E-book:

Three Considerations for **Optimizing** Your Days Payable Outstanding

PRGX®

Contents

Overview

Working capital can be described as the funds used to run day-to-day business operations such as buying raw materials and services, paying your employees and keeping the lights on.

Undoubtedly, maintaining consistent cashflow to offset expenses and well thought out investments is crucial for healthy operations. In times of economic uncertainty, it can be even more critical for business owners and finance leaders to have a clear understanding and control over their company's working capital.

In this e-book, we explore how businesses can uncover hidden opportunities and optimize their days payable outstanding.

While there may be many scenarios that could lead to financial inefficiencies, there are three considerations this e-book will explore.

1

Paying Too Early

Companies strive to pay their suppliers on time. In most cases, payment terms are established at the beginning of the relationship to ensure fair and on-time payment.

But, what happens when a company does not measure this agreed upon term over the life of its supplier relationships? Are you paying your vendors too early or too late? Paying too late can result in fees and lost confidence, but what happens if your company pays too early?

Consistently paying your suppliers too early is equivalent to giving them an interest-free loan. For example, you pay supplier A $500M annually and have a payment term of 45 days, but measuring your payment term shows that you pay the supplier in 28 days. That's equivalent to giving supplier A an interest-free loan of $500M for 17 days. Think about what you could you do with $500M during a 17-day span.

To measure whether your company has a gap like this in place, start by reviewing the vendor terms specified by the contract, invoice or vendor master. Then, measure the terms against the actual payment performances. You can calculate the gap between what and when you are currently paying your suppliers versus what and when you should be paying them.

Once you find this gap and close it, you can quantify your company's working capital opportunity. So, your first overall goal is to measure your organization's payment performance and to quantify the value gaps that you could be leveraging.

> **“If you are not actively measuring or managing your payment terms, there will mostly likely be a gap between your target and actual payment performance.”**

So, how do these gaps occur? Some of the usual suspects include system inconsistencies, bad invoice terms, manual overrides and the exceptions process. One of the best ways to identify these gaps is to systematically connect and compare key points in your source-to-pay process. By comparing contract terms to invoice terms to vendor master terms to actual payment performance, you'll highlight the key problem areas.

As an example, a common source of a term gap is when a supplier payment term has been changed over time. When an existing Net-30 supplier is negotiated to a Net-60, sometimes the new term may not be updated correctly in your supplier management system. As a result, the supplier continues to be paid at Net-30 leaving 30 days of opportunity on the table.

To identify and fix this, you first have to begin by defining, measuring and quantifying the gaps. Once you have a measured and quantified opportunity, it will be easier to bring the gap to the attention of your accounts payable (AP) team and actively manage it moving forward.

2

Paying Too Late

The second consideration for optimizing your Days Payable Outstanding is to move away from paying suppliers too late. While financial disincentives for late payments can exist and vary, paying too late can also cause issues in your supplier relationship itself.

As often noted by industry veterans, suppliers are "great at getting paid". When suppliers face consistent late payments, they may find themselves forced to take alternative measures like negotiating in additional terms, penalties, or padded pricing to recapture lost funds and protect themselves for the future.

Additionally, for many clients a large source of support call/email volume that AP teams receive is around unpaid or late invoices. The time and resources to address these issues can be quite costly, not to mention the time spent working to rebuild supplier confidence. While addressing this issue isn't a particular area where you will recover lost funds (at best, maybe minimize penalty payments), you can, however, proactively find and eliminate a potential pitfall in your supplier relationship.

A third-party audit provider can help the process by finding and measuring your payment performance for each supplier compared to their relative targets. Armed with pointed insight and supporting data, you can now take action and close the gap.

3

Modeling Payment Terms

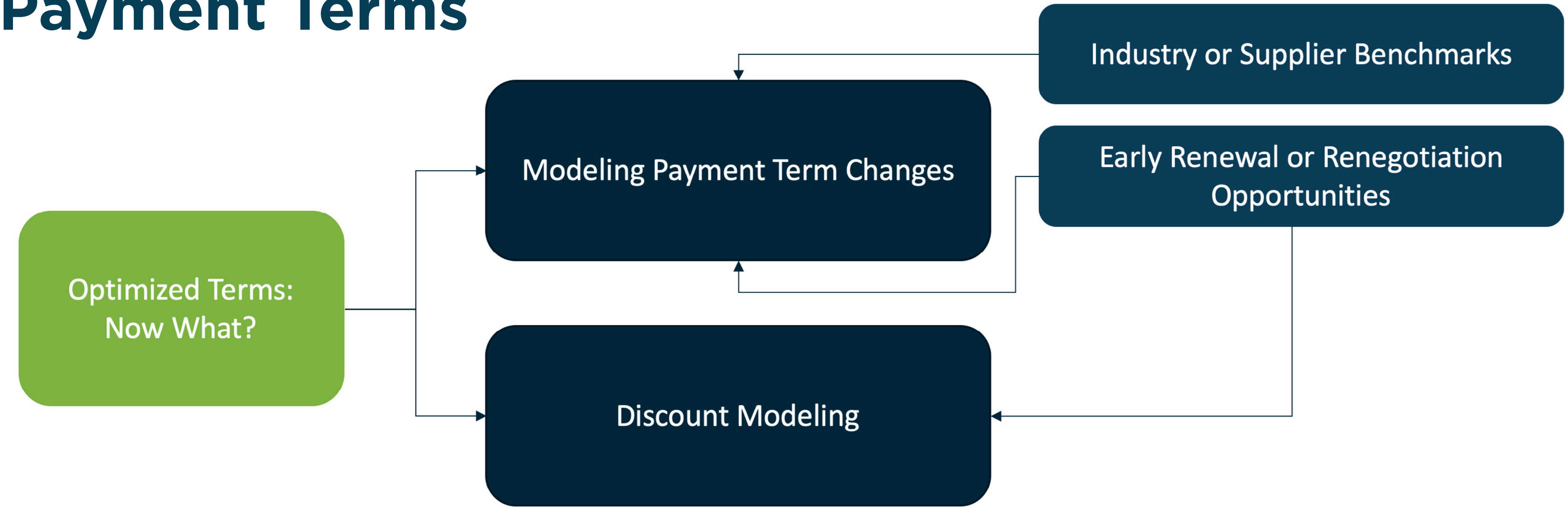
A third consideration for businesses when considering how to optimize their days payable outstanding is to model their payment terms to understand how they can be improved based on industry best practices. Can my terms be improved? If so, what should be my target? And how am I doing compared to my peers and the market?

Let's say your company has been doing a great job optimizing all current terms and is now planning a payment term change program to shift a certain number of suppliers from Net-30 to Net-60 or 90. Having a rapid modeling platform that can calculate potential gains for specific vendors would be valuable in setting the right targets. What if the platform could even help you identify suppliers that are coming up for renewals to further aid in target setting?

Or, what if your company wanted to test the impact of spend pushed toward a payment discount program? A platform that rapidly compared multiple scenarios of Net versus Discount term valuations would prove invaluable. For example, consider Net-10 with a two percent discount versus a longer payment term without a discount (Net-90). Based on your current financial circumstances, payment amount and cost of cash, which one would be more beneficial? On the other hand, how do your terms compare to industry or supplier benchmarks? By understanding your terms, you can start benchmarking against your industry or peers based on factors like the size of your spend, your category and region. This can in turn help you model and determine your optimal payment terms.

Armed with data and insights, you can now set a course of action that efficiently sets customized paths for different categories, countries, regions and suppliers. Rather than taking the one-size-fits-all hammer approach to all of your suppliers, you're now able to make data-driven decisions to maximize your value opportunities and supplier relationships.

Modeling Payment Terms



Once your business has optimized your payment terms, there are two options that you can follow – modeling payment term changes or discount modeling. When considering modeling payment term changes, you will need to determine if you are within the benchmark of your respective industry or your peers. When considering discount modeling, you will need to identify the benefits of introducing discount programs or discount terms and if your vendors would be open to renegotiating your agreement.

Summary

If you're not already actively measuring and managing your payment terms, you're leaving valuable working capital uncaptured.

You need a partner that can quickly and efficiently highlight your gaps and opportunities to recommend action and measure progress on an ongoing basis.

Knowing, comparing, and modeling around the industry and supplier benchmarks is a great example of driving business impact using data and analytics.

About PRGX

PRGX helps companies spot value in their source-to-pay processes that traditional approaches simply can't. Having identified more than 300 common points of leakage, we help companies dig deeper and act faster to get more out of their recovery audits.

We pioneered the industry 50 years ago, and today we help clients in more than 30 countries take back US$1.2 billion in annual cash flow each year.

It's why 75% of top global retailers and a third of the largest companies in the Fortune 500 rely on us.

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