

# INDUSTRY INSIGHTS FOR REMITTANCE PROCESSING

Below outlines related thoughts from a variety of sources as it pertains to Accounts Receivable (A/R) and Remittance Processing. We hope you'll find it informative as well as thought provoking. In our research a few themes emerged. First, paper checks are not going away any time soon. While electronic payments are growing, the decline of checks is minimal. Thus, the ability to handle paper and electronic payments efficiently is critical. Second, new technology is creating more efficient ways to handle the A/R process, yet this fact has been slow to make it into the mainstream. This is primarily due to the third trend; wholesale lockboxes are slow to react. Keeping pace with technology requires one of two things, investing heavily in new systems, or automating the process in-house and thereby taking a portion of revenues away from the antiquated bank lockbox system currently in place. Finally, the impact of improving the visibility into your collections process can have benefits beyond simply cost savings to improve the bottom line for the company.

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## The Value of the Check

According to the Association for Financial Professionals, 74% of all business-to-business payments are made by check regardless of the banking industry's initiative to move to electronic payments. While this may surprise some, Executive Vice President at U.S. Bank, Tom Rea was quoted as saying, "It is safe to say the industry as a whole may have underestimated just how valuable the check is – not the paper itself, of course – but the information rich payment system built around the check."<sup>1</sup>

So what accounts for this popularity?<sup>2</sup>

- The speed of a check; it is the only payment method that can be cashed immediately upon receipt
- The amount of information contained on a check, it is the most detailed payment type available
- The existing infrastructure
- The investments made by banks over the years to ensure the system works and works well
- The inherent safety of the check; it has the most fraud controls in place

Based on the 2007 payments study by the Federal Reserve, the value of checks paid has increased since 2000 while the volume has dropped. Interestingly, as electronic payments are growing, only 24% of those new

transactions are replacing checks, pointing to e-payments as growing the “market”, not simply replacing checks.<sup>3</sup>

A recent “Alternative Payment Methods” survey conducted by the Credit Research Foundation (CRF) found that 100% of respondents indicated that they accept paper checks as a form of payment, and nearly two thirds said that paper checks account for more than 75% of their payments received.<sup>4</sup>

### **The Requirement for Consolidated Receivables**

Additional findings from the study revealed that while nearly half of those surveyed are planning to implement EIPP (Electronic Invoice Presentment & Payment), more than a third plan to make no changes whatsoever.

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While the payment landscape is evolving, it is doing so at a glacial pace. Paper checks will continue to dominate as the preferred payment method, especially in the business to business arena, but there is the need for developing products and services that accelerate receivables turn and create greater efficiencies in the process of making commercial payments.<sup>5</sup>

The ability to handle both check and electronic payments efficiently is going to be vital for companies for the foreseeable future. As noted, “It is true that the paper check was conceived in a different age...but as long as the check continues to serve the needs of companies and consumers, the value of the check to the U.S. economy is not declining, but growing.”<sup>6</sup>

Celent points out that companies are increasing their use of e-payments, but the pace is extremely slow, encumbered by inertia as well as lack of integration between accounting/ERP systems and payment systems, inadequate dissemination of standards, lack of e-financial supply chain prioritization and/or resources (IT, human, and financial), and insufficient bank-provided services.<sup>7</sup>

### **Evolving the Lockbox**

After years of little change for the traditional wholesale lockbox, the amount of innovation today is exceptional, providing financial institutions offering wholesale lockbox services many years of revenue. However, it will require they move from their complacent overreliance on lending and invest both in upgrading lockbox platforms and revisiting selling strategies if they hope to remain competitive.<sup>8</sup> Fueled by clients’ quest to reduce days sales outstanding

(DSO), lockbox has endured the decades. While banks have long since exited the retail lockbox business as a result of dwindling margins driven by large third party processors, similar dynamics are appearing in wholesale lockbox. As in so many other areas, truncating paper allows work to be performed where it can be done most cost-effectively.<sup>9</sup>

Additional risks for bank wholesale lockbox include remote deposit capture (RDC), which banks are combating by providing virtual lockbox solutions in order to maintain the keying fees associated with the lockbox. Also of concern to banks are third party solution providers. Such providers are beginning to play a greater role in exceptions adjudication and cash application, eliminating keying fees associated with the lockbox. A final group of competitors are independent software vendors specializing in AR processing. A benefit of these third party solutions is that clients are able to realize greater efficiency by automating much of the process while still maintaining their banking relationship.<sup>10</sup>

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### **Impacting Collections and Improving Profits**

While optimizing the A/R process has always been important, today's economic environment has forced companies to take a close look at their financial supply chain and what they are finding is that the impact of posting the right data as quickly as possible can improve the overall financial health of the company.

In response to the recent credit crisis, CRF surveyed members and found that a company's approach to collections is more critical than ever. Though not always easy to quantify, an important finding is the potential cost of a misguided credit decision. The implication can be in the hundreds of thousands of dollars in either bad debt loss or lost future revenues. One solution recommended is to automate the remittance and collections process. Evidence shows that these models have become quite successful and are becoming more widely used to create efficiencies in the management of large account portfolios, as long as the expenses related to building the model is manageable.<sup>11</sup>

In recent paper from Tatum, it is noted that as the credit markets have dried up customers may have more difficulty paying bills, however postponing cash collections is a mistake to avoid. Cash is the most important commodity

and it is important to collect receivables in a timely manner; if a customer gets behind today, he may not be able to borrow the money to catch up.<sup>12</sup> An excellent summary of the current situation is captured in the November issue of AFP Exchange which points out the imperative need for liquidity in an organization. Without it, a company can quickly vanish. Working capital is the liquidity available to run the operations of the business and also a measure of the operational efficiency for the business by looking at the ratio of cash dedicated to inventory and A/R to total working capital. Killen Associates has estimated that, "a typical U.S. corporation with \$1 billion in revenue spends \$27 million annually in unnecessary working capital due to a lack of visibility into the financial supply chain processes." Thus, decreasing costs and cycle times and increasing transaction speed in both A/P and A/R plays a substantial role in improving the profitability of a business.<sup>13</sup>

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Automation is invaluable in optimizing core processes by shedding light on the financial supply chain to minimize manual data-entry errors, integrate and accelerate information flow, improve the velocity of transactions thereby reducing delays in cash application, payment reconciliation and collections float, and finally reduce the overall cost per transaction. These real bottom-line benefits exist in hidden value trapped by inefficient processes and are independent of economic factors and competition. However, in today's sluggish economy reaping these benefits is something businesses ignore at their own risk.<sup>14</sup>

<sup>1,2,3</sup>David Walker, October 2008, "What's Next for Checks?" Digital Transactions

<sup>4,5</sup>Lyle P. Wallis, September 2006, "The Evolution of Business to Business Payment Methods" CRF

<sup>6</sup>David Walker, October 2008, "What's Next for Checks?" Digital Transactions

<sup>7,8,9,10</sup>Bob Meara, July 2008, "Evolution of Wholesale Lockbox, Let the Good Times Roll!" Celent, pp. 7:9, p. 3, p. 55, p. 56

<sup>11</sup>Lyle P. Wallis, November 2008, "Managing Receivables in the Midst of Today's Economic Environment" CRF

<sup>12</sup>Tatum, 2008, "Five Mistakes CFOs Need to Avoid in a Volatile Economy"

<sup>13,14</sup>Zahid Khalid, November 2008, "Optimizing the Financial Supply Chain" AFP Exchange