BY DAVID SCHNITT

The Right Leverage

As we round the corner toward 2015, we're entering a crucial phase in the annual lifecycle of manufacturing. With 2015 planning and financials set in place, now is the time for manufacturers to put processes in place that will drive positive business results and establish a framework for reaching next year's goals.

With manufacturing in the U.S. predicted to grow in 2015, many firms are striving to take their business to the next level through geographic expansion or supply chain improvements. For mid-size manufacturers, growing to the next level without strains on business processes is crucial to their success. To continue to grow and scale their operations successfully, it's important for mid-size firms to consider how their back office will grow and develop as their business expands. Can your purchasing team manage an expansion into a new

Manufacturers need to put processes in place that can drive positive business results and help reach future goals.

Benchmarking and data collection can provide valuable operational insight and help manufacturers make better decisions.

market? What about your accounts payable department?

Benchmarking and data collection are two important methods for manufacturers to provide data for better decision-making and drive actionable business insights in 2015. Through the identification of patterns and trends in purchasing and other processes, manufacturers can optimize the factors that can have the greatest return on investment. For the back office, data collection can be crucial in helping the CFO and finance department understand where costs are incurred and where they can be reduced to help save the firm more. By having a greater control over costs, CFOs of manufacturing companies can more effectively manage cash flow and identify potential opportunities to cut costs and improve savings.

Overusing POs

We've seen many CFOs of manufacturing companies have a lack of control over business processes, which can lead to a worrisome trend: manufacturers' over-reliance on costly purchase orders (POs). By overusing POs, manufacturers increase the cost of the procurement process and overspend by relying on a process that gives manufacturing executives the illusion of control over their business processes.

Purchase orders are typically issued by a manufacturer for specific goods, parts and raw materials. They are a legal document that specifies pricing, quantities and other conditions when ordering product. Furthermore, POs are issued by a highly skilled purchasing department, whose job is to negotiate and secure the best prices, terms and other conditions for the products necessary for the business. The best organizations have purchasing teams that act seamlessly across the enterprise and can determine when POs should be issued and when they may not be necessary.

What's happened, however, is that many manufacturers now issue POs for every transaction, even for services, office supplies and utilities.

At face value, this doesn't sound like such a big problem. But by issuing POs for every transaction, manufacturers increase the overall cost of the purchasing process and dramatically complicate their internal processes. Costs go up because expensive purchasing professionals have to spend time creating POs and sending them to the vendors. Then, when the invoice arrives, the AP department has to match the PO to the invoice and receipt. In our experience, many manufacturers have a 30 percent exception rate in the matching process, which means that those invoices are routed back to purchasing so they can amend the PO in order to match the invoice. This raises the costs further while at the same time reducing the amount of time the procurement team can spend negotiating the purchase of crucial goods and raw materials for the business. It's not unusual for many companies to create POs so they can match them to invoices that they already received.

In fact, we often see that the total cost of the procurement to payment process (P2P) for an item bought with a PO costs one-and-a-half to two times as much to process as one bought without a PO. In addition, using POs eliminates the review of invoices by department managers, who often find errors and other issues when reviewing invoices for approval.

For instance, one of our clients in the manufacturing industry had a rule that anything bought for more than $5,000 had to have a PO. In practice, this meant that many invoices arrived into the AP department, which then had to route them to purchasing so they could create a PO to match to the invoice. To fix this, we reengineered the process so procurement only issued POs when they could add value in the purchasing of those specific goods and services by negotiating better pricing, terms or other conditions. The company regained control by electronically routing invoices to department managers for approval and they were held accountable each month for their spending versus budget. The client's procurement costs went down dramatically and their control increased, as well, since there was greater focus on budgets and spending by department.

Internal accountability, understanding cost per invoice and benchmarking can help manufacturers' financial performance.

Effective Data

Collecting data has never been easier for manufacturers – as long as the controls are in place for gathering this information. With this in mind, here are three ways manufacturers can collect and leverage data to form actionable business insights for 2015:

+ Hold every department accountable. You can have far more control over your operation by holding each department accountable for a specific budget. This also shifts responsibility to department managers instead of relying on the purchasing team.
+ Determine your cost per invoice. I'm always surprised by the fact that so few mid-size manufacturing firms know this information. To calculate your cost per invoice, calculate the total cost of all accounts payable functions (salaries and benefits, IT, overhead, recruiting, training, outside vendors, etc.) and divide it by the number of invoices processed per year. Once you figure this out, you can compare your cost per invoice against other firms of similar size to see if you can improve.
+ Conduct benchmarking reports. Whether conducted annually or quarterly, benchmarking reports can help you track and anticipate the myriad costs of running a business next year. Within accounting and finance in mid-sized companies, benchmarks haven't budged in the last 20 years. With this knowledge, you can more decisively find solutions that will cut costs while also being able to anticipate the effect this will have on the finance department.

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