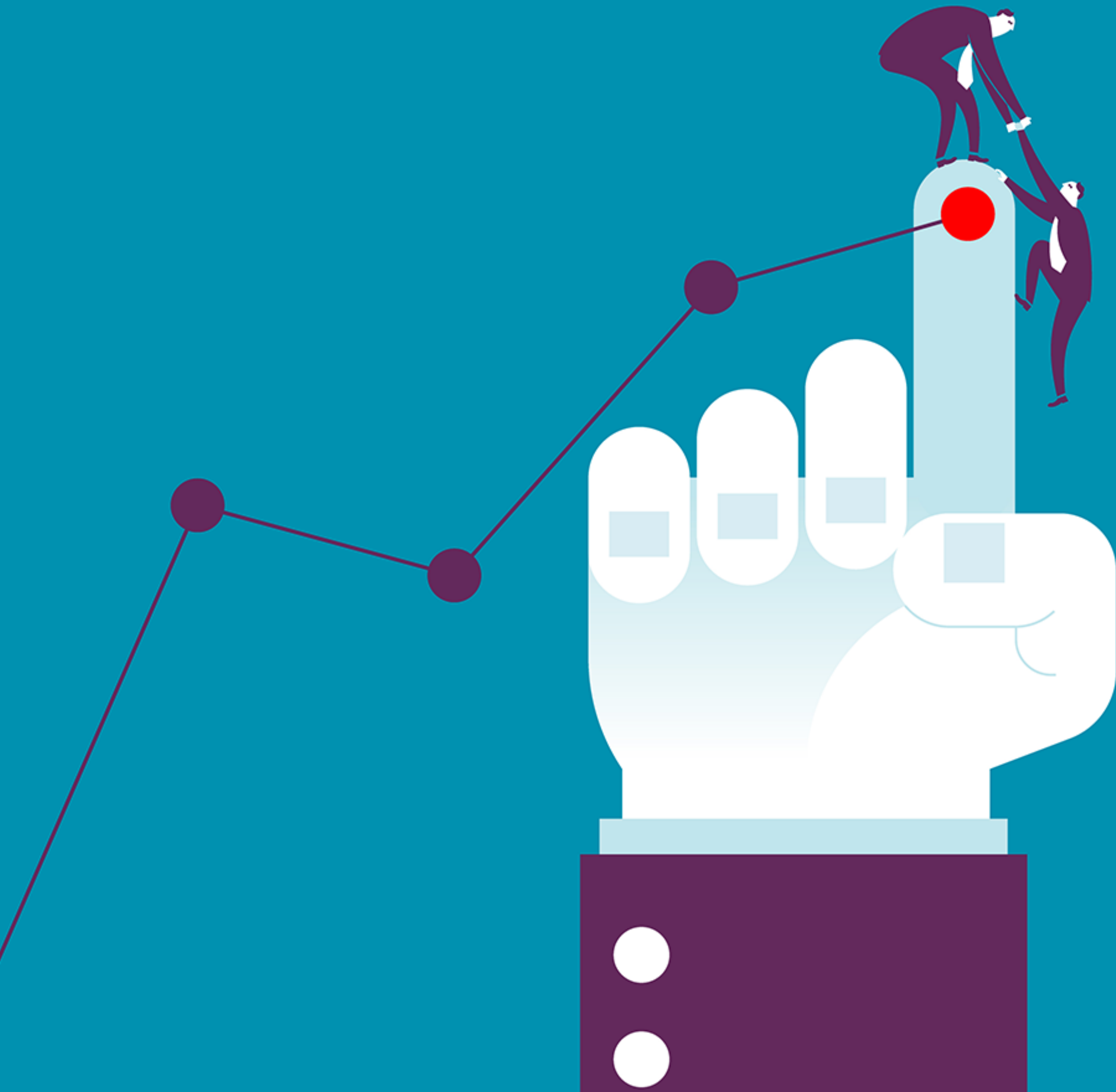

The Purchase-to-Pay Partnership

How applying an integrated approach can contribute to a successful P2P implementation

A Purchasing Insight publication sponsored by Canon

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Executive Summary

Purchase to Pay means different things to different people. Finance and procurement people see P2P from different perspectives and they don't always see things the same. But there is one thing they both agree on: the implementation of purchase to pay best practice is best done with cooperation from both the finance and procurement communities.

It may appear obvious but it is not always possible for finance and procurement to work collaboratively – they work in very different world and have fundamentally different cultures. The barriers need to be broken down and each community needs to have an appreciation of the other and work in partnership.

This paper discusses the challenges of implementing improvement in purchase to pay and how the different stakeholders can work together for mutual benefit.

What is P2P?

Purchase to pay is essentially about the management and optimization of a chain of events within a business. It links people, processes and technology in an often complex network of interlinked components. It includes requisition and approval of business processes, ordering and fulfillment, payment and dispute resolution, accounting, cash and asset management as well as logistics. It relies on robust data and technology to support it and most important of all, it requires overall governance that recognizes that P2P doesn't start and end within purchasing or accounts payable but that it spans the organization and beyond. The suppliers' sales order process is a key component as are the strategies and technologies deployed across the supply chain.

Figure 1 Advantages of Purchase-to-Pay automation

Purchase-to-Pay is the process that structures the communication and approval processes around non-production purchases within organizations.
An optimal cooperation between purchasing and finance departments leads to improved control, predictability, security, compliance and cost reduction of both the purchase department as well as the accounts payable department. (See Figure 1)

Figure 2 Key process steps in Purchase-to-Pay

An optimal P2P process aligns the procurement strategy with the organizations financial guidelines. Implementing the P2P process covers the 5 basic steps as drawn in Figure 2.
Supplier selection: For all strategic, tactical and even operational suppliers a purchase contract is agreed which aligns with the strategic procurement plan. All contractual details like product portfolio, purchase price, standard discounts, delivery times, service delivery, etc are secured in an automated system.
Purchase request: Individual employees who require the purchase of non-production goods or services are forced to generate a purchase requisition. This employee bases his requisition on the standard portfolio as agreed in the purchasing contracts. An approval process, based on the company mandate structure, automatically executes. The

purchaser processes the approved purchase by forwarding the PO to the supplier.
When the delivered goods or services and the invoice are received, the system automatically creates a booking and integrity check.
Automated two or three-way matching reduces workload at the AP department since only discrepancies need attention of a controller. The cost can be allocated against the correct GL accounts to give full control over the outstanding payment obligations.
After automatic processing the booking of the invoice will be paid.
Intuitive dashboards inform each process owner on his personal KPIs to optimize his work.

P2P from different points of view

There are many varied perspectives on P2P and like many other business processes it appears different depending on the perspective taken.

The finance-centric view

When it's owned by finance, P2P is seen as a means of imposing control. The business needs to ensure that proper processes are in place to ensure that purchase orders (POs) are properly authorized, that proper segregation of duties are in place and that capital and operational expenditure are properly differentiated. Finance seeks to optimize DPO (days payable outstanding) in order to ensure that the organization holds on to cash for as long as possible. Above all, finance wants to ensure that there are no anomalies that will make the job of accounting difficult.

The procurement-centric view

The purpose of P2P is the same when it is managed in the procurement organization however the emphasis is different. There is more focus on building and maintaining processes that reduce cost and ensure that the goods and services are delivered to the business accurately and in a timely fashion. Accuracy of catalogue data and order functionality are higher on the agenda and the importance of prompt payment to maintain good supplier relationships is seen as more important than management of DPO.

Purchase to pay from a purchasing point of view is about two things: process and compliance. That is, ensuring that an appropriate and efficient process is in place to allow the organization to purchase the goods and services that it requires and, importantly, to ensure that it uses preferred suppliers i.e. those suppliers with a contract to supply goods and services. Unlike the finance perspective, compliance is less about compliance to proper process for control or audit purposes, it is about compliance to contract and compliance to the preferred supplier list so that negotiated deals are fully exploited and savings maximized.

The P2P Partnership

The more the scope of P2P is limited, the less effective it is. At it's most effective, P2P spans the whole extent of the physical and financial supply chain; from supplier to customer from payment terms to treasury management. Effective P2P is all about partnership.

For procurement and finance to partner effectively, it is important to understand the extent to which P2P reaches both from a process point of view and an organizational point of view.

Procurement encompasses a wide variety of business process from spend analytics and market research through contract negotiation as well as the purchasing process. P2P is more about effective process rather than sourcing and negotiation but procurement in its widest sense should not be seen as out of the scope of P2P. The terms of engagement between the buyer and supplier are a key component of the P2P relationship and critical elements of the contract negotiation, such as payment terms, are certainly within scope.

And what of the organizational boundaries? P2P does not start with purchasing and end in payment. It starts within the supplier and its sales-order processes and ends with the month end accounting processes, including cash-flow management.

This is the P2P Partnership. A chain is only as strong as its weakest link and the only way to ensure the health of a full end-to-end purchase to pay process is to take an end-to-end partnership view. No single component is independent of the rest and every component is as important as each other.

An AP automation project that runs in isolation will have limited success. The easy invoices will fly through without touching the sides (they do anyway!) but no amount of automation will fix poor P.O. compliance. If an AP project is run from within finance, it can only be successful if purchasing is on board.

Take a purchasing initiative like dynamic discounting. Agreeing to a 2% discount in return for early payment can give a compelling return on investment of over 30%. Some suppliers will give their right arm to be paid in days rather than months but unless you get the accounting treatment right and fully understand the impact on cash flow and DPO, the initiative will be quashed by finance. Paying early seems harmless from a purchasing perspective but cash flow is the lifeblood of a business and things look very different when viewed from finance.

Of course most organizations recognize the importance of purchase to pay processes but it's not just that processes are managed more efficiently or that an organization can respond and adapt to change more quickly. Getting it right can have a massive financial impact.

Implementing a partnership approach to P2P is only possible if all aspects of the P2P spectrum are fully understood. For example, if purchasing people don't understand what their finance colleagues do, it is impossible to collaborate.

Take goods received not invoiced (GRNI), for example. It is an important number for finance. When it's a big number that's a bad thing and when it's a small number, it's a good thing. And keeping it low means having good ordering and receipting processes. Explaining the critical importance of GRNI to a buyer is a major challenge, because, to be frank, the buyer doesn't care.

Similarly, getting agreement on prompt payment is difficult because purchasing and finance have opposing interests: happy supplier versus good cash flow.
But these challenges have to be overcome. Buyers don't need to become accountants and the finance community doesn't need to become procurement experts but they both need to sit on the same side of the wall, develop a shared agenda and respect each other's expertise.

P2P is about partnership. It's a partnership between buyers and suppliers, but also, and more importantly, an internal partnership between finance and procurement.

What do purchasing and finance people do exactly? What are the business drivers within purchasing and finance? What jargon does they use and which bits of it should they each understand? For a finance person working within a purchase-to-pay project or environment it is vital to understand what makes purchasing people tick and vice versa.

What Procurement People do?

Procurement is often an undervalued business function but procurement people play a critical role in any business. So what do they do exactly?

Strategic sourcing

Strategic sourcing is the term most commonly adopted by organizations to describe a holistic approach to procurement that is designed to operate at a strategic rather than operational or tactical level.

There are a number of variations in the methodology but they share the goal to ensure that the right goods and services are procured at the optimum value for money and with minimum risk. This involves spend analysis to understand what is bought from where and at what cost; supply-market analysis to understand the supplier landscape, and the development and implementation of a strategy to optimize the engagement of the supplier market.

The difference between procurement and purchasing

The terms 'purchasing' and 'procurement' are often used, incorrectly, interchangeably. So what is the difference between purchasing and procurement? What does procurement entail and what exactly does purchasing mean?

Procurement

Procurement is the overarching function that describes the activities and processes to acquire goods and services. Importantly, and distinct from 'purchasing', procurement involves the activities involved in establishing fundamental requirements, sourcing activities such as market research and vendor evaluation, and negotiation of contracts. It can also include the purchasing activities required to order and receive goods.

Purchasing

Purchasing refers to the process of ordering and receiving goods. It is a subset of the wider procurement process. Generally, purchasing refers to the process involved in ordering goods such as request, approval, creation of a purchase-order record and the receipting of goods.

Procurement drivers – what gets purchasing people excited?

It's a curious fact that purchasing people are a lot like sales people. They're driven by the quest for the deal; they get great satisfaction from knowing that they make a real commercial impact to their business and they think that the commercial world revolves around them. OK the last attribute is a bit unfair but it is true that purchasing people, like sales people, do have an important and significant role that directly – and very obviously – has a bottom-line impact on their organizations. It can be a very satisfying role.

P2P from a purchasing point of view

Purchase to pay from a purchasing point of view is about two things: process and compliance. That is, ensuring that an appropriate and efficient process is in place to allow the organization to purchase the goods and services that it requires and, importantly, to ensure that it uses preferred suppliers i.e. those suppliers with a contract with the business.

Unlike the finance perspective, compliance is less about compliance to proper process for control or audit purposes, it is about compliance to contract and compliance to the preferred supplier list so that negotiated deals are fully exploited and savings maximized.

What do finance people do?

Finance isn't just about accounting and payments. There is a wide variety of important business activities that fall under the broad area called "finance".

Accounts Payable

As its name implies, Accounts Payable (AP) are responsible for payments, usually to suppliers. They check that invoices are valid by comparing the details on an invoice with the details on a related Purchase Order (if there is one) and also against confirmation of delivery. This is known as a 3-way match and is one of the fundamental P2P processes.

Accounts Receivable

Accounts receivable (AR) are responsible for collecting money from customers including the collection of late payments. AR are not directly part of the P2P process. Their equivalent set of processes are often referred to as O2C or Order to Cash.

Treasury Management

Treasury management people take responsibility for the management of cash. For a cash rich organization, they will seek to ensure that the best return on surplus cash is obtained. They may also be responsible for optimizing foreign currency exchange costs. An important part of their responsibility is to manage cash flow which, in simplistic terms is ensuring that customer payments are made as quickly as possible and that payments to suppliers are made as late as possible.

Accounting and reporting

All organizations have a legal responsibility to make proper accounts according to local accounting conventions. This is the primary responsibility of a finance function. Sales and expenditure needs to be recorded and reported within an exacting set of rules and guidelines to ensure that all payments are legitimate and that all taxes are paid correctly.

Compliance and control

It is not just the books that finance is responsible for. There are many other rules and regulations that a business must comply with and the responsibility for ensuring compliance often falls to finance. Compliance with regulations such as Sarbanes Oxley for example which requires that a business has properly auditable controls for all business process. The implementation of pragmatic segregation of duties with appropriate controls and measures is a key component of P2P.

Finance Drivers

DPO

DPO (Days Payable Outstanding) is one of the most important P2P KPIs within finance. It measures the average length of time it take s to pay a suppliers. The longer the payment term, the more cash an organization holds on to so it is good for cash flow for DPO to be a big number. But high DPO can mean that suppliers are unhappy. Holding on to supplier payments deprives suppliers of cash and as a consequence, price may rise. This can offset the cash flow advantage. There is therefore a potential conflict between finance and procurement who would sooner see payment terms acceptable to suppliers in order to keep prices low.

GRNI

If goods are recorded as having been received before an invoice has arrived, a business will often accrue funds in order to be ready to pay when the invoice arrives, Occasionally, invoice fail to arrive and the GRNI (Goods Received Not Invoiced) accrual can become very large. The reasons for a large GRNI accrual are many and varied. Often it is simply due to errors in the P2P process e.g. the invoice has arrived but has been matched with the wrong P.O. or goods have been recorded as having been delivered when they have not. While GRNI is an accounting KPI that seems irrelevant to the rest of the business, it is a use indicator of the general P2P health of an organization.

Critical success factor for P2P

By pursuing best practice in purchase to pay, organizations can make a quantum leap in cost saving, control and compliance. So what are the key actions that an organization can take to further exploit the opportunities that are available?

1. A common set of KPIs between finance and procurement

Much is said about the need for finance to partner with procurement but all too often it amounts to no more than informal collaboration on tactical issues. If the partnership is to be meaningful, it is critical that both parties work to the same agenda; that they are fully aware of each other's business drivers and goals; that these goal do not conflict and that they share responsibility for KPIs.

Days paid outstanding (DPO), for example, a finance KPI, can only be managed effectively with the close collaboration of procurement. Procurement people should be aware of DPO's importance and should be rewarded for managing it successfully.

Action: Finance and procurement need to collaborate so that they fully understand the P2P opportunities that exist within the supply chain, such as cash flow and treasury management, so that effective strategies can be developed.

Get buy-in at the most senior level to develop and adopt a set of commercially focused KPIs across both procurement and finance to build synergy.

2. Single sponsorship across procurement and finance

In many organizations, procurement reports to a commercial-savvy CFO who 'gets' procurement. This way the synergy between strategic sourcing and purchasing best practice can complement the way finance works. But even where this sort of governance structure is not in place, supply-chain-related finance programmes should include senior procurement sponsorship and similarly, strategic procurement initiatives should have senior finance sponsorship.

Action: Ensure that there is formal alignment between finance and procurement, if not as part of the corporate structure then as part of the functions' project governance models.

3. Synergy initiatives

Finance and procurement rarely work to the same agenda but when they do, magic can happen. Purchasing people want great relationships with suppliers and will seek valuable discounts in return for early payment but finance wants to pay as late as possible. Getting the balance right between discounts and DPO is tricky but achieving it can deliver huge returns.

Action: Identify and put in place a set of synergy initiatives – i.e. a set of projects that build on the common strengths of finance and procurement. For example, a project to further optimize DPO; a dynamic-discounting programme or financial supply-chain-optimization initiative.

Consider a matrix management style approach so that the barriers created by functional silos are broken down.

4. Financial reporting

If cash flow and DPO are at the center of your universe it can be difficult to appreciate the significant value of early payment discounts. The fact is, the cost of finance associated with early payment can be trivial, especially when interest rates are very low compared to the return on cash that discounts can offer.
Convincing the CFO that early payment is a good idea can be a challenge but ignoring highly lucrative discounts in favor of DPO is like allowing the tail to wag the dog. Develop a way of reporting that directly captures the relative merits of discounting and DPO to ensure you make the right balance between the two.

Action: Explore the commercial benefits of discounts compared to improvements in DPO and enhance your reporting to capture the value of discounts compared directly to the value of DPO. Actively pursue opportunities to derive a greater return on capital with dynamic discounting.

5. Electronic invoicing

Financial supply chain initiatives are highly attractive but you need to walk before you can run. Techniques like dynamic discounting require a tightly controlled and automated AP function. Offering a discount for payment in 10 days is only useful if you are in a position to pay in 10 days.

Action: If you are not already close to 100% paperless invoicing, prioritize it. Eliminating paper doesn't just improve your carbon footprint it allows you to automate AP.

6. Supplier master data management and e-invoicing

The management of supplier master data – names, bill-to addresses, delivery addresses etc. is a fairly routine operational matter. It's often undervalued and under resourced leading to duplicate, out of date or incorrect records. Yet by taking a wider view, investing in good supplier master data can pay for itself many times over by looking at the effect it can have on an AP automation programme.

Action: Invest in tools and resources to effectively manage supplier master data. Accurate supplier data can dramatically increase the straight through processing rates for scanned invoices where intelligent data capture is employed.

7. E-procurement and accounting rules

There's a perennial headache in finance concerning the correct allocation of spend. Purchasing people have little knowledge of the importance of correct allocation of spend in the general ledger and sub ledgers and neither should they but incorrectly coding capital expenditure as operational of attaching the wrong GL code can have a very serious impact on an organization.

Action: Where an e-procurement system is managed within the procurement function, procurement should invite finance colleagues to play a central role in the design of product hierarchies and categorization in order to eliminate time consuming and expensive reworking within finance.

8. Accounts payable and supply relationship management

Too often, a strategic relationship with a supplier at a procurement level is frustrated by an entirely separate and dysfunctional relationship at a payment level. It easy for purchasing to blame finance when invoices don't get paid and in the worst cases it can escalate to a point where supplies are halted. But the reasons for delayed payment are often complex and the root causes can be found in any places. Incorrect or missing P.O. details on the invoice, poor receipting processes within the business or shortcomings within accounts payable – they can all contribute.

Action: Create a joined-up P2P operation team with representative from finance and procurement. For commercially critical suppliers in particular, joining up the purchasing and AP with the suppliers' account management team and accounts receivable to ensure there is constant visibility of payment issues and their roots causes, helps to reduce the number of issues and can eliminate commercially disastrous escalations.

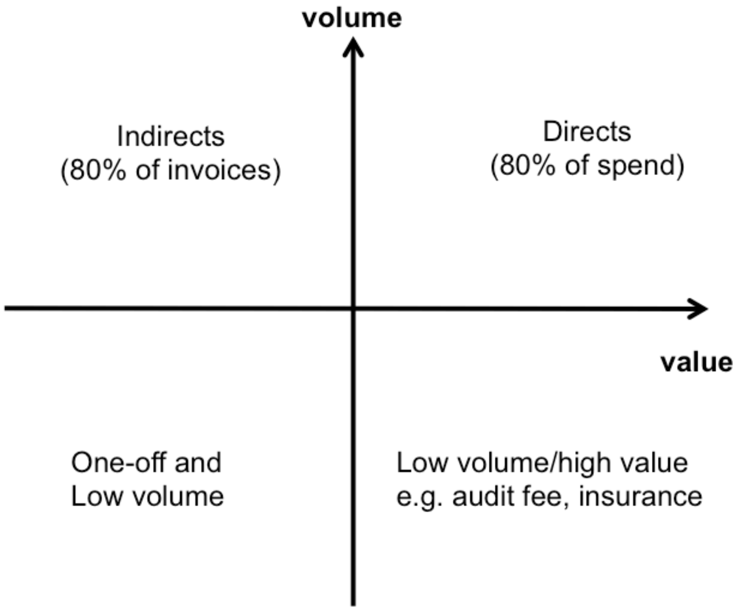
9. GRNI and purchasing processes

A GRNI (goods received not invoiced) report may not give the average purchasing person sleepless nights but for finance people, excessive GRNI numbers are a real problem. It is normal that goods are received before an invoice arrives but when there is a gap of more than a few months between receipt and invoice that should ring an alarm bell. Finance have to accrue for this spend (set money aside) and uncontrolled GRNI leads to significant accruals which in turn effect the profitability of the business.

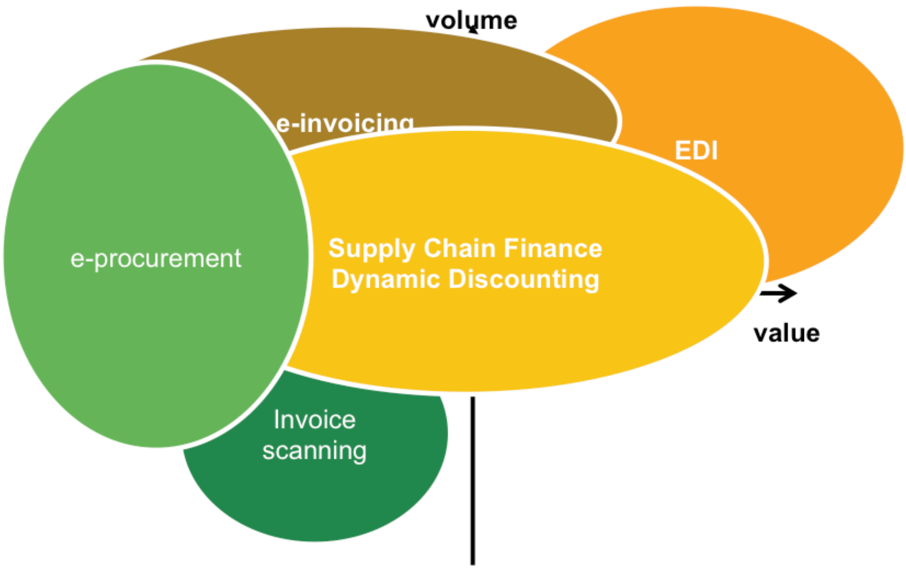
Action: Ensure procurement appreciate the commercial importance of GRNI accruals. Successful management of GRNI can only be achieved when purchasing and finance work together. Purchasing need to appreciate the commercial implications of poor practice and finance need to appreciate the purchasing process and support their purchasing colleagues to get it right.

Where to start – the P2P audit

The correct steps to take to implement effective P2P very much depend on the starting point. An immature organization may have to work hard simply to get to the starting line. Others may already have reached a high level of maturity, but whatever the starting point, it is worth going back to basics and beginning with a high level audit assessing your level of P2P maturity.



This doesn't have to be detailed – it can be a back of an envelope analysis. It doesn't need to be exact. Consider your organization's spend profile in terms of volume – numbers of POs, numbers of suppliers and numbers of invoices and invoice lines – and think in terms of the four P2P quadrants – High Volume/Low Value, High Volume/High Value, Low Volume/Low Value and Low Volume/High Value. Each quadrant has different characteristics.



Not all P2P components are appropriate for each quadrant. Complex supply chain optimization techniques such as demand planning simply aren't worth the investment for most indirects and while EDI and e-invoicing will pay for itself for high volume suppliers, low volume and one off suppliers are unlikely to take this on board.

By collating the existing P2P initiatives and assessing their maturity it's possible to identify areas where closer collaboration – whether that is between finance and purchasing or collaboration with suppliers - will unlock further benefits.