

HOW COMPANIES CAN USE NEW PAYMENT TOOLS TO OPTIMIZE WORKING CAPITAL



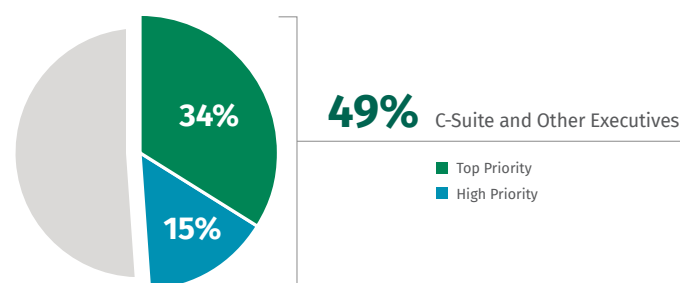
By **Michael Cummins**, Head of Treasury Solutions | Published July 2023

- Amid higher interest costs, the expenses associated with working capital are an increasingly pressing issue for middle-market companies
- A range of new tools and technologies in the payments space can help companies to extend payables terms, capture early-payment discounts, earn revenue share on card spending, and trim administrative costs related to working capital
- To be strategic about payments and working capital, finance and treasury teams must work together

Treasury departments are facing a new era for working capital. After 15 years of near-zero interest rates, many treasury teams have higher financing costs for working capital. They are also seeing a shift in the dynamics of buyer and supplier relationships. In a higher-rate environment, it's valuable to suppliers to get payment sooner – which can put buyers in a more powerful position in negotiations with suppliers. However, suppliers remain price-sensitive to the costs of accepting commercial cards and other forms of payment.

A change to working capital ultimately affects both cash flow and balance sheets for companies. For instance, improvements to working capital can lower financing costs, allow companies to de-leverage or avoid new leverage on balance sheets, and ultimately boost cash flows after interest and debt payments. According to a survey by [Deloitte](#), nearly half of C-suite and other executives say that optimizing working capital is a priority for their organization. With an economy on unstable footing, more executives may turn their attention to working capital in the months to come if growth stagnates while rates remain higher.

49% OF C-SUITE AND OTHER EXECUTIVES WANT TO OPTIMIZE WORKING CAPITAL



Source: Deloitte

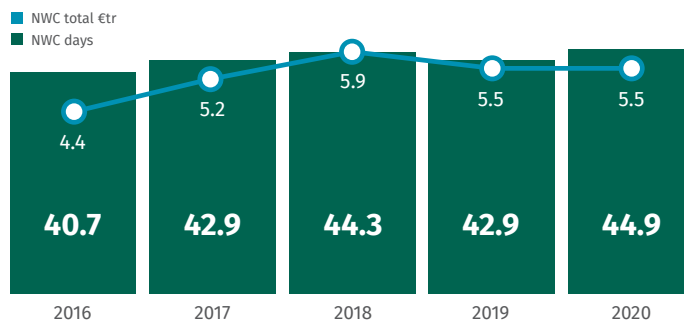
Tackling the higher costs of working capital

Counterintuitively, higher interest rates are actually linked with higher levels of working capital, historically. It seems like the opposite should be true, since working capital has a cost associated with it. Lower cost – via lower interest rates – would seem like a time to increase working capital. Yet, history suggests that companies do the opposite, according to a 2014 analysis by [The Global Treasurer](#).

In fact, working capital levels did rise over the course of the pandemic, one report suggests. [Auditing, tax and advisory firm PwC Global](#) reported that net working capital days rose to a high of 44.9 days in 2020, and net working capital levels globally were at €5.5 trillion.

Pandemic prompted higher net working capital levels

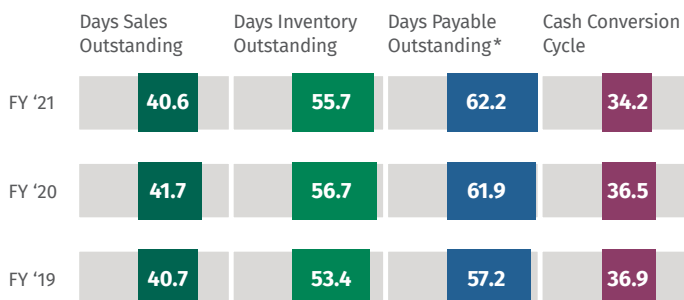
NET WORKING CAPITAL (NWC) AND WORKING CAPITAL DAYS



Source: PwC Working Capital Study 21/22

Since the shutdown shock, companies have seen an improvement in their cash conversion cycles (CCC), on average. A shorter CCC is generally a sign of efficiency in working capital, since it means cash is not tied up for long periods in inventory or by delayed customer payments. The CCC shortened between 2019 and 2021, falling from 36.9 days to 34.2 days, according to a report from [The Hackett Group](#). An increase in days payable outstanding (DPO), a source of working capital, was the primary driver of the improvement, even offsetting some increase in days inventory outstanding (DIO), a user of working capital.

Since 2019, the cash conversion cycle has shortened



*The DPO number is subtracted from DSO and DIO to get the cash conversion cycle metric. (An increase in DPO represents an improvement to working capital.)

Source: The Hackett Group 2022 Working Capital Scorecard

Of course, the CCC is not a useful measure for all companies; it mainly reflects the operational efficiency of manufacturing or product-based businesses. The metric does not provide as much information on companies that sell services, since inventory is not a factor. Still, the relationship between payables and receivables is a salient issue for every company.

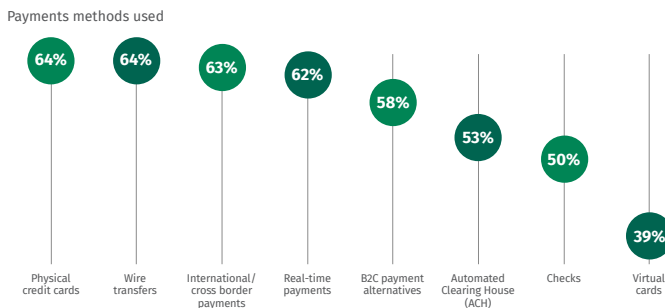
The surprising tools for optimizing working capital

Most companies share the goal of getting more from each dollar of working capital, and one strategy to get there is to shorten the CCC. Management teams can see improved CCC from shortening their receivable collection cycle (days sales outstanding, DSO), from lowering inventory on the balance sheet (DIO), or from lengthening payment cycles (DPO).

Payment technologies can boost working capital, to the surprise of many company managers. Some payment tools, like commercial cards, can actually shorten DPO from the suppliers' perspective while lengthening it from the company's perspective. Payment technologies can confer other benefits as well, including lower administrative costs and more efficient reconciliation of payments, lowering total expenses for working-capital management.

Businesses are using a custom mix of payments, including physical and virtual cards

ALL PAYMENT METHODS ARE USED, BUT NONE ARE UNIVERSAL



Source: Citizens 2023 Payment Trends Survey

Consider commercial cards to make payments

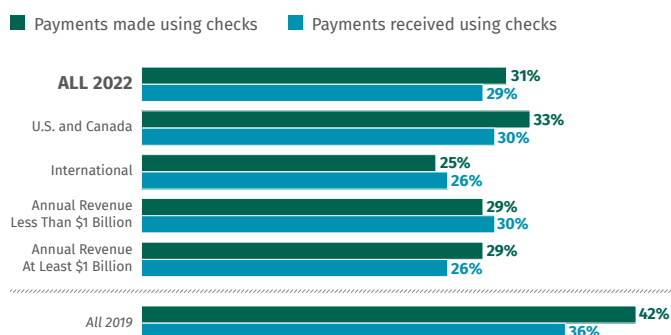
Commercial card programs can help businesses simplify their payments and gain efficiencies in their accounts payable process, thus reducing administrative costs. There could even be an extra benefit to working capital by combining credit float and extended supplier payment, under the right circumstances. For example, it may be possible to negotiate longer payment terms with suppliers, say up to 60 days, and to make use of credit float via extended repayment terms with the card issuer. The combination of these two levers can generate a boost in working capital.

Retire checks for good

The cost of paper checks can actually be quite high. Though many perceive checks to be nearly free, true-cost estimates from industry resources, like [PwC](#), report businesses spend over \$24,000 a year to send 500 checks a month. This cost includes the full life cycle of the payment, from printing checks to mailing costs to reconciliation and administrative time. Yet, many businesses continue to rely on checks. Particularly in business-to-business (B2B) industries, checks and cash still represent a substantial share of payments, according to data from the [Association for Financial Professionals](#).

Businesses still rely on checks

B2B PAYMENTS MADE AND RECEIVED BY CHECKS



Source: 2022 AFP Digital Payments Survey

Tap into tech for better reconciliation

There are a number of payment technologies that can help companies improve reconciliation processes, which can streamline costs associated with working capital. Some tools offer better data feeds than others to track transactions. Virtual cards and integrated payables provide valuable reconciliation tools with user-friendly data access. Additionally, these payment technologies can be effective at streamlining payment processes for businesses that pay multiple invoices with a single payment, like seen at manufacturing, retail and healthcare companies.

UNDERSTANDING NEW PAYMENT TECHNOLOGIES

Virtual Cards



are one-time use cards for a specific invoice amount that have built-in protection against fraudulent use. They are typically issued digitally, not physically.

Integrated Payables



refers to a process where all payables to vendors are consolidated into a single file that is sent to the payer's bank, which then follows the instructions to make all the payments.

Capture revenue share with commercial cards

Commercial cards can also help companies improve their return on working capital through rewards. Depending on the card terms, a revenue share or rewards program could offer benefits. Some cards offer a range of other benefits as well, including things like travel protection or expense management, which aren't directly benefiting working capital efficiency but can be valuable in other respects.

For each industry, a custom solution to optimize working capital

Treasury teams must prioritize stability and predictability. The discipline can understandably be slow to adopt new tools and technologies, as the continued reliance on paper checks suggests. Still, the new payment technologies available are worth investigating, for their potential impact on working capital alone. From extending payable timelines to capturing revenue share or trimming reconciliation costs, these tools can be used to optimize working capital at a time when interest costs are higher.

Working capital is a different puzzle for every industry and company. Each faces a unique set of circumstances, working with different supply chains, vendor types and client types. In order to optimize working capital, most companies will want to explore a custom mix of solutions that fit their specific needs. Ultimately, finance and treasury teams must collaborate to make any strategic changes to payments as they aim to optimize working capital.

Key Takeaways:

- Modern payment technology offers a range of new tools and benefits that could help companies optimize their working capital.
- Potential benefits include maximizing float on payables, maximizing revenue share on payables, negotiating improved payment terms with strategic suppliers, and removing costly paper processes from payables.
- Treasury and finance teams must coordinate and work together to explore and implement the technologies that could benefit their unique business.
- The best solution varies by industry and company, so it is worthwhile to speak with a trusted advisor and quantify the working capital benefits.



Michael Cummins, EVP and Head of Treasury Solutions, is responsible for the Commercial Bank's Treasury Solutions business which includes the product development, sales and account management of working capital solutions including cash management, commercial card, liquidity, and trade and supply chain finance. Mike and his team are dedicated to providing working capital solutions throughout a client's life cycle, with a focus on evolving payments capabilities and enhanced digital offerings.

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