Whitepaper

The Year of the Cash

Improved Cash Management and optimized holistic processes achieved by applying the P2P concept

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The Year of the Cash

"Cash is King" was the title of a Supply Management Review article in April 2009 by John Matson, then principal in KPMG's Advisory Service in Los Angeles. The story was about improving Working Capital, about "educating " operations on the language of finance and, of course, about metrics to be used to free up cash. But there is much more behind the re-capturing cash issue. It is the story of the relentless pursuit for Best Practice / Best-in-class or even World Class Performance in operational processes. And the major challenge here is to integrate procurement and related financial processes by taking a holistic view. It is certainly an IT systems issue but it is not IT's issue alone. It is also an issue of leadership, cooperation, coordination, and last, not least of smart change management. But let's look at this scene step-by-step.

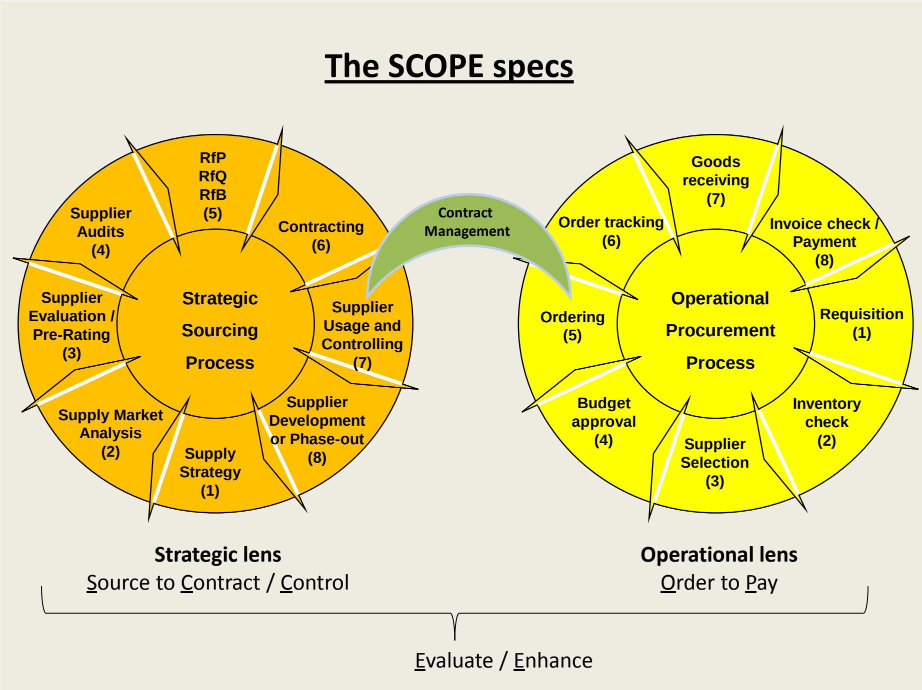
Shifting the focus in Procurement and beyond

For quite a while now, experts as well as leading practitioners are predicting a major shift in the role of Procurement. For instance, in 2005 The Economist Intelligence Unit conducted a global survey of over 350 senior executives looking out ten years into the future. The expectations regarding the Chief Procurement Officer (CPO) of 2015 were, besides others, that performance will be the key target instead of price, that a common IT infrastructure will be used in the supply network, and that financial and risk management expertise will be the key factors for success. It can be argued, if either the CPO or the CFO or both should be responsible for managing the financial streams related to the supply-side. However, it seems to make more sense that Procurement and Finance are closely related and that the profit as well as the cash situation of the company is more influenced by this interrelationship than commonly imagined. Due to the fact that many manufacturing companies today buy a major share of the value-add of a product from the supply markets, Supply Management or Procurement already is responsible for much or most of the manufacturing costs of a firm's products. In the Automotive industry the share of value-add delivered from suppliers reaches up to 85% and in some cases even more than that.

What is true for this strategic make-or-buy setup has similarities when looking at the processes that are critical for all, manufacturing as well as service companies and the public sector. Procurement processes have been optimized in many organizations by restructuring projects and by introducing IT systems that help to make processes leaner and faster, more reliable, more compliant and less error-prone. Even though the technology has existed for more than ten years now and even though the do's and don'ts as well as best practice cases are well known by most Procurement managers there is still some way to go for many companies in electronic procurement. Experience as well as empirical studies we are conducting on a yearly basis tells us, that many companies are still not "done" with these projects. . Introducing the first five electronic catalogs and picking the "low hanging fruits" is a different story from rolling out an entire system through all departments, national and international subsidiaries and covering 80% or even 90% of the overall spend in the related categories. The same holds true for Rfx systems, eAuctions, and Supplier Relationship Management (SRM) tools. Last, not least automated processes in Accounts Payable as well as in Accounts Receivable comprise huge potentials, especially when combined with electronic invoices. So the challenge here is to get all the potential profits out of the systems and not just a more or less small fraction.

The SCOPE model

Before going into the details let’s take a look at a simple model that shows the interrelation of the strategic sourcing process and the operational ordering and payment process. Each of the processes should be structured, managed and supported as a unity by implementing seamless IT supported processes. The two (strategic and operational) lenses are connected by Contract Management, an essential bridge between these two “worlds”. We dubbed it SCOPE due to the major process steps Source, Contract, Order, Pay, and Evaluate we have to consider. Of course, strategic sourcing is of outstanding importance, since without getting hold of the best suppliers (globally) a company cannot be competitive. However, in terms of cash on the table, these suppliers and the contracts we agreed upon with them are potentials that have to be put into life, so they might be more in the sky than in the pocket when looking only through the strategic lens. A sound contract management puts these potentials on the table, makes them accessible to anybody in the company who needs the supplier’s goods. Finally, the order-to-pay process (the operational lens) is responsible for delivering the savings or profits from the contracts, so that they are in the pocket at the end of the day. In order to make this system work better and better it has to be continuously evaluated and enhanced.



Each process starts at step (1) and runs until step (8), representing the general structure of a strategic sourcing process and of the operational procurement process. While individual strategic processes depend on the supply markets, suppliers, the demanded goods etc., the transactional procurement process differs depending on the value of the products, their level of standardization, delivery and inventory policies and the installed IT systems to support the processes. For purchased services the process looks slightly different regarding e.g. “(7) Goods receiving”, but the general structure is pretty much the same.

With the right SCOPE spectacles (or eyeglasses) a company is perfectly prepared to deliver best-in-class performance in Sourcing and Procurement, including optimized cash management. So, just have them fitted to your needs and put them on!

From separated to integrated processes

It has been pointed out by many experts that a "procurement" process does not only cover the steps that were traditionally performed by the guys who type in orders and who were located in a pure transactional purchase order department. In fact, the entire process stretches all the way through goods receiving, receipts, inventories, invoice checking, and payments. And unfortunately, the latter steps are less frequently part of a seamless, integrated process than one should expect. It seems that in many instances the seemingly two different worlds of Procurement and Accounting and Finance have had and still have a hard time getting together. Considering that it has been well known for some time that the process from goods receiving to payments can be relied upon for a major share in the overall savings in process costs from introducing eProcurement, it's hard to believe that so many companies fail to take full advantage of such a fully integrated and IT-supported process. Regarding the often more confrontational than cooperational or simply ignorant relationship between Procurement and Finance we wouldn't have expected anything else, or would we? Looking at the substantial savings that were ignored, we should expect something else and we definitely should work on getting these savings a.s.a.p. or our competition will show us how this works.

When a company introduces for instance an IT tool that helps optimizing the workflow for ordering catalog goods (Desktop Procurement Systems – DPS), steps (1) to (7) of the operational procurement process are usually covered quite well. An employee inside the company has a request for a certain good he or she needs. Let's focus on the usual MRO materials (Maintenance, Repair, and Operations) for this example, but notice that a broad range of goods can be supplied via eCatalogs. Since order-to-delivery cycles are typically very short (24+ hours), no on-hand inventories exist any more. So the requisitioner accesses the MRO catalog(s) strategic sourcing has contracted with the respective supplier(s) and that have been connected to the eProcurement software (via a catalog engine). He or she just adds the needed articles to his or her virtual shopping cart and clicks the order button. The rest is usually done by the IT (workflow) system. The available budget of the requisitioner is checked and the order is transmitted to the supplier. In case the budget does not cover the expenses of the order, the process is routed to get signed by a defined supervisor or according to another pre-defined exception rule, it may be rejected. The normal case would be that the order is received instantly by the supplier who delivers on the next day to a defined delivery address, maybe even to the desktop of the requisitioner. The latter either acknowledges having received the materials as ordered (quantity, quality, and timeliness) or files a short complaint when delivery was imperfect.

By using such a system, **process costs are typically reduced by 25% and cycle time by 50%** in average compared to conventional processing, whereas **savings might reach 90%** both regarding costs and time. So much for the good news. Unfortunately, many don't really care so much about integrating step (8) "Invoice check and payments". Collective billing is an often deployed scheme here, so that invoices that collect all deliveries in a certain period of time, often monthly, are sent out by the supplier to its customers (Statements rather than invoices). Sometimes, it is even agreed upon a procedure where the customer pays for the deliveries that were received according to the eProcurement system without checking or waiting for the supplier's invoice (Evaluated Receipt Settlement). Random checks assure that booking and payments are in line. In return for timely payments a price discount might be negotiated with the supplier. This brings us to the next leap in optimizing the supply side: The cash optimizing Purchase-to-Pay (P2P) concept.

The Cash Optimizing Purchase-to-Pay (P2P) concept

What is P2P? As described above, integrated operational processes that cover the order process on the one hand and connect the payment process on the other are a starting point of P2P. But the P2P idea covers much more. In fact holistic P2P concepts connect Procurement and Financial Supply Chain Management by embedding concepts such as reverse factoring, eInvoicing, or dynamic discounting thus putting a special focus on re-capturing cash as well as on lean, fast, and reliable money-related processes. According to Purchasing Insight exchanging a discount in return for early payment (dynamic discounting) could yield a return of 30+%. The Aberdeen Group points out that Best Practice companies can process an invoice in four days only and at a cost of 3 USD, while 30% of the respondents in the sample of their study needed more than 20 days at a cost of nearly 40 USD. So why is it that the P2P concept hasn't been picked up by so many companies, so far? And why is it that quite a few P2P projects fail or why the potential benefits have not been reached in their entirety? The answer is as so often: it's about people that are not willing to cooperate and – to some extent – about last century legacy IT systems.

Healing the first symptom gives you the first challenge of getting Purchasing and Finance not only at one table, but making them cooperate and letting them develop, implement, and "live" a holistic P2P process instead of striving for sub-optima inside the walls of their functional silos. The second challenge is to optimize the processes between your company and your suppliers on the transactional and finance side, thus adding the financial issue to the often logistics-only approach to Supply Chain Management. Healing the symptom of old-days legacy systems isn't easy either, but a more technical issue and thus a little easier to change, since there is adequate P2P software on the market.

A point to start with is making Finance and Accounting on the one side and Procurement on the other making each other understood in term of their goals, strategies, procedures and their ways of thinking. Accounts Payable (AP) automation systems run into problems when Purchase Order (PO) compliance is low. Trading in early payments for price discounts might make purchasing happy, but could result in problems regarding cash flow management. Obviously, Finance and Procurement are pursuing some goals that are interrelated but point into different directions. Breaking objectives down to Key Performance Indicators (KPIs) Procurement looks for cost reductions while Finance measures Days Payables Outstanding (DPO) or might look for a the-later-the-better AP cash management approach. No question cash flow optimization can yield substantial effect on the financial performance of the company and is paramount to protect liquidity. But it is unquestionably also true that substantial savings from purchasing are directly raising the profits of the company, so that leverage is extremely high. Procurement and Finance are closely related, so that only a holistic P2P approach can maximize the benefits for the company.

As already mentioned, bringing in the suppliers is a must. Strategic sourcing is busy with qualifying and developing the suppliers they want to work with today and in the future. They run audits, discuss KPIs and performance levels with the suppliers, optimize the exchange of order data as well as the logistics side of deliveries and sometimes phase-out suppliers that underperform too much too often. So Supplier (Relationship) Management is an integral part of daily work at the purchasing department. Discussing financial issues at the same table with the suppliers only takes two things: clear P2P KPIs that weigh both, Procurement's and Finance's objectives and the competence to understand these objectives and KPIs. No rocket science, but not trivial either!

General materials / services categories and related processes

Before getting into details of P2P processes we should get a clear picture of what happens in a typical manufacturing company in terms of order processes and supplier relations. For this we differentiate between four general categories:

(a) **Materials the company orders due to its production schedule**, e.g. for series production, for which a mid- to long-term contract exists with selected suppliers and where demand is calculated according to the manufacturing master plan. These orders are typically transferred from the Enterprise Resource Planning (ERP) system via (Web-)EDI to the (rather small number of) suppliers. The related order data is more or less automatically transferred into the Finance (FI) module of the ERP system.

(b) **Materials that are kept in stock** and that are often, but not always standard commodities needed in manufacturing or other departments. Economic Order Quantities as well as best buy opportunities (special offers, price discounts, etc.) prevail. Since suppliers might be changed more or less frequently, a rather large list of different suppliers evolves. For each of them a set of data including payment terms, accounts, etc. have to be managed.
The **same** holds true **for** the typically **wide range of services** a company buys from the market. In this domain, keeping order, delivery, quality and payment data up-to-date and error-free is a Herculean task and, in quite a few companies, a rather big mess and the FI ERP module seldom shows the current situation.

(c) **Materials that are standard commodities and that are ordered via eCatalog / Desktop Procurement System (DPS)**. Due to 100% documentation of orders and deliveries (if it's done properly) inside the DPS all the process-related data is at hand. Typically only one or just a few suppliers are contracted for each category of materials, so that the requisitioner only sees these catalogs to place his or her order. We'll end up with a manageable number of suppliers and supplier data.

(d) **All the maverick buying and the not-according-to-contract orders**, a permanent and heavy headache for anyone who is responsible for procurement processes. This often results in non-compliant, non-controllable processes, where personal relations, seeking personal advantages or even bribery may play a role or where just simple smugness is responsible for not sticking to the standard process. Maybe even more often employees (especially in larger companies) simply don't know about the "right" way of processing certain orders and about the currently contracted (preferred) supplier so that they do what they think is best. As a result we have more non-standard processes and suppliers are getting orders even though they might not be under contract any more.

Obviously, categories (b) and (d) are the ones that are prone to erroneous processes and incomplete data, so that the processes of the related materials and services are hard to optimize. Furthermore, supplier management and initiatives to reduce the number of suppliers to a reasonable amount is nearly impossible as is leveraging demand in order to negotiate better contract terms, e.g. reducing price. Compliance and control are other issues here. But don't be mistaken, similar problems might be found for category (a) and (c) items, due to technical, motivational or structural problems.

Integral parts of a holistic Purchase-to-Pay (P2P) concept

We have discussed the general motivation for introducing a P2P system. Let's take a look at some crucial elements and details now. It must be well understood that correct data is paramount in order to implement lean, fast processes that are fully transparent, that fulfill all compliance rules and that are controllable. However, this cannot be accomplished without close and trusting cooperation among Procurement, Accounting and Finance. Cooperation is filled with life by coordination in daily business, so processes, figures and rating schemes have to be in line. Last, not least supplier integration plays a critical role and you need the right IT systems and know how to integrate them to get the job done.

1. **Procurement, Accounting and Finance cooperation and coordination**
   These departments must cooperate, they have to be willing to do so. If they weren't, appropriate, maybe even drastic measures have to be taken to make them do so. A formal "contract" would be helpful, so that the alignment does not only have to rely on the responsible people that were involved in developing this agreement today. One should thrive for a clear, single governance of the entire P2P process. Otherwise major problems due to separate interests might evolve during the implementation process and in the daily routines. The leading objective in this cooperation should be a best-in-class P2P process that maximizes the benefits for the company and not for a certain department only. So we are looking for synergies on the one hand and we have to weigh opposing objectives and find out the compromise that is best for the company on the other. This includes developing a common set of KPIs and putting them into action in day-to-day business as well as a reporting scheme that includes both procurement and related financial figures. It has to be clear to everybody that correct and up-to-date purchase order data in addition to delivery data is essential for optimizing payments and cash management. The same holds true for understanding that late payments as a rule may have a severe negative impact on the relationship with the supplier which has been built up with great effort over many years.

2. **Supplier Integration**
   Streamlining the P2P process includes measures such as eInvoicing, AP automation and the like. Suppliers have to be as e-ready as your own company to make the system work properly. And of course, the suppliers should be convinced that they benefit in the same way as your own company does. Sending out (electronic) invoices through just one channel, without losing time and money should be a welcome incentive. Receiving payments always according to terms that have been agreed upon should make supplier's finance and cash management department happy as well. Besides that negotiations with the supplier that include financial objectives and parameters instead of price and other contract terms only gives both sides a far wider range of possible agreements and this is to the mutual benefit of both supplier and customer.

3. **State-of-the-art IT systems**
   Without discussing this issue in detail here, it should be stated that P2P processes will not work without adequate IT systems. Integrating processes data from different sources and IT infrastructures can be challenging, but is a must in order to maximize benefits from the P2P concept.

Starting a P2P project

Everything starts with knowing what you spend with whom. So a **Spend Management** project in order to get a sound foundation for further action is a prerequisite. Depending on the outcome of such a project, demands might be further bundled or unbundled, single, dual or multiple sourcing strategies might be altered due to a reasonable balancing of leverage and risk, suppliers might be phased-out or new ones contracted. The typical case would be that far too many suppliers are on the list and with many of them there is either no living contract in place, none or very few orders have been placed, or they may not even exist anymore. Others might have been taken over by competitors and of course, we can see – maybe for the first time – all the different prices, contract and payment terms with the same supplier our different business units, subsidiaries, facilities, and locations have agreed upon with them. Furthermore, we see that we not only could gain from bundling and negotiation a single contract for everybody, but that a number of our suppliers belong to the same mother company and that we spend quite a fortune with this organization, so that a little talk between our CPO and their sales department might bring in even more savings and more favorable contract terms, including financial P2P issues.

The many initiatives that might result from the insights we gained from the Spend Management analysis might go on for quite a while. However, it's time to start the actual P2P project. First, a **P2P team** has to be put together. Obviously, Procurement, Accounting and Finance as well as IT must be involved and, as all of them have a weighty saying in this matter, the number and hierarchy level of the participants should be well balanced. The team leader should be a reputable personality with good knowledge of the domain who is able to mediate and guide the development process. Keep in mind that P2P doesn't work without IT, but that the IT system should do what the functions are aiming for and what they agreed upon and not what a software developer or the IT department think is right. In a typical project development process objectives have to be discussed, weighted and agreed upon. Breaking down these to KPIs on the one hand and determining general processes that best support these goals is next. Typically an as-is process analysis is part of the game, whereas the blueprint for the new structure should be ambitious but achievable. Changing processes usually includes altering organizational structures. This in turn changes who is responsible for certain steps and who is doing the work. Organizational charts as well as process charts are playing field of this game.

It has to be **analyzed in detail** what the procurement policies are and how they are interrelated with payment terms. When working on finding out about these things the team gets more transparency to how many and which purchase orders as well as receiving receipts are not documented properly or not at all in the available systems. It can be seen how many and which orders are not properly assigned to the right general ledger code. It also lifts the fog regarding which orders are placed with suppliers that don't have a current contract anymore and if the invoices related to orders were according to the negotiated terms (or e.g. based on the old, higher prices). The same holds true for paying the suppliers for their deliveries according to terms. So the contracts themselves have to be checked and if Contract Management is properly installed to assure that these contracts are put into action and others are not in effect anymore. Finally a critical look at the existing IT infrastructure has to be taken and necessary changes, upgrades, and new investments have to be identified.

Of course, the departments have to be informed about this ongoing project and positive outlooks should be communicated in order to prepare the field for later implementation of the P2P system.

Implementing P2P and harvesting the benefits

Implementing a holistic P2P systems and making it work on a daily basis is a challenge of its own. The successful development of a blueprint for the optimal processes and responsibilities by integrating Procurement, Accounting, Finance and suppliers doesn't mean that the system work is done. Implementation issues cover **Contract Management** as an essential cornerstone. In fact, investments in software systems for contract management are going up 25% each year according to Forrester Research. This is no surprise when looking at 20,000 to 40,000 contracts larger companies have to manage. It is estimated that up to 2% of total annual spend can be saved by eliminating inaccurate, non-compliant, not up-to-date orders. A thrilling USD 40M on a company that spends USD 2B each year!
The only way to harvest all the benefits in this domain is to automate contract management and get rid of paper-based processes. And this has to be done in a way, that whoever needs this information can easily access all relevant information inside the contracts, e.g. item prices, quantity discounts, contract period, payment terms, etc. Traditional repositories won't do this job. Furthermore, essential contract information has to be built into the transactional processes in order to ensure contract compliance. Inadequate operational compliance costs approximately 4% of total spend according to the Aberdeen Group. So our company that spends USD 2B each year would even lose USD 80M. Besides this there is the issue of regulatory compliance. Companies have to comply with rules regarding auditing, reporting, certifications and the like imposed by regulatory agencies. Good corporate governance as a general objective and individual regulations such as Sarbanes-Oxley-Act or Dodd-Frank-Act should be followed.

eInvoicing is another major building block of full-blown, holistic P2P systems. Liabilities nobody knows of, inaccurate, unauthorized or duplicate payments, incorrect cost allocations and the like are daily business in many companies. Accounts Payable (AP) and Accounts Receivable (AR) are more often living a life of their own instead of being aligned in an operational cash management and treasury concept. A larger gap between days of sales outstanding on the one hand and average invoice processing time might cost the company a fortune. The more accurate the figures we could get out of the IT system the better the visibility and the more effective the cash management. Electronic invoices help to accomplish this objective, to speed up transactions and to reduce errors. Empirical data from a survey conducted by The Institute of Financial Operations shows that time spent entering or scanning invoices into the Finance IT system is a key challenge besides approvals and misplaced or lost invoices. Speeding up the invoicing process, reducing process costs and errors are the most compelling reasons for eInvoicing. Nearly 90% of the respondents believe that e-invoicing can help optimize cash flow and working capital management, 83% that profits can be increased and top-line performance can be accomplished. Also 90% say that eInvoicing excellence improves operational efficiency and even more than 94% that relationships to customers and suppliers would be improved. Purchasing cost reductions are seen by more than 75%.

Looking again at the overall P2P concept, Contract Management as well as eInvoicing are major building blocks but shouldn't be seen as isolated, IT-focused projects. **Spend Management** analysis should be performed on a regular basis in order to get a sound basis for reassessing purchasing strategies as well as for the individual P2P concept. Only if the P2P principles and processes are put into action consequently on a daily basis the company will reach best-in-class performance.

About the Author

Ronald W. Bogaschewsky holds the Chair of Business Management and Industrial Management at the University of Würzburg, Germany. He is Co-founder of the Center for Supply Management (www.cfsm.de), a research and consulting company and Co-founder of ondux, a company that developed and runs a Social Network for publication administration. He heads the Working Group "Purchasing and Logistics" of the renowned Schmalenbach-Gesellschaft für Betriebswirtschaft e.V. Ron is member of the board of the German Association for Materials Management, Purchasing, and Logistics e.V. for more than 15 years.

Ron has more than 30 years of experience in Supply Management Research. He has published 100+ articles in this domain as well as in Production and Operations Management. He is member of several scientific societies such as the Production and Operations Management Society and acts as a referee for several renowned international journals.

In many industry and consulting projects he has delivered substantial value to the partner companies. The projects focus on Supply Management, eProcurement, P2P, Global and Strategic Sourcing, Global Value Chain Design, Knowledge Management, Business Culture Integration, and Social Media.

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