Rising Rates, Accounts Payable and BACK TO THE FUTURE?

Even without a DeLorean, 2017 will arrive before we know it and we must make inevitable changes to our business plans today

By Neil McHugh

It's 2017, the future! And while we don't reside in Hill Valley and hoverboards still don't exist, interest rates have finally risen back to normal levels. You've considered everything to best prepare your organization for this future. Or have you? Have you contemplated how rising rates could help unlock value trapped in your accounts payable (AP) and accounts receivable (AR) functions? If not, or if you're not sure, please read on.

The most progressive, best-in-class organizations are developing formal payment strategies to define optimal payment types, terms and the payments mix necessary to maximize returns. The commercial card is quickly emerging as an invaluable component to these strategic plans as new technology automating business-to-business (B2B) card payments is strengthening an already impressive suite of benefits. Rising interest rates will only create additional opportunities for both trading partners to further enhance these benefits.

To understand how an organization may use B2B card solutions to derive value from AP and AR in a rising rate environment, we must first become familiar with the latest solutions and what has led to their development. Over 20 years ago, the first purchase cards (p-cards) were developed, serving as the foundation for all modern commercial card solutions. Designed on the premise that value created by streamlining the procure-to-pay process for small-dollar, card-in-hand payments greatly outweighs the risks of eliminating costly traditional control steps, such as purchase orders (PO) and invoice matching, p-cards are successfully utilized by thousands of organizations. While valuable when used for the subset of payments they were designed for, p-cards are not ideal for larger payments where POs, invoices and other standard controls are warranted.

In recent years, card-based e-payables solutions have evolved to target these invoiced payments and the considerable spend opportunity they represent. Furthermore, these new solutions seamlessly integrate card payments into an existing AP work stream without process reengineering. e-Payables volume now accounts for 55 percent of total spend for organizations using both e-payables and p-cards, and e-payables spending is projected to grow at an impressive annual rate of 13.8 percent through 2018.[1]

There are presently two e-payables forms available: virtual cards and buyer-initiated payments (BIPs). The first generation solution, virtual cards, automates the front-end payment submission process for AP and systemically emails payment details to suppliers. Virtual card solutions are frequently referred to as *pull pay* because the supplier manually (I reiterate, manually) pulls the payment via data entry upon receipt of the email. While automating the front-end process served as a purposeful advancement for AP, the supplier process remained manual, and therefore, not easily scalable. This burgeoning challenge amongst users spearheaded the creation of the next-generation card solution, buyer-initiated payments (BIPs). Commonly referred to as *push pay*, BIPs offer legitimate straight-through processing, facilitating an automated credit push from buyer to supplier, without any manual engagement from the supplier's AR staff. BIP is the flux capacitor of B2B card payments. Using this cutting-edge tool, buyers and suppliers can experience the same level of efficiencies that made corporate automated charge (ACH) payments attractive for so many years.

In addition to enhanced automation, e-payables offer many of the same benefits as traditional p-cards. Buyers can reduce processing costs (e.g. eliminate checks and 1099 reporting), increase working capital, lessen credit exposure to suppliers, earn cash rebates, enhance reporting and improve internal compliance. During the past five to seven years, opportunities to reduce costs and earn rebates paid by card issuers (banks) have served as the principal growth drivers. In a 2014 Supply Chain Finance Survey, 62 percent of respondents indicated that "reducing processing costs" was the greatest consideration when choosing a payment network.[2]

With an average cost savings of $9 per e-payables transaction in comparison to paper checks,[3] the cost savings offered by e-payables align perfectly with this cost-centric focus. Concurrently, an influx of new card providers, coupled with buyer willingness to promptly pay the balance owed to their card provider, has fostered more fervent price competition, driving market-level rebate pricing to possibly unsustainable highs.

The achievable value is not limited to a buyer's AP function. Suppliers can create value from AR as well. Increasing numbers of savvy suppliers are learning that they, too, can receive genuine benefits, including accelerated, more guaranteed payment, process efficiencies and lower AR costs. These same suppliers are also realizing the conventional notion that a 3.00 % card-processing cost is somewhat unfounded and should not inhibit their participation. All card acceptors have access to various processing levels with their merchant services provider that can reduce B2B merchant discount fees to less than 2.00 % and even below 1.00 % for certain transactions. Great Scott!

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However, not every payment is a prime target for e-payables. But supplier/payment segmentation activities and exploratory dialogue are leading more and more trading partners to realize win-win situations can and do exist. The rising frequency of everyday success stories are almost always rooted in trading partners listening to each others' goals and discovering common ground together. Getting paid faster is as important to suppliers as reducing processing costs is for buyers. When asked if given the choice in AR, faster funding or better rates? 72 percent of respondents to the 2014 Supply Chain Finance Survey answered faster funding.[2] e-Payables, or any card solution for that matter, will enable buyers to initiate payments sooner than with checks or ACH, helping suppliers achieve this primary objective.

One thing we can be sure of is that interest rates will rise. The questions to consider are when will rates rise and how will rising rates create new value for various trading partner relationships using e-payables? The general consensus is that rates will begin to rise sooner rather than later. The signs are clear as reflected in the yield curve. During the December 2014 Federal Open Market Committee (FOMC) meeting, 15 of the 17 participants indicated the appropriate monetary policy action is to raise the federal funds rate in 2015. Presumably, additional rate increases would be implemented gradually and the federal funds rate would reach normal levels by the end of 2017.[4] Even without a DeLorean, 2017 will arrive before we know it, and thus it is imperative to proactively incorporate these inevitable changes into our business plans today.

Although a systematic monetary policy may bring about slow, gradual changes in interest rate levels, any uptick will create new incremental economic benefits for the users of e-payables. For buyers, rising rates will increasingly enhance working capital benefits. Currently, many buyers elect to pay their card balance quickly to receive a higher rebate. In this typical cost-benefit scenario, the value of the increased rebate outweighs the potential return earned with short-term investments. Albeit different for each buyer, increasing occurrences of break-even points will be achieved as rates rise. As those conditions present themselves, buyers may elect to extend their settlement dates with their card providers (e.g. pay off the balance on the 20th of the month vs. the 10th of the month), receive a lesser rebate and invest their cash to maximize their overall return on working capital.

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In addition to investment yields, rising rates will also increase the cost of capital. This is key, considering the aforementioned 2014 Supply Chain Finance Survey concluded, "The majority of companies use an unsecured line of credit to finance their working capital."[5] During this protracted period of low interest rates, since early 2009, the weighted average effective loan rate for all U.S. commercial and industrial loans has been less than 3.00 %; an amount that never dipped below 2.96 % from 1998 to late 2008 and peaked at 8.28 % in 2000.[6] As these indexed borrowing costs rise with market interest rates, suppliers are urged to consider card acceptance as a faster, lower cost alternative source of working capital.

Those suppliers that are reluctant to accept B2B card payments or those who have not been able to reach agreeable win-win economics with specific buyers may find those economics rapidly becoming an advantageous reality. Suppliers can also consider further complementing these pending macro-economic adjustments by negotiating faster payment from buyers and leveraging the available interchange options from the card networks to reduce processing costs. Combined, these actions will provide suppliers with easy access to a newly available, lower cost source of working capital.

The next few years will certainly present significant opportunities for AP and AR to be opportunistic and excel. The new e-payables solutions, especially BIP, bridges automation gaps to create efficiencies for both buyers and suppliers. Both parties can achieve impactful results, and while every single benefit will not apply to every single user, there is something to be gained by everyone. Understanding how e-payables will help your organization in tomorrow's business environment is critical for success. If you haven't explored these solutions, this writer encourages you to do so. If you presently use them, consider developing a strategic plan to optimize results amid rising rates. While you may never have the opportunity to ride a hoverboard, this opportunity is real and can make a real difference to your bottom line. Now, that's heavy. ■

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