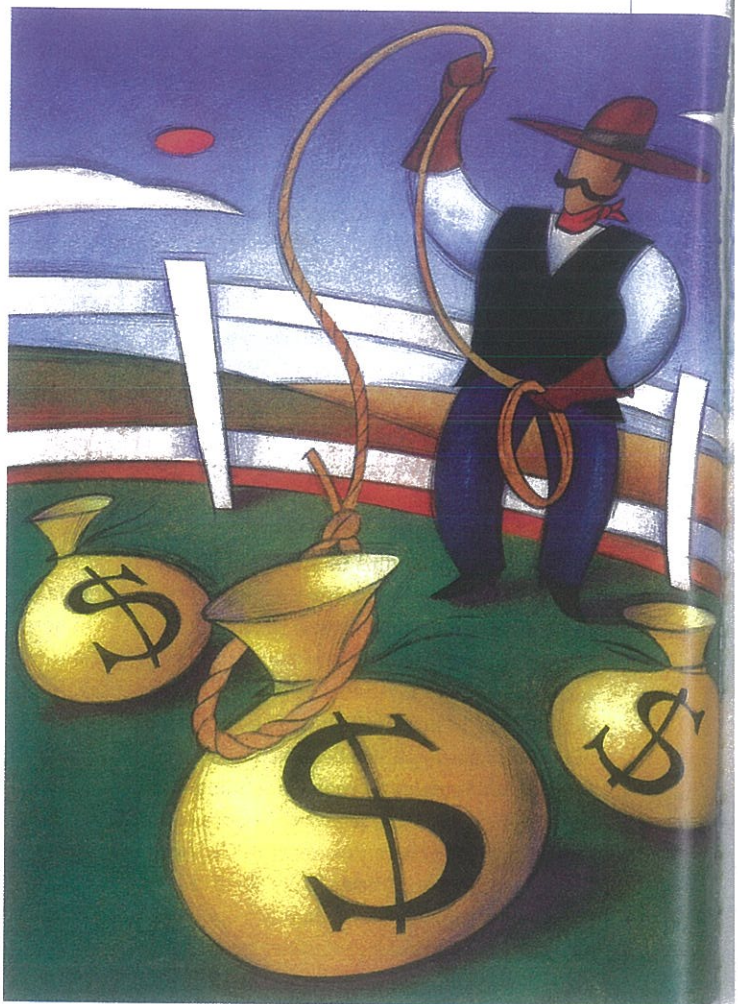
TAKE A HOLISTIC VIEW, CREATE LASTING VALUE

Burzin Dubash dwells at length on ways to optimise procure-to-pay cycle of companies



Working capital is the cheapest and the most accessible finance available. It provides businesses with the crucial opportunity to pay down costly debt and regain borrowing headroom. A focus on working capital can help management drive transparency and accountability throughout the organisation. Most companies focus on reducing debtor days, delaying vendor payments and/or bringing down inventory instead of taking a more holistic view while managing working capital.

Create long-term value. Focusing on working capital management provides companies the opportunity to create lasting value. Working capital is a lens through which management can examine an organisation's productivity and efficiency. Implemented correctly, working capital management will make companies much stronger tomorrow than they are today. In order to drastically improve management of working capital, companies need to take a cross-organisational view of the cash-conversion cycle, including procurement to pay, forecast to fulfillment and orders to cash cycles. They need to break down and evaluate individual components of each element of the cash-conversion cycle and then bring about lasting changes in how cash is managed.

Holistic approach. The fundamental problem with enhancing working capital management is that typically the whole function doesn't come under a single person. The responsibility for procurement, inventory management, customer contracting, credit management and logistics are with different parts of the organisation, with often competing agendas. If companies want to shrink the cash-conversion cycle, they need to get everyone in the supply chain—from procurement to production and treasury through to customer service, working together and thinking like a CFO.

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In my previous article, I had talked about the three key processes that could be optimised in almost every enterprise to release that precious working capital.

While I had dealt with inventory management previously, I will look at some strategies of optimising the procure-to-pay (P2P) cycle in this article.

Effective management of the P2P cycle is one of the easiest ways for businesses to improve cash flow, and a regular review of policy and procedures in this area also helps in identifying further opportunities to deliver hardcore rupee savings. Creditor management is about maximising the period from purchasing goods and services to paying for them, thereby reducing working capital requirements in the business. This objective of maximising the credit period must be carefully balanced to ensure relationships with suppliers are not damaged and stock levels optimised.

The accounts payable profession (if that's an appropriate term to use) is unregulated though there are international standard-setting bodies, an example of which is the International Accounts Payable Professionals (IAPP), an association of more than 5,000 members in the US, Canada, the UK and other countries. What is interesting is that as part of its Professional Standards Framework, the IAPP has established a new definition of the accounts payable function: *Accounts Payable (AP) is a strategic, value-added accounting function that performs the primary non-payroll disbursement functions in an organisation. As such, the AP operation plays a critical role in the financial cycle of the organisation. AP enables an organisation to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of the entire payables process. In addition to the traditional AP activities whereby liabilities to third-party entities (suppliers, vendors, taxing authorities, etc.) are recognised and paid based on the credit policies agreed to between the company and its suppliers, today's AP departments have taken on much wider roles, including fraud prevention, cost reduction, workflow system solutions, cash flow management, internal controls and vendor (supply chain) financing.*

So let's examine how businesses and their AP professionals can do justice to the following objectives:

CREATE CROSS-FUNCTIONAL RESPONSIBILITIES:

Our experience has shown that companies can best manage working capital by creating cross-functional teams with the CFO as the "overall sponsor". This helps create a common view and shared responsibility for outcomes. Team members need to collectively agree on cash targets and key performance indicators. This ensures that every team is held accountable to each other and also to the organisation. Also, it is critical that non-performance is properly dealt with; reward and compensation need to be tied to these collectively reached cash-flow targets and key performance indicators (KPIs).

> **Effective management of the P2P cycle is one of the easiest ways to improve cash flow ... a regular review can spot opportunities.**

HAVE A CLEAR AP MANAGEMENT POLICY:

All companies should set a clear policy on creditor management that will underline their approach to sourcing and negotiating terms and conditions. That policy should take account of optimal stock holding levels (including the importance of holding buffer stocks to avoid stockouts) and timing of other cash flows within the business. The purchasing strategy should be aligned to business goals and priorities should be set. Is price the most important issue, or is certainty of supply or quality of product paramount? Determining the key drivers for the business will guide you in your approach to managing AP.

NEGOTIATE CREDIT PERIODS SMARTLY:

Your ability to optimise the credit period will be driven by a range of factors, including the relative importance and dependence of your business on particular suppliers and their dependence on your business as a customer. Where goods required in the business can be sourced from a number of suppliers there may also be opportunities to negotiate favourable terms with existing or new suppliers—who will be keen to retain or win you as a customer.

REDUCE THE NUMBER OF SUPPLIERS:

By reducing the number of suppliers by striking up key strategic sourcing partnerships, companies can usually negotiate better payment terms, and greater reliability in terms of product quality and supply, while decreasing the AP workload and the risk of payment errors. However, care must be taken to ensure that overdependence on too few suppliers does not carry too high a risk for the business.

PARTNER WITH YOUR SUPPLIERS:

Partnering with your suppliers is by agreeing to pay them on set dates—which could assist in negotiating extended credit terms for yourself. Stockholding considerations will be important in negotiating with suppliers, in terms of the holding costs to both your business and the supplier. Better terms can often be agreed by negotiating purchasing agreements where commitments to take set (or minimum) quantities at set dates are made, thereby enabling your suppliers to better plan their production schedules.

BOOST FRAUD PREVENTION AND DETECTION MEASURES:

AP fraud techniques have increased in recent years, as more people have learnt to penetrate AP systems and make fraudulent transactions. Companies now must protect themselves against a variety of AP fraud techniques. In response to these security issues, leading companies establish systematic anti-fraud controls that focus simultaneously on fraud prevention and detection. Key fraud prevention and detection measures include the following:

- Publishing a clear code of ethics regarding financial fraud;
- Segregating AP job functions so that no individual employees can single-handedly authorise and access payments;
- Employing stringent controls to monitor AP applications;
- Managing vendor master files closely to reduce potential for payment error and fraud;
- Using data analytics to constantly monitor key AP trends; and
- Performing random procurement audits.

USE COMPLIANCE EFFORTS AS PROCESS IMPROVEMENT OPPORTUNITIES:

As an integral part of corporate finance operations, AP departments are likewise heavily engaged in compliance efforts. Rather than viewing this as a burden, however, forward-looking AP departments use compliance efforts to build world-class performance. It is important that management takes a step back periodically to critically review their operating processes and strive to bring in greater efficiencies and controls leading to an overall improved AP function.

STRATEGIES FOR BRINGING IN EFFICIENCIES IN YOUR AP PROCESS

- Automate or eliminate steps in invoice processing.
- Leverage technologies such as optical character recognition (OCR) and work-flow systems to digitise invoice documents.
- Integrate ERP systems; use electronic invoice matching applications.
- Implement a No-PO (purchase order) No-Pay policy.
- Use electronic fund transfers for just-in-time payments to maximise your credit terms.
- Rationalise payment terms to a few standard periods.
- Rationalise payment-approving authorities.
- Keep your payment date commitments to your vendors.
- Explore payment discounts from your vendors.
- Eliminate disputes; create a single point of contact within the organisation with whom vendors can interact to resolve their disputes.
- Reduce errors; overpayments, payments made to the wrong vendors, fake invoices, or even late payments represent a common problem for payables.
- Train personnel; provide your accounts payable staff with regular formal training.

By going for key strategic sourcing partnerships with suppliers, companies will be able to negotiate better terms of payment.

Too often, the AP process breaks down precisely where invoice processing begins. Companies commonly find themselves spending a lot of time tracking delinquent invoices or re-keying information erroneously into the AP database. Worse yet, suppliers sometimes add to the confusion by issuing a single invoice for multiple shipments or in some cases, multiple invoices for the same shipment, thus making the task of matching invoices to receipts even more difficult. As a result, companies end up wasting precious time correcting invoice errors, delaying the entire payment process.

Fortunately, companies that apply best practices have found a way to circumvent the problem by leveraging information systems and redesigning the AP process to automate or eliminate steps in invoice processing. Today, many electronic applications are available to integrate the procurement, receipting and payment activities and to make less burdensome the need to re-key invoice information or to match invoices with receipts manually. And, with most of the routine transaction processing tasks in AP becoming automated and process driven, AP professionals can take part in more value-added activities, including being a catalyst for cost-control efforts while at the same time ensuring strict compliance with the organisation's procurement policies. CFO

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