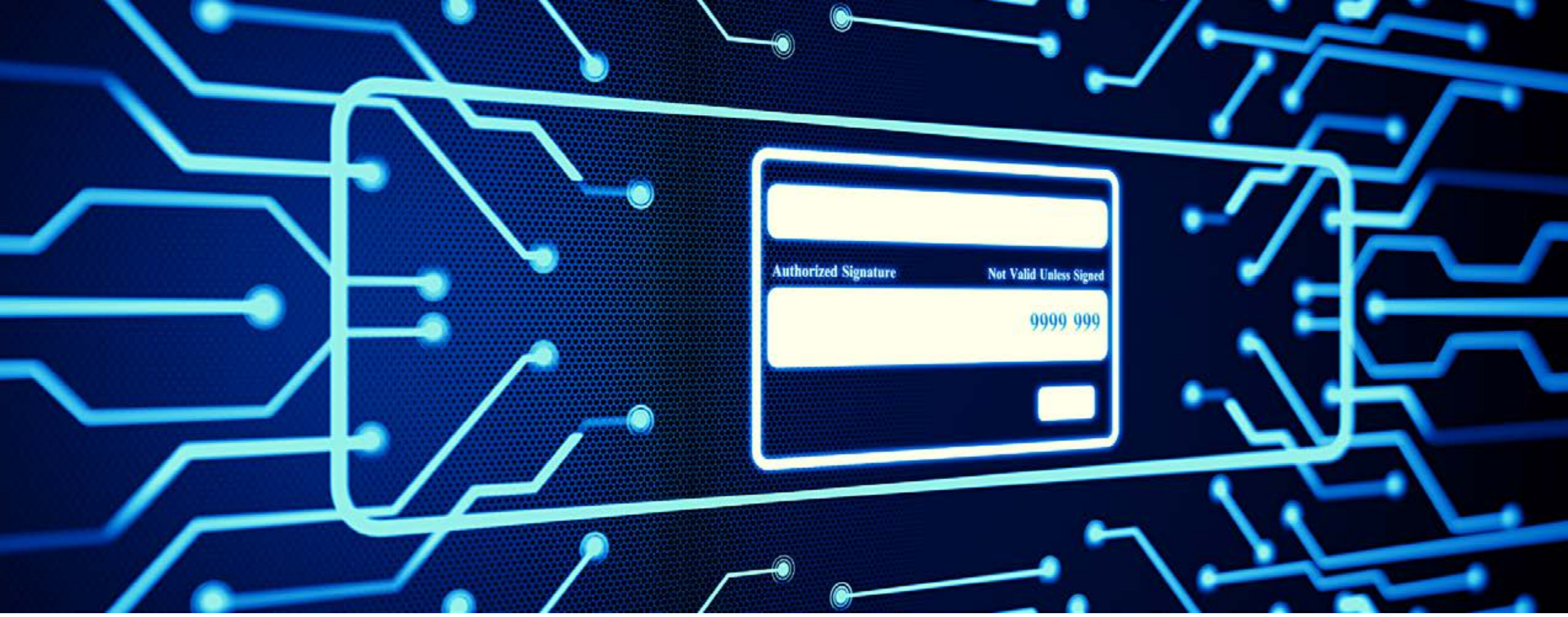
Once automated, the next step is to develop a vendor payment strategy that is informed by improved data. This is precisely where ePayments showcases its expansive business value. On the whole, paying vendors electronically creates more flexibility and greater precision in the payment process. While paper checks have a variable "float" from the time it takes for a vendor to receive and deposit a mailed check, ePayments allow for precise scheduling of the payment that eliminates the perceived benefit of the variable "float." Digital payments create financial agility that cannot be replicated with manual payments. With ePayments, organizations have access to a powerful tool to support the development and execution of a strategic vendor payment strategy that can shift payment decisions (i.e., pay early, pay on time, pay late, take earned discounts, generate rebates, etc.) based on the immediate needs of the business.

Unprecedented global events and uncertainties have increased the pressure on AP to become a more strategic component of the business' financial operations. To fully realize this, AP must be better positioned to impact and support working capital optimization strategies. Since AP is fundamentally a cash-distribution function (based upon the large percentage of funds AP pays compared to total business disbursements), more visibility into and control over vendor payments can help support a more detailed and refined cash management strategy. This is simply not possible without a vendor payment strategy that is supported by underlying B2B payment technology.

B2B Payment Options

More businesses are realizing the benefits of adopting and expanding their use of digital solutions to pay their vendors. Organizations are moving beyond their long-held comfort zone of writing paper checks and exploring the electronic payment methods that are available today. When it comes to managing their B2B payments, AP, finance, and treasury leaders have many different options and factors to consider; this is not simply a case of "select one and be done" with planning. The process is not complex, but it does take some time and planning.

The good news is that the general breadth and depth of electronic payment options available in the market today can address the general payment needs of large and small enterprises. This is important because possessing greater variety and flexibility in a B2B payments program increases the likelihood of increased vendor adoption and usage (and therefore, ROI). The different B2B payment options available today include:



ACH (automated clearing house) - a digitally-based payment clearing house and settlement facility designed to process the exchange of electronic transactions in the United States, such as credit transfers and direct debits, between participating financial institutions. Cash-back rebates are available with some ACH solutions.

ACH International - similar to the US-based ACH at the core, however, there is no single universal ACH system that can be used to electronically send and receive funds across borders. In fact, there are upwards of 100 unique systems around the world, each one typically representing a distinct country.

Wire Transfer - a method of electronic-funds transfer from one person or entity to another. It can be made from one bank account to another, or through a transfer of cash at a bank.

Paper Checks - no description needed

Purchasing Card (P-card) - similar to personal credit cards, P-cards are physical pieces of plastic that an employee must have with them in order to make a purchase. P-cards can be reused for multiple transactions, varying in amount.

Virtual Cards (V-card) – are just that – virtual. The credit card number is specific to a single transaction and for a predefined payment amount. Since the card number is temporary, it makes it extremely difficult for fraudsters to use the card for another purchase. Cash-back rebates are available with some virtual card solutions.

Ghost Cards - similar to virtual cards in that there is no physical card issued for its use. However, ghost cards can be used over and over, akin to a physical purchasing card.

Debit Cards and Pre-Paid Debit Cards – a physical bank card that is used to replace cash when making a purchase. Unlike a credit card, the amount of the purchase is automatically and immediately transferred and deducted from the cardholder's account. Their use, while not widespread for B2B payments, is on the rise.

Digital Wallets or Payment Applications - typically refers to an online application or payment service that allows an individual or business to make an electronic payment or transaction. Similar to debit cards, digital wallets and electronic payment services were initially used by individuals to pay businesses for goods or services. However, their usage has morphed and is starting to expand as a way for businesses to pay vendors.

Supply Chain Finance (SCF) - not a payment method in the same way as ACH, wire transfer, and commercial cards. Rather, SCF solutions use third-party capital – typically from a bank or other lender – to pay invoices.

B2B Payment Optimization

With all of the options available for paying vendors, what is the best way to go about deciding which to use and when? Key factors to consider when determining what payment options to include in your AP mix are:

- Vendor size
- Payment amounts
- Support for domestic and global payments
- Costs and fees charged for each payment method
- Rebates available for both buyers and suppliers
- Availability of payment reconciliation functionality
- Integration capability with accounting/ERP and AP systems
- Ability to communicate with payees for payment status, issues, and inquiries
- Approval rules and security measures for fraud prevention including ensuring regulatory compliance and vendor authentication
- Cash and working capital management requirements

Optimizing your B2B payment mix not only requires an understanding of the comparative strengths and weakness of the various payment options available; it also requires knowledge of your suppliers and transactions with them. This entails segmenting the supplier base by frequency of transactions along with dollar amount being paid. A possible strategy would be to segment suppliers into the following four 'buckets' - (low dollar amount/low volume of transactions, low dollar amount/high volume of transactions, high dollar amount/low volume of transactions, and high dollar amount/high volume of transactions). Once this has been done, the optimal payment method can be determined for each vendor based on their specific grouping.

To remain competitive in today's ever-changing business world, organizations must consistently leverage a variety of tools and solutions that drive efficiencies, improve visibility, and increase functional value. According to Ardent Partners' research, electronic payments now account for 60% of B2B payments today, an all-time high since the firm started tracking this data in 2010. The use of ePayments has grown significantly over the last five years with virtual cards, in particular, growing in usage and popularity. Recent innovations in the space, and the increasing sophistication of AP and procure-to-pay ("P2P") teams have resulted in increased use of virtual card programs as an effective way to manage both spend and working capital.

Virtual Cards, Real Benefits

The use of virtual card usage in the market continues to expand year over year because businesses are moving away from paper checks and other less secure and efficient payment methods. As with any successful program, a win-win situation must exist for all parties involved. In the case of virtual cards, increased adoption can be directly correlated to the fact that both buyers and vendors can benefit from their use. With respect to vendor adoption, it is critical that businesses seeking to optimize the scope and impact of their virtual card programs develop and execute strong vendor enablement strategies that drive vendor adoption by clearly communicating the value of the program to their vendors.

Organizations can gain much from implementing virtual card programs. Virtual card programs offer a plethora of benefits that can reduce costs while also improving the level of visibility, control, and accuracy in the vendor payment process. Their rise not only in usage but also in prominence and overall business impact is of little surprise. Highlighted below are some of the key benefits virtual card programs offer AP departments:

- **Cost Savings** – manual processing of paper check payments is time-consuming, error-prone and costly. Virtual card payments help automate the process resulting in faster payment approval and processing, not to mention significant cost savings for every transaction.
- **Improved Efficiency** – virtual card usage can help streamline procurement and payment processes and eliminate certain tasks associated with invoice processing. Their use can also enable a reduction in the number of invoices and payments that need to be processed, allowing organizations to process more transactions faster and more efficiently.
- **Fraud Reduction** - virtual cards are designed for a single-use, transaction-specific way to pay a pre-determined amount to a specific vendor. Leveraging 'tokenization' (the random generation of a card number that can only be used once for a specific, predetermined amount), virtual cards are extremely secure and can help mitigate and prevent fraudulent payment activity from occurring.
- **Enhanced Visibility** - virtual cards provide organizations with improved visibility into invoice and payment data, and allow them to gain greater clarity, predictability, and control over cash flow.
- **Earned Rebates** - virtual cards include 'rebates' generated based upon a program's spend which serve to return cash directly to the business' bottom line without the business taking additional actions. Rebates are usually paid out as a percentage of card spend made within a certain period of time. While rebates are not the only reason for migrating to virtual card payments, they are certainly an added benefit.

Virtual Card Programs: Vendor Benefits

As automation of the B2B payment process increases, businesses are finding that more of their vendors will now accept virtual card payments for the goods and services they sell. The increased vendor willingness to accept virtual cards can be linked to the benefits vendors gain by receiving payments faster and more securely (versus other forms of payments; this is particularly true when compared to the unpredictable timing of mail-delivered paper checks). Additionally, receiving virtual card payments can generate efficiency gains and improved visibility into payment status that can ease cash management stress and help improve financial planning and overall performance. Highlighted below are some key benefits vendors gain from accepting virtual card payments:

- **Faster Receipt of Payments** - vendors can expect to receive payments faster from customers that pay via virtual card.
- **Lower Days Sales Outstanding (DSO)** - receiving payment faster helps reduce an organizations' DSO and result in an improvement in available working capital to invest back in the business.
- **Improved Remittance Information** - with other forms of electronic payment, such as ACH and wire transfers, the payment often arrives without remittance details, leading to additional reconciliation work and issues. Virtual cards provide enhanced transaction details such as invoice numbers and/or payment reference numbers, enabling automatic matching and visibility, which can help lower the time and cost required to process outstanding invoices and monies due.
- **Secure, Automated Payments** - virtual cards are extremely secure and minimize the risks of sharing financial information externally. Payments are also automated and do not require any manual intervention which also serves to eliminate additional security exposures.
- **Enhanced Visibility** - virtual cards provide organizations with improved visibility into invoice and payment data, and gain greater clarity, predictability, and control over cash flow

Conclusion

Once upon a time, it made sense for businesses to pay their vendors with paper checks. But that time has long passed and those that continue to pay by paper will not live happily ever after. The major global events in recent years have magnified the challenges and risks of relying on paper checks and manual processes for B2B payments.

Paying well by paying electronically remains a best-in-class finance strategy. Soon however, it will be table stakes and the new market leaders will be those groups that optimize their B2B payments by becoming a strategic hub of actionable intelligence for the CFO and other key stakeholders to analyze organizational spend and develop a proactive supplier payment strategy that can influence working capital, as well as supplier relationships and profitability.

Now is the time for forward-thinking AP groups to adopt digital payments, including virtual cards, aggressively and begin optimizing their vendor payment strategy to generate the important and frequently elusive "win-win" for buyers and vendors alike.

About the Author:

BOB COHEN, VICE PRESIDENT OF RESEARCH, ARDENT PARTNERS

Bob is a globally recognized expert in accounts payable, B2B payments, business networks, Procure-to-Pay, supply chain finance, and strategic marketing. For more than 20 years, Bob has focused on helping enterprises develop and execute strategies to achieve operational excellence in their finance, procurement, and marketing organizations.

As an analyst, he benchmarks thousands of enterprises across all facets of their accounts payable, business networks, supply chain finance, and B2B payments operations and leverages these insights in his roles as Vice President of Research. His real-world buy side experience in ePayables and P2P transformations, solution adoption, and customer use cases provide him with a unique context for his research, writing and advisory services. He is also the editor of PayablesPlace (www.payablesplace.com), the global source for ePayables news, research and analysis the news and research for Accounts Payable, Shared Services, P2P, Finance, and Treasury leaders.

Prior to becoming an analyst, Bob helped hundreds of AP and P2P teams achieve Best-in-Class performance via their use of ePayables, P2P, and Business Network solutions. He spent 12 years working as the Vice President of Marketing at Basware where he helped establish the firm's U.S. presence in the AP and P2P automation spaces. Bob also worked at American Express where he helped the commercial card giant better align its products and services with a continually evolving market.

Bob is a sought-after presenter, having presented more than 100 times over the past decade. Bob holds a B.A. in Marketing from Bryant University and an M.B.A. from the University of Connecticut in Finance. He welcomes your comments at rcohen@ardentpartners.com or 203.403.7109. You can also connect with Bob on LinkedIn.

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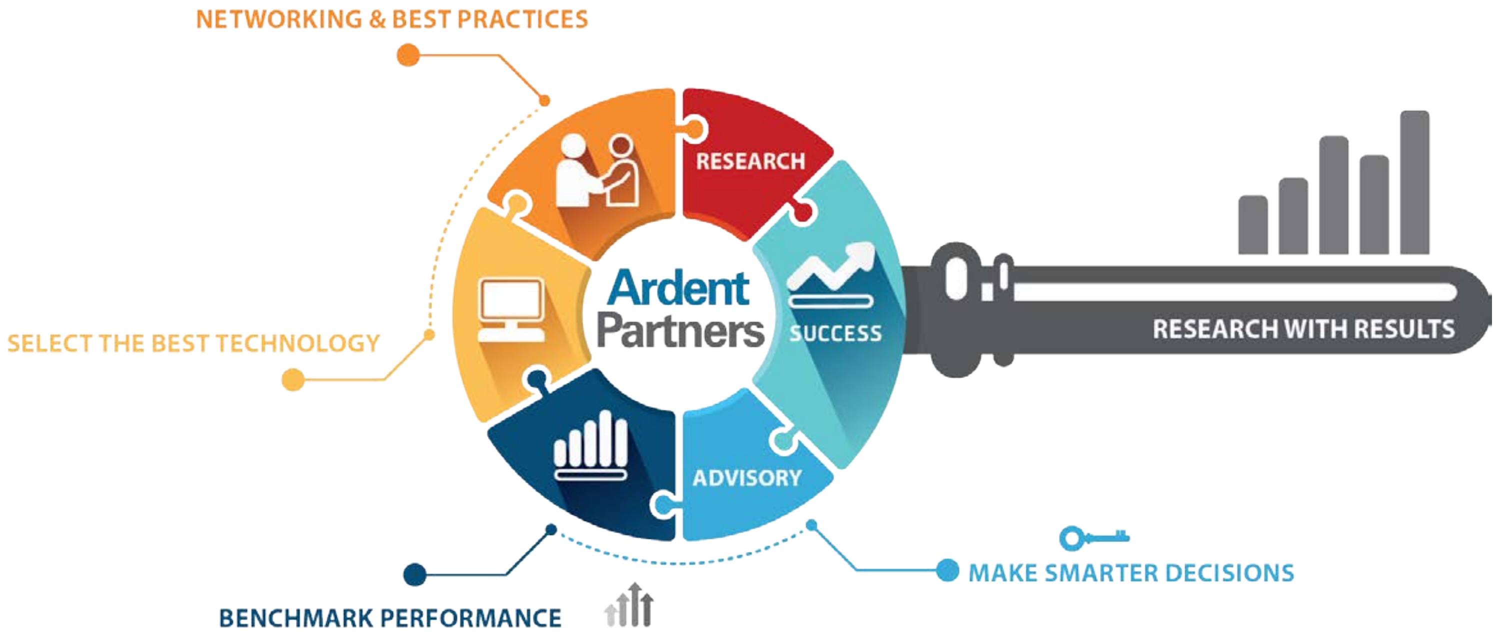

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