



Aberdeen *Group*

The CFO's View of Procurement

Getting More to the Bottom Line

September 2005

Offered by Source One



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Executive Summary

Uncertainty, slower revenue growth, and lower profit margins caused by higher interest rates and commodity-driven inflation will place greater demands on both Finance and Purchasing to control costs. Despite the advancement of the purchasing function and executive support of procurement policies and procedures, CFOs see broader business limitations that must be addressed to ensure the enterprise-wide procurement activities are established as key contributors to corporate competitiveness. This report provides insights into procurement, its strengths, and weaknesses from the viewpoint of finance managers.

Issues At Hand

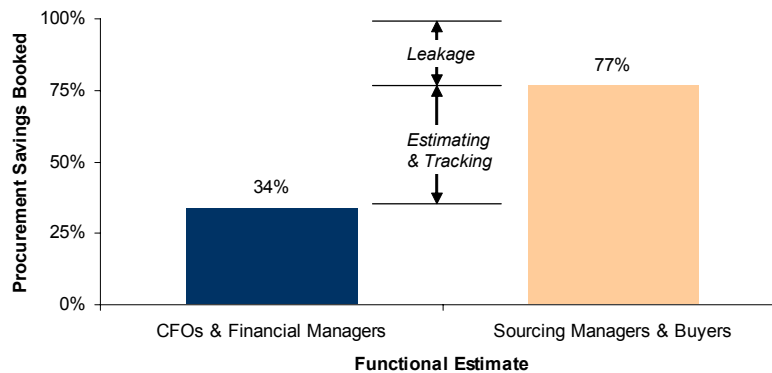
CFOs acknowledge the increased influence of procurement over the past five years, and most see it as a growing contributor to corporate competitiveness. CFOs and CPOs (chief purchasing officers) agree on the priorities for procurement going forward. Initiatives that directly manage supply availability, transportation/logistics costs and escalating commodity prices are areas where procurement should play a leading role. Business model changes are areas in which procurement must have “some role” and actively support the line-of-business managers. These initiatives include evaluating outsourcing make/buy decisions, improving cash flow, complying with new regulatory requirements, and manage sales, general and administrative cost.

Finance managers surveyed indicate that procurement’s current skill-set strengths lie in their negotiation and contracting capabilities. But the weaknesses — costing, project management and process innovation — are indicators of the enterprise-wide limitation of the procurement program.

Key Business Value Findings

No surprise, the CFO’s real concern is getting savings to the bottom line. Financial managers estimate that 34% of projected procurement savings, on average, getting booked is dramatically lower than the 75% to 80% savings capture rate being reported by sourcing managers.

Figure i: Estimated Percent of Projected Procurement Savings Booked



Source: AberdeenGroup, March 2005

Aberdeen analysis illuminates four underlying limitations that are likely contributing to the savings gap:

1. Various functional interpretations of the term “savings”;
2. Lack of company-wide guidelines to calculate, track and budget for the savings;
3. Passive involvement of finance in procurement activities; and
4. Limited use of formal procurement plans that link to business plans.

The overall gap in procurement savings far exceeds the functional discrepancy on how savings are calculated or reported earlier. Four process limitations collectively present a savings gap that, in most cases, exceeds actual savings booked.

1. Estimating and tracking, savings gap: 30 – 40%
2. Internal/supplier compliance, savings gap: 20 – 25%
3. Lost negotiation effectiveness, savings gap: 5% - 7%
4. Unaddressed spend, unaddressed expenditures: 18.5% of revenue

AberdeenGroup believes these are real case for concern.

Implications & Analysis

Companies that reported the highest confidence in booking procurement savings and had the highest levels of expenditure under management consistently demonstrated three best-in-class traits:

- The finance organization provides dedicated resources to procurement or participates as core member of sourcing teams;
- The companies use formal, preferably multi-year procurement plans to project, audit, and validate procurement savings; and
- Position financial systems to complement purchasing applications to improve visibility and compliance.



In addition, four technologies were identified that best-in-class companies, those with the highest levels of savings bookings or spend under management, use more often than average or lagging performers. Aberdeen finds that top performance is linked to the use of the following technologies:

1. Single or integrated ERP
2. Financial analysis/BI application
3. Contract management
4. T&E / expense automation software

Recommendations for Action

CFOs must illustrate to their entire companies the specific impact procurement activities have on key financial metrics as the basis to drive savings to the bottom line.

Savings guidelines or standard methodologies not only protect the credibility or compensation of purchasing; finance should establish standard corporate savings guidelines and reporting methodologies that address capital, direct, expense, working capital, and cash flow savings calculations.

Despite indications that finance is involved during budgeting cycles, less than half of companies Aberdeen surveyed reported using formal procurement plans. Jointly, finance and purchasing need to ensure specific procurement plans are clearly integrated into corporate performance planning activities and validate the impact of savings on key financial metrics.

Less than a third (31%) of all companies consistently consider cash flow and working capital elements as part of procurement savings goals. Finance skill-sets and systems need to focus on cash-flow elements such as working capital, trade financing, and payment terms, and ensure non-traditional procurement categories are addressed by planning and savings guidelines.



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Chapter One: Issue at Hand

Key Takeaways

- CFOs and financial managers confirm the strategic growth of procurement over the past five years, have a favorable view of procurement, and see its contribution as key to corporate competitiveness.
- Improved visibility in to budget and spend data, in combination with stronger functional skill sets, have improved procurement's performance.
- Independent studies indicate CFOs and CPOs are in general agreement about the priority of key business issues that procurement should address.

As the economy continues to teeter from bearish to bullish, controlling costs continues to be a corporate imperative. Continued international and new domestic stresses now influence business performance. Global growth has slowed and upward pressures on costs have reappeared, proving forecasts made by the IMF, Federal Reserve, and business journals such as *Business Finance* accurate.

Uncertainty, limited revenue growth rates, and lower profit margins caused by higher interest rates and commodity-driven inflation will place greater demands on both finance and purchasing to control costs. Despite the advancement of the purchasing function and executive support of procurement policies and procedures, CFOs see broader business limitations that must be addressed to ensure the enterprise-wide procurement activities are established as key contributors to corporate competitiveness.

AberdeenGroup and *Business Finance* magazine jointly conducted a primary benchmarking study of approximately 100 CFOs and senior financial managers during August 2005. The study assessed program challenges, priorities, capabilities, and technologies of the procurement program. This report provides insights into procurement, including its strengths and weaknesses from the viewpoint of finance managers. The research reveals the actions taken — and not taken, by purchasing and finance that most influence positive business performance.

Procurement's influence has increased over the past five years and is seen as a key contributor to corporate competitiveness.

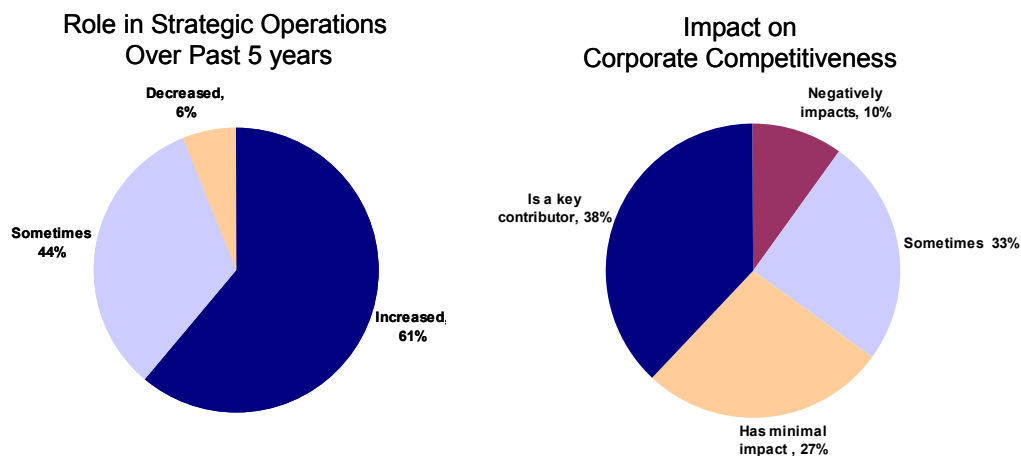
Finance and purchasing resources find themselves closely aligned as they jointly attempt to manage uncertainty. Each challenges its resources to be stewards for the mandate to contain costs, generate savings, and improve compliance, all while trying to anticipate and support growth opportunities. CFOs acknowledge the influence of procurement has increased over past five years and is seen by most as a growing contributor to corporate competitiveness (Figure 1).

Whether by design or favorable concurrence, several drivers are having a favorable impact on procurement performance. In 2004, regulatory awareness led unprecedented levels of executive sponsorship and advocacy for purchasing and payables policies and procedures. More senior governance of procurement has not only realigned organizations,



75% of enterprises will have completed or will be in the process of shifting to a centered structure by 2008¹, which has allowed procurement to attract and invest in its personnel. To procurement's own credit, over half of the financial managers surveyed indicated that stronger procurement resources and their skills are major drivers of procurement's improved performance. In addition, the continued maturation of enterprise, financial, and procurement applications is providing better visibility into budgets and spend data, a win for both finance and procurement.

Figure 1: CFO's Viewpoints of Procurement



Source: AberdeenGroup, September 2005

Agreement on the Roles Going Forward

Independent AberdeenGroup research surveys of CFOs and CPOs indicate the two executive groups are in agreement about the priority of key business issues for procurement. The top three business initiatives in which procurement should play a leading role were ranked consistently by CFOs and CPOs. The list includes actions that directly manage supply availability, transportation/logistics costs, and escalating commodity prices.

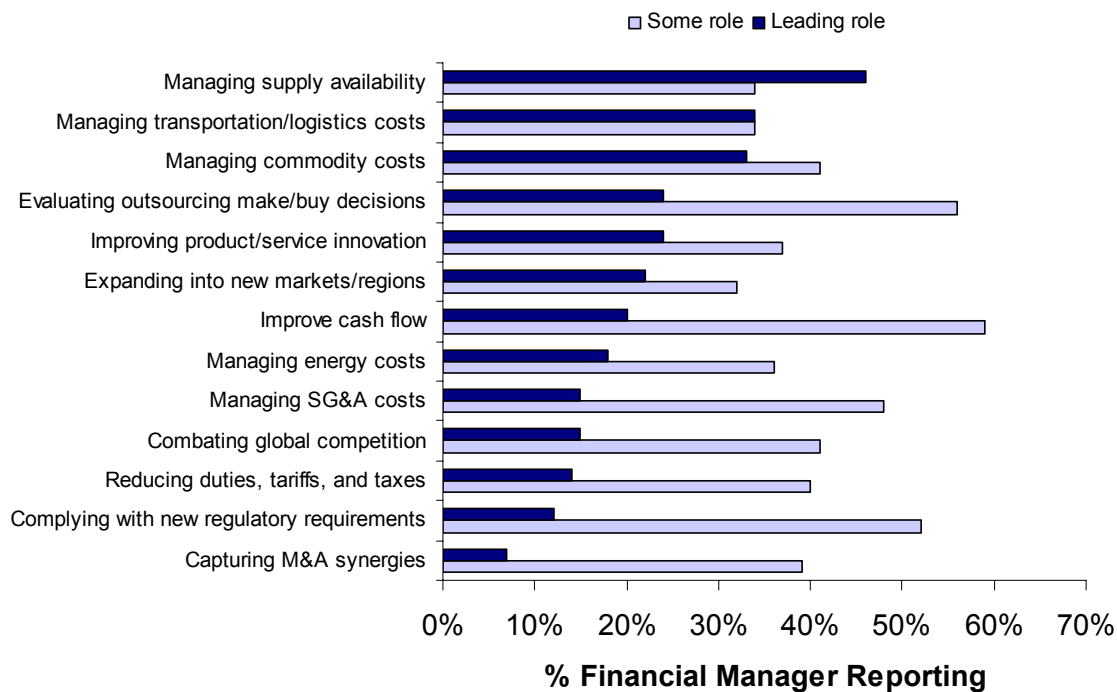
New dynamics stemming from the modern business model are reflected in those areas in which procurement must have "some role" and actively support the line-of-business managers. These initiatives include evaluating outsourcing make/buy decisions; improving cash flow; complying with new regulatory requirements; and managing sales, general, and administrative cost categories.

Financial managers surveyed indicate that procurement's current skill-set strengths lie in its negotiation and contracting capabilities, company knowledge, and internal and supplier customer service levels.

¹ *The CPO's Agenda: Five Strategies for Procurement Transformation* (March 2005).

However, three capabilities of procurement were ranked clearly as weaknesses: costing capabilities, project management, and process innovation. These weaknesses provide insights into the key weaknesses of the enterprise-wide procurement program.

Figure 2: Role of Procurement in Select Business Initiatives



Source: AberdeenGroup, March 2005



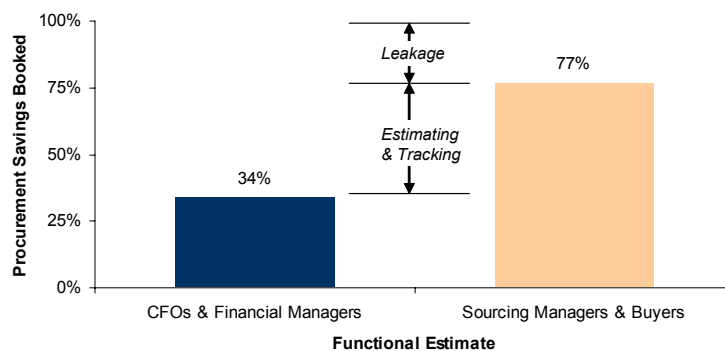
Chapter Two: Key Business Value Findings

Key Takeaways

- The CFO's real concern is bottom-line savings.
- A significant gap exists between the financial manager's estimate of project savings getting booked, 34%, and the 75% to 80% estimated by sourcing managers
- There are four underlying limitations in most procurement programs that are likely contributing the savings gap:
 - Various interpretations of the term "savings";
 - Lack of company-wide savings guidelines and methodologies;
 - Passive involvement of finance in procurement activities; and
 - Limited use of formal procurement plans.

Aberdeen's research identifies deeper concerns about procurement that require further action and stewardship by finance and purchasing. True to form, CFO's have only one central concern — getting the projected savings to the bottom line. Aberdeen has previously reported about the purchasing executive's awareness of the savings "leakage" that exists due to contract compliance issues². But the financial managers' estimate that 34%, on average, of projected procurement savings get booked is dramatically lower than the 75%-80% savings capture rate being reported by sourcing managers. Whether or not the gap is as wide as reported, such a wide gap is surely having negative implications for corporate financial performance.

Figure 3: Estimated Percent of Projected Procurement Savings Booked



Source: AberdeenGroup, March 2005

² *Spend Compliance Management: Implementing and Sustaining Supply Savings (December 2004).*

Everyone understands that an actual shortfall in savings directly affects profits, but even if the majority of savings projections are met, this savings gap creates uncertainty which, in turn, erodes the confidence level and detracts from business plan accuracy. The gap is an indication of the deeper estimating and tracking limitations that exist and that need to be addressed to improve corporate competitiveness.

Aberdeen analysis illuminates four underlying limitations that are likely contributing to the savings gap:

1. Various functional interpretations of the term “savings”;
2. Lack of company-wide guidelines to calculate, track and budget for the savings;
3. Passive involvement of finance in procurement activities; and
4. Limited use of formal procurement plans that link to business plans.

What Do You Mean By Savings?

One factor contributing to this discrepancy is tied to the interpretation of the term “savings” by the various disciplines involved (or those that should be involved) in procurement activities. Although the definitions of savings are overly simplified (Table 1), in each case the perspective of savings is functionally correct. Scope of responsibilities, personal metrics, planning needs, and analytic skill-set each skew the businesses interpretations of savings.

Table 1: Savings Definition by Functional Role

Role	Definition of Savings
Sourcing Manager / Buyer	Incremental discounts negotiated from the supplier's first quote or otherwise benchmarked market prices across anticipated purchase volumes
Business Manager	Pricing that is an improvement over prior-year price paid or agreements
Financial Manager (Line of Business)	Direct cost or expense reductions reflected as a positive variance or working capital improvements in the budget
CFO, Controller, Treasurer (Corporate)	Business plan financial impacts that affect earnings or cash-flow plans, including financing and global exchange implications

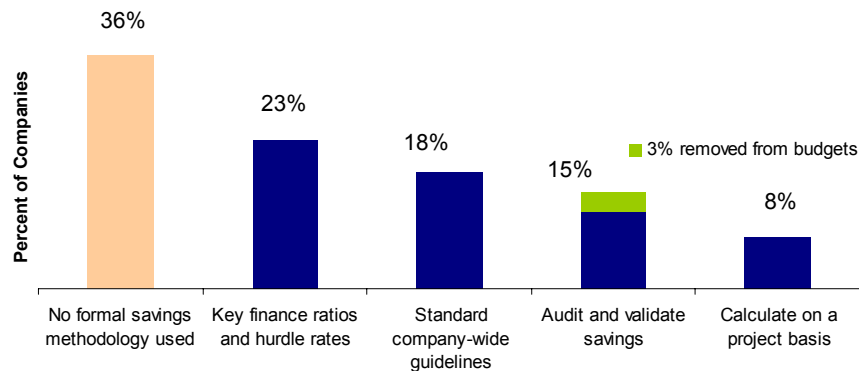
Source: AberdeenGroup, March 2005



Lack of Company-Wide Savings Guidelines

According to Aberdeen's research, only one in five companies has standard company-wide guidelines in place to calculate savings (Figure 4). Even fewer companies audit or validate the savings that have occurred. Moreover, it is very rare for companies to guarantee savings by removing them from line-of-business budgets.

Figure 4: Savings Methodologies Used By Corporations



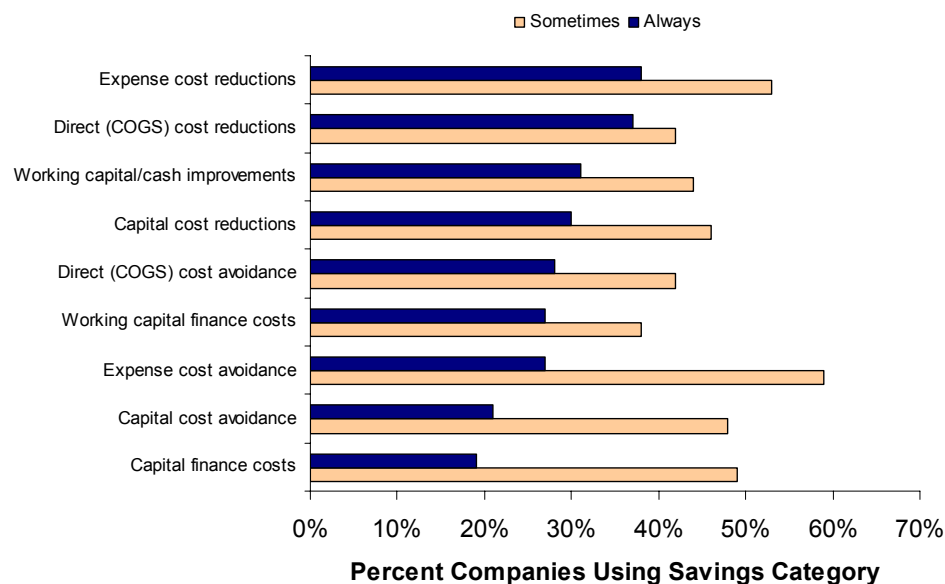
Source: AberdeenGroup, September 2005

Watching the Sausage Getting Made

With no standard methodology and few guidelines in place, the process of calculating savings is not pretty. The formula often changes from spend category to spend category, project to project, with each team (or helpful supplier) selecting the savings categories that get included in the calculation (Figure 5).

Savings guidelines or standard methodologies are often thought to be in place only to protect the credibility or compensation of purchasing. But, clear guidelines assist the entire organization to not only estimate and report procurement related savings, but also apply these savings appropriately to the financials as they get booked (or not booked).

Figure 5: Categories Used in Procurement Savings Calculations



Source: AberdeenGroup, March 2005

A line-of-business financial executive recently shared that it is commonplace for a project manager to ramble off a list of qualitative and quantitative benefits associated with the “deal.” There is no clear distinction of the hard-dollar savings that impact financial measures and the softer business benefits that provide value but are not seen on the bottom line. One recurring example is the treatment of cost avoidance as opposed to cost reductions, on direct cost and expensed purchases as illustrated in Table 2. Cost avoidance often gets rolled into savings estimates. Yet, unless sources and timelines are clearly identified in a business plan, evading certain outlays now is no guarantee of a financial windfall in the P/L.

Table 2: Differentiating Procurement Savings from Benefits

Category Savings	Cost Reduction	Cost Avoidance
Direct* Cost	Savings	Saving/Benefit
Expense Cost	Savings	Benefit

*Cost of goods sold or cost of goods for resale

Source: AberdeenGroup, May 2004

Although direct and expense cost reduction and avoidance are generally easily taught to and applied by the various managers involved in procurement decisions, other more complicated or strategically sensitive elements tied to cash flow — such as working capital, trade financing, and payment terms — are not as easily understood and therefore not adequately factored into procurement efforts at all. This study found that less than a third

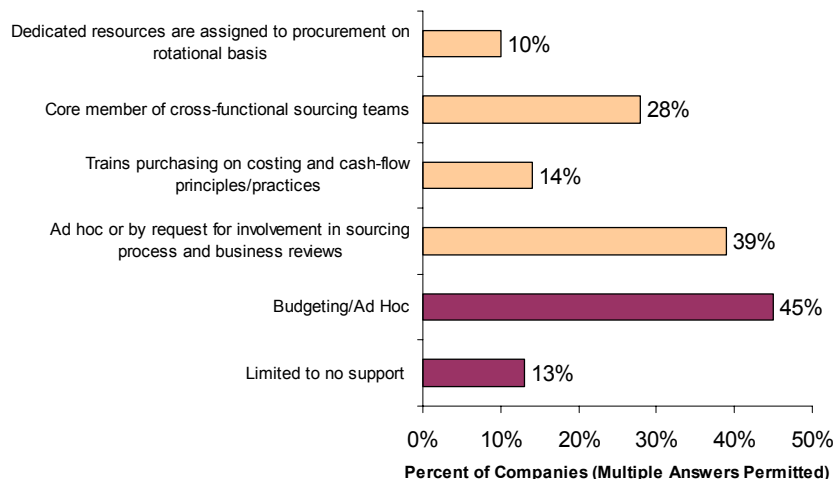


(31%) of all companies consistently consider cash flow and working capital elements as part of procurement savings goals.

Passive Involvement of Finance in Procurement is No Help

Purchasing and business managers are not solely to blame for these short comings. Financial involvement is “ad hoc,” not that of a fiduciary steward. Aberdeen finds that finance’s involvement in a procurement program primarily takes place only during budgeting cycles or are based on ad hoc requests (Figure 6). Only 10% of the finance organization provided dedicated resources to support procurement perform costing, cash flow and other working capital analysis.

Figure 6: Level of Finance Involvement Within Procurement Activities



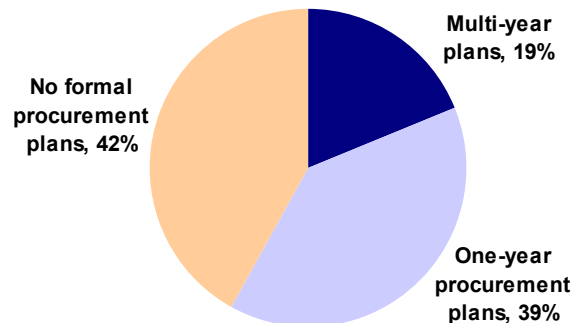
Source: AberdeenGroup, March 2005

Limited Use of Formal Procurement Plans

Despite indications that finance is involved during budgeting cycles, less than half of companies Aberdeen surveyed reported using formal procurement plans (Figure 7). The lack of clear association of procurement savings and their supporting actions in the business plans creates the opportunity for the dramatic gap between projected savings and those actually passing through to the bottom line.

Without alignment of plans, it is not possible to ensure savings are calculated, allocated, and recorded correctly in the business plan. Line-of-business managers and corporate executives cannot anticipate the savings and benefits, incorporate them (or the lack of savings) into decision-making, and validate their impact on key financial metrics.

Figure 7: Type of Procurement Plans in Use

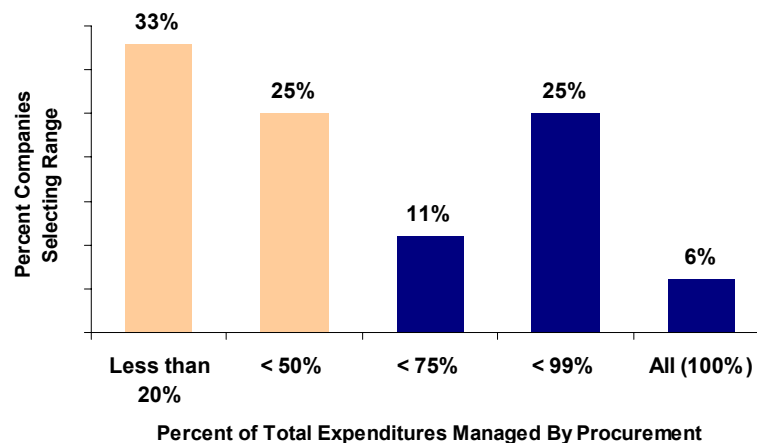


Source: AberdeenGroup, September 2005

Spend Under Management

Aberdeen believes that the lack of formal purchasing plans is also a major contributor to the low percentage of third-party expenditures — 54% on average — under formal management by procurement as cited by the financial managers participating in the survey (Figure 8). Planning documents and financial statements account for expenditures not necessarily addressed by the traditional purchasing department. Financial managers interviewed revealed known categories that consistently get overlooked and often dwarf the typical procurement items. Very often, large contract manufacturing deals, HR benefits, legal and consulting services, and technology agreements are excluded from the traditional procurement process. Although business managers are addressing these strategic and “relationship-based” categories individually, the broader systemic issues of estimating and reporting savings still remains.

Figure 8: Percent of Total Spend (By Range) Under Procurement Management



Source: AberdeenGroup, September 2005



Sizing the Real Gaps that Exist

Not only is the gap between projected and booked savings significant, but low spend under management further hinders procurement performance. Depending on the industry, from the financial manager’s perspective indirect expenditure can be anywhere from 7% to 40% of revenue — 18.5% is a cross-industry benchmark.³

The first obvious impact is the percent of total expenditure that may be completely “ad hoc” and uncontrolled, opening up the time-tested purchasing argument for lost scale and leverage. But Aberdeen research indicates that poor spend visibility does erode negotiation and contracting performance between 5% to 7%, widening the gap. For example, a company with visibility into more than 75% of its total expenditures typically earns savings of 15%, on average, after negotiation and contracting, while a company that analyzes less than 50% of its expenditures saves only 10.8%.

All told, the overall gap in procurement savings far exceeds the functional discrepancy on how savings are calculated or reported. Four process limitations collectively present a savings gap that, in most cases, exceeds actual savings booked. AberdeenGroup believes this is case for real concern.

Table 3: Overall Procurement Savings Gaps

Improvement Area	Lost savings potential
Estimating and tracking	30 – 40%
Internal/supplier compliance	20 – 25%
Lost negotiation effectiveness	5% - 7%
Unaddressed spend	18.5% (average indirects)

Source: AberdeenGroup, September 2005

³ Center for Advanced Purchasing Studies

Chapter Three: Demonstrated Best-In-Class Performance

Key Takeaways

- Historical misconceptions of procurement as a functional or staff role must be overcome.
- All companies that estimated they captured greater than 60% of projected procurement savings demonstrated best-in-class financial organization support.
- Companies making use of formal single or multi-year plans are three times more likely to report the highest level of savings capture.
- In addition to newer procurement systems, four financial systems are tied directly to better procurement program performance.

Best practices are not a guarantee of success, but they demonstrate the required competence to become successful. Successful procurement programs suggest historical misconceptions of procurement as merely a functional responsibility that must be overcome. Companies that reported the highest confidence in booking procurement savings and had the highest levels of expenditure under management consistently demonstrated three best-in-class traits:

- The finance organization provides dedicated resources to procurement or participates as a core member of sourcing teams.
- Use formal, preferably multi-year, procurement plans to project, audit, and validate procurement savings.
- Position financial systems to complement purchasing applications to improve visibility and compliance.

Clarifying the Traits that Lead to Best-in-Class Savings Capture

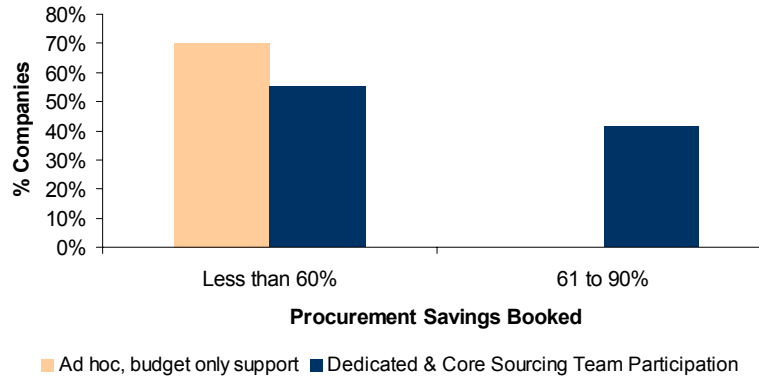
To clarify which actions relieve the CFO's greatest concern, Aberdeen compared companies with best performance in terms of savings booked and spend under management with companies with lagging performance in these areas. Middle-of-the-road companies were excluded from the analysis.

All companies that estimated they captured greater than 60% of projected procurement savings demonstrated traits of best-in-class financial organization support (Figure 9), according to CFO and financial manager responses. Consistently, these companies assigned dedicated finance resources to the procurement activities or were consistently core members of sourcing teams. In contrast, lagging companies reported having limited financial involvement or support only during budget periods (Figure 9).

Likewise, the highest percentage of savings booked is reported by those companies using formal procurement plans. In best-in-class companies, those indicating between 61% and 90% of savings capture, use a formal single or multi-year plan and outperform those not using such plans by three to one (Figure 10).

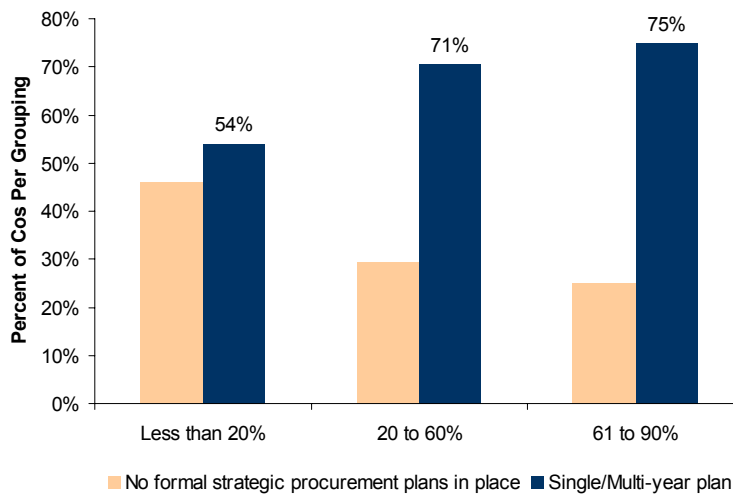


Figure 9: Impact of Finance Support on Procurement Savings Booked



Source: AberdeenGroup, September 2005

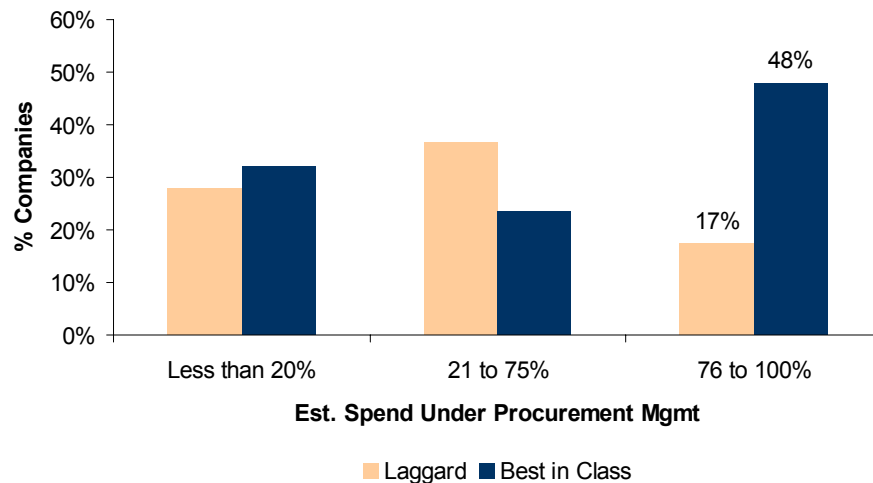
Figure 10: Impact of Formal Procurement Plans on Procurement Savings Booked



Source: AberdeenGroup, September 2005

The payoff of finance’s direct or more permanent involvement in procurement activities provides another important dividend. As noted earlier, the ability of a company to uncover, analyze, and manage all third-party expenditures expands the pie of savings generated. Nearly half of the companies demonstrating best-in-class financial organization support achieved the highest level of spend under management, while only 17% of those providing ad hoc support reach this level of performance (Figure 11).

Figure 11: Impact of Finance Involvement on Spend Under Management



Source: AberdeenGroup, September 2005

Financial Systems Integral to Procurement Performance

It is not just the finance organization that needs to be involved; its systems are also key enablers of procurement performance. In addition to newer procurement systems, numerous financial systems are tied directly to better procurement program performance.

The impact of investments in procurement systems is notable. For instance, Aberdeen’s [E-Procurement Benchmark Report](#) (December 2004) found that e-procurement users reduced off-contract (“maverick”) spending 64%, saving 7.3% for each dollar brought back on contract. In addition, e-sourcing tools continue to be adopted to reduce the time and labor of going to bid while helping companies manage costs and risks that might impact supply chain performance and affect profits negatively. Aberdeen’s ongoing benchmarking of e-sourcing usage found that more than 80% of Fortune 1000 companies (and nearly half of mid-market companies) have tested online negotiation capabilities, such as reverse auctions and e-RFx. Most large enterprises are transitioning to broader e-sourcing platforms that automate and manage complete sourcing projects.

AberdeenGroup investigated more than a dozen financial and purchasing-related technologies companies use or plan to use to address procurement. The list includes:

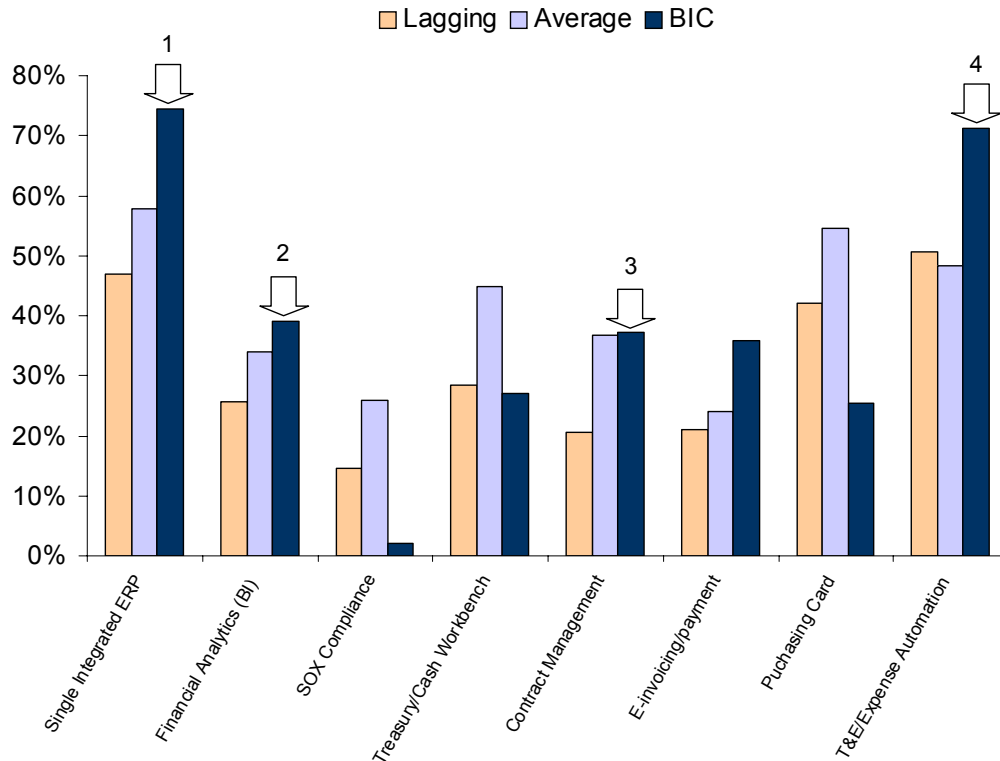
- Single ERP or integrated budgeting and GL
- Financial analytics/ Business intelligence
- SOX compliance tracking and reporting
- Treasury cash management workbench
- e-Procurement
- Spend data cleansing and classification
- e-Sourcing platform (Reverse auctions, e-RFx, optimization)
- Contract management application
- Supplier performance measurement application
- Specialty services procurement application/service
- e-Invoice receipt and settlement application
- Purchasing card administration and reconciliation application
- Travel and expense submission and approval automation application



Of the systems associated with finance functions (i.e. Controller, Planning, Treasury, or Accounts Payable), four technologies were identified that best-in-class companies, those with the highest levels of savings booking or spend under management, used more often than average or lagging performers. Aberdeen finds that top performance is linked to the use of the following technologies (Figure 12):

1. Single or Integrated ERP
2. Financial analysis/BI application
3. Contract management
4. T&E / expense automation software

Figure 12: Finance Technologies Linked to Best-in-Class Procurement Performance



Source: AberdeenGroup, September 2005

Some of the promises of major software providers and systems integrators are now supported by the direct correlation of using a single or integrated enterprise resource planning (ERP) application to participants' reporting of best-in-class savings performance. In using the single or integrated ERP, it is inferred these organizations are more confident in calculating and booking procurement savings based on common business information across functional teams.

Similarly, although it's a seemingly transactional system, the travel and expense automation management (T&E/EAM) application has displayed that its corporate users show greater confidence in booking procurement savings. Intriguingly, the expense automation reporting solution showed an equally strong correlation for its ability to boost booking savings confidence as well as increasing spend under management. This suggests that these applications not only shed light on incidental expenditures, but also support Aberdeen's findings that subsequent analysis delivers hard-dollar savings of 6% to 7%.

The two other technologies indicative of best-in-class performers were financial analytics or business intelligence (BI) applications and contract management. Each cross-functional solution is rapidly being adopted in the market today. Approximately one-quarter of the financial managers surveyed indicated they plan to use BI applications within the next 24 months. Financial analytic applications respond to the CFO's goal of developing and deploying proactive, profit-centric corporate performance management programs to identify and exploit opportunities and risks, looking to increase return on asset and earnings. Operationally, the tools assist in sales and operations planning (S&OP) to effectively respond to demand and supply variability with timely determinations of the impact on plan and supply chain horizons⁴.

Clearly the confidence in booking savings increases with the usage of contract management applications to access and manage the agreements that dictate the terms, pricing, and service levels of a company's supplier relationships. These systems improve internal and supplier compliance up to 55%⁵ and provide the visibility to measures business and financial performance with regulatory performance.

⁴ *Closed Loop Corporate Performance Management Benchmark Report* (March 2005).

⁵ *Best Practices in Contract Management: Maximizing Value of Business Relationships* (September 2005).



Chapter Four: Recommendations for Action

Key Takeaways

- CFO must illustrate to the entire company the specific impact procurement activities have on key financial metrics as the basis to drive savings to the bottom line.
- Establish standard corporate savings guidelines and reporting methodology that address capital, direct, expense, working capital, and cash-flow savings calculations.
- Ensure specific procurement plans are clearly integrated into corporate performance planning activities and validate the impact of savings on key financial metrics.
- Position financial resources (organization and systems) to focus on cash flow elements such as working capital, trade financing, and payment terms and ensure non-traditional procurement categories are addressed by planning and savings guidelines.

The gaps revealed in this report indicate the deeper planning, estimating, and tracking limitations that prevent procurement savings from being booked successfully. Although purchasing continues to transform itself from within by upgrading its skill-sets and systems, finance's involvement is still required to ensure its impact is fully realized.

Aberdeen recommends the following actions to improve procurement performance:

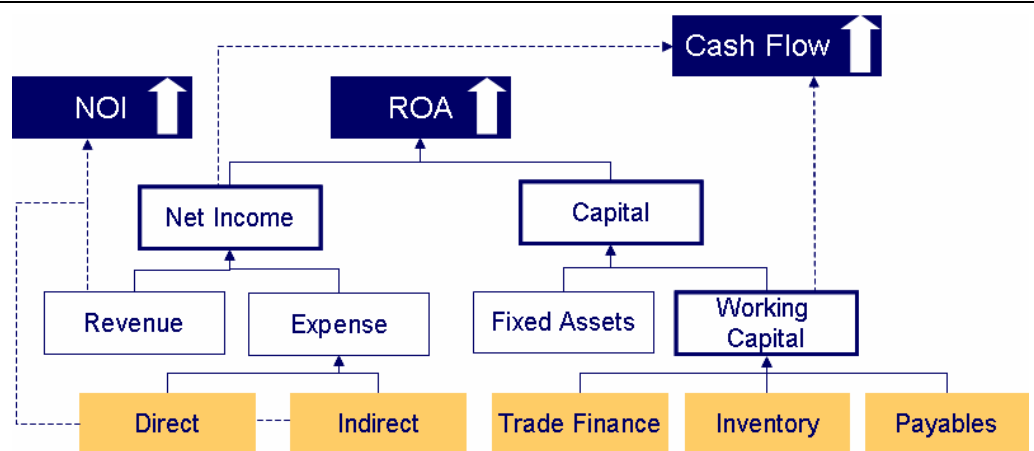
Illustrate Specific Impact of Procurement on Key Financial Metrics

The CFO's view of procurement must be widely shared within the organization. By illuminating the positive impact procurement activities have on corporate competitiveness the entire organization can adopt a more strategic view of procurement. This more holistic view of procurement provides the basis for formal procurement plans and corporate savings guidelines.

According to the CFO of a \$2 billion equipment and services company, before the company invested in a communications and training program that established a financial imperative for procurement and compliance, internal use of great tools was very low. Now the company's middle managers pull from the annual report to weigh the importance of key supplier relationships.

Aberdeen believes that financial, line-of-business and purchasing managers can all become more effective by building a simple understanding of the how procurement impacts key financial metrics like net operating income (NOI), return on assets (ROA) and the most often overlooked cash flow. In general, five procurement elements are of greatest interest to finance: direct costs, indirect costs, inventory, trade financing options, and payment terms (Figure 13).

Figure 13: Procurement's Impact On Key Financial Metrics



Source: AberdeenGroup, September 2005

Establish Standard Savings Guidelines and Reporting Methodology

Authoring standard savings guidelines creates a common definition for the term “savings” across the corporation. The goal of these guidelines is not to diminish the importance of relationship, process, or strategic benefits. They do provide the framework to ensure all financial elements of the deal — including financing and cash flow — are considered and to track financial savings after the deal to business and supplier performance.

Although the specific needs and requirements that each role incorporates into evaluation and selection criteria will and should differ, standard guidelines delineates “hard” financial savings from “soft” business benefits.

A strong set of guidelines addresses the following needs:

- It defines methodology for classifying cost reduction versus cost avoidance, and for calculating expense, capital and working savings calculations.
- It identifies treatment for other recognizable procurement benefits such as productivity, resource reallocation, risk mitigation, etc.
- It indicates the milestones, systems, or reports that will be used to validate, audit, or verify results.
- It allocates savings and benefits by period, business unit, division, and geography.
- It designates individual approvals required for sign-off of savings by magnitude of savings, type of savings, or budget impacted.

Integrate Procurement Objectives Clearly In Business Plans

The most direct way to close the savings gap is to ensure specific procurement objectives are clearly integrated into corporate performance planning activities and continuously validate their impact on key financial metrics. Through the existing financial organiza-



tion structure, finance and purchasing can assist each division, business unit, and major functional team in building a procurement plan that addresses seven elements outlined after this paragraph. Even basic responses to each item improve operational alignment around procurement activities to ensure savings happen. In addition, the plan provides a canvas upon which other, more horizontal, finance or procurement initiatives like leveraging common spend or improving cash flow can be overlaid.

The seven elements of a procurement plan include:

- Procurement's impact on strategic vision, business plan and key financial metrics or budget
- Analysis of current costs (direct, expense, capital) and cash flow forecast
- Prioritized listing of key spend categories, savings targets and benefit goals
- Actions to measure key supplier relations
- Touch-points with other business initiatives
- Assigned business, finance and procurement resources
- A time phased savings plan

Ensure Cash Flow, Working Capital Are Addressed Strategically

The best deal may not always be the one with the lowest price. Finance participation in contracting and negotiation can justify a slight cost increase in exchange for deferred payment or other working capital concessions.

A simple audit of current payment and trade financing policies can deliver rapid, near-term savings. In many cases, business and purchasing professionals have focused on cost reduction efforts and inadvertently overlooked important cash flow and working capital elements.

Often opportunities exist to reduce financing costs, generate return on cash, or reduce supply chain financing requirements for suppliers by evaluating existing trade financing options. Aberdeen's research of accounts payable practices indicates that accounts payable terms are typically applied without sophistication or specific goals. In one particular case, a large utility had, in its own words, more than 50 "standard terms" that were applied by the buyer or business manager indiscriminately. Treasury took a proactive position, shortened the list to seven standard terms, and indicated the use case for each.

A major retailer not only extended days payable outstanding (DPO) but set in motion via its electronic invoicing application offers to suppliers for early payment in exchange for incremental discounts. The deal was accepted by 5% of the suppliers and earned the company an effective APR (discounts) of 36% on the payables balance affected.

Position Financials and Systems to Support Procurement

Typically, the combined, fully loaded cost of the entire finance and procurement organization is approximately 3% of company revenues. Interestingly, this is about the equivalent of procurement savings not being booked in the average company in this study. Since the prophecy of outsourcing these functions entirely has not yet materialized, it's imperative of both to position resources to ensure procurement's strategic contributions.

Assign dedicated finance resources to support specific procurement teams or clarify the role of finance as a core member of sourcing teams. In smaller organizations, finance's involvement is likely to remain geographical. However, in larger enterprises, finance leaders have created career paths that include financial analyst roles dedicated to support the procurement activities of specific business units. These finance and audit roles are aligned to one or more director-level procurement or sourcing managers. In addition, treasury and audit are using e-learning tools to deploy budgeting and savings guidelines.

Leverage Technology to Reduce Reporting Effort, Improve Visibility

A single, integrated ERP has demonstrated its ability to provide the planning and transactional data required for spend management. In fact, Aberdeen finds that more than 60% of all spend analysis data is routinely pulled from GL and payables systems. Continued consolidation of disparate systems reduces the time and energies required for reporting and permits greater integration into e-sourcing and e-procurement solutions.

In addition, utilize electronic invoicing to automate one of the last paper-based transactional processes in many companies. Beyond transactional benefits of 50% to 60% and even more granular spend visibility, in conjunction with a supplier messaging and credit providers, payables can generate a second wave of meaningful discount-based savings or supplier financing-based returns on cash.

Don't underestimate the importance of T&E/Expense Automation Management (EAM) solutions. EAM solutions are now often versatile applications that provide FAQs, workflow, and for many organizations, become the first line of offense to manage compliance and build visibility to non-traditional categories of spend.

Business intelligence (BI)/financial analytics and contract management solutions are fast becoming the bookends of corporate and supplier performance management. BI helps business and financial managers understand the impact of drivers on P/L and supply chain performance. Contract management is rapidly building acceptance and provides the carrot and stick to increase contract compliance, both internally and with suppliers.

Conclusion

Finance and purchasing must wisely align their resources to jointly steward the executive mandate to contain costs, generate savings, and improve compliance for as long as market uncertainties remain. The CFOs surveyed and interviewed acknowledge the positive influence procurement has had over the past five years, and with solutions that overcome the identified limitations, procurement can certainly continue to be a contributor to corporate competitiveness.



Author Profile

Jeff Pikulik
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Jeff Pikulik focuses on the successful deployment of financial value chain best practices in the Global 5000. His efforts continue to reveal strategic planning benefits and cost savings beyond the traditional supply chain. Specifically, Pikulik works with executives and business unit managers from all functional backgrounds and their cross-functional teams to bring many time-tested strategies and tactics into the mainstream.

Pikulik currently examines how transferable best practices are being applied to address specific opportunities internal and external to the corporation. Based on these findings, business and purchasing executives will be able to clearly define the financial opportunity and organizational approach by understanding the consistency and predictability of proven best practices as applied to nontraditional supply expenditure categories.

Pikulik has helped executives in the energy, pharmaceuticals, and hospitality industries deploy strategic procurement programs to achieve “second-wave” cost-reduction results and better organizationally align with the business owners and users of indirect expenditure categories.

Appendix A: Research Methodology

AberdeenGroup and *Business Finance* magazine jointly conducted a primary benchmarking study of approximately 100 CFOs and senior financial managers during August 2005.

Aberdeen supplemented this online survey effort with telephone interviews with select survey respondents, gathering additional information on strategies, experiences, and results.

Responding enterprises included the following:

- **Job title:** The research sample included respondents with the following job titles: C-Level executive (26%), SVP/VP (18%), Director (29%), Manager (27%).
- **Financial duties:** By function, the respondents represented Financial Planning (45%), Controller (45%), Treasury (23%), Audit (19%), Analysis (52%), and other non-financial duties (22%). Multiple responses were permitted.
- **Industry:** The research sample included respondents from across 30 different industries including discrete manufacturing (36%), consumer products (13%), process industries (10%), services sector (25%), and the public sector (25%).
- **Geography:** Three-quarters of all study respondents were from North America. Remaining respondents were from the Europe (11%), Asia (8%), and South America (6%).
- **Company size:** About 27% of respondents were from the largest enterprises (annual revenues of more than \$1 billion); 49% were from mid-size companies (revenues between \$51 and \$999 million) and less than 23% of respondents were from small businesses (annual revenues of \$50 million or less).



Appendix B: Related Aberdeen Research & Tools

Related Aberdeen research that forms a companion or reference to this report include:

- *The CPO's Agenda: Five Strategies for Procurement Transformation* (March 2005)
- *Closed Loop Corporate Performance Management Benchmark Report* (March 2005)
- *Best Practices in Contract Management: Maximizing Value of Business Relationships* (September 2005)
- *Harnessing Payables to Capture a Second Wave of Procurement Savings* (December 2004)
- *Best Practices in Spending Analysis* (September 2004)

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