PO Processing Cost: Average Cost, How To Calculate It, and How To Reduce Costs with Software

IN THIS ARTICLE

Many businesses try to cut costs by limiting spending, but how much could you save by spending more efficiently?

Every purchase order (PO) made, approved, placed, and paid costs you money to process.

If you're not processing efficiently, PO processing costs can have a surprising impact on your bottom line.

With the right technology and process improvements, you can reduce your PO processing costs and bring measurable cost savings to the purchase order process.

In this article, we'll help you understand what those costs are and what you can do to reduce them.

What Is PO Processing?

Purchase order (PO) processing is the set of steps that it takes to create, place, and pay for a PO.

These steps include requesting the purchase, approving it, sending it to the vendor, and paying for it after the goods and services have been received.

The purchase order process is part of the greater procurement process that also includes finding and vetting suppliers, setting up contracts, budgeting, spend management, and more.

PO processing can either be done manually, with paper-based forms and Excel spreadsheets, or with PO software that automates the requisition, approval, and PO creation process.

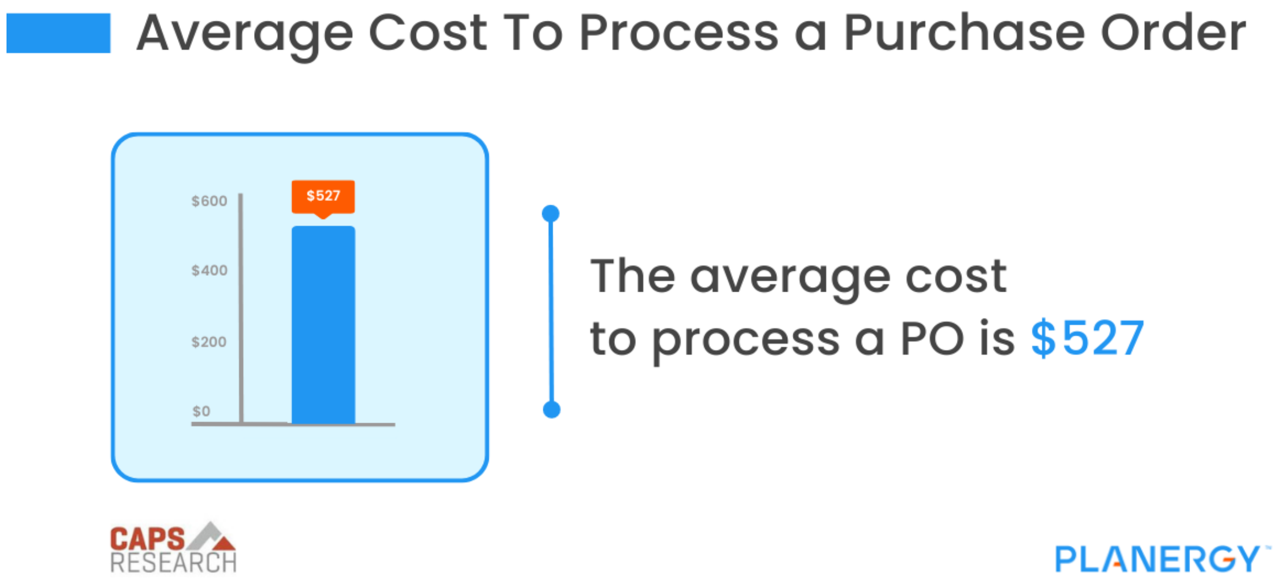
While software has a cost, it streamlines the PO process and ends up saving your company money and time compared to manual processes.

It also reduces errors, cuts labor hours needed for managing POs, enforces compliance with internal controls for purchasing, and helps improve supplier relationships by making it easier to pay on time.

How Much Does It Cost To Process a PO?

According to CAPS Research (Center for Advanced Procurement Strategy) 2022 Metrics of Supply Management (MoSM), the average cost to process a PO is $527.

However, these costs have a wide range across different industries, so it's important to calculate your company's PO processing costs for yourself.



Source: CAPS Research 2022 Metrics of Supply Management Cross-Industry Report

To understand your PO processing costs, you must be able to define and measure each PO process.

This cost will vary between companies and can be difficult to pin down due to differences in accounting procedures, industry specifics, and internal business practices.

Once you're able to quantify these PO costs, you can look for areas to reduce them.

> *CAPS Research found that the average processing cost per purchase order was $527 in 2022. This cost varies across industries due to different processes, procedures, tools, and regulatory requirements.*

What Factors Contribute To the Cost of Processing a PO?

Many factors contribute to PO processing costs. There are fixed costs (e.g. overhead, salaries, benefits, and infrastructure) and variable costs (e.g. postage, hourly staff wages, office supplies, etc.) that are incurred with each PO creation, approval, and fulfillment.

Variable costs are especially important to identify and, if possible, limit. These costs change from one purchase order to the next and can dramatically alter your calculations.

The easiest way to understand both fixed and variable costs is to break down the purchase order process and identify costs for each stage:

- ## Internal Purchase Order Processing

  This involves identifying needs, choosing what to purchase, selecting vendors, and creating purchase requisitions. This also involves the requisition approval process and creating the PO and sending it to the supplier.

- ## External Purchase Order Processing

  This covers interactions with suppliers after the PO is submitted. External PO processing can include revisions, clarifications, adjusted quantities; or discussions about shipping times, product availability, and potential replacements for items ordered.

- ## Order Management

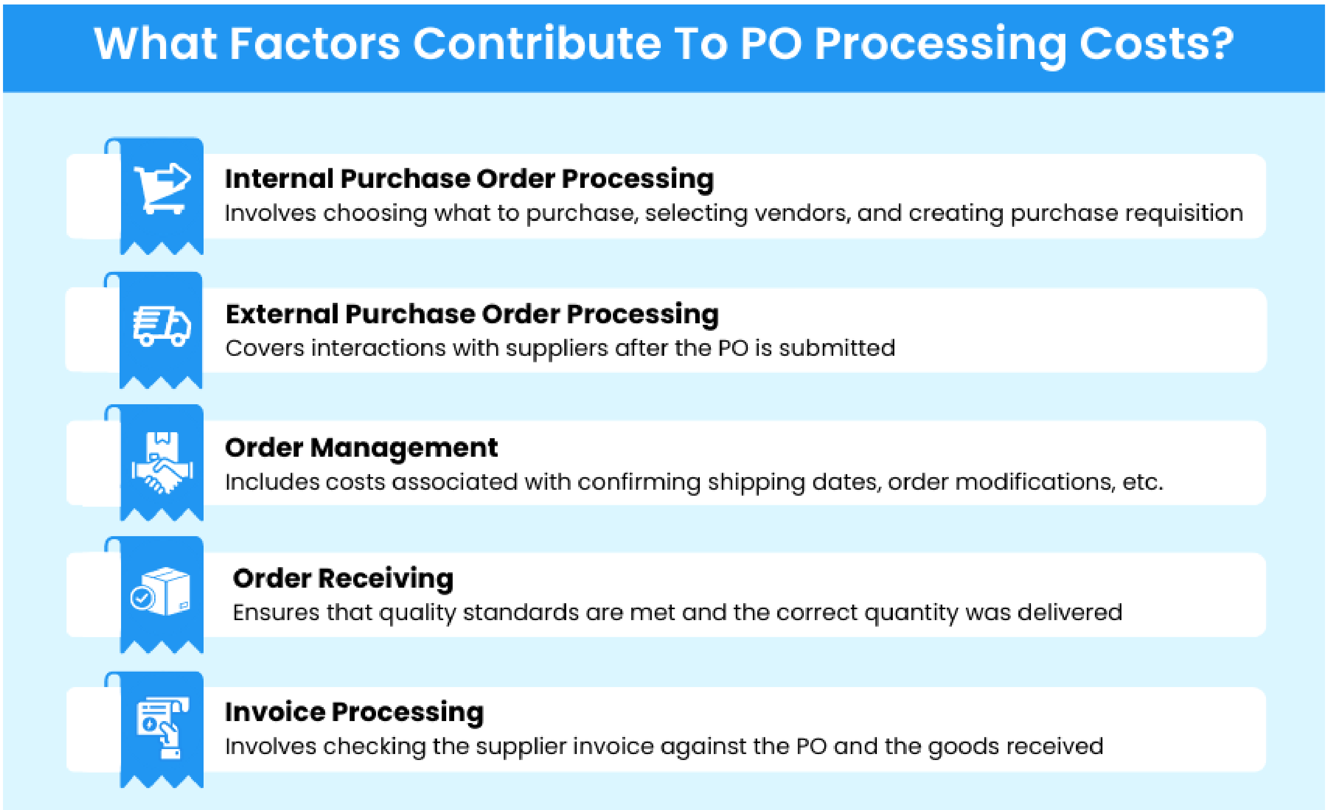
  After the order is placed, there may be costs associated with confirming shipping dates, order modifications, or other communication related to the status of the order.

- ## Order Receiving

  Once you receive the order, it needs to be checked to ensure that quality standards are met and the correct quantity was delivered. If there’s a problem, there may be additional costs related to returns, additional shipping, and correcting errors.

- ## Invoice Processing

  Your accounts payable team will check the supplier invoice against the purchase order and the goods received notes (or other receipting information) for any discrepancies as part of the 3-way matching process. This can be automated using AP automation software within a procure-to-pay solution.



If the invoice and PO don't match, you will incur more costs as staff will spend time on corrections, exceptions, and approvals.

After breaking the process into clear steps and tallying your fixed and variable costs, you should also factor in the time it takes to complete each step.

To figure out the time costs related to PO processing, ask yourself:

- How much are you paying staff involved per hour for the tasks they carry out in each step?
- How many POs are you processing and how long do they take to work through these steps?
- How many exceptions are you dealing with and how long does each one

take to resolve?

Manual processes in your supply chain can be incredibly time-consuming and are a great place to look at when considering how much automation can save you.

Also, the more you can reduce the involvement of senior management in the processes the better.

The cost per hour for their involvement will be higher than junior members of staff.

Calculating Your Average PO Processing Cost

Once you identify the fixed and variable costs for each step of the PO process and your time-related costs, you can calculate your average PO processing cost.

The cost associated with each stage is the average time spent on each process within it, multiplied by the minute-rate cost.

Resource Cost = (Average time spent on a task) * (minute-rate cost per resource)

Note: The minute-rate cost is the hourly cost divided by 60.

Calculating the staff costs for a buyer to create a purchase requisition starts with the annual compensation (including benefits) for that buyer divided by the total hours worked in a year.

For our example, the buyer’s salary + benefits cost $92,000 per year and 1,820 is the number of work hours for a full-time employee in one year.

$92,000 ÷ 1,820 = $51

We then take that hourly rate and divide it by 60 to get the minute rate:

$51 ÷ 60 = $0.85

Now you know you’re paying the buyer $0.85 a minute to create a requisition. If the average requisition takes 10 minutes to create, then you’re paying an average of $8.50 for each one to complete this step.

You can repeat this calculation for each staff member or other resource and total them up for each stage.

You can find your average PO processing cost by dividing the total cost for all stages by the total number of POs you processed in the period being measured.

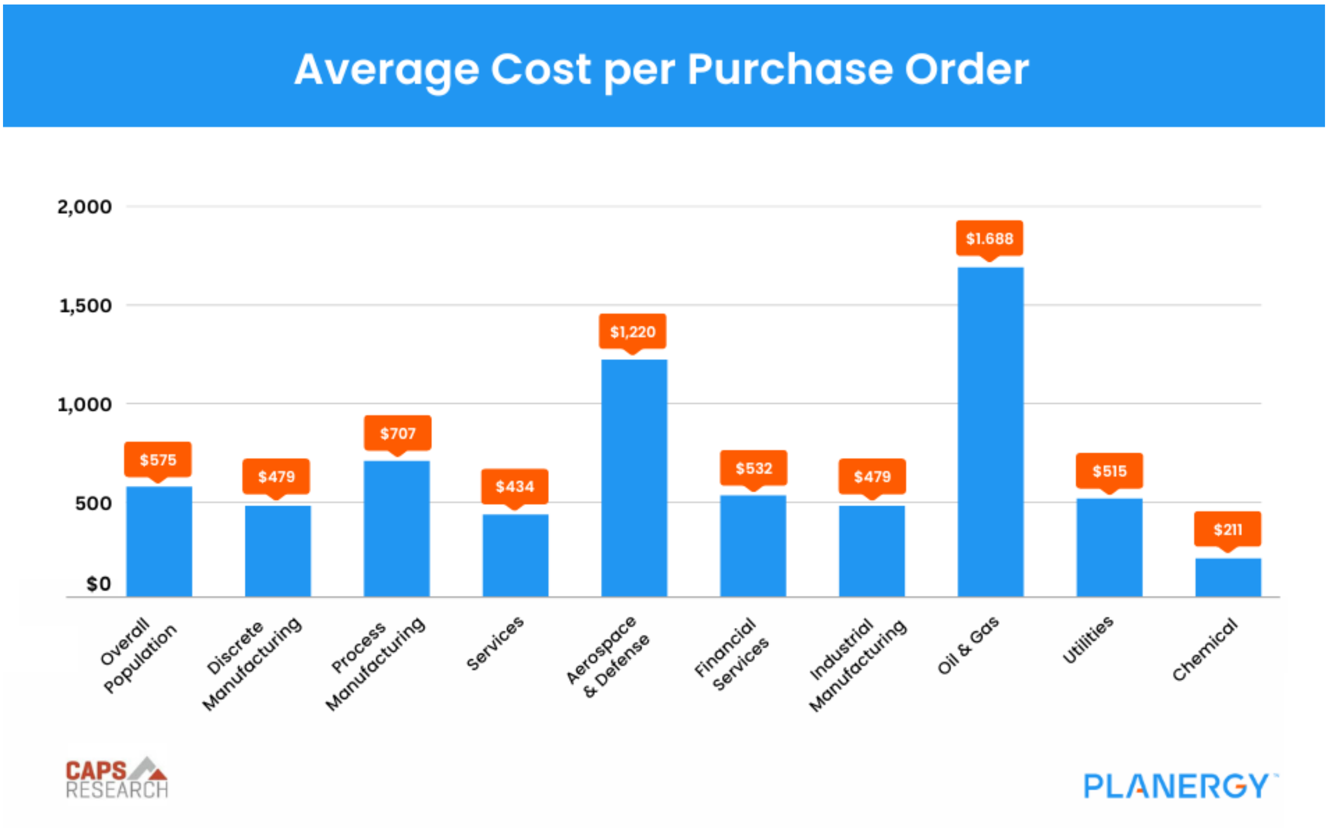
Once you understand your costs, you can start to find tremendous opportunities for savings. You can also identify which areas are costing you more than others and focus on creating efficiency there.

Cutting 20% off of your PO processing costs has a strong impact when multiplied by 1,000s of purchase orders per year.

Do PO Processing Costs Vary for Different Industries?

PO processing costs vary greatly across industries and verticals. Industry-specific factors play a significant role in how much it costs an organization to spend money. Costs are higher in industries with more complex contract structures, strict regulations, and increased scrutiny.

As you can see in the chart below, average processing costs vary greatly across industries. Ranging from $211 in Chemical companies compared to $1.688 in Oil & Gas companies.



Source: 2021 Metrics of Supply Management Cross-Industry Report

Regardless of how complex an industry is, companies can still save significant amounts by digitizing and automating as much of the process as possible.

How Can You Reduce the Cost of Processing POs?

The most effective way to reduce the costs of processing POs is to embrace procurement automation. Every second you spend processing POs increases your costs.

Making your processes faster, more accurate, and less labor-intensive will give you the biggest bang for your PO buck. This is how purchasing software streamlines and automates these processes to deliver value.

Implementing an effective eProcurement software solution will cut costs across your entire procure-to-pay process.

It becomes easy to streamline the PO cycle with automated approval workflows and reminders, the ability to instantly create POs from approved requisitions, through guided buying help staff buy from preferred suppliers, and give full visibility into company spend with real-time budget information at the point of approval.

Efficient software can reduce the PO cycle from days to mere hours.

Procurement software also increases accuracy and reduces risk as each PO is automatically verified against the linked invoice and shipping documents. Human errors, exceptions, and hours spent correcting them are eliminated—while fighting invoice fraud at the same time.

Procurement software can also integrate with both Enterprise Resource Planning systems (ERP systems) and Customer Relationship Management (CRM) systems. This helps you not only reduce the cost of processing POs but add value to the entire organization as more collaborators are able to better support your procurement strategy.

It’s More Than Just the Cost of a Purchase Order

Working out the math to understand your purchase order overhead costs can be illuminating. You realize how much extra you spend while you are spending, which many companies don’t consider. Using a purchase order system to cut these costs is fantastic, but the value goes beyond cost-cutting.

Many organizations exist in software siloes that don’t communicate well outside the platform.

Aligning your procurement team and finance department under one system is invaluable. You get more buy-in to procurement initiatives, better communication, and more people actually fulfilling the goals that procurement sets out, which further increases cost cutting.

Understanding your purchase order process cost and taking action to fix it with procurement software can create a flywheel effect of value creation.

Labor hours are saved, costs are cut, and people start to work together towards greater common goals and furthering your company’s mission.

What’s your goal today?

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