CANON BUSINESS PROCESS SERVICES

A Practical Guide to Accounts Payable Outsourcing

by The Hackett Group

Can Your Department Cut Costs and Improve Service Levels by Outsourcing Accounts Payable?

Will your business see significant savings by outsourcing all or part of your AP function? This report by The Hackett Group and provided to you complementary by Canon Business Process Services explores the benefits and drawbacks of AP outsourcing along with important considerations as you assess outsourcing for your business. Read the report to learn more about the options available to improve your AP performance.

For more information about how Canon Business Process Services can help your company improve your accounts payable operation, please call 888-623-2668 or visit cbps.canon.com.

COMPLIMENTARY RESEARCH

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The Hackett Group
World Class Defined and Enabled

A Practical Guide to Accounts Payable Outsourcing

Use cases, benefits and considerations, and selecting a partner

By Jimmy LeFever

EXECUTIVE SUMMARY

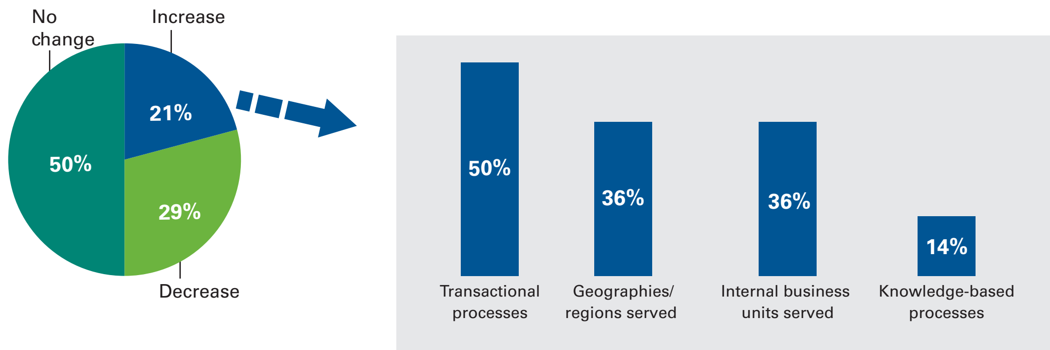
Accounts payable outsourcing has been around for years. But for many companies, the efficiencies gained from outsourcing do not outweigh the associated costs. There are myriad reasons why outsourcing may not make sense, but for most, it is because they have already invested heavily in a robust and efficient shared services center. For others, the reason is a lack of sufficient scale. Still, for some organizations, outsourcing certain aspects of accounts payable is a good fit. Some processes are more suited than others, particularly those that are relatively high-effort and low-value, such as document receipt, data entry, and supplier inquiry response. Companies evaluating outsourcing should consider both its potential advantages, such as increased efficiency and decreased cost, as well as its disadvantages, including increased compliance risk and risk of intellectual property theft.

STATE OF THE ACCOUNTS PAYABLE OUTSOURCING MARKET

Creating efficiency in accounts payable and similar processes is usually a large undertaking. Countless moving parts and stakeholders are involved in what is seemingly a simply process: paying the bills. There are generally two distinct directions that worldclass finance organizations go in when transforming accounts payable: establishing ashared services/global business services center internally or outsourcing. For particularly large organizations, the former usually makes the most sense and is a more cost-effective solution. For smaller organizations or those that are growing rapidly, outsourcing may be a good solution. In a Hackett Group poll, purchase-to-pay practitioners were asked for their three-to-five-year outlook on the utilization of outsourcing partners (**Fig. 1** on page 2). Twenty-one percent of respondents stated they expected an increase in outsourcing. Among this group,half anticipated a rise in outsourcing of transaction processing.

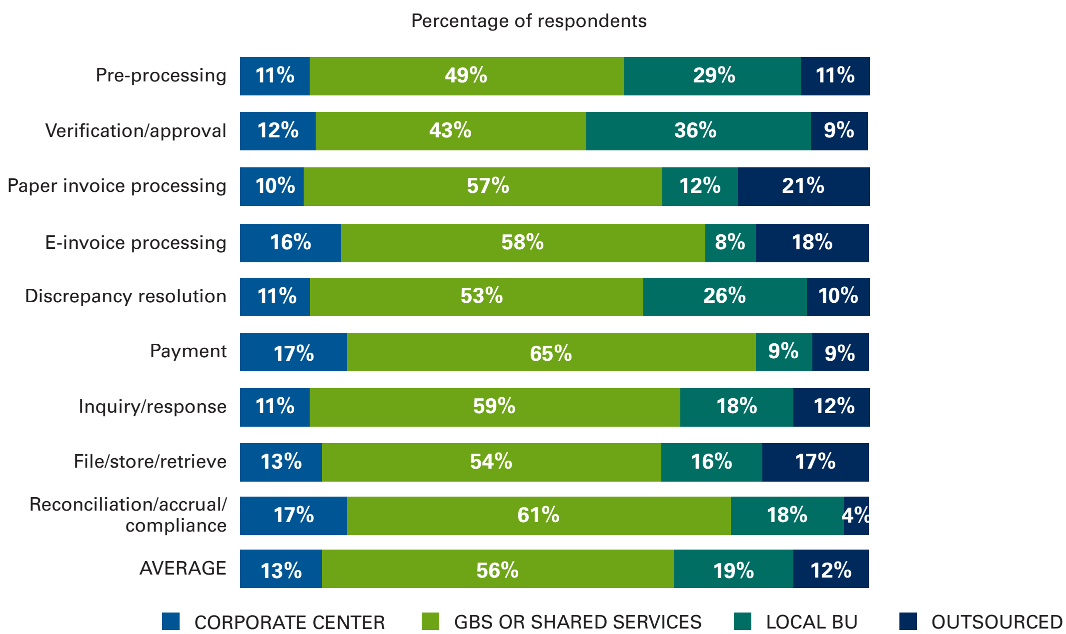
Purchase-to-pay organizations that outsource activities do so most often with AP processes, especially invoice processing (both paper and electronic formats), inquiry/response, and file/storage/retrieval (**Fig. 2** on page 2).

FIG. 1 Expected 3-5 year change in outsourcing of purchase-to-pay processes



Source: Service Placement Poll, The Hackett Group, 2017

FIG. 2 Accounts payable process sourcing



Source: Service Placement Poll, The Hackett Group, 2017

WHAT SHOULD BE OUTSOURCED?

Generally, processes that are best suited to outsourcing have a high contribution to operational performance but low strategic importance. These processes are often described as "tactical" and require little to no organizational knowledge to execute. Nor do they present a high security risk if data is lost or stolen. Compared to outsourcing, they also require significant cost to build out capabilities internally. But outsourcing, in addition to its benefits, also has drawbacks (**Fig. 3** on page 4). These must be understood and feed into any decisions about service placement.

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Outsourcing is defined as the process of hiring an outside party to be responsible for a planned or existing activity that is or could be done internally. Common examples include call centers, document-shredding services and facilities management.

Accounts payable outsourcing may comprise processes or parts of processes from invoice preparation and processing to payment, document storage and reconciliation.

ACCOUNTS PAYABLE PROCESSES

Pre-processing: Handling and sorting of mail to prepare for verification and approval.

Verification/approval: Review of invoices to determine proper first steps, i.e., match with PO or route for approval or discrepancy resolution. Includes routing and account or department coding.

Processing: Receipt and processing of electronic inputs (EDI, ERS, adjustments, etc.). Includes manual processing of rejected transactions, researching/clearing of invalid data, and input of invoice data into payables system. Includes batching invoices for filing.

Discrepancy resolution: Identification of discrepancy cause (price/quantity difference, short pay, missing PO number, etc.). Includes notification of such to buyers, follow-up of aging documents and input of corrections.

Payment: Creation of payment file and various methods of execution (i.e., check, ACH, card payment, wire).

Inquiry response: Response to internal or external calls, emails or other inquiries regarding the status of invoices or payments.

File/store/retrieve: Retiring of inactive documents for future use.

Reconciliation/accrual/compliance: Accounting reconciliation for the payables checking account and general ledger. Includes accrual and support of tax audit staff/agencies.

AP processes that would benefit most from being outsourced depends on the size, speed of growth, scale and other attributes of the company. Generally speaking, the most impactful areas to outsource are invoice preparation, receipt, data entry, supplier inquiry response and payment. These tend to be labor-intensive but do not require knowledge specific to the company or include highly sensitive data, meaning there isn't an intrinsic reason they need to be done internally.

- **Invoice preparation:** Outsourcing providers are able to make use of large numbers of PO boxes, which reduces transit time of paper invoices. They also have invested in machinery to open, collate and sort documents at scale. These machines would be cost-prohibitive for all but the largest companies. Outsourcers also generally have scanning technologies for paper invoices to get them into digital form.

- **Invoice receipt and data entry:** Outsourcing providers make use of lower-cost labor than traditional, salaried AP clerks (generally in the form of offshore or onshore part-time/temporary labor). Again, their scale makes it feasible to invest in and deploy large, expensive scanners with intelligent data capture solutions.

- **Supplier inquiry response:** Ask any AP resource what their top complaint is and they will likely say it's phone calls and emails from suppliers inquiring about the status of their invoices or payments. When handled internally, this work distracts from other, more business-critical activities. Having a service provider handle the majority of these inquiries results in increased satisfaction of both suppliers and internal staff.

- **Payment:** Outsourcers can take over not just payments but also electronic payment conversion. They can prioritize payments with the highest returns (card payments with rebates) over payments that have the highest cost (checks and wire). They can collaborate with companies in campaigns aimed at transitioning suppliers to more cost-efficient payment methods, sharing some of the savings with clients. This capability is potentially lucrative enough to outweigh the cost of the outsourcer.

FIG. 3 The benefits and drawbacks of AP outsourcing

Benefits	
Cut costs and save time	Outsourcing providers often reduce the cost of transactional processing and cycle time significantly.
Efficiency	Service providers often have automation capabilities available from day one, allowing clients to take advantage of these tools without upfront investment.
Always "on"	Most service providers offer 24-hour services, which is particularly impactful for global organizations that couldn't replicate this without numerous AP centers across the globe.
Error reduction	Human error is reduced by a combination of technology and service level agreements promising a certain level of accuracy.
Better analytics	For organizations that do not yet have analytics capabilities, outsourcer will make available a large amount of data and often offer visualization dashboards to analyze invoice data.
Ability to scale faster	Perhaps the most meaningful benefit for fast-growing organizations is that service providers may be the only reasonable option. Rapidly hiring AP staff to keep up with growing invoice demand will never be as simple as paying more to a provider to process more invoices.
Clearly defined cost structure	Similarly related to the ability to scale faster, growing AP operations have a number of lesser-known variables, including salary and overhead increases. Most service providers offer a straightforward pricing model (usually per invoice or per payment) that can be easily forecasted for growth.

Drawbacks	
Loss of controls or IP	When an organization outsources anything, it gives up a certain level of control and visibility into the process, particularly in real time. For companies whose invoices may contain sensitive IP information (e.g., recipe ingredients) the prospect of outsourcing AP might be a non-starter.
Increased compliance risk	For some highly regulated industries, such as healthcare, outsourcing generally isn't possible because of government regulation, such as HIPPA (invoices may contain patient information). For other organizations, there may be geographic limitations, and thus a provider that offshores is not suitable.
Audit and error resolution issues	Error auditing will generally be conducted by the service provider with limited visibility by the client. Occasionally this will result in a temporary inability to effectively resolve issues or locate the source of the problem.
Exception processing will likely be less streamlined	Exception processing will inherently involve an extra step when AP is outsourced, thereby lengthening the process.
Duplication issues will raise costs	If an organization has a lot of duplicate invoices, it may pay higher-than-average outsourcing fees, as most outsourcers charge for both documents, regardless of their duplication.
Dependency	An organization that outsources is dependent on the business health of the service provider. If it were to suddenly cease operations, this could have a very negative impact on the client's operations or credit rating.
Bound by long-term agreements	Standard outsourcing contracts are generally for 3-6 years. Although outsourcing may make a lot of sense today, this may not be the case in the future, for example if the company is acquired or merges with one that has a very robust shared services department.

Source: The Hackett Group

IMPORTANT CONSIDERATIONS

There a several questions organizations should ask themselves to assess the potential benefits and drawbacks of outsourcing AP, including these:

- **Would developing a shared services/global business services organization be a better choice?** For very large organizations, a captive service center may be able to achieve the same level of efficiency and cost reduction as outsourcing. This is particularly true for mostly domestic organizations that do not require service in more than one language or have to deal with foreign-tax implications.

- **Can automation offer the same or similar benefits as outsourcing AP processes to a purchase-to-pay provider?** In many ways, automation can substitute a large amount of the manual work involved in accounts payable. Organizations should consider whether technology can handle what they are trying to outsource or a comparable level of service is available from a current technology service provider, or potentially both.

- **Is the company's AP process already efficient?** Before considering outsourcing, organizations should first ask whether internal process improvements could deliver easy efficiency increases. Process automation offers significant gains and technology in this area is mature. For example, already-complex approval hierarchies will only become more so by adding a third party.

- **How uniform are the invoices?** And what percentage are sent in paper format? Invoice uniformity and level of paper invoices have a large impact on the cost and efficiency of AP outsourcing, especially if an organization is outsourcing invoice receipt and data entry. Service providers nearly always charge more for handling paper invoices than electronic ones. Also, increased uniformity of invoices will reduce cycle times when outsourced. Organizations should explore ways to reduce paper and raise invoice uniformity before considering outsourcing (except in cases where the desire is to outsource only the payment portion of the process).

- **How sensitive is the information contained in the invoices?** As previously mentioned, for some organizations there may be security or compliance concerns when outsourcing accounts payable. Healthcare organizations, for example, may have trouble finding an outsourcer that can comply with HIPPA and other data-privacy regulations. Likewise, organizations whose invoices may contain trade secrets may not find outsourcing to be a viable option.

The above list is not meant to be exhaustive but should be a good starting point for organizations that wish to explore outsourcing one or more AP processes. Other considerations specific to industry, business type, or the organization itself should be explored as well.

SELECTING AN OUTSOURCING PARTNER

When selecting an outsourcing provider, organizations should start with the business case. Every adept provider will be able to present a clear ROI model that shows a return over current internal processes. This will generally take the form of cost-per-invoice or cost-per-payment, before and after. Other considerations are listed below:

- **Adequate breadth and experience:** Organizations should choose a provider that can handle their level of invoice volume and geographic reach. Confirm whether the provider is equipped to scale quickly should the need arise.

- **SLA review and negotiation:** Remember that processes and invoice makeup may change over time (likely moving to more electronic). Be careful not to get locked into minimums or maximums in terms of type, frequency, formats, etc. Also, carefully read accuracy promises. Some providers will promise 99.9% accuracy, but it's at the character level. That means that invoices with more than 999 characters, on average, contain one discrepancy apiece. Accuracy promises should be at the document level.

- **Double-blind keying:** OCR technology has not proved entirely adequate for capturing invoice data. Double-blind keying, in which a human worker keys in invoice data, which is then checked by another person, results in significantly higher levels of accuracy.

- **Technology integration and IT signoff:** Involve IT early to ensure they have a full list of requirements for potential outsourcing providers. The latter need detailed technical information to adequately assess the level of implementation that will be needed, a cost that could drastically affect ROI.

- **Compliance and legal approval:** Obtain signoff from internal compliance and legal departments on allowing the information present on invoices to be shared with a third party. In some cases, such as those involving trade secrets, there may be a need to gain executive or even board approval to outsource invoicing.

CONCLUSION AND RECOMMENDATIONS

Organizations considering outsourcing accounts payable should carefully consider the use cases presented in these pages. For very large companies or those whose invoices contain sensitive data, a shared services model likely makes more sense. However, for middle-market organizations or others experiencing rapid growth, outsourcing may be the right choice, at least for paper-invoice receipt, payments and supplier inquiries. Still, it rarely makes sense for organizations to outsource all of accounts payable.

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About the Advisor

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In addition to conducting research on topical subjects, Mr. LeFever advises clients as they work to optimize their processes, organization and technology (both on-premises and cloud-based). His subject matter expertise includes sourcing, contract management, procure-to-pay, order-to-cash, payments, and travel and expense management. Before joining The Hackett Group, he was director of research and consulting at PayStream Advisors.

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