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Defeating Dark Purchasing

Take back control with a strategic, digital approach to procurement.

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Eliminating dark purchasing can lead to savings of up to 25 percent.

SOURCE: Supply Chain Quarterly, September 2016.

THERE IS A LARGE discrepancy among today's business organizations between what they think they spend within the procurement function and what they actually spend. This shadowy area where items purchased cannot be easily justified by capital outlay or by material inventory is known as dark purchasing. The ubiquitous loss of revenue and control that occurs as a result of dark purchasing is a systemic challenge for companies of all sizes.

Companies can eradicate dark purchasing by taking steps toward control and visibility. A digital solution for the procure-to-pay process streamlines, accelerates, and exposes each task of the procurement journey, all the way through payments. E-procurement is an area that increasingly is being recognized by all internal departments of an organization as

crucial to not only creating greater efficiencies in their business, but also intrinsic in maintaining good relationships with suppliers and customers.

The time is ripe for organizations to integrate their supplier networks, control spend, track cash flow, and create a healthy environment for ongoing growth. However, the continuing reliance on manual processes, fragmentation in procurement functions, and confusion about who does what and how they do it means that businesses are forgoing tremendous opportunities to control spend and accelerate growth. For these reasons, dark purchasing is, unfortunately, a fact of life for too many organizations. This paper will address the lurking menace of dark purchasing: where it exists; why it flourishes; and how to defeat it.

Understanding the Dark Areas in Procurement

Purchasing is a necessary part of any business. But when an organization hasn't implemented a uniform method of procurement, or when that method is inadequate, the organization becomes vulnerable to leakage of revenue, inadequate tracking of both invoices and payments, delays in payments, missed opportunities for rebates and for growth, and outright theft. These are the dark areas in procurement. As an example of the revenue at

stake, a 2015 IOFM study found that 21 percent of companies lost at least \$250,000 per year in invoice disputes and other payment disagreements.¹

Expenses related to procurement have a direct impact on a company's bottom line. The more a procurement department spends, the less capital is available for the rest of the company to utilize. By maximizing value in every transaction, the company will save money and positively influence its bottom line. Despite the seemingly obvious value in identifying and regulating

expenditures for both direct and indirect spend, many companies continue to rely on manual processes to manage the procurement cycle, especially in the steps from invoicing to payments. Indirect spend alone can make up to 20 percent of total company spend. When dark purchasing is eliminated from that spend, it can lead to savings up to 25 percent.²

When asked by PayStream Advisors whether their organization uses an e-procurement solution, a shocking 66 percent of respondents said no.³

Accordingly, these same respondents reported that they experienced problems caused by manual processes. During the invoicing process, they experienced high processing costs and delays, missing invoices, sluggish approval cycles, lost discounts, and unhappy vendors. Similarly in procurement, it's much of the same, with additional challenges related to poor or declining supplier relationships, which included poor supplier dispute times, late payments, and poor data management. All of these factors create an environment in which the flow of capital becomes difficult to track.

Perceptions of Procurement

Dark purchasing occurs when expenses are incurred outside of a company's established procurement practice – often to unapproved vendors, resulting in redundant or unnecessary purchases. How does this happen? AmeriQuest Business Services (AQ) conducted a survey of 2,000 key people involved in their organizations' procurement process and found that respondents are confused by the procurement process at their organizations. **[See AQ Procurement Survey Results on next page.]**

More than a third of respondents were unsure how procurement is viewed within their company, and nearly one in five said it has no visibility within the company. Despite the fact that all those surveyed were somehow involved in their company's procurement activities, 15 percent said they didn't know which department manages procurement. Nearly a quarter said that the procurement function belonged to the finance department; 22 percent said the operations department; and seven percent said IT.

The good news is that about two-thirds of respondents to the AQ survey report that they do not feel frustrated at all when they have to make purchases for their company. However, dark purchasing exists because companies aren't necessarily aware of it, presenting the possible explanation for the high level of complacency in procurement as cases of "ignorance is bliss." Supporting this concept is the statistic that more than 40 percent of respondents to the AQ Procurement Survey reported that they either don't have a procurement process in place, are not sure, or do have one but it's not followed. This disconnect potentially implies that procurement professionals at many organizations are comfortable (i.e., not frustrated) with how things are currently done but not that the process is the most efficient.

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Dark purchasing depends on non-standardized processes and human error.

A complicating factor to a globally consistent understanding of organizational procurement is that the function of purchasing varies among types of industries. In the professional services for example, PayStream Advisors found that 71 percent of organizations surveyed operated without an e-procurement solution.⁴ This dearth of procurement automation can be attributed to the size of the professional services companies: many surveyed report a revenue of less than \$100 million. Their processes typically are not standardized because they don't have an expectation of either ROI or scalability of a solution to their specific needs. These perceptions are inaccurate and contribute to fertile ground for sowing dark purchasing.

In professional services, as in all other industries, including healthcare, education, manufacturing, and retail, the primary stumbling blocks to procurement automation adoption

AQ PROCUREMENT SURVEY RESULTS

20.4%

respondents had no procurement process in place.

13.3%

had no idea if their company did, or did not, have a procurement process in place.

1/3+

are unsure as to how procurement is viewed within their company and nearly 1/5 said it has no visibility within their company.

25%

noted that procurement is simply seen as a function of accounts receivable/accounts payable.

25%

said they order supplies on their own and then file expense reports.

15%

didn't know which department managed their company's procurement, even though they were directly involved in the process reports.

are often related to inaccurate perceptions, including that current processes work best, that automation will not deliver ROI, and that business process re-engineering is too difficult.

Over half of respondents to the AQ Procurement Survey acknowledged that they purchase supplies for their organization on their own, either through approved vendors or by buying and then filing an expense report. This "non-PO practice" is where dark purchasing dwells. Perhaps even more alarming is the finding that the more a procurement professional makes, the more likely they are to order supplies on their own and then file an expense report, rather than using an online system to order with approved vendors. Less than a quarter of the respondents to the AQ Procurement Survey indicated that procurement was viewed as a strategic business partner.

According to the survey, 43.5 percent of people making between \$100,000 and \$149,000 used an online system with approved vendors. Meanwhile, 40 percent of people making over \$150,000 bypassed the approved vendor process. Ironically, this stat dips into the supposition that executive-level purchasers are less compliant with company protocol

for making purchases than are management-level employees.

Knowledge as a Weapon Against Dark Purchasing

The data from the AQ Procurement Survey illustrate the importance of having an experienced procurement department that centralizes all purchasing functions. Even smaller companies may not realize they can benefit from pooling strategies or group purchasing rates that typically benefit larger corporations, if they don't have an experienced procurement department executing their deals. The misconception is that indirect spend is negligible and not important to the overall mission of the company.

One of the first steps companies can take to fight dark purchasing is to clearly identify and assign procurement responsibilities within an organization. Internal stakeholders and particularly C-suite executives need to buy into the importance of a transparent procurement process. Additionally, they need to have access to the tools and training that connect them to the same network that all procurement officials use.

A lack of knowledge about how procurement works within a

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66 percent of organizations do not use an e-procurement solution.

SOURCE: APQC, Open Standards Benchmarking Survey on Accounts Payable and Expense Reimbursement

company leads to a lack of control. And if control is the goal for reducing or eliminating dark purchasing, then knowledge is indeed power. Most organizations across multiple industries recognize that automating procurement is the pathway to knowledge, both about what is spent and where it's spent.

When administrative and executive players in organizations across industries were asked about the factors driving them to consider

procurement automation, they were very clear: 83 percent want to streamline requisition and procurement processes; 58 percent want better visibility and transparency across procurement; 42 percent want improved control and security; and 33 percent want cost control over maverick spend, i.e. dark purchasing.⁵

CFOs are better able to manage their working capital once they improve the performance of their financial processes through automation. According to the CFO's Guide to Automating Accounts Receivable, "Automated solutions can accelerate payments, shrink DSO [days sales outstanding], reduce bad debt, and even remove credit default risk." CFOs also know that the lack of automation steals time they don't have. Regardless of company size, most finance teams spend nearly half their time (49 percent) on transaction processing, according to APQC.⁶

While the AQ Procurement Survey found that 57.9 percent of companies have a procurement process that works well, the delivery of an effective process is too often contingent on time. Meanwhile, like a perfect storm of events, the greatest pressure on financial and accounting teams is the demand for timely information. Procurement departments may not always give finance ample time to evaluate and approve purchases. According to research by the Aberdeen Group, "Procure-to-Pay and B2B Integration: Leveraging Synergies," 69 percent of information required in supply chains is needed within a day, and 40 percent is needed within one hour.⁷

Environments that Collude with Dark Purchasing

Dark purchasing depends, among other things, on non-standardized processes and human error. Optimal management of direct spend is directly

REASONS FOR DARK PURCHASING

DECENTRALIZATION

A primary culprit is the lingering manual processing and decentralized workflow. While strategic planning and budget forecasting are among the top priorities for senior finance executives to regain control, they are not always able to follow through. According to IOFM's 2015 Accounts Payable Automation Survey, nearly 30 percent of accounts payable departments are either partially or completely decentralized.

MANUAL PROCESSES

Manual processes hobble an organization's ability to control processes and manage data securely. In addition, high processing costs create a cycle of revenue depletion. Part of the issue can be attributed to the fact that 58 percent of invoices are still manually keyed into the financial system.* [APQC, Open Standards Benchmarking Survey on Accounts Payable and Expense Reimbursement] Upwards of 66 percent of organizations do not use an e-procurement solution.³

CONFUSION AROUND PROCUREMENT

Too often, those who are directly involved in their company's procurement process either have no process in place, don't know if there is a process in place, or don't know which department manages their company's procurement process—this is according to more than half of respondents to the AQ Procurement Survey.

related to the fact that expenditures on goods and services are generally incorporated into the product being manufactured. Direct spend benefits from being centralized within the procurement department itself, with controls in place that ensure accurate accruals and well-managed cash flow. However, indirect spend is often decentralized and managed in functional areas or business units of the enterprise, raising the specter of rogue or maverick spend, which can plunge the entire process into darkness.

A report by Accenture found that a billion-dollar company will waste about \$15 million annually due to a lack of control.⁸ Indirect spend is more susceptible to dark purchasing because, while it accounts for 20

percent of spend, indirect purchases typically involve 80 percent of all suppliers. Meanwhile, direct spend has a built-in control of accounting for 80 percent of spend, but involving 20 percent of suppliers. This 80/20 split points to the greater difficulty in managing indirect spend. Even though it's not reaping revenue, indirect spend is actually depleting revenue. Every procurement dollar in indirect spend that is brought under management represents savings of 10 percent to 20 percent.⁹

The other big factor in dark purchasing is human error, which is vastly more likely due to existing manual processes, no matter how effective they seem to be. But organizations often stop at automating accounts payable or go as far as emailing invoices, but don't

take advantage of the full-spectrum of automation tools, which are now available as a holistic approach to the entire P2P process.

As an example of this technology disconnect, straight-through processing, which can be accomplished with virtually no human intervention, occurs in only about 13 percent of companies surveyed by IOFM.¹⁰ In addition, the sheer number of remittances processed each month—Aite Group estimates that corporate America generates 15.5 billion remittances each month—coupled with delivery via non-automated channels like email, free-form document, fax, or phone, presents a mind-boggling struggle to reconcile invoices with payments and data with analysis.¹¹

SOLUTIONS TO DARK PURCHASING

AUTOMATE

End-to-end payables automation is the application of technology to optimize the flow of invoices through businesses in order to achieve documented results of 70% faster processing of invoices; 80% reduction in cost to process invoices; and 100% of payment disbursements handled.¹³ An automated solution additionally provides 100% visibility with access to analytics that help to transform AP into a revenue center.

CENTRALIZE

A centralized, cloud-based platform presents the opportunity to take much of the friction and work out of the traditional paper-based purchasing (from whence dark purchasing arises) by linking purchasing and accounts payable to a unified system

EDUCATE

A knowledgeable and experienced procurement department not only can streamline the purchasing process but also can identify and improve important functions like group purchasing rates, pooling strategies, and infrastructure technology. And then communicate and train the organization on procurement policies and strategies.

NOTES

1. CFO: The CFO's Guide to Automating Accounts Receivable, p 3.
2. Avery, Susan. CSCMP's Supply Chain Quarterly, September 16, 2016.
3. PayStream Advisors: 2016 P2P for indirect Spend Report, figure 1.

4. PayStream Advisors: 2016 Purchase-to-Pay for Professional Services Report.
5. PayStream Advisors: 2015 Spend Management Report.
6. IOFM: The State of Procure-to-Pay in 2016.
7. Aberdeen Group. Procure-to-Pay and B2B Integration: Leveraging Synergies, September 2014.
8. "Taming the Tail-spend Beast." Accenture, 2015.
9. "Getting a Grip on Tail Spend." Accenture, 2014.

10. IOFM: 2015 AR Automation Study.
11. IOFM: Transforming Accounts Receivable Processes to Speed the Revenue Cycle, page 4.
12. Peterson, Reginald PhD. "Batting Dark Purchasing: Why Transparency in Procurement is Critical."
13. Corcentric. Definitive Guide for AP Automation, 2016.

Purchasing slides into the shadows when there is no consistent and quantifiable way to track invoices and payments. Too often, purchasing is made on an as-needed basis, and unless a system is already in place to support both direct and indirect purchases, the optimization of cash flow and strategy development remains an elusive achievement. Instant access to the information needed, as well as its location in one central area, is crucial to accurate spend analysis.

Defeat Dark Purchasing

The most comprehensive automation solution will integrate with an existing system, while offering agility and scalability that is tailored to the company's current processes and potential growth. According to research from Gartner, 2016 Strategic Roadmap for Source-to-Settle Suites, "Many procurement and sourcing suites are combinations of separately

acquired, distinct modules that were originally designed as stand-alone solutions. The idea of a suite is more recent, and integrations do not always meet expectations." As noted in The CFO's Guide to Automating Accounts Receivable [2016], "A common mistake that a company can make when trying to improve its financial processes is adopting the easiest solution rather than one that adds value for customers."

Collaboration is the key to a successful spend management program and another benefit of a centralized digital solution. Finance, accounting, procurement, and IT teams are finding that the bigger business gets and the larger their global marketplace grows, the less likely they are to be able to keep track of it all. Cost control and supplier negotiations are the top procurement improvement goals for organizations surveyed by PayStream Advisors.³ The best way to achieve those goals is to ensure that

procurement and AP become strategic partners. The good will and trust that is cemented between vendors and customers due to everyone having access to verifiable information at any time means fewer disputes, faster payments, and greater potential for captured discounts.¹²

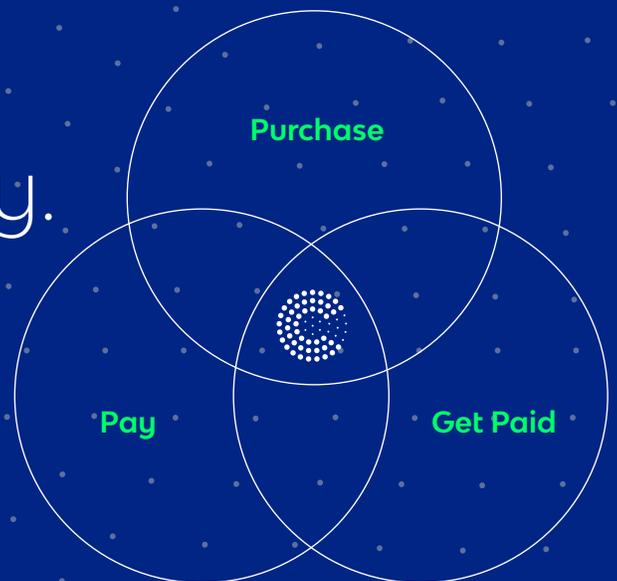
Digitizing the procurement process for an enterprise may seem daunting, but it is the most effective way to ensure spend stays on track. When manual processes are eliminated and a digital strategy implemented, organizations are able to centralize control over all company spend, validate pricing and terms, and attain full visibility into all purchase transactions. The battle can be won: An end-to-end payables automation solution that is integrated across the enterprise is the most effective way to defeat dark purchasing and potentially save millions each year.

If you suspect dark purchasing is lurking in your spend, we'll help you shed a light on it.

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Spend smarter,
optimize cash flow,
and drive profitability.

Corcentric is a leading provider of procurement and finance solutions. We help companies reduce costs and improve working capital by optimizing the way they purchase, pay, and get paid.



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