

BasWare

**How to set-up a Best Practice Key
Performance Indicator Reporting System
for the Purchase-to-Pay Process**

White Paper

1 Executive summary

Executives' main goals for purchase-to-pay (P2P) process improvement today are:

- Higher productivity
- Cost savings
- Lower processing costs
- Adequate controls
- Positive contribution to working capital goals
- Provision of insights for effective decision support

Key elements of a strategy addressing these goals highlight the need to:

- Consolidate the activities of the P2P process as much as possible by utilizing Shared Services
- Establish an end-to-end process view regarding process strategy, process optimization and process ownership
- Balance risk and controls for each group of commodities and process transactions via standardized processes
- Automate transaction processing as much as possible
- Establish an active supplier and category management process
- Support process management and monitoring by using an appropriate key performance indicators (KPI) model.

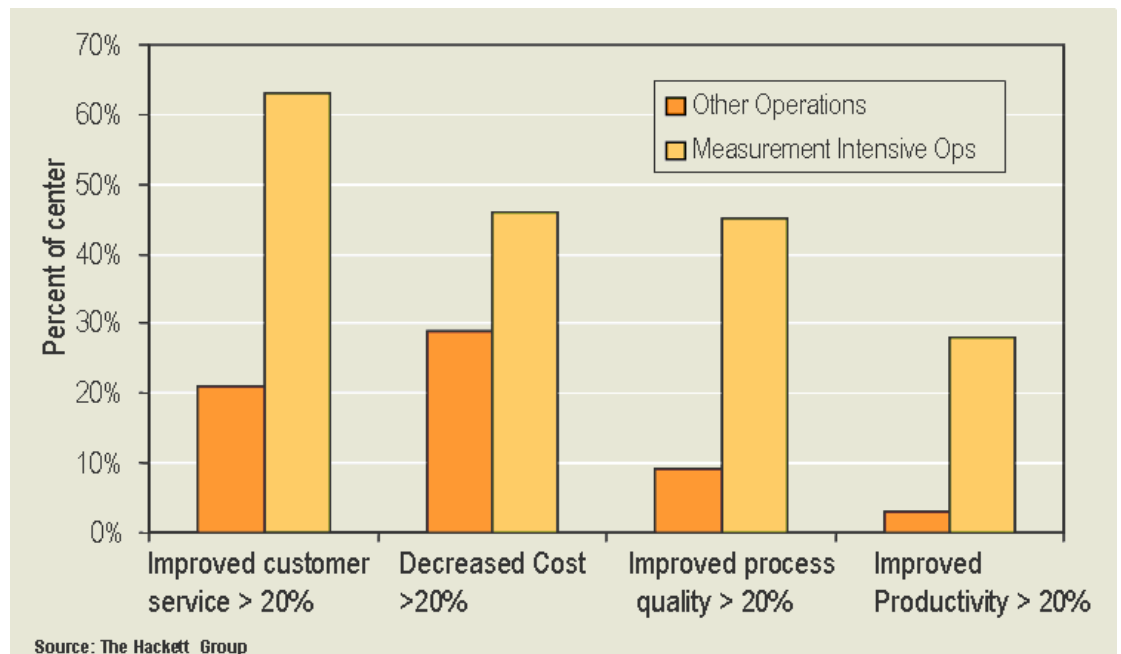


Figure 1: Measurement intensive operations have been significantly more successful in using their internal process data to guide process improvement efforts

Hackett research shows that measurement-intensive operations are more likely to succeed in improving customer service, lowering costs, and improving process quality, as well as improving productivity (Figure 1).

A best-practice KPI model helps to:

- Support mid- and long- term internal and external comparisons
- Show the level of compliance towards the end-to-end process strategy
- Measure success of current projects and initiatives
- Provide indication of below-target performance and allow root cause analysis

The linkage between the end-to-end process strategy and the KPI system is observed by The Hackett Group as an emerging best practice.

This perspective explains the key principles and benefits of KPI measurement and reporting. It provides guidance on what to measure in the end-to-end P2P process, and what benefits can be provided by software for P2P process automation.

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Comments

All comments to this document can be addressed to BasWare Product Marketing mailbox@basware.com.

BasWare Corporation

Address: Linnoitustie 2, Cello Building, FIN-Espoo, Finland

Postal address: P.O. Box 97, FIN-02601 Espoo, Finland

Tel. +358 9 8791 71

Fax: +358 9 8791 7297

www.basware.com

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2 Setting up a KPI Model for the P2P Process

When setting up an appropriate KPI model, some basic principles have to be followed.

- Choose KPIs in line with goals and objectives.
As the KPI model is a support tool to monitor and track the performance of the P2P model, the selection of KPIs is driven by the overall goals and objectives.
- Stay focused on what you measure.
Be aware that there are over 115 items that can be measured so it's important to focus on only the measures that are key to reaching the agreed performance objectives.
- Ensure that the benefits of a performance measure are in proportion to the effort required to collect the data.
If it is too complicated to collect the required data, and the benefits are not obvious or uncertain, it is better not to include the respective indicator.
- KPI results must drive action.
As the name clearly states, KPIs indicate the level of performance. Therefore poor performance shown by a KPI needs to be followed by actions (e.g. root cause analysis, initiative/project kick off etc.). Positive indications should be reported back to the teams to build momentum or provide incentives to the organization. In Shared Service Organizations, a subset of KPIs is used in conjunction with Service Level Agreements (SLAs) and are reviewed with internal customers.
- Tailor KPI reporting to the needs of recipients.
Different subsets of the KPI model are used for different recipients. The selection of KPIs, as well as the means of communication, should be tailored to the needs of the respective recipient. Figure 2 shows these recipients and the corresponding focus for KPI selection (strategic vs. operational).

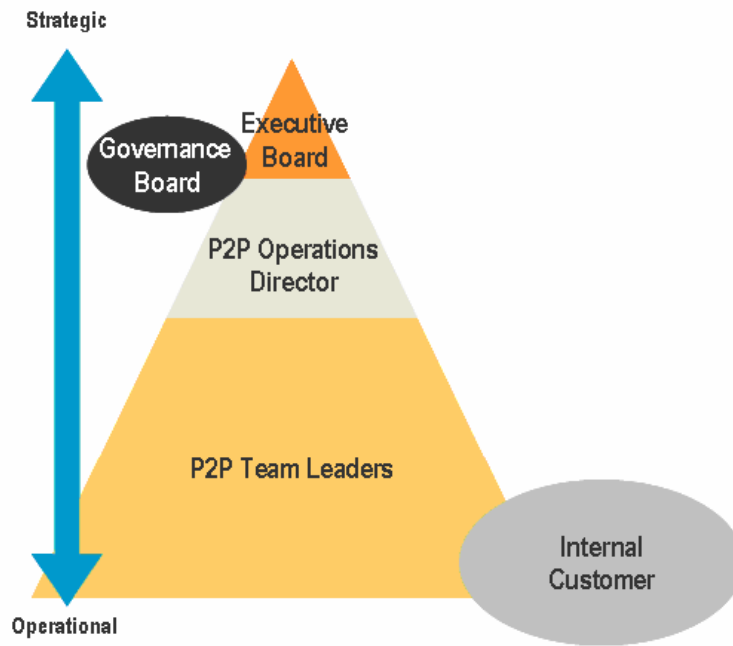


Figure 2: KPI Model to be Tailored to the Needs of Different Recipients

- Balance different aspects.
No single KPI can provide a comprehensive view of the overall situation. Therefore the performance management system (see Figure 3) should focus on multiple aspects including:
 - Costs
 - Productivity
 - Quality
 - Employees
 - Strategic alignment

Costs: <ul style="list-style-type: none"> - Cost per FTE - Total cost of operations - Procurement cost control and optimization - Costs per transaction - Working capital effects 	Quality: <ul style="list-style-type: none"> - Customer satisfaction and Audit ratings - Input Quality - Output Quality - Backlog - Process Automation - Effectiveness 	Strategic Alignment: <ul style="list-style-type: none"> - Preferred supplier - Controls - End-to-end process strategy
Productivity: <ul style="list-style-type: none"> - # of FTE - Transactions per FTE - Cycle Times - Automation and Presentment 	Employee: <ul style="list-style-type: none"> - FTEs and span of control - Staffing mix - Workforce development - Employee satisfaction 	Supplier specifics: <ul style="list-style-type: none"> - Baseline information - Processes - Automation - Supplier quality - Internal quality - Payment term optimization

Figure 3: Reporting Dimensions for a KPI Model for P2P

- Start measuring prior to change
 - Only by measuring performance prior to a change can the following benefits be gained:
 - Change can be tracked and business cases re-assessed easily
 - Assessment of performance levels becomes more objective and discussions less emotional
 - Risk-mitigation is introduced through provision of early warning signs and opportunity for root cause analysis

3 Best Practice KPI Models for the P2P Process

Within the annual Finance Shared Service Survey, The Hackett Group asked the participants which KPIs they use in the Accounts Payables process. The most common KPIs have been identified (see Figure 4) and include measures focused on productivity, cycle time, cost, error rates and on agreed service level.

Even though it is likely that most of these identified criteria will be included in each of the KPI tools for the P2P process it is important to build the actual KPI reporting model around key best practices:

- Focus on the recipient of the KPI report
- Alignment with the end-to-end process strategy which includes supplier base optimization, supplier and commodity classification and a risk-balance processing strategy

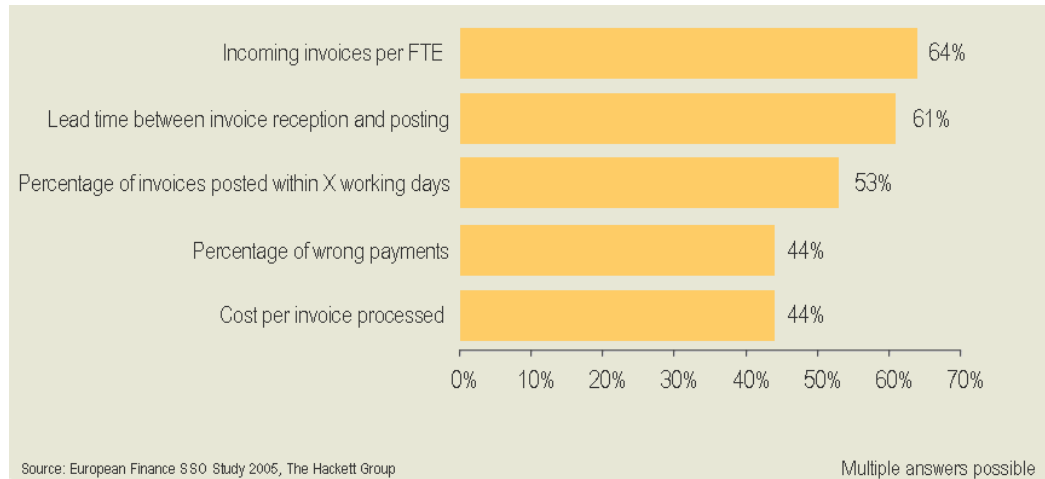


Figure 4: Most Commonly Used KPIs in Accounts Payable

Providing appropriate KPIs dependent on role

As discussed earlier, scorecard models need to be tailored to the needs of recipients. In general there are three main groups of recipients:

- Executives
- Heads of operations
- Team leaders

Figure 5 shows a sample of potential KPIs on the scorecard for each of these three groups, from an Accounts Payables perspective.

Executives naturally focus on more strategic aspects, for example, costs, value-add to the organization, compliance and measures indicating how well the company strategy is supported. Typical cost measures referenced on executive scorecards are: overall cost of the function, average annual labor costs, and cost per transaction.

Value-add in the P2P process will mainly focus on contribution to working capital improvement and savings on external spend. Compliance measures will summarize the results of an internal audit and indicate potential risks.

Heads of operations need to report to executives and use KPI reporting for operational management. In addition to the relevant measures reported on the executive scorecard, this group needs to see productivity process quality, indicators regarding the workforce and employees, and project-specific measures.

Strategic cost measures will focus more on transaction-related costs rather than total cost of operations. Value-add measures will also include the cost of process failure, (e.g. the cost of late payments). Besides classical productivity figures like transactions per Full Time Equivalent (FTE), measures looking at the level of automation are becoming more common. Quality measures for

heads of operations combine indicators of the overall quality of services (e.g. customer satisfaction, percentage of erroneous POs, number of inquiries normalized by number of invoices) with indicators to be used for root cause analysis (e.g. reasons for long cycle times).

Indicators regarding workforce and employees will provide the head of operations with information such as staffing mix and span of control, average training hours per FTE and indicators of employee satisfaction (e.g. satisfaction rating, overtime per FTE, fluctuation or sick hours per FTE).

Project-specific indicators will be defined per project and depend on the objectives and goals set for it. However, it is a best practice to define at least one KPI per key project so it can be tracked, monitored and re-assessed as appropriate.

If performance management is applied down to the team leader level, heads of operations need to track the KPIs against which the team leaders are measured.

They – or dedicated resources managing the SLAs – also need to track the performance indicators defined within the respective SLAs. In most cases, separate scorecards or reports will be defined for SLA-related reporting.

Finally, team leaders will have scorecards focused purely on the relevant operational and project-related measures they are responsible for. Operational measures will address the productivity and quality dimensions. Cost aspects and employee related measures are less important for individual team leaders.

	Executives	Head of Operations	Team Leader
Cost	Cost as % of revenue	Cost per Invoice	
	Average cost per FTE		
	Interest benefits of average payment terms		
	Average payment time		
	FTEs per billion of revenue		
Productivity	Invoices per AP FTE		
	% of electronically received invoices		
	Invoice cycle time		Days from inv. data capture to appr. routing
Quality	Audit reports		
	Customer Satisfaction rating		
	Cost of late payments as % of spend		
	Invoice backlog		
	% of invoices processed automatically		
	# inquiries as % of invoices		
Employee	Value and # invoices on hold		
	% invoices sent manually for appro.		
	Number of FTE		
	Staffing mix		
	Outsourcing ratio		
	Span of control		
	Turnover rate		
	Training hours per FTE		
Overtime per FTE			
Sick hours per FTE			
Strategic Alignment	Employee satisfaction rating		
	% of sup. making up 80% of trans.		
	% of inv. linked to „one-off“ sup.		
	% of invoices covered by PO		
	% of inv. covered by PO and GR		
	% of inv. line items covered by ERS		
	% of payments made via Pcards		
% of inv. covered by RIMs			
...			

Figure 5: Sample Scorecard for Accounts Payable

In addition to these general requirements it is also necessary to customize individual scorecards to the needs of the respective customer and the recipient of the KPI report. In addition to these sample scorecards, further focus setting is recommended.

End-to-end process strategy and KPI reporting

Increasing overall productivity, by keeping costs low or even reducing them, while in parallel ensuring enough controls are in place, is a problem that can only be solved with limited success within one function. Adding improved impact on working capital and improved decision support to these requirements makes it an impossible task.

The key to this problem is the development of an end-to-end process strategy consisting of

- Goals for supplier base optimization
- Supplier and commodity classification and term standardization
- End-to-end risk-control balanced processing strategy.

Normally, *supplier base optimization* looks to reduce the number of active suppliers and put in place a carefully selected pool of preferred suppliers.

Supplier and commodity classification and term standardization addresses the different types of commodities purchased, the strategic impact of the commodities, the relationship with the respective supplier and the risk patterns related to it.

The end-to-end risk-control balanced processing strategy (see also Figure 6) defines a preferred processing approach per commodity class characterized by its risk pattern. This strategy would define the standard process including the specific controls, the preferred means of document transmission (electronic vs. paper), and standard payment terms per commodity class. For example, catalog orders with self billing (ERS) could be the standard process for low value standard products purchased from a preferred supplier while key raw materials for the production process are handled via contract call off orders, goods receipt postings and electronic invoices with a three-way match.

The end-to-end process strategy makes the requirement for monitoring and measuring even more obvious.

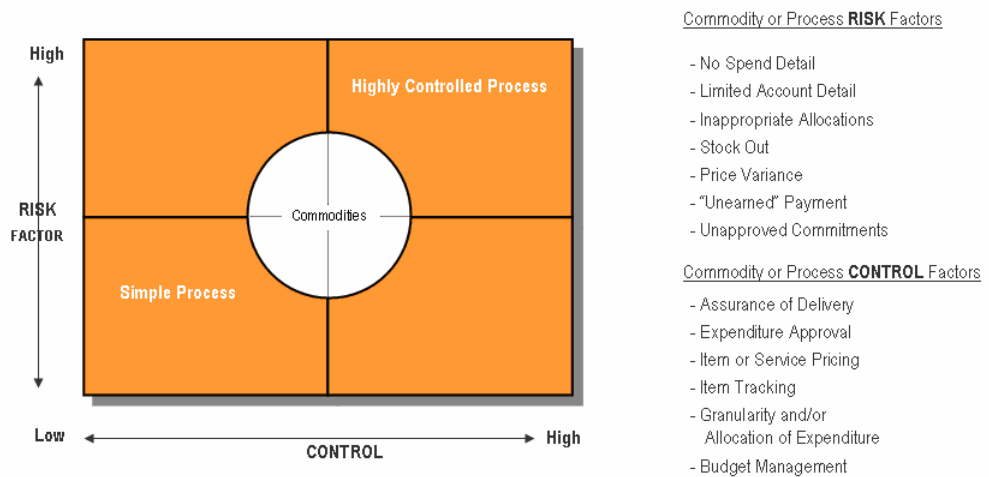


Figure 6: Risk-Controlled End-to-End P2P Process Strategy

Key measures and analysis of strategic alignment include:

- Pareto analysis on transactions and spend (the number of suppliers that make up 80% of total spend or 80% of transactions)

- Threshold-related analysis of one-off suppliers (the number of suppliers that have less than x transactions)
- Utilization of controls including contracts, purchase orders (POs), goods receipts or invoices
- Utilization of standard end-to-end processes

Trend analysis and target setting and tracking are key management practices needed to ensure the continuous improvement of overall end-to-end process performance.

4 Benefits Provided by Software Providers for P2P Automation

Software providers for P2P automation can add value in several key areas of KPI reporting. First, they can provide standard definitions for KPIs within the P2P process. This is a real value-add, because the biggest problem relating to interpreting and comparing KPIs is ensuring the application of equal definitions to ensure “apples-to-apples” comparisons.

Technically the biggest issue is being able to provide optimized and consistent data models. These need to balance response times for KPI reports with sufficient data granularity to allow meaningful analysis and drill-downs.

Combining these two aspects provides the biggest benefit to be provided by software providers - automation of data extraction. This can be utilized for feeding an integrated reporting tool/data storage system, and/or providing extracted data for upload to a separate reporting tool.

A KPI reporting tool consisting of the data model, plus a front end tool for results presentation, should be easy to use, yet flexible.

Flexibility is required in several areas:

- Multiple scorecards useable in parallel with different sets of reported KPIs
- Changes on scorecards need to be easy to make
- External inputs must be easy to integrate
- Multiple ways of analysis should be supported

Flexibility of analysis type is a key differentiator. It is vital that comparisons can be made between different organizational units and against pre-defined targets and scorecard reports, as well as drill-down and root cause analysis features.

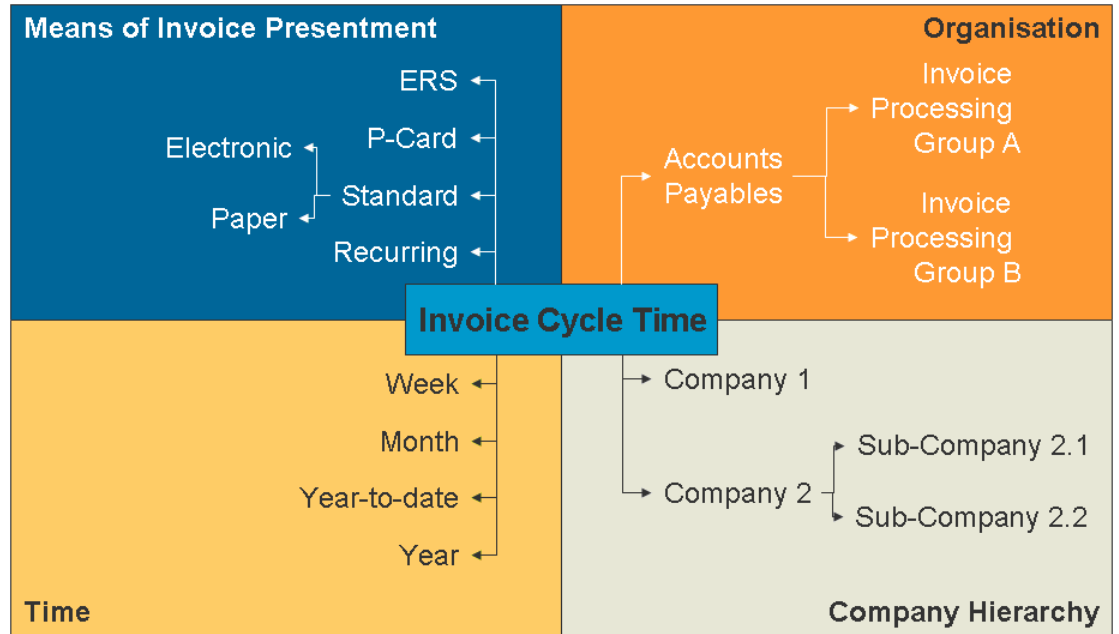


Figure 7: Use of KPI Model for Deep-Dive Analysis of Single KPIs

Scorecard reports will show the selected aggregated KPIs of different reporting dimensions, including the pre-defined comparisons (in most cases these will be time, trend, against target and pre-defined thresholds for early warnings). Drill-down analysis will allow the analysis of an individual KPI by specific dimensions.

The drill-down dimensions depend on the data model defined (see Figure 7). Root cause analysis will support the breakdown of other influencing KPIs (see Figure 8).

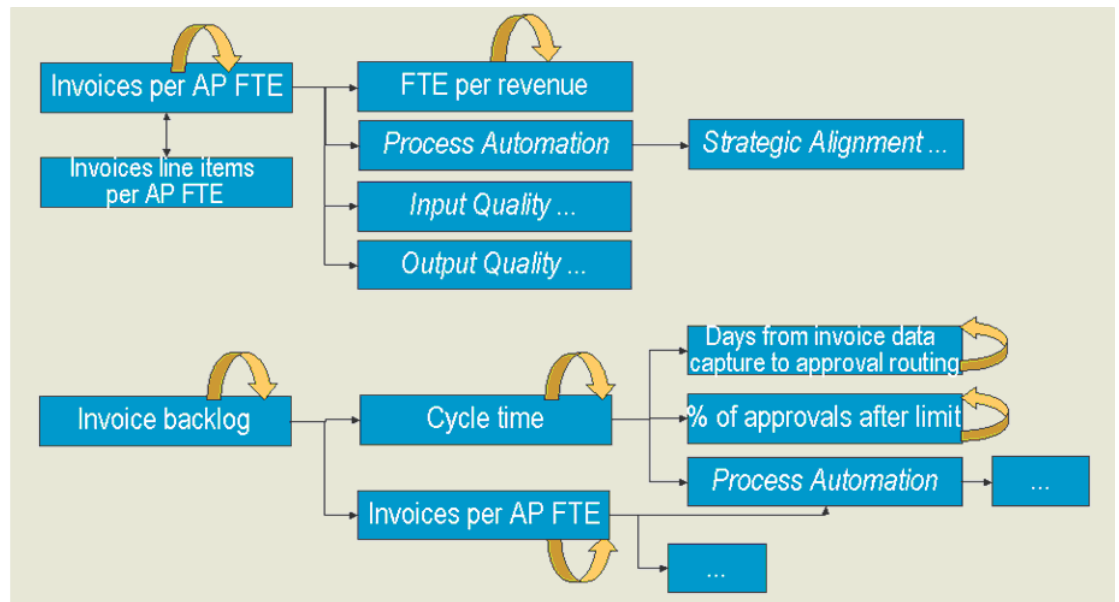


Figure 8: Root Cause Analysis in Order to Define Appropriate Actions

Last, but not least, P2P automation software providers offering KPI reporting tools must have a business consulting capability. Consultancy support is likely to be required for selecting the right set of KPIs, customized to the needs and the strategic goals and objectives of the client.

Consultants need to be able to explain the definitions (input data as well as KPI calculation), objectives and ways of interpreting the KPI. The KPI interpretation and definition of appropriate actions make the difference between basic and truly successful implementations of performance management tools.

5 Looking Forward

This white paper highlighted key principles of performance management in the end-to-end P2P process. We have elaborated the needs of end-to-end process focus, as well as the benefits the for P2P-process automation software provider can offer.

Future white papers on performance management in the P2P process will further explore the strategic aspects of KPI reporting e.g. KPIs reported on executive level, KPIs used for measuring strategic alignment of the P2P process, and how KPI reporting in the P2P process can be used for improved decision support; and how KPI reporting can support a process of continuous improvement in the end-to-end P2P process.