CFO

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PROCURE-TO-PAY

The CFO's Ultimate Benchmarking Guide to the P2P Process

PROCUREMENT, ACCOUNTS PAYABLE, AND PAYMENTS ALL NEED TO RUN AT PEAK EFFICIENCY

INTRODUCTION

Is your company doing all that it can to streamline the procure-to-pay (P2P) process so that you can be the best in your industry? Or, like many organizations, do you need help identifying areas where you can make improvements? Savvy CFOs ensure that the finance and procurement teams are working in synch to ensure the P2P process is a profit center.

While the P2P process hasn't always been front-and-center for finance chiefs, there is a clear argument that they should be paying closer attention to the performance of this critical function. When procurement, accounts payable, and payments are automated, it takes a heavy burden off of the finance team and enables them to dedicate their time and talent to value-added activities, such as identifying areas for growth and performing in-depth data analysis.

The challenge is that many companies simply plug away using the same old manual, unconnected systems that they've had for decades. The consequence is a lack of visibility into the costs and resources being dedicated to P2P systems. The adage "you can't

improve what you don't measure" has particular relevance to the P2P process. When your P2P process is streamlined, the organization is taking advantage of all discounts, purchase orders and payments are handled with fewer exceptions, and vendors are paid on time.

This white paper will recommend ways to benchmark your company's P2P process. By quantifying the state of your procurement, accounts payable/vendor management, and payments function, you can better strategize future growth.

- **Procurement:** The big issues here are capturing early-payment discounts and reducing labor and processing costs. Metrics such as the **total number of suppliers,** the **number of vendors per category, return on indirect procurement investment,** and **procurement costs as a percentage of total indirect spend** are key indicators of how your purchasing function is performing. A large amount of dark purchasing — items that fall outside of standardized purchasing processes — can be a key contributor to poor performance.

- **Accounts payable/Vendor management:** Metrics such as **total cost of processing an invoice, procurement cost as a percent of total of indirect spend, total contract renewal rates,** and **volume rebates captured** are critical to track. By consolidating vendors across the organization, companies can also achieve better pricing due to economies of scale.

- **Payments:** An important number here is the **number of invoices being processed electronically.** It is also critical to examine the **median transaction costs for each type of payment,** the **cost of checks versus electronic payments,** and the **ability to capture early-payment discounts.**

Procurement Sets the Tone for P2P Efficiency

The first "P" in the P2P process is procurement, and a company's purchasing strategy and processes have a significant impact on efficiency and sustainability down the line.

"If you don't have cohesion in the buying process from the beginning, including prior to when the actual purchase is made, things will not flow smoothly," said Matt Clark, Chief Operating Officer, Corcentric, a leading provider of procurement and finance solutions.

One clear sign that your procurement process is in need of an overhaul is if negotiations are based strictly on price, and do not address terms such as discounts for early payments that will generate working capital. In essence, you are not taking advantage of a valuable negotiated term of the contract that is independent of price. "As each day passes, convergence of procurement and accounts payable becomes more pronounced. They have to be working hand in glove," adds Clark.

One of the most important benchmarks is the number of suppliers. Companies should try to reduce the vendor pool as much as possible and coordinate their purchasing power among divisions and offices.

"You want to look at how many suppliers your company has per million dollars of spend and continuously look for ways to reduce that number," said Amy Fong, Senior Advisor for The Hackett Group's

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Procurement Executive Advisory Program and Program Leader for the consultancy's Purchase to Pay Advisory Program.

According to The Hackett Group's report, *The Benefits of Supplier Consolidation Extend Far Beyond Sourcing Savings*, reducing suppliers contributes a 3.35 percent cost reduction for indirect spend and a 9.18 percent reduction for general equipment and supplies in the top quartile of companies observed. Added buying power and lower average shipping costs are two key components of these savings.

Respondents to the *2016 Indirect Spend Benchmarking Study* reported an average of three active suppliers per million dollars of direct spend. In addition, 89 percent noted that supplier consolidation was among the top three initiatives they were undertaking to create value.

Finance executives also want to look at how much spend is concentrated among top suppliers, and how many suppliers are supplying the same or similar items. "If your spending is spread out among a lot of suppliers and you don't have a high concentration of transactions with a group of preferred vendors, that can be a sign that your procurement process is not well managed," Fong said.

There should also be a high rate of purchases made through preferred suppliers through approved purchasing channels. Of course, there will be a need from time to time to make one-off purchases that fall outside of the company's policies for capital outlay, but those should be limited.

Companies can save up to 25 percent by eliminating dark purchasing with tools to improve control and visibility, according to a September 2016 report from *Supply Chain Quarterly.*

Taming the Tail-spend Beast, a report by Accenture, noted that indirect spend is more susceptible to dark purchasing. Although it accounts for 20 percent of spend, indirect spend lacks the controls associated with direct spend, the report noted.

Accounts Payable/ Vendor Management Key to P2P Success

Working smarter with fewer suppliers actually is the largest source of savings and accounts payable efficiency, according to The Hackett Group report. The cost to maintain each supplier relationship was between $700 and $1,400, including sourcing the supplier and setting up internal systems.

If there is a high percentage of invoices being processed manually, that is a clear indicator that the process needs to be reviewed. While non-automated companies report purchasing costs of $18 per purchase order, highly automated companies have reduced their purchasing costs to less than $5 per purchase order, according to The Hackett Group.

The time to process an invoice is also an important metric, and there is a significant gap between companies that process invoices manually and those that leverage automation. Best-in-class organizations with fully automated processes take an average of 3.9 days to process an invoice, compared to 17.1 days for manual processing, according to *ePayables 2016: Eyes on the Prize,* a report from consultancy Ardent Partners.

It is important to take a look at how long it takes to prepare an invoice to be paid, said Christopher Good, Managing Director, Conway MacKenzie, a financial and operational management consulting firm. "You want to be efficient so that you don't miss capturing the discounts for early payments, but you don't want to pay too early. The ideal is to pay in a time frame that doesn't impact the relationship with the supplier or increase what they charge for their goods or services."

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Ensuring a Smooth Payment Process Through Automation

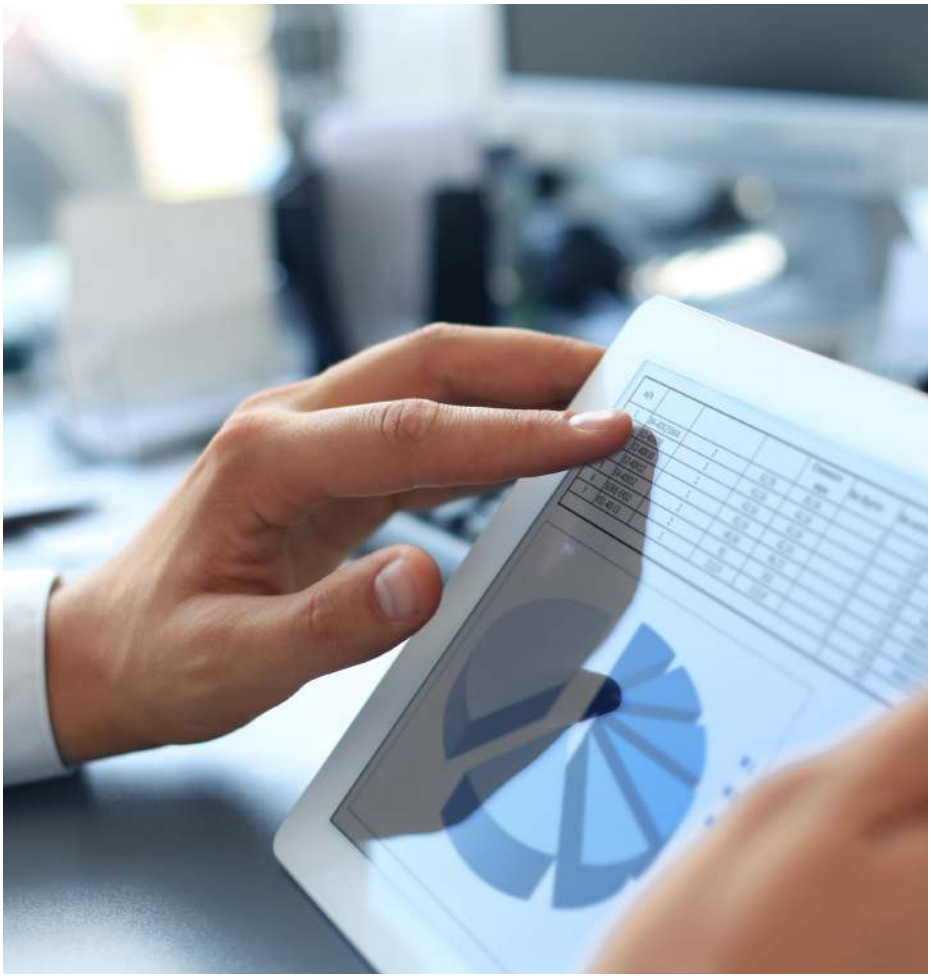
Timely payments are key to ensuring that things don't break down in the "last mile" of the P2P process. It is critical that the payment leg of P2P be as efficient as possible, or supplier relationships will deteriorate and discounts for early payments will be missed.

Progressive companies want to automate as much of the process as possible. APQC's survey found that at the median, 58 percent of invoices are still manually keyed in to the financial system. Top-quartile performers have pushed that percentage down to 42 percent or fewer, while the lowest performers are at 77 percent or more.

A key concern here for the CFO is to ensure that the company is maximizing working capital. Companies need to analyze the payment process to identify issues such as unrealized discounts through late payments of invoices. But they also want to hold on to their cash as long as possible while still paying on schedule to receive negotiated discounts.

According to The Hackett Group's *2015 Purchase to Performance Study*, top performers make 90 percent of their payments on time, enabling them to meet contractual obligations and capture available discounts.

Top performers also have a high match rate between invoices and payments. According to The Hackett Group's research, top performers have a 90 percent first-pass match rate compared to 73 percent for their peers. Automation clearly makes the payment process faster and more accurate.



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The method of payment also matters in terms of efficiency and control. Progressive companies are migrating the bulk of their payments from check to electronic payments. A recent Association of Financial Professionals (AFP) *Benchmarking Survey* found that 59 percent of payments today are initiated electronically. As further evidence of the move to electronic payments, the Federal Reserve reported that check payments decreased by 2.3 billion between 2012 to 2015. The reasons for the shift include greater efficiency, more manual processes, improved security, and greater control over the timing of payments.

The AFP report noted that the average company spends nearly $85,000 a year manually processing payments, with most of those costs associated with checks. Checks cost an average of $3 to process, compared to $0.56 per ACH transaction and no cost for payments for virtual cards.

Automation provides a platform for growth, and companies should also be looking at how many payments they are able to process per full-time staffer per month and seek ways to process more payments with the same number of people. "You want to be able to scale the business without adding staff," Corcentric's Clark said.

CONCLUSION

CFOs Hold the Keys to Improving the P2P Processes

Wrangling the P2P process can be challenging, but modern CFOs realize that solid procurement, accounts payable, and payment processes are essential to business success. If you can't perform these functions well, growth is stymied and people are stuck managing routine tasks at the expense of more value-added work.

One challenge is that there are so many departments, far-flung offices and stakeholders—internal and external—that the process becomes unwieldy unless the finance chief is able to bring order to the process.

Another issue is that too many purchases still take place under the radar, through one-off deals with unapproved vendors and no contract management oversight.

As business performance leaders and managers of risk, finance chiefs need to keep a close eye on how their P2P process stacks up against their peers.

By centralizing, streamlining, and automating the process from beginning to end, companies can turn this essential function from a cost center to a profit producer.

Key takeaways:

- If your procurement strategy isn't agile and streamlined, you're going to fall behind the curve. If you're not keeping a tight rein on the number of suppliers, for example, things can spiral out of control quickly.
- Consolidate spend among top vendors and take advantage of the full purchasing power of your organization to become a top performer.
- If the process falls apart in the payment cycle, you run the risk of missing negotiated discounts for early payment and losing the trust of suppliers who expect on-time payments.

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