Automating Procure-to-Pay

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There has been an increased focus on the Procure-to-Pay ("P2P") process over the past several years. This has resulted in a growth in conferences focused on P2P, consulting organizations specializing in P2P improvement, and solution providers all offering the silver bullet that will solve all your procurement problems.

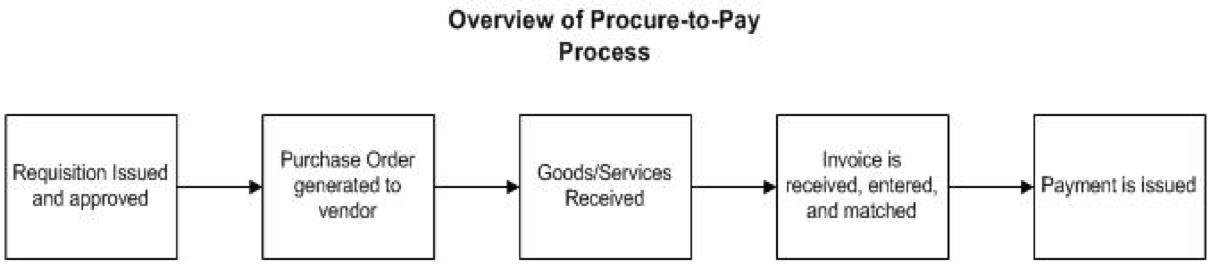
The sudden interest in P2P should not be surprising, but it should be surprising that it has taken so long for the spotlight to be put on a part of the business that is so vital to the profitability of so many organizations. Procure-to-Pay refers to the entire process by which organizations buy and pay for goods and services, from the request for the product by the operations staff to the issuance of the purchase order, receipt of the goods, and finally payment of the invoice. What could be more important than how your company spends it money?

Yet understanding and controlling the procurement process has not been a priority in most organizations. When it comes to automation, the focus has been on the front-end, customer facing process (such as point of sale for retail organizations or patient tracking for healthcare), or the back-end human resources and financial processes through an Enterprise Resource Planning (ERP) solution. P2P has simply not been given the attention that it needs. The result is a chaotic purchasing environment.

Does Procure-To-Pay Matter?

Regardless of their role, every executive should have an interest in Procure-to-Pay automation, as it can have a significant impact on the bottom line. As a finance leader, addressing P2P will ensure more accurate financial statements, increased profitability, and better controls. As an information technology leader, it is important to be aware of the different available technologies to ensure that the best technologies are selected and that they will work well together. As an operations leader, changes in the P2P process will significantly change the way that operations staff interact with vendors and with corporate staff. P2P process improvement is coming as organizations realize the benefit, and will have an impact across the enterprise.

Even large well-funded public organizations do not have the technology in place to be able to understand and control their procurement process. The technology used to create and issue purchase orders often varies from one location to the next, with some using the company ERP software, issuing purchasing orders manually or using another system, or others not issuing purchase orders at all, but rather just calling in their orders to the vendor. Without this technology, establishing



controls over these processes and cashing in on this opportunity is almost impossible.

A savvy executive can identify significant improvements through standardization and automation of the procurement process. The results can be better financial controls, lower costs of products, reduced overhead and better relationships with operations staff and vendors.

What is Procure-to-Pay Automation?

Generally P2P automation refers to using technology to streamline part or all of the procurement process. The common components of the procurement process that are automated include:

Requisitioning – Requisitions are generated by operation staff that wish to purchase goods or services. In manual environments, requisitions are often completed on paper, or requisitions are not created at all as orders are typically called into the vendor directly. The objective of automation of the requisition function is to provide a method for the operations staff to complete the requisitions electronically, often selecting items from a limited catalog or template of items that they are permitted to order.

Requisition Approval – Most organizations require approval prior to a purchase being made. In a manual environment, this requires completing a form to request goods, and forwarding that form to the approvers. This often leads to delayed and lost paperwork. Manual approval processes have long proven to be ineffective, as approvals are often not obtained or obtained after-the fact due to the time required to obtain approvals. Workflow automation solutions allow for these invoices to be routed electronically, reducing approval time.

Issuance of Purchase Orders – Once a Requisition is approved, a purchase order is issued to a vendor. Without automation, purchase orders are called-in to vendors or faxed. In a highly automated organization, purchase orders are sent electronically with acknowledgements being returned electronically from the vendor.

Receiving Invoices - The most common way for invoices to be submitted from vendors is by mail. Upon receipt, invoices are manually entered. In automated AP departments, invoices can be received electronically using a method such as EDI or E-payables. Invoices that are received manually can still be scanned and have information extracted using Advanced Data

Capture, creating a fully electronic environment.

Matching Invoices – Once received, invoices should be matched to purchase orders and receipts so that an invoice is paid based upon actual goods received, at the price negotiated with the vendor. Vendor over-billing or billing in error is common, yet not all organizations use the three-way matching process to prevent overpayments.

Objectives of P2P Automation

Technology and process solutions designed to automate procure-to-pay come in a variety of forms, but most subscribe to the same basic tenants and incorporate some piece of these functions:

- Creating paperless procurement environments
- Reducing time required for each step of the procurement cycle
- Increasing the number of transactions received or sent electronically
- Increasing visibility of information, including company spend
- Eliminating manual processes

Issuing Payments – The end of the era of the paper check has long been predicted. In the consumer world, it has essentially become a reality, replaced by credit and debit cards, as well as online banking services. In the world of business-to-business commerce, it has taken a much longer time for adoption to occur. However, a combination of ACH and procurement cards are quickly increasing the volume of payments processed electronically, steadily reducing the number of checks issued by many organizations.

Benefiting from Procure-to-Pay Automation

In any information technology project, the case for change must be made, and that business case will focus on why change is necessary. When it comes to procure-to-pay, the benefits should prove to be overwhelming, and the case for change will focus on the "what" to do rather than the "why."

The number one benefit from procure-to-pay automation is simple, it will save money. Automation will allow your organization to better understand how it spends its money and act upon that information to increase compliance to contracts, negotiate better pricing, reign-in maverick buying, negotiate and take more discounts, and prevent vendors from overcharging. Elimination of manual processes will speed up the procurement process, eliminating costly manual steps and ensuring that work is not duplicated. Procure-to-Pay is the process of how your company spends its money – and automation of Procure-to-Pay is designed to help you reduce the amount of money that you spend.

There are many aspects to the benefits of automation of P2P. There are financial, technical, audit, operational, and logistical considerations and benefit. When considering the reasons to automate procure-to-pay, it is easiest to summarize them into the following categories:

Visibility - Visibility and accuracy of information should be one of the key objectives of procurement automation. A well run company is one in which there is visibility to all financial activity. When reviewing the data in financial systems, an auditor should be asking not only what is in the system, but what is not in the system. To ensure accurate financial statements and compliance to audit requirements such as Sarbanes–Oxley, effort must be taken to ensure that all transactions are properly reported. In a chaotic purchasing environment, many hidden transactions may be found. For example, if purchase orders are issued manually, there is no visibility to commitments that have been made. If there is not three-way matching (such PO to Receiving to Invoice), there is no visibility to ensure that the goods have been properly received prior to issuing payment. If invoices are received directly by operations staff and sent for approval before being recorded in the financial software, these likely valid liabilities are not reflected and cash flow decisions are being made based on incomplete data.

Understanding and Controlling Spend - It's become cliché to say that "information is power." Yet, with information, we can better understand our operations, how we spend our money, and then make informed decisions about how to make it better. Without automation, spend information is complied across multiple systems, obtaining information directly from vendors, assembled based on GL coding, or in many cases just educated guesses. The first step to reducing your costs is to understand what you are buying and what you are paying for it. When reviewing our own personal finances to determine how to lower our bills, we demand to know the details. It isn't enough to know that we spent $500 this month on utilities; this doesn't tell us what to do to lower them next month. We want to know how much we spent on phone, on cable, and on electricity. To take action to reduce our cable bill, we may want to know what we are paying for extra movie channels. A procurement executive should be able to expect the same level of detail to be available. The devil (and the opportunity) is always in the details. Using the visibility of information obtained through P2P automation, a procurement leader is able to evaluate vendor and employee compliance to contracts and agreements, and adjust behavior to increase that compliance. Are vendors charged the agreed upon prices? Is operations staff buying from the vendors with the best price? These questions are vital to understanding where the opportunity is to reduce costs. Once we know how much we spend on products and how we purchase them today, we can identify where better pricing can be negotiated. We can then take that information to vendors to attempt to negotiate better pricing. When you know what you buy, how much you buy, and what you pay for it today, you are in a much stronger negotiating position.

Audit Controls - Chaotic purchasing environments create significant risk for fraud, which could include vendor fraud or employee fraud. If purchasing is not controlled based upon established contracts and pricing, there is opportunity for vendors to influence staff who make purchasing decisions so that their decisions are not necessarily in the best interest of the company. Or worse, an employee could be bribed to accept invoices for higher dollar amounts or for services that were not performed. Procurement fraud almost always involves some type of collusion between an employee and a vendor. In addition to fraud, incorrect payments can take place due to processor errors or simply not catching vendor errors. Without a process of validating receipts such as three-way matching, a vendor could short-ship a product. It is not uncommon for vendors to"duplicate-ship" products. As a result, both packages are accepted and paid for, increasing the amount of money spent and the inventory on hand. The three-way matching process is critical to ensure that payments are issued only for goods received, and issued only one time.

Reduce Processing Costs - There have been many studies done to determine the cost to issue a purchase order. Some of these incorporate the entire requisition to check process while others focus on a specific portion of it. Estimates from $25-95 have been found, but the actual numbers can be significantly different from one organization to the next. However, all of these studies agree that there is a cost, and that the cost contributes to making the case for procurement automation. Why is this process so expensive? In a manual environment, a single purchase requires a large number of manual steps involving many different people within the organization. Forms must be filled out, approvals must be obtained, purchase orders must be issued, receipts entered. The invoice must be entered, matched, and a check produced. Each of these steps consumes time – and as each step is automated, costs are reduced. Reduced processing costs are one of the key drivers of change in Procure-to-Pay. As organizations grow, they consider alternatives to hiring additional staff in purchasing and AP functions. Centralization of these functions is considered, which can produce even more savings opportunities through efficiencies in volume. Reduction of staff is a tangible form of ROI, which can help to get a P2P automation project prioritized.

Automation Risks and Challenges

In a recent trip to a Fortune 1000 retail company, the newly appointed procurement leader shared his vision of the future state of his procurement organization, and discussed the challenges of getting there. While the retail merchandise spend was being tracked through a merchandising system, they had no visibility to the non-merchandise spend, which represented hundreds of millions of dollars. He understood the need to gain control over this spend, but the number one challenge was clear. In an environment where most purchases were completed manually he simply had no information to be able to truly understand the current environment. In addition, without the data necessary to evaluate the opportunity, it is complicated to prioritize the project with his executive leadership.

This is unfortunately not an unusual situation. Many P2P leaders struggle with obtaining the budget necessary to automate. In decentralized environments, there is not enough information to truly understand the extent of the problem and use that information to build the case for change.

The following are the most common challenges for organizations that have recognized the need for change in their procurement processes:

Prioritization - When it comes to information technology projects, budget and time usually is given to the projects that are customer-facing, such as point of sale for retail organizations or patient tracking for healthcare providers. It is very challenging for back-office functions to gain the attention of leadership for procurement automation. The case must be made for change.

Diverse Technologies – Technology is often a barrier to automation of procurement functions. In most cases, it is simply the lack of proper technology. Even at organizations with the latest technologies in other areas of their operation, they are still issuing purchase orders manually, or their purchasing is completed on a variety of different systems, often due to legacy software that has remained after a merger or acquisition. While they may be desire and interest in implementing advanced features such as workflow and EDI, there may still be significant work to be done just to get the enterprise to the same place in use of basic technology for issuing and receiving purchase orders.

Inconsistent Processes - Partially as a result of the differing technologies that may be in use today, often there is wide variation in procurement processes from one facility to the next, creating a significant barrier to procurement automation. If each facility has differing approval limits, or has no approval limits at all, deploying workflow for requisition approval may require that each facilities approval limits be setup and maintained separately, or may require a significant effort to define and deploy system-wide standards. Large organizations often have a shocking variety of practices when it comes to processes such as when a purchase order is required, how to address returns to vendors, who products should be purchased from, and payment terms on invoices. Deployment of technology is a great opportunity to force standardization of processes, but making those changes with the operations staff can be a barrier to rapid and successful deployment.

Cultural Change - Environments where there is limited controls leave authority to local staff that may have become used to making their own purchasing decisions. Automating and standardizing approval and purchasing processes may restrict the vendors they can buy from, the items purchased, limit their authority, or force them to obtain approvals that they were not obtaining before. In some cases, these changes will be welcomed but in other cases, there will be resistance. Even in highly automated organizations, the system can be bypassed. One of the most common causes of rogue buying (buying outside of established contracts and processes), is the need to procure something quickly–the pressure to buy something fast to meet the needs of a customer or of the internal staff such as a physician who desires a specific implant from a specific vendor for a surgery.

Decision Paralysis - Another significant challenge is when organizations are unaware of the Procure-to-Pay automation options available to them. Others are simply overwhelmed by the large number of options that they may consider, many of which have conflicting or overlapping capabilities. This often leads to decision paralysis, with the project being shelved as no clear decision can be made. In most cases, it is better to put in place basic forms of automation rather than to do nothing at all.

Procurement leaders are challenged to cut through the noise and get their most important question answered:

Which of these technologies will help me to run my business better?

Leveraging ERP

The first step to automating procure-to-pay is to ensure that you are using the basic functionality commonly available in an ERP system such as maintaining an item file, inventory control, issuing purchase orders electronically, receiving, and matching purchase orders to invoices. These functions are a standard part of most ERP systems yet it is constantly a surprise how many organizations have not implemented these functions, even when they already own the software to do so.

As we explore procure-to-pay automation solutions, it is important to understand the relationship between procure-to-pay automation and ERP software. Many procurement solutions are positioning themselves as an alternative to using ERP for the basic functions related to purchasing and AP. However, an ERP system is the foundation for a organization's backend data and there is value in doing as much as possible within the ERP product, Having all the data in one system ensures the ability to view data from one module to the next, tracking every aspect of a transaction from requisition to procurement to payment to general ledger posting, adding in associated transactions such as returns and reclassifications. When basic procurement functions are performed outside of the ERP, often these "connections" are lost and research becomes more time consuming.

Why do some organizations ignore the capabilities within their ERP? In many cases, the ERP software is originally purchased because of the "bells and whistles", but these functions never get implemented. Due to the large cost and complexity of an ERP implementation (much of which is due to the cultural and process change), the focus on these new functions is lost along the way and the money is spent essentially to replace the functionality that existed before. The fancy new features get forgotten, the new controls are not put in place, and the reporting to take advantage of all the data being collected are never designed. Many of our customers are not even aware of the extent of features that exist to automate procurement using products they already own or could add-on to their system at a minimal cost.

Organizations should first look at the ERP solution when considering automation of Procure to Pay processes. Doing so may lead to the most integrated and cost effective solution.

This article is a section of the book, Opportunity in Chaos, *Chapter 14, written by Brian Rosenberg*

For more information about automating Procure-to-Pay, please see visit the RPI website at www.rpic.com