

The bottom line is...

How do the finance directors rate the performance of those buyers who report to them? Gareth Mytton finds that totting up the figures is still a vital part of the story:

CFOs and financial managers... have a favourable view of procurement and see its contribution as key to corporate competitiveness. The verdict of The CFO's view of procurement, a recent report by analysts Aberdeen Group (www.aberdeen.com), should give heart to the many purchasers who ultimately report to the finance chief but who may also have concerns about their own reputation.

Historically, finance departments did harbour doubts about the effectiveness of their colleagues in purchasing, says Jeff Pikulik, research director at Aberdeen Group and author of the report, which surveyed about 100 senior finance professionals. Today, the function has won much wider backing across organisations because it has promoted its achievements - in Pikulik's colourful and telling phrase, purchasing "made the ra-ra noises in the hallways".

Harbir Sidhu, a qualified accountant and client development director at the buyingTeam consultancy, points to three areas where finance directors feel purchasers do well: improvements in price, service quality and specification; providing a challenge to the status quo; and the ability to deliver competitive advantage by developing suppliers.

Another aspect of purchasing that finance people value is negotiating skills, adds Beverley Tew, chief procurement officer at the BBC. "There's a fear of talk about big numbers and long-term relationships," she says.

What finance directors want from purchasers is value, explains Terry Grove, programme manager at National Grid. Grove has held a senior role both in finance and procurement and, like Tew, is a qualified accountant. This value is a key aspect of the procurement-finance relationship, he says.

Aspects to control

Grove, who played a key role in completing the £5.9 billion sale of four of National Grid's distribution networks, says delivering value has at least three aspects.

One is demand management. Purchasers can act as the bridge between customer and supplier by forecasting demand patterns. A simple control is the use of authorisation levels for differing types of expenditure.

Second, purchasers can build requests for useful data into the contract from the outset. A couple of examples are the provision of mobile phone and hotel usage.

Finance people like statistics, Tew explains. How divisions are performing, the number of vendors, the price of a purchase order, the cost of raising one and contract compliance. At the BBC, her team can produce reports that even include who's used a taxi rather than the shuttle bus between its buildings.

A third demand on purchasers is effective process management. Benchmarking is a useful tool to demonstrate efficiency of operation. And at a time when regulations such as Sarbanes-Oxley are imposing new recording requirements on business, the finance director wants to know effective policies and processes are in place and are being followed - process automation and built-in system controls are important.

Tew adds that buying something off a pre-negotiated contract can be resource-intensive - the deal has to be used - and the broadcaster's "finance community" is looking to her and the purchasing team to simplify the process.

Clear strategy

Grove has told CIPS conferences, that having a clear plan on stock holding and maximising the number of stock turns can make a significant difference to the balance sheet.

Apart from a focus on total cost of ownership over the course of a contract, CFOs also want purchasers to be innovative in their agreements, says Silla Maizey, procurement director at British Airways, who reports to the finance director. For example, in an advertising and marketing deal, the CFO may look for a direct link to performance, which could mean the supplier's remuneration is linked to key performance indicators or extra revenue generated by a campaign. Last year, the airline sealed a five-year contract with advertising agency Bartle Bogle Hegarty (BBH) that did just that.

Harbir Sidhu also explains that, better visibility of cost and expenditure - by division, region or business unit - can provide better understanding of the cost base, giving purchasers new insights. It's important to take time to understand what financial directors want. This should ensure FDs' expectations are realistic.

Ian Scott, finance director of the infrastructure and procurement division at PricewaterhouseCoopers, sets a broader remit for the purchasers who report to him. "They need to put practical terms and conditions in place, but still make money."

It's no good setting out to make savings when the business is trying to improve its service, he adds. By asking others what they need, procurement also raises its profile and helps colleagues in customer-facing roles to offer a more attractive service.

Scott also advises purchasers to check their activities align with the organisation's strategy. A big tender can take from three to six months, but the market could have changed. What's the point of a contract that's perfect but six months out of date?

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Saving grace

But the biggest concern for CFOs is still, according to Pikulik, savings. This is an area where purchasers need to show greater financial subtlety and acumen. The Aberdeen Group report warned: 'The financial managers' estimate that 34 per cent, on average, of projected procurement savings get booked is dramatically lower than the 75-80 per cent savings capture rate being reported by sourcing managers.'

Why is this happening? The CFO's view of procurement points to four potential causes and, by implication, solutions. One is the different interpretations of "savings". For a sourcing manager or a buyer, a saving could be a discount on a supplier's initial quote or a benchmarked market price. To a business manager, it could be an improvement on the price paid in previous years. But to the CFO, a saving affects earnings or cash flow plans. Grove adds that, when he was in purchasing, bringing in the volume discounts promised in some contracts required the use of a specialist team who identified six-figure savings because of the volume of invoices.

The lack of organisational guidelines on calculating savings is another explanation. Cost reduction and cost avoidance are often combined and are not always described in terms of time. As Sidhu points out, purchasers may be working in a rising market - energy and steel are two obvious examples - "so it's about cost containment".

A third weakness is the rarity of finance helping procurement analyse costing, cash flow and other working capital analysis.

The final flaw is the absence of formal procurement plans tied into budgeting cycles. Pikulik explains that these ensure purchases and savings are accounted for correctly over the three or five-year plans common in the public and private sectors. This prioritises procurement's efforts against the business plan. So we say that if I save some price per unit on

each item, I can make an assumption about future results, he says, although he warns this is not easy to do.

Speaking the same language

Sidhu agrees that purchasers need to understand how organisations apply financial data to their decision-making, and points to the importance of financial skills and training. They can learn about these things in a few ways, Pikulik adds. If you have a finance professional take part in a project, people will pick it up and can apply it. Finance teams usually have an internal system purchasers can learn on as well.

Such closer ties between purchasing and finance are a recurring theme in how the former can give finance chiefs what they are looking for.

It's important that the FD and the CPO are closely aligned, says Tew, who is part of the monthly meetings for the BBC's finance directors. Repeating this relationship elsewhere could help others to deliver the savings they promise.

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