



# Simple AI for Finance

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# CAN YOU MAXIMIZE CASH FLOW THROUGH REAL-TIME PAYABLES OPTIMIZATION?

**A singular focus on maximizing Days Payment Outstanding (DPO) is not sufficient to optimize an organization's payables strategy. There are multiple drivers that can affect optimality and a holistic consideration of tradeoffs is essential for optimal decisions. An integrated analytical system, using artificial intelligence, can enable organizations to make real-time decisions to improve their margins and return on assets. We believe optimizing payables strategies can switch an Accounts Payables function from a cost center to a profit center.**

Daily and/or short-term financial decisions can significantly impact an organization's performance. The lack of a holistic and strategic approach can further amplify financial constraints. The impact of the global pandemic has highlighted the importance of being strategic and nimble at the same time. A prudent cash management strategy and strong cash culture across people, process and technology separates top performers from average ones. Managing Working Capital and specifically, Accounts Payables is a critical lever in driving excellence in cash management. There is an enormous opportunity to unlock cash tied in working capital.

- ~\$1.28T working capital opportunity across top 1,000 non-financial US companies alone<sup>1</sup>
- \$464B capital tied in Accounts Payables<sup>2</sup>
- Improving DPO by 1 day can result in about \$5M in working capital improvement for an organization with \$5B revenue<sup>3</sup>

Many organizations effectively manage payables strategies during contract negotiations by standardizing payment terms and purchase order policies. However, these policies remain in place for long periods without accounting for variation in revenue flow, cost of capital, early payment incentives and late payment penalties. Payables policies should not get calcified. An optimal payment strategy can be deployed

by embedding an Artificial Intelligence (AI) based decision engine that recommends optimal payment decisions on a daily basis while considering multiple factors simultaneously. Such an

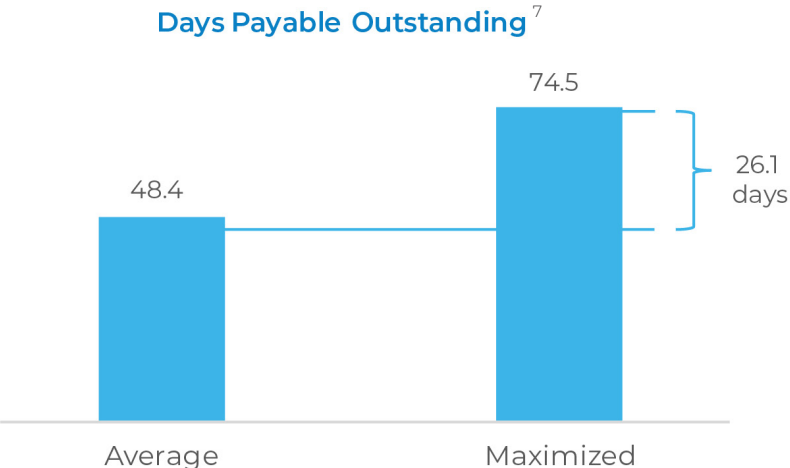
optimization system would improve cash availability and reduce cost of capital while maintaining strong supplier relationships.

## The state of practice: Companies passively manage payment strategies

When the WHO declared COVID-19 to be a 'pandemic' on March 11, 2020, it underscored the importance of efficient cash flow management. Since then, according to Yelp.com<sup>4</sup>, more than 98,000 businesses in the United States alone had permanently shut down. **82% failed businesses cited a lack of cash flow**, financial mismanagement, and poor planning as key factors. With a severe stress on revenue, bloated inventory and uneven to almost zero demand across various sectors, managing working capital and subsequently accounts

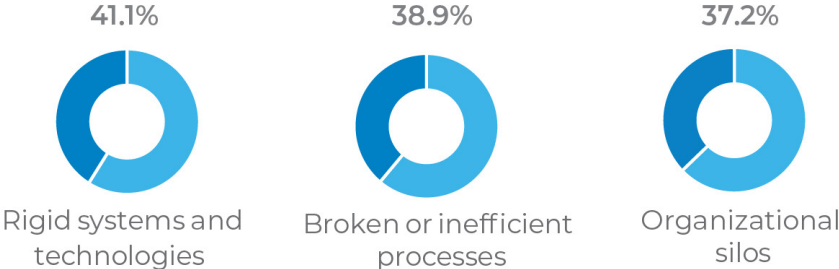
payables became even more critical for a company's survival. Best-in-class companies are now converting cash 3X faster than their competition.

DPO is a key measure for accounts payables. For a company with ~\$5B revenues, a 1-day DPO improvement translates to ~\$5M in working capital opportunity or ~1% of its revenues. It is estimated that **an optimized DPO will be 26 days better at 74.5 days than the average performer at 48.4 days**<sup>5</sup>. In fact,



Source: Celonis

### Top 3 obstacles in optimization of payables strategy<sup>8</sup>



65% companies prioritize invoices by first in, first out or by due date

Source: Celonis

DPO was the biggest working capital shift for top performing companies in 2020, rising by 7.6% to 63.6 days<sup>6</sup>. Correlate these numbers with your organization to understand why an optimized payables strategy is critical. If your organization is amongst the 65% that prioritize invoices either first in, first out or by due date, there is a significant missed opportunity to improve your overall cash conversion cycle. To create a successful payables strategy, there are several factors to consider while defining your approach:

- Daily changes in cash availability and payment capacity
- Efficient usage of all supplier discount programs
- Real-time trade-offs between early cash incentives, late

payment penalties, credit cost and available cash

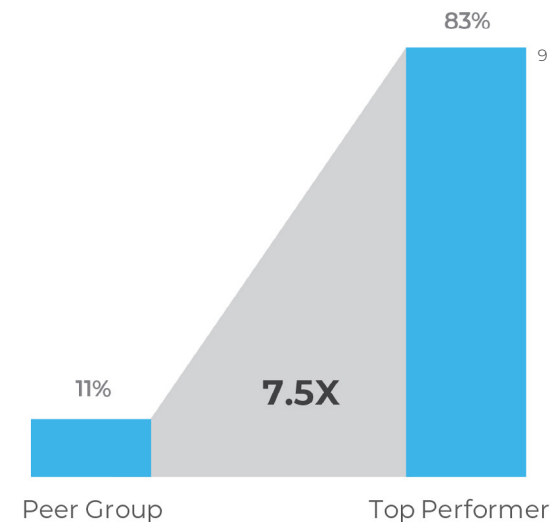
- Frequent review of payables policies for optimal working capital management
- Identifying strategic vs. non-strategic suppliers as there is greater negotiating power with non-strategic suppliers
- Effective usage of payment channel

Today, the industry lacks a robust system to actively optimize payment trade-offs in real time. In this paper, we propose an AI-based analytical approach to optimize payment decisions for an organization's accounts payables.

## The possibilities: Optimizing trade-offs real-time for a powerful payables strategy

An optimal payment strategy must consider both long term supplier management and day-to-day invoice payment trade-offs. A robust AI-based optimization system will consider optimal cash levels (amongst other factors) to increase DPO, reduce capital cost and improve margins & return on assets while at the same time maintaining or bettering supplier relationships. Top performing companies can achieve a 7.5X better outcome on an average as compared to their peers. The drivers of payment optimization will vary by geography or by industry, but can broadly fit into one of the categories below:

**Payment terms:** An organization must negotiate the longest payment



terms while considering arbitrage between their capital as compared to that of their supplier, supplier health and relationship

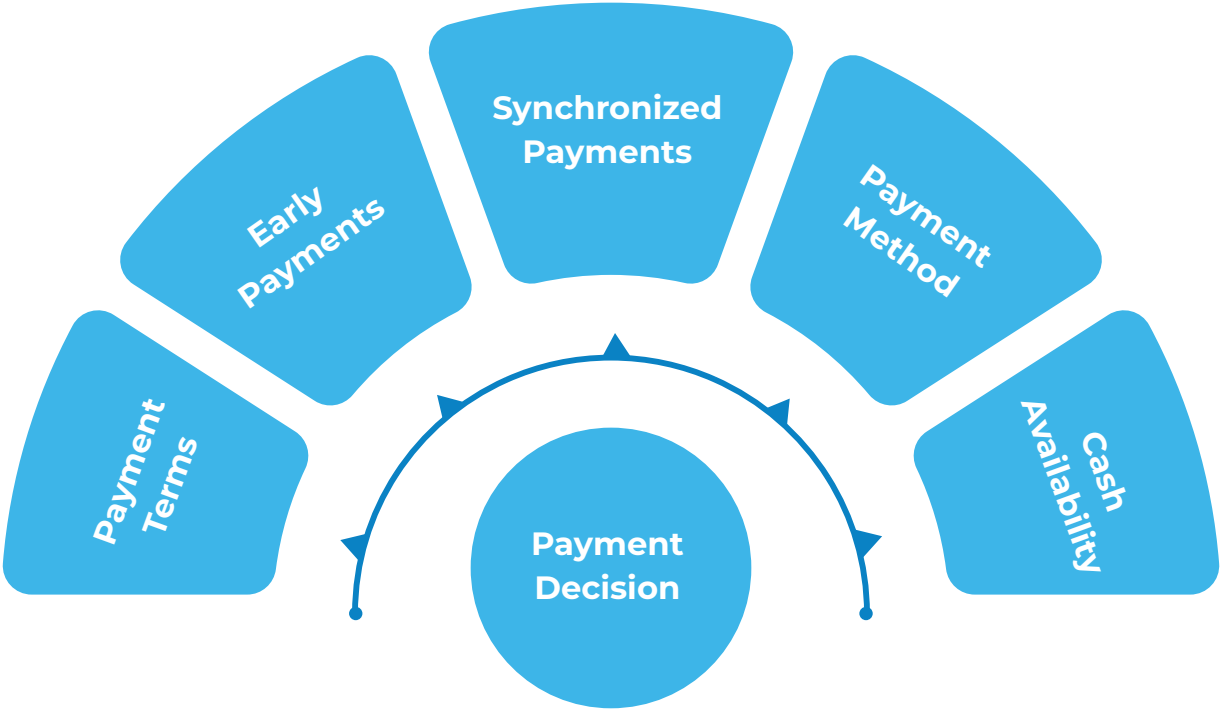
**Early payment incentives:** Focusing on just increasing DPO may not be the best strategy when early payment incentives could improve cash availability and lower cost of capital. Identifying strategic vs. non-strategic suppliers can also help identify where supplier negotiations may be more effective

**Synchronizing invoice payments to revenue:** Surgically delaying payments on selected invoices/categories can increase

cash availability and reduce credit utilization. However, rampant delay could result in poor supplier relationships, penalties and a weak position during contract renewal

**Payment methods:** The optimal payment method can enable cash back through corporate cards and faster payments could maximize DPO

**Cash availability:** Accurately forecasting accounts receivables collections is a critical driver to enable the optimal tradeoff decision for each invoice



A robust optimization engine recommends payment decisions for each invoice on a daily or weekly schedule. These decisions could be dates, amounts or a combination of both. A digitally integrated system enables frictionless flow of data coupled with advanced analytical models to predict cash/optimize tradeoffs and delivers through a simple, intuitive user-interface.

In our opinion, there are 4 basic building blocks for an optimized payables strategy:

- Suppliers master profile
- Frictionless data flow
- AI optimization engine
- Intuitive user interface

### **Suppliers Master Profile:**

Real-time and up-to-date supplier master for a seamless flow of available discounts, trade/volume credits and promotions

### **Frictionless Dataflow:**

Bi-directional data flow to enable real-time flow of invoice details, available cash, payment terms and payment decisions

### **Optimization Engine:**

A system of advanced analytical models that accurately predict available cash and holistically optimize payment decision for each invoice considering all tradeoffs

### **Intuitive User Interface:**

Enable human intervention in the decision process such that there is a control; machine generated decisions can be over-ridden based on unforeseen conditions

## **Key Recommendations**

Our research shows that at a minimum, there is a hidden ~1% (of your revenues) working capital improvement opportunity to free up cash that you can use to drive investments in other much-needed areas to grow your business. There are numerous factors listed below to consider while thinking about a holistic Accounts Payable strategy:

- Real-time payment policy optimization has a significant impact on improving DPO, cost of capital and overall margins while ensuring a robust supply chain
- Payment plans should consider linkages and trade-offs between early pay incentives, late pay penalties, cost of credit draws and investment opportunities

- Accurate forecasts of available cash through operations minimizes interest cost on credit draws
- Synchronizing supplier payments with accounts receivables collections ensures positive operating cash flow
- Maximizing supplier discounting programs enables savings
- Offering supply chain financing to suppliers to improve their cashflow and ensure supply chain resilience
- Deploying an advanced analytical engine to optimize payment schedules real-time while considering tradeoffs

## About the Authors

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## SimpliCapital

SimpliCapital enables transparency, certainty and improvement in Financial Operations. Our SaaS product seamlessly integrates data from ERP systems and financial institutions. An intuitive user-interface enables near real-time analytics and an Artificial Intelligence based analytics engine dramatically improves predictability through accurate forecasting.

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<sup>1</sup>Hackett Group: 2021 Hackett 1000 report

<sup>2</sup>Ibid

<sup>3</sup>Celonis: The 2021 State of Business Execution Benchmarks Report

<sup>4</sup>Yelp: Local Economic Impact Report (September 2020)

<sup>5</sup>Celonis

<sup>6</sup>Hackett Group: 2021 Hackett 1000 report

<sup>7</sup>Celonis: The 2021 State of Business Execution Benchmarks Report

<sup>8</sup>Ibid

<sup>9</sup>Hackett Group: Predictive Forecasting: Increase forecasting accuracy by adopting a driver-based approach (2018)