

Get a handle on how your organisation really buys

**Five fundamental
questions every
CFO should ask about
their organisation's
Purchase-to-Pay process
in order to drive savings**



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Introduction

Whether your organisation is a Commercial company, Not-for-Profit organisation, or Public Sector entity, there's no such thing as "business as usual" today. Every executive must be looking for ways to streamline the organisation – especially CFOs and other senior financial managers. Market pressures dictate the need for ongoing cost reduction or at least containment.



Although sometimes necessary, forward-thinking CFOs recognise that sporadic cost-cutting campaigns are not the real answer – creating a culture of cost-consciousness, efficiency and productivity is the only way to obtain lasting cost-base leadership.

After payroll (and direct materials in the case of manufacturers, distributors, and retailers), the biggest source of cost in almost all organisations is the procurement of the expense items, outside services, and capital items needed to support your organisation's operations – the items that represent the "cost of doing business". This is usually referred to as indirect procurement.

With so much expenditure and organisational resource involved in the daily Purchase-to-Pay cycle, you know there must be opportunity for savings you can't ignore. You know that if you can improve that process, you can improve the bottom line. But the question is, "where to start?"

This guide

This guide has been developed to provide a practical way to get started in the pursuit of the savings that are to be found in the Purchase-to-Pay cycle for most organisations.

Specifically, it's designed to help you:

- ④ Get a handle on how things are really done today.
- ④ Identify where the savings opportunities lie.
- ④ Start a dialogue among key managers.
- ④ Develop a vision of how to address the problems and opportunities.
- ④ Gain a general view of how a good Purchase-to-Pay (P2P) software solution can help you do that better, faster and cheaper.

You can use the pages at the end of this guide to make notes as you go along.

A few important notes before you read on:

- ④ We fully recognise that this is a complex issue, and that this brief guide is not a "silver bullet" that will transform your organisation overnight. Our goal in developing this guide is simply to help you understand the issue and start a dialogue within your organisation that can lead to that transformation as quickly and confidently as possible.
- ④ For the purposes of this guide, we are focusing only on the day-to-day Purchase-to-Pay cycle and purposely not addressing the equally important strategic procurement functions that your head of procurement is directly responsible for. The suggestions here are intended to help you improve your organisation's cost management performance no matter where you currently stand with respect to those issues.
- ④ Some points we raise here will already be obvious to you, some may not. Some issues we discuss, you may already have well in hand. The important thing is to recognise how all five issues are inter-related, and how a weakness in just one or two areas can be significantly affecting your overall performance as an organisation. Like many key business functions, the trick is finding the right balance between controls and productivity.

5 key questions –

The five key questions you should ask about your organisation's Purchase-to-Pay process in order to drive savings are:

1. Do the right people really have control of what we're buying?
2. Do managers have enough visibility of purchase commitments to properly manage their budgets?
3. Are we getting the best value for what we're spending?
4. Are we properly managing the payment process?
5. Are we as efficient as we can be?

The P2P cycle for indirect procurement encompasses everything that happens from the time an employee sets out to buy a product or service they need in order to do their job, through the appropriate authorisation process, to sending the Purchase Order (PO) or purchase release to the supplier, and ultimately to receiving and paying the supplier's invoice.

The class of software systems that have come into being in recent years to address this important cycle is generally referred to as Purchase-to-Pay or Procure-to-Pay systems – P2P systems for short.

The following pages will give you insight into what's behind these questions, why they are important, key indicators to look for, and how an effective Purchase-to-Pay system can help you address the challenges and achieve the improvements you're ultimately after.

Q1. Do the right people really have control of what we're buying?

Financial controls are essential for any organisation and pre-purchase authorisation is key to effective Purchase-to-Pay management. As people throughout your various departments and functions spend money on behalf of your organisation, you want to know that those expenditures are being reviewed and authorised by the right people before they are committed.



While you don't want to burden employees with excessive controls for low value goods like office supplies, you do want to know that multiple levels of management have seen and authorised major expenditures. Most purchases lie somewhere in between the extremes and should have some level of authorisation. Certainly, you want managers to have the opportunity to approve any significant purchase within their department in order to effectively manage their budgets.

Why it's important

Budget control: Without proper authorisation controls, employees may buy things that are not budgeted, not a current priority, or not appropriate for their function.

Quality and risk control: For some types of purchases, such as capital equipment, computer hardware and specialised outside services, the involvement of an expert that understands technical, legal or other category-specific issues beyond the requesting employee may be needed to ensure the right purchase is made.

Fraud prevention: Though the vast majority of purchases are well-intentioned, there is always the risk of fraudulent buying – something you certainly want to prevent.

What to look for – key indicators

- 🕒 **Invoices with no PO#:** A high percentage of invoices arriving in Accounts Payable (AP) without an approved purchase order (PO) on file probably indicates insufficient authorisation controls.
- 🕒 **Excessive AP workflow:** A high percentage of invoices being coded in AP and sent to an appropriate department for approval, effectively getting approval on what has already been spent (i.e. "spent control" vs. "spend control").
- 🕒 **Frequently surprised managers:** When managers are surprised that purchases have been made within their department, there is clearly a problem with the authorisation process.

How to improve

- 🕒 **Clearly define authorisation rules:** Develop clearly defined rules for approval requirements based on monetary value, item category, department, and other criteria.
- 🕒 **Make everyone aware:** Make everyone in the company aware of these policies and the importance of adhering to them.
- 🕒 **Track unauthorised purchases:** Ask your AP manager to track invoices with no PO to identify frequent offenders.

The value of an effective Purchase-to-Pay system

- 🕒 **Make it easy to define your policies:** Because it provides a pre-designed framework, a good P2P system will make it easy to define your authorisation policies and procedures without the need for extensive paper documentation.
- 🕒 **Ensure compliance:** A good P2P system will check all purchase requests against the established rules and route them to the appropriate person(s) for authorisation as needed. Routine purchases can be automatically approved when appropriate.
- 🕒 **Make it easy for employees to do the right thing:** A good P2P system eliminates the need for employees to be fully aware of approval requirements. They need only submit their request and the system will automatically apply the correct authorisation process.
- 🕒 **Make authorisation easy for managers and buyers:** Using workflow technology, a good P2P system will conveniently organise requisitions and purchase requests for those who do the authorising. In many cases, requests can be authorised with a few mouse clicks and from mobile devices.
- 🕒 **Make it visible:** Since everything is captured electronically, everything in the P2P system is visible to the people who need to know. Employees can always see the status of their request, managers can always see what they've approved, denied or questioned, and executives can see a complete history of all activity.

Q2. Do managers have enough visibility of purchase commitments to properly manage their budgets?

Managers need more visibility than just last month's financial statements if they are to effectively control their budgets and be fully accountable for their function. In today's fast-paced world, they also need clear, up-to-date visibility of outstanding commitments in order to see the full financial picture within their scope of responsibility. In addition to paid invoices (what they see on last month's financial statements), the full picture includes open purchase orders (POs), approved but not yet placed POs, and outstanding purchase requests.



Managers who don't know the full cost pipeline simply don't have the information they need to make good financial and operational decisions. That puts them and your entire organisation at a competitive disadvantage to those who do.

Why it's important

🕒 **Budget control:** Since purchase commitments are made well in advance of when they are paid, trying to manage a budget with just last month's financial statement is like trying to drive down the expressway with one eye closed – accidents are bound to happen.

🕒 **Cash flow management:** At times, department managers are asked to help manage cash flow in addition to their budgets – that's a lot easier when they can see the commitments that are already made when deciding if they can approve another request.

🕒 **Operational productivity:** A department manager's primary responsibility is to perform an operational function such as order fulfilment, maintenance, or customer service. If, in the effort to manage the budget, a manager needs to spend an inordinate amount of time "asking around" about open commitments, or trying to re-do his/her plan because (s)he's suddenly over budget, productivity and operational results are going to suffer.

What to look for – key indicators

- 🕒 **Manager behaviour:** Are some managers often surprised to find that they are over budget, or likely to go over budget? Conversely, are some managers overly cautious about doing necessary things because they're concerned they could go over budget due to expenditures they're not aware of?
- 🕒 **Frequent EOY budget crises:** Situations where important activities cannot be covered in the budget because less important things were already purchased (i.e. times when things are not getting done due to budget constraints).
- 🕒 **Ask managers...** How do you decide if you can approve a request or not? What do you look at to know where you really stand with your budget? Do you often just guess about open commitments?
- 🕒 **Ask yourself...** How do you know what your organisation's overall cost pipeline is? Do you have visibility beyond last month's financial statements? Do you have the visibility you really need to know where the organisation stands with respect to budget and upcoming cash requirements?

How to improve

- 🕒 **Institute good authorisation procedures:** As discussed under the previous question, this is critical to having any chance of knowing about purchase commitments before the invoice arrives.
- 🕒 **Capture purchase activity early:** Put in place a way of capturing purchase requests and commitments as early as possible. Try to capture enough detail to enable managers to really know what the request or commitment is, who originated it, what it's for, and why it's needed. Be sure proper account coding is done up front.
- 🕒 **Make the information accessible:** Make it easy for managers to see summaries and details of open commitments in addition to their financial statements. Enable this at multiple levels of organisational roll-up.

The value of an effective Purchase-to-Pay system

- 🕒 **Make capturing the information practical:** Capturing purchase commitments and requests may not even be practical without a Purchase-to-Pay system – the effort to do this on its own may not be justified. But since a P2P system captures and holds purchase activity from the time of request through PO, invoice and payment authorisation, it provides this information as a natural by-product of streamlining the buying process.
- 🕒 **Easy access:** A good P2P system will provide a summary and drill-down capability for all outstanding commitments within a given manager's span of responsibility. Combined with General Ledger (GL) account balances, this provides a complete picture of expenses.
- 🕒 **Better decisions:** With the ability to easily view to-date and future expenditures right at the time of authorising new requests, managers can more quickly make the right decision to approve, deny or delay. With the ability to analyse the full cost pipeline at any time, managers are better able to make the right decision when asked to do things like contain costs, help with cash flow, and reduce budgets.

Q3. Are we getting the best value for what we're spending?

No matter what your annual expenditure level, you want to get as much for your organisation's money as possible. You want the lowest prices and best overall value for everything you buy. That's why your procurement people research suppliers and negotiate contracts. Once good suppliers are identified and contracts set, you want as much of your spend to go through those suppliers as possible.

An important way for you to get a handle on how effectively your organisation is using its money is to ask:

1. How much of our spend is with preferred suppliers and contracts; how much is not?
2. What information do we have when we negotiate supplier contracts? Do we capture detailed information about our spending over time (e.g. on what, with whom, and at what prices)?

Why it's important

- ④ **You don't want to pay more than necessary:** Every time someone buys something from a supplier other than one with whom you have a favourable contract, the price savings you worked hard to negotiate are lost.
- ④ **You want the best overall value:** Price alone is not always the only criteria for selecting the best supplier. When an employee buys something from an unauthorised source, they may not understand how to evaluate other important dimensions such as quality, delivery or payment terms. What may look like a "good price" might actually cost more.

- ④ **You want to avoid undue risk:** Another factor in selecting a supplier is the potential risk they might entail in terms of their ability to ultimately deliver the product or service they sell. If your performance to your customers relies on their performance to you, you want to be sure you know the supplier well before selecting them. In some cases – especially with outside service providers – there could even be liability transferred to your organisation if they don't meet certain regulatory requirements.
- ④ **You want to fully leverage your spend:** If employees around your organisation are buying essentially the same product or service from many different suppliers (e.g. stationery), you are losing a lot of buying power. By consolidating those purchases with fewer suppliers, your volume with them goes up; making it much more likely that they will agree to discounts based on the higher level of business you provide them.
- ④ **You want to continuously improve:** If you don't have any good way of knowing what is being spent by category, supplier, etc; your procurement people do not have the basic information they need for activities like contract negotiation and supplier consolidation that can lead to further savings over time.

What to look for – key indicators

- ④ **Percent of spend under management:** This is the measure of how many purchases are with what you consider your preferred suppliers – typically ones with whom you have a contract specifying negotiated prices or discounts. A high percentage is, of course, what you're after. If it's low; discuss why that is.
- ④ **The number of active suppliers in your vendor master file:** If you have many suppliers in the same category with whom you've paid invoices over the past year, that may indicate lost opportunities for volume discounts. If the number is expanding over time, the lost opportunities may be growing.
- ④ **Reporting ability:** Ask your purchasing or IT manager to produce a report that summarises the money you've spent per supplier for key product or service categories. Talk with your purchasing manager about whether or not he feels well-equipped with the right data when he goes to negotiate a new supplier contract.

How to improve

- ④ **Identify and focus on preferred suppliers:** Clearly identify the one or few suppliers you want to use per category. Your procurement professionals may already be well down the road on this. If not, start with those suppliers with whom you have formal agreements.
- ④ **Make them known to employees:** Again, you may already have this process in place, but if not, provide a reasonable way for people to look up the supplier they should use for a given purchase.
- ④ **Develop an understanding of the importance of using preferred suppliers:** Be sure everyone who initiates purchases understands the importance to your organisation that they first consider a preferred supplier and only look elsewhere if absolutely necessary.
- ④ **Capture all purchase history:** If you are not already doing so, initiate a process by which you capture enough detail about all purchases for later analysis. You probably already have total spend per supplier, but you will want to categorise that at a lower level of detail (category, commodity, etc) in order to make the information as useful as possible.

The value of an effective Purchase-to-Pay system

- ④ **Make it easy to buy from preferred suppliers:** A good P2P system will make it much easier for employees to buy from a preferred supplier. Online catalogues can lead them directly to the right supplier(s) for commonly purchased items. Some systems will allow users to "punch-out" to a preferred supplier's website, use their shopping cart to select items, and bring those items back into the P2P system for the normal authorisation process. With a P2P system, it can be much easier to buy from the right supplier than the wrong one.
- ④ **Make it easy to capture history for spend analysis:** A P2P system captures all the details of a purchase in electronic form, ensuring all relevant coding in terms of purchase category, supplier, contract, etc. Much of this information is automatically applied from the catalogue and other sources within the system without requiring user input. This history is then available for reporting and analysis – an invaluable tool for contract negotiations and other strategic procurement activities.

Q4. Are we properly managing the payment process?

The Accounts Payable (AP) function plays a key role in the Purchase-to-Pay cycle, and in your organisation's cash management process. You count on your AP team to make sure your organisation pays only those invoices that are correct, and where the supplier, in fact, has delivered the goods or services for which they are billing.



That is a big responsibility and one not easily performed given the wide range of invoices that arrive every day in most AP departments. It can take a lot of time and effort to verify the validity of certain invoices.

The reality is that the effectiveness and efficiency with which AP does its "to-pay" part of the cycle is largely dictated by the way in which your organisation does the "purchase-to" part of the cycle. In other words, the more information the AP department has about what's been purchased, the better job they can do when the invoice arrives.

Why it's important

- 🕒 **Potential for overpayment:** The last thing you want to do is to pay more than the agreed price, or for a greater quantity than ordered, or for goods or services never delivered. And you certainly don't want to mistakenly pay the same invoice twice.
- 🕒 **Potential for fraud:** Most invoice errors are, of course, unintentional; but there is always the possibility a supplier or someone else will try to submit false invoices if they think controls are lax.
- 🕒 **Savings from early payment discounts:** When suppliers offer discounts for payment before the standard due date, that can be a valuable way to reduce the effective cost of the things you buy. In some cases, you may even be able to suggest such discounts with companies that don't typically offer them.

What to look for – key indicators

- ④ **A high percentage of invoices that arrive without a corresponding PO#:** The more research it takes to verify an invoice, the more likely it is that it will be paid without positive verification.
- ④ **Reliance on manual invoice matching:** Even when the purchase order (PO) is properly referenced, the job of visually matching the details of hundreds of invoices to paper/image copies of the PO can be mind-numbing. On a busy day, it's only natural that people may do only a cursory check.
- ④ **High discounts lost:** If it takes too long to register, validate, and authorise invoices for payment, discounts are probably being lost unnecessarily.

How to improve

- ④ **Capture PO information for as many purchases as possible:** Obviously, the most important tool for ensuring an effective payment process is to capture purchase order (PO) details in the upstream purchasing process so they can be matched against the invoice when it arrives. That means insisting that employees get a PO number before ordering, and that suppliers reference the PO on their invoices.
- ④ **Establish matching tolerances:** Very small discrepancies between an invoice and PO (e.g. less than 1% value on a line item) may not be worth the time and manpower to investigate. Tolerances will make it practical to pursue all important discrepancies by eliminating time spent on unimportant ones.
- ④ **Rigorously resolve all important discrepancies:** For invoices with a PO#, this means going to the originator to find out which is right based on what they ordered and received. For invoices with no PO#, this will require first figuring out who placed the order – not always an easy task.

- ④ **Minimise the elapsed time for payment authorisation:** This is important for many reasons, one of which is to be in a position to leverage early payment discounts. A long average lead time between invoice receipt and posting is also an indicator of inefficiencies, but we'll address that with the final question.

The value of an effective Purchase-to-Pay system

- ④ **Make it easy to capture all PO details:** Because a good P2P system captures information electronically throughout the lifecycle of a purchase, purchase order information is available for matching to the invoice without the need for extra data entry; and certainly without the need for problematic paper files.
- ④ **Automate the matching process:** With all the right information about the purchase captured and available, the Accounts Payable department need only register the invoice – the information will automatically be matched against the PO (and receiving information when appropriate). Valid invoices will be automatically authorised and discrepant invoices put on hold. Tolerances can be easily set to filter out trivial mismatches.
- ④ **Speed resolution of discrepancies:** For invoices that don't match the PO, a good P2P system will provide an electronic troubleshooting process enabling AP to quickly route it to the originator for resolution.
- ④ **Accelerate the overall process:** By eliminating much of the paper shuffling, automating time-consuming processes, and leveraging electronic communications, a good P2P system can dramatically reduce the elapsed time between invoice receipt and posting while at the same time improving validation controls. Among other benefits, this can enable your company to take advantage of all available early payment discounts, and maybe even negotiate such discounts with more suppliers.

Q5. Are we as efficient as we can be?

This may be the key question - your organisation may have good purchase authorisation and payment controls in place today, but at what cost?



How much time and effort does the current process take? How much manpower is really involved in a typical purchase transaction? How much time does it take an employee to buy something in order to do their job? How much time do managers spend reviewing and authorising requests while trying to make sure they stay on budget? How much time do professional buyers spend on purchases that don't really need their expertise? How much time do Accounts Payable (AP) clerks spend every day tracking down information to verify the accuracy of invoices?

The P2P cycle is the ultimate case of a business process with a delicate balance between the need for controls and the time required to follow them. When the effort to comply becomes too great, it's amazing how inventive people can become in finding ways to work around the process. Once that starts happening, an organisation has the worst of all worlds.

Why it's important

- 🕒 **Organisation-wide productivity:** No matter what business you're in, high productivity throughout your organisation is key to success. If employees must take a lot of time to get the goods and services they need to do their jobs - e.g. find the right source, create a request, chase their manager for approval, respond to AP to authorise invoice payment - that takes time away from their real job. If line employees spend even a small percentage of their time in such non value-adding activities, that can be a lot of lost productivity. No organisation can afford that.
- 🕒 **Cost of compliance:** Another way to look at the same issue is the cost of each purchase transaction. The more time it takes from employees and managers, the higher the transaction cost that is really being added to the direct cost of each purchase.
- 🕒 **Cost of Accounts Payable:** Payment controls are essential, but the cost of the Accounts Payable (AP) function deducts directly from your organisation's bottom line. A people-intensive, paper-intensive AP process is almost certainly costing your organisation more than it needs to.
- 🕒 **Cost of inconsistent compliance:** If the "proper" buying process is cumbersome and time-consuming, some employees will skip it entirely and go around the controls you've worked so hard to put in place. That, of course, leads to all the problems discussed in the previous questions.

What to look for – key indicators

- 🕒 **Paper:** Is there a lot of paper (or even a lot of standalone electronic forms that don't populate a database) involved in your current procedure? Are forms often being lost, causing people to spend a lot of time chasing them or re-creating them?
- 🕒 **People:** Are there people in your organisation for whom a noticeable portion of their time is spent "buying things for people"? (i.e. administrative assistants or buyers placing orders for things that are really not that specialised).
- 🕒 **Frustration:** Do employees express frustration with how hard it is to get what they need to do their jobs? Or how long it takes? Do managers express frustration with the effort required to keep up with purchase approvals, or to really know what it is they are being asked to approve, or to figure out where they really stand with their budgets? Are a lot of purchases still taking place outside the proper process even though it's well defined? Does that indicate the process may be onerous and the frustration with it has just become too great?
- 🕒 **Lead time for invoice posting:** What is the average elapsed time between when an invoice is received and when it is authorised for payment? For many invoices, more than a couple days probably indicates inefficiencies. You also may want to track the percentage posted in "x" days of receipt.
- 🕒 **Invoices processed per AP employee:** On average how many invoices are processed per month per Account Payable FTE (Full Time Equivalent)? Less than 50 probably indicates an opportunity for improvement, though this can vary by organisation. You can also do a quick calculation of average AP cost per invoice this way.
- 🕒 **Number of supplier inquiries per month:** A high number of supplier calls probably indicates a high number of late or incorrect payments. This, too, is adding to the actual cost per invoice, and therefore per purchase.

How to improve

Obviously, the only way to improve is to streamline the process without giving up the necessary controls. That leads us to the value of a good P2P system...

The value of an effective P2P system

- 🕒 **Lower cost per transaction:** A good P2P system reduces the time spent by employees, managers and Accounts Payable (AP) personnel on just about every purchase. That reduces both the productivity loss and direct cost of each transaction. It provides an easy, intuitive way for employees to request or buy the things they need to do their jobs. The system guides them through the process without the need to spend time looking up the policies, forms, etc. It enables more direct ordering by employees, reducing the overhead of administrative help for many types of items.
- 🕒 **Accelerated buying process:** With a good P2P system, everything happens more quickly because it uses electronic records and communications instead of paper. There is no time required for physical movement of paper. Managers have immediate access to all the information they need about budgets and commitments in order to make an authorisation decision. AP has PO information at hand as soon as invoices arrive. The speed and visibility of the entire process eliminates frustration and makes it easy for everyone to comply with the organisation's policies and procedures.
- 🕒 **Dramatically streamlined AP:** With a good Purchase-to-Pay (P2P) system, much of the invoice review process is automated. Many invoices flow through to posting "untouched by human hands" while their correctness is thoroughly verified using automated matching. Far fewer invoices arrive without Purchase Order (PO) numbers since most purchases are the result of a PO produced by the system. When discrepancies are identified, it provides email-based workflow so the originator can resolve issues quickly. The invoice registration process can be dramatically accelerated with tools such as OCR (Optical Character Recognition) and electronic invoices. A P2P system can even provide a supplier portal for self-service supplier status inquiries, and more. The cost savings opportunity is clear.

Summary

As you ask these five key questions, generate dialogue, and get a clearer picture of how your organisation really buys and pays for things today, it is likely that you will become aware of one or more situations:

- ④ You may find that you need to establish and communicate more complete policies and procedures for purchase authorisations, and for buying from preferred suppliers.
- ④ Even if your policies are clear and complete, you may find that people are not following them because they are not fully aware of them, or because they are just too onerous.
- ④ You may find that your Accounts Payable (AP) department has an impossible task, trying to somehow identify the originator of invoices and determine their validity with little to go on when the invoices show up. Some people refer to this as performing "spent control" after the fact rather than the preferred "spend control" at the front end of the process.
- ④ Or... you may find that all the controls are, in fact, in place; but that the time it takes to comply with them is hurting your organisation's agility, or that the manpower requirements and lost productivity are costing your organisation much more than it should.

Most organisations will find all these issues to various degrees.

It takes People, Processes, and Systems

As you discuss ways of streamlining the Purchase-to-Pay cycle, it will quickly become clear that it's all about creating a culture of cost consciousness and the need to follow the right procedures. And that the only way you can do that is to make it easy for everyone involved. And, furthermore, that the best way to do that is almost certainly to utilise technology.

A good Purchase-to-Pay system addresses virtually all of the issues you uncover in an integrated fashion, that's why so many companies are turning to them.

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Notes



