

Section Three:

Purchase-to-Pay Processes

Gregory Cronie, Head Sales, Payments and Cash Management, ING

Making payments efficiently, cost-effectively and securely is pivotal to every well-managed finance function. Many of the discussions on payments in banks' brochures and media articles surround payments processing, particularly straight-through-processing, security and bank connectivity. These issues are, of course, very important in achieving a best-in-class payments operation. However, in addition to processing, managing payments is also a strategic element of working capital to ensure that the company is able to take advantage of early payment discounts offered by suppliers where these are beneficial, manage FX risk created by foreign

currency payment obligations and time payments with cash inflows to avoid liquidity issues. Furthermore, the cash management organisation needs to be structured to minimize the number of cross-border payments to manage payment costs.

As fig 6 illustrates, this time with Company A on the left and the supplier on the right, the purchase-to-pay process mirrors the order-to-cash process, typically including the following steps (and challenges):

A. Company A receives the invoice from the supplier and needs to reconcile these against the order details before authorisation and payment. This is

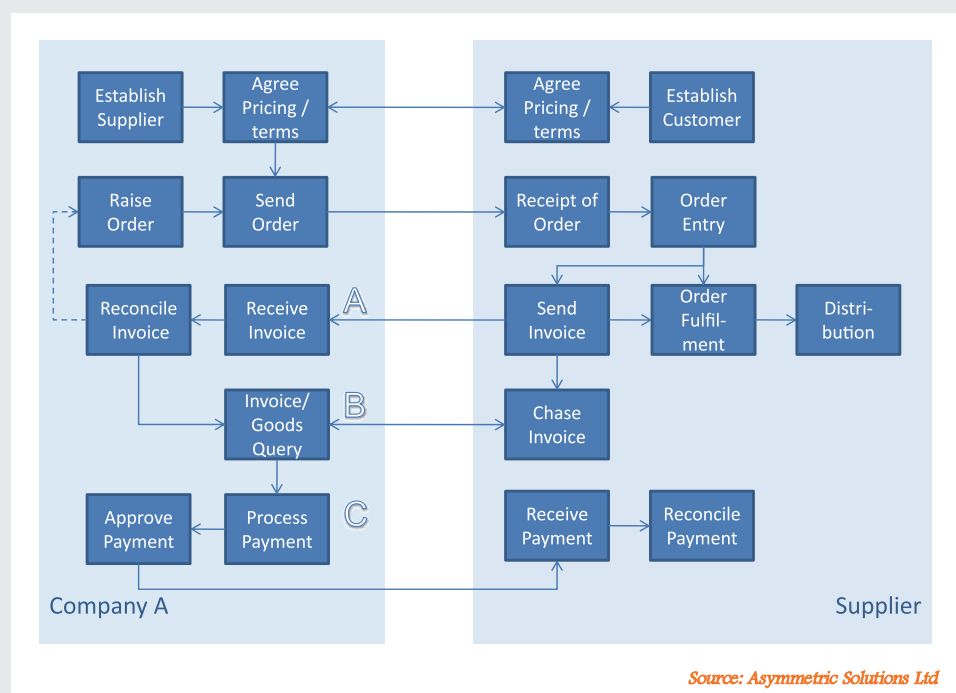
time-consuming if the original purchase order number is not shown on the invoice.

B. The company may wish to query the invoice and again, the better aligned the information between itself and the supplier, the quicker this is to resolve.

C. Once approved, which may need to be done by one or more business managers, the payment can be processed. This can be an involved process internally, particularly in the case of multiple payment origination systems, large numbers of "one off" supplier payments when supplier bank account instructions need to be set up and approved, if there are frequent changes to payments or if a variety of

Managing payments is a strategic element of working capital to take advantage of early payment discounts, manage FX risk created by foreign currency payment obligations and time payments with cash inflows to avoid liquidity issues.

Fig 6: Purchase-to-pay processes





different payment methods are used. If a company operating internationally empowers its business units to make its own payments, the payments infrastructure and processes can often be fragmented, with connections to

multiple banks in different locations. This makes it almost impossible to ensure that consistent security standards are being adhered to, and treasury does not always have a clear picture of the company's cash

requirements. Even when Accounts Payable is centralised, the payments process itself can be cumbersome if the integration between internal systems and the banking electronic banking system is inadequate or there are multiple banking systems in place, necessitating a variety of different interfaces in various formats.

Purchase to Pay Metrics

Days Payable Outstanding (DPO) is the most common metric associated with purchase to pay. DPO refers to the average number of days it takes for a company to pay its suppliers. It is calculated as:

$$\frac{\text{Accounts Payable} \times \text{Number of Days}}{\text{Cost of Sales}}$$

Or:

$$\text{Accounts Payable} / (\text{Cost of Sales} / \text{Number of Days})$$

In theory, the higher the DPO, the better for the company, as by holding cash for longer, the potential for interest income is greater. However, this is frequently done by paying later than the agreed payment terms, therefore “squeezing” suppliers. This approach can be counterproductive as well as unethical (after all, no company wishes to be treated in this way by its suppliers) by antagonizing suppliers who are then less likely to be prepared to offer preferential pricing or payment terms. A better approach is to seek discounts for early payment or look into supplier financing (see Part Two of this Guide).

Remedies to Purchase-to-Pay Challenges

As with order-to-cash processes, there are various ways of addressing these challenges, combining internal processes and technology with external banking, cash management and connectivity arrangements.

The potential remedies for many of the challenges are similar to those of order-to-cash, such as purchase order services and eInvoicing, so we will not repeat them here. It is important to emphasise however, the benefits of a collaborative approach between suppliers, customers and their banks to ensure that information is universally understood and exchanged in a consistent way between systems. One of the implications of this is

Fig 7: Example Challenges & Remedies in the Process-to-Pay Process

	Challenge	Remedy
Invoice Receipt	Needs to be reconciled with purchase order	eInvoicing solution with reconciliation between purchase order and invoice.
Invoice Query	Particularly in an industry where there may be more frequent queries (for example invoice post-delivery with amounts based on prevalent rates rather than fixed amounts)	As above, an eInvoicing solution can be very helpful in ensuring rapid query.
Payment Processing	<p>There are a variety of potential challenges, particularly if Accounts Payable is a decentralized function, e.g.</p> <ul style="list-style-type: none"> • Consistent security • Consistent processes • Multiple payments origination systems • Multiple payment types • Banking interfaces and formats 	<p>A variety of challenges can be satisfied by addressing four main areas to achieve greater consistency:</p> <ul style="list-style-type: none"> • Payments centralisation • Payments system to manage routing, approvals and file formats • Cash management centralisation/ bank rationalisation • Single approach to bank connectivity



the need to standardise the way in which data is communicated to avoid the need to set up different formats for interfacing data between various counterparties. Standardisation, including some of the industry developments in this area, is covered in Part Three of this Guide.

Payments Factory

Many companies are increasingly discouraging local payments wherever possible, preferring instead a centralised payments function - often described as a payments factory or payments hub. This may be held within a shared services centre, be part of treasury or an independent function. As the case study below describes, there are a variety of benefits in channeling payments originating from different systems through to a central payments system where authorisation, validation and formatting can be done before transmission to the banks. Banking interfaces can be managed centrally including (where appropriate) multi-bank connectivity channels such as SWIFTNet, as described further in Part Three of this Guide.

Single Payments Bank

Companies making payments in different countries and currencies will often use different banks, particularly where payments are decentralised. This is more expensive and means that unless using a multi-bank platform such as SWIFTNet, payments need to be transmitted through different electronic banking systems. Working with a single bank regionally enables companies to channel payments through to a single bank, even if payments are then made through local accounts/entities. In Europe, SEPA (the Single Euro Payments Area) will enable payments to be made anywhere in the Eurozone, as a local payment, irrespective of source and destination, reducing the number of cross-border payments. Again, this is covered more fully in Part Three of this Guide. ■

Case Study: Centralising Payments at one of Europe's largest pension schemes

The company had been maintaining a large number of interfaces between proprietary systems at a cost of €30-€40,000 per year. As well as the issue of cost, the firm wanted to achieve greater bank independence, allowing them to decide on our banking relationships based on the quality of service rather than simply the links that were in place. Consequently, the company made the decision to connect to SWIFT in order to rationalise the number of proprietary systems and make decisions more strategically.

Setting up a payment hub, through which the payments would be directed, was a fundamental change in the way that the company operated. In the past, they sent a payment file through to the banking systems, and payments were authorised at that stage. By moving to SWIFT, authorisation needed to take place in the internal systems instead. This was going to be a major issue, as there were a large number of systems in different departments which produce payment files, all of which have different file formats, business processes and security frameworks. Consequently, they decided that they needed to introduce a uniform way for processing payment files, authorising payments and translating the files into a common format, which could then be sent through to SWIFT.

They decided to focus first on their pension payments, for which they use ING. They selected a major payments system to form the centre of our payment hub. This implementation took around 6 months to complete and has been very successful, with around 225,000 payments a month now passing through the system. All approvals are conducted in this system and files are translated into a common format. The Accounts Payable department receive payments one week in advance of the settlement date, but there can be changes to these payments between receiving the payment information initially and the actual payment. Files are checked and deleted as necessary in the system.

The payment hub model has been highly advantageous, bringing a robust solution for authorisation and payment amendment and a standardised, rationalised approach to bank connectivity.

In Part Two.....

Part Two of ING's three-part Guide to Financial Supply Chain Management will appear in the December/January edition of TMI. In Part Two, we look at supply chain financing and the opportunities which various financing techniques present for corporates to unlock cash from the financial supply chain.

At the end of the series, the full Guide will be available as a single publication either electronically or in hard copy. In the meantime, if you have any questions, please contact:

Robert Dekker
Global Head of Sales Corporate & Institutional Clients
Payments and Cash Management
ING Wholesale Banking
+3120 5635141
robert.dekker@ingbank.com

Gregory Cronle
Head Sales
Payments and Cash Management
ING Wholesale Banking
+3120 5765071
gregory.cronle@ing.nl