

## A/P Transformation: Managing the Paper First to Deliver Value Later

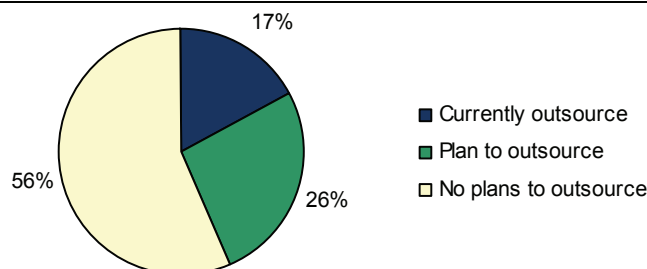
Often considered more of a tactical Finance and Accounting (FAO) activity, accounts payable is undergoing a transformation which is enabling the business function to deliver significant cost savings and process efficiencies to the overall enterprise. Long a paper laden process, performance improvement is often linked with efficient management of paper (i.e. purchase orders, invoices, and checks). The final frontier is the elimination of the paper trail altogether as the transition to an electronic environment is undertaken.

Document management is a significant concern for companies as they enter into and operate in a more virtual world. While it is critical first step in automating the entire A/P cycle, it is one of many that must be addressed. Accordingly, enterprises see performance improvements by taking a holistic approach to A/P transformation. Outsourcing and automation of invoice receipt and presentation, approval workflows, and payment processing are among the other many A/P-based processes addressed. Based on the impressive improvements in operational efficiency and cost savings, A/P transformation efforts also open opportunities to larger FAO outsourcing projects.

### Behind the Curtain

Behind the curtain of financial performance are the various functions that provide the inputs for financial reporting and drive the financial health of a company. A/P is one such function. Viewed as more of a back-office function, little attention is paid to it unless bills are paid late or go unpaid. Despite previously being relegated to low profile status within many companies, there is a tangible transformation now taking place in A/P departments. While automation is being utilized to improve the performance of this function, and therefore the entire enterprise, outsourcing is also on the rise. Third-party experts are being leveraged to raise the value contribution of this function (Figure 1).

**Figure 1: Current and Planned A/P Outsourcing Activity**



Source: Aberdeen Group, February 2008

### Research Brief

Aberdeen's Research Briefs provide a synopsis of the principal findings derived from primary research, including key performance indicators, Best-in-Class insight, and vendor insight

"Our reason for outsourcing was simple - we wanted to lower costs and increase efficiencies, just like everyone else. A/P has always been an afterthought, which is probably why it always seemed inefficient."

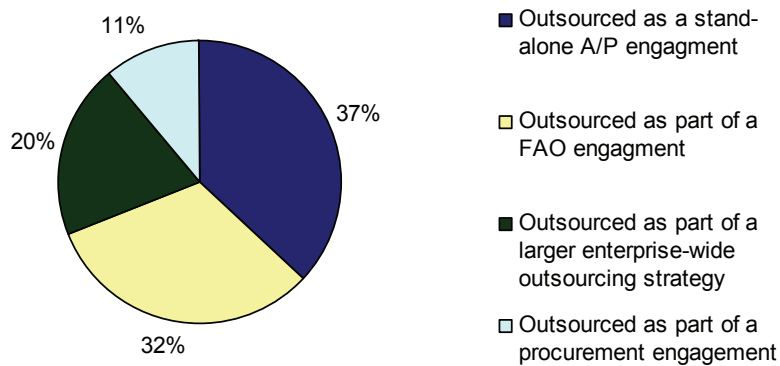
~ Vice President, Small Telecommunications Enterprise

It is clear that adopting an outsourcing strategy for A/P is gaining momentum; over one-fourth (26%) of the more than 150 primarily finance and accounting, procurement and logistics professionals indicated that they planned to engage in some level of outsourcing of their A/P operations in the next two years (*Accounts Payable Transformation: Better, Faster, Cheaper*, December 2007). The lessons have been learned from the early adopters and the overall level of A/P outsourcing continues to rise.

### **A/P Outsourcing: Getting in the Door**

There is no standard prescription for engaging in an outsourcing relationship, but there are two distinct preferences exhibited by enterprises for the initial structure of the engagement (Figure 2).

**Figure 2: How A/P Outsourcing Engagements are Initiated**



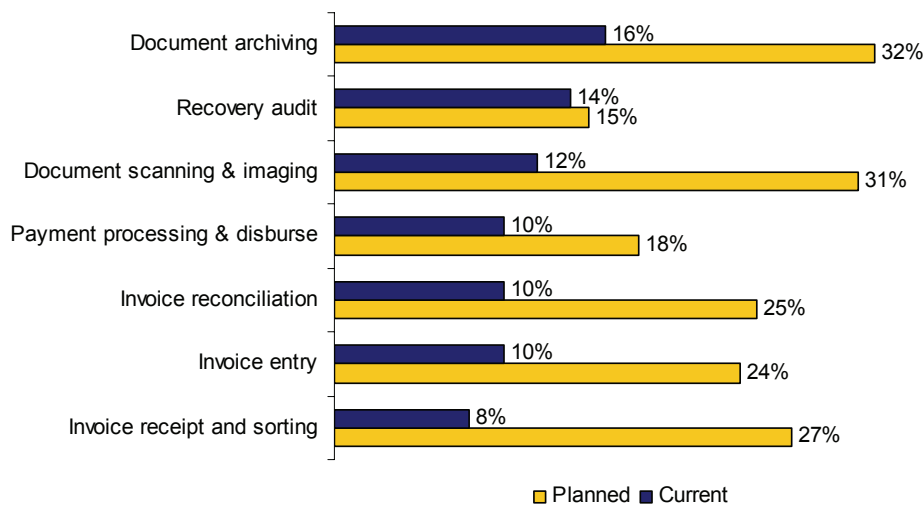
Source: Aberdeen Group, February 2008

Over two-thirds (69%) of companies outsource A/P as either a stand-alone engagement or as part of a larger FAO project. In either case, the opportunities potentially open doors to each other for additional outsourcing engagements. As part of the larger finance and accounting structure, a successful A/P outsourcing partnership paves the way for outsourcing other finance-related tasks.

### **The Path Taken**

As there are a myriad of sub-processes in the entire A/P cycle to choose from, companies are faced with the difficult task of deciding where to start. While current overall A/P outsourcing efforts are relatively modest, as a collective set, enterprises are working hardest to manage their current paper and electronic documents via electronic document archiving, scanning, and imaging (Figure 3). Future plans are also centered on document management, but invoice and payment management emerge as high priority outsourcing tasks for A/P as well.

**Figure 3: AP Processes Currently and Planned for Outsourcing**



Source: Aberdeen Group, February 2008

Document management is certainly a hot button issue for A/P departments as 79% of invoices are still received in a paper-based, non-electronic format. It is therefore necessary for enterprises to better handle these invoices by converting them to electronic formats (document scanning and imaging) and then maintaining a record of them (document archiving) to meet regulatory and even internal audit requirements. These scanning and archiving processes involve conversion of all file types to a common electronic format to bolster utility and usability across the enterprise. Document management is a critical first step in standardization of the A/P function and paves the way for better management of, and accessibility to, information. The current and planned outsourcing efforts for document management also indicate that companies recognize the need for better information quality to capitalize on the opportunities available to improve performance.

After improving the quality of information and the ability to manage the wide range of documents submitted for A/P is demonstrated, enterprises are then looking to address the invoice management side of the equation. Their efforts, however, do not stop here. Companies additionally outsource and automate other finance and accounting areas such as purchasing card management, check requests, and expense diaries to fully optimize their finance and accounting operations.

**Does it Pay in the End?**

Engaging in transformation of A/P (through outsourcing and automation) has certainly enabled those enterprises that have done so to distinguish themselves from the overall competitive set in terms of visibility into A/P operations and processes (Figure 4). Nearly two-thirds (62%) of the Best-in-Class have achieved a high level of visibility into their A/P operations while over 70% of the Industry Average and Laggards (shown as all others) indicate that they have only achieved moderate and even low or no visibility into A/P.

**The Aberdeen Competitive Framework**

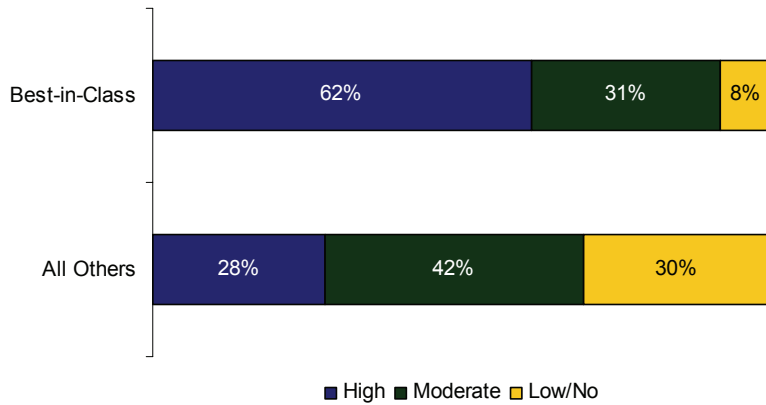
The Aberdeen Competitive Framework defines enterprises as falling into one of the following three levels of practices and performance:

- √ Best-in-Class (20%) - Practices that are the best currently being employed and are significantly superior to the Industry Average, and result in the top industry performance
- √ Industry Average (50%) - Practices that represent the average or norm, and result in average industry performance
- √ Laggard (30%) - Practices that are significantly behind the average of the industry, and result in below average performance

All others represents the average performance of the Industry Average and Laggard enterprises together.

Aberdeen distinguished Best-in-Class enterprises by the cost and cycle time required to process a single invoice.

**Figure 4: A/P Visibility Resulting from Transformation Efforts**



“Cost reduction was definitely a focus, but we were also hoping to increase A/P visibility across the company. So far, it’s been tremendously helpful and has met our expectations on each front.”

~ Large, North American Manufacturing Enterprise

Source: Aberdeen Group, February 2008

Visibility into a business function within any company has strong foundations in the organizational structure for managing the function. In the case of A/P, a high degree of centralization of A/P oversight is a key characteristic for higher performance. The higher level of visibility for the Best-in-Class has ultimately led to them to superior levels of performance for cost and efficiency (Table 1).

**Table 1: A/P Performance**

	Best-in-Class	All Others
Cost to process POs electronically	\$4.08	\$9.52
Cost to process non-POs electronically	\$3.28	\$10.52
Invoice processing cycle times	8.6 days	18.0 days
Overall exception rates	7.4%	11.1%
PO exception rates	4.4%	11.5%
Non-PO exception rates	6.3%	14.5%
Days Payable Outstanding (DPO)	25.4 days	39.7 days
On-time payments	82.0%	60.5%

Source: Aberdeen Group, February 2008

“We leverage our outsourcing relationship and the centralized management structure for A/P to help us drive a standard process platform throughout the entire firm.”

~ A/P Manager, North American High-Tech Enterprise

**Case in Point**

A large, North American-based manufacturer of industrial goods was faced with outdated A/P technology and processes. Compounding the difficult situation was the decentralized management structure in place for their A/P operations. Invoices were processed, microfilmed, then manually indexed and stored at a different location for each division within the company. A shift to a shared-services model for A/P management was enacted and a new facility was constructed to house this new division. However, this new organizational structure removed the ability to simply "run down to the film room to look up information."

This manufacturing company then partnered with an A/P service provider, outsourcing the imaging and management of invoice documents. The ability

to capture, store, and retrieve documents electronically was established within 90 days. Information is available for online viewing within 24 hours of receipt by the outsourcing provider. Additionally, data can now be accessed for supplier dispute resolutions and audits within seconds. Searches can also now be conducted by A/P personnel using any one of 10 index parameters instead of a single document control number. This company is now managing its A/P documents electronically, leading to increased efficiency and enhanced customer care. The success of A/P outsourcing has led the leaders of this industrial goods company to deploy outsourcing services for other finance and accounting processes, most notably accounts receivable. The efficiencies gained within the A/P cycle have been noted and the belief is that they can be replicated in other FAO activities.

## Recommended Actions

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Enterprises have taken significant steps to improve the performance of their A/P function and deliver value to the organization by outsourcing and automating. While they have done well to centralize operations, there are still key areas of the A/P process that can be addressed to improve performance:

- **Manage A/P transformation holistically.** Organizing, archiving and scanning / imaging of invoices certainly begins the transformation of A/P from a paper-based to an electronic function. However, cost reductions are optimized when invoice handling, management, and payment are also addressed. Document management serves acts as a gatekeeper to the rest of the A/P cycle, ensuring that purchase orders and invoices received are converted to common electronic format from which information is easily accessible and of better quality. Efficiently managing the paper which frequently comes in contributes to operational improvements and supports the quantitative gains available. Outsourcing and automating one half of the A/P process without the other (or other A/P sub-processes as well) does not make complete sense, and will not result in long-term value. Managing the paper to ensure data quality, standardization, and accessibility is the first step in ensuring that A/P delivers enterprise-wide value as an entire function. Other A/P processes cannot be ignored when document management is relied upon to maintain performance improvements.
- **Standardize processes enterprise-wide.** Establishing a consistent set of A/P processes and procedures across the enterprise goes part and parcel with a centralized operational structure. The Best-in-Class are 77% more likely to have standardized A/P processes across the company. Engaging in a more scripted approach enables these A/P practices to be consistently performed, no matter where they originate. Reduction (and hopefully elimination) of the discretion used by A/P personnel when processing POs and invoices which, in turn, leads to inflated costs and savings leakage will be avoided. Standardizing the format of documents is a logical place to begin as document management is, basically, the starting point for the A/P cycle. Establishing common, electronic formats for the purchase

orders and invoices lays the foundation for establishing standardized processes to manage these documents.

As a critical multi-faceted cog in the cash management machine, the A/P function is ripe with opportunity for a makeover that will deliver value to the organization. Often considered more of a tactical organizational activity, accounts payable is now being viewed as a rising opportunity for outsourcing. However, automation is also a critical driver for the transformation, which will generate operational efficiencies and optimize the financial value of A/P to the enterprise. The decisions are difficult and these processes often rely on each other, to some degree, for ultimate delivery of performance improvements. Focusing on any single one at the exclusion of the others can end up leaving an enterprise treading water. Successfully outsourcing A/P also opens the door to other potential opportunities within the other finance and accounting functions of an enterprise. A familiarity with protocol and processes, along with a demonstrated track record of performance improvements can make it an easy decision for companies to expand and extend the outsourcing relationship to other FAO activities.

Transforming A/P has resulted in some companies distinguishing their performance from their peers. These Best-in-Class enterprises have addressed A/P holistically and established a more centralized structure for management of this business function. Further, strategies to leverage outsourcing and automation to improve A/P have resulted in:

- Better visibility into A/P operations
- Lower costs to process invoices
- More efficient processing of invoices

For more information on this or other research topics, please visit [www.aberdeen.com](http://www.aberdeen.com).

#### Related Research

<a href="#"><i>Accounts Payable Transformation: Better, Faster, Cheaper</i></a> ; December 2007	<a href="#"><i>The A/P Knockout: North America Defeats EMEA</i></a> ; February 2008
<a href="#"><i>The CFO's View of Procurement</i></a> ; November 2007	<a href="#"><i>A/P Transformation: One Size Does Not Fit All</i></a> ; December 2007

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