

basware

White Paper

Strangers No More - How Procurement and Finance can thrive in the downturn

At Basware, we have spent over two decades helping to bridge the process and functional gaps between procurement and finance in countries around the world.



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1. Strangers No More

In most companies, procurement and finance have usually fostered a cordial and professional working environment. Still, the relationship between the two groups is quite often episodic at best. When interviewed off-the-record, most organizations would be hard pressed to say that their procurement and finance groups have a close working relationship. Our own experience suggests that in only a minority of organizations do both groups work hand-in-hand on a daily basis to achieve common objectives with a common set of metrics and management approaches. But in some leading companies, the downturn is beginning to change how procurement and finance collaborate. Top performing businesses are finding that procurement and finance are increasingly sharing responsibility for both cost and risk reduction when it comes to reducing expenditures, cutting transaction costs, mitigating potential liabilities and identifying creative ways to prop up the bottom line despite the glum economy. In addition, some procurement executives are increasingly working hand-in-hand with CFOs and controllers to make sure that identified savings drops to the bottom line as quickly as possible.

When it comes to helping their companies thrive in the downturn, procurement and finance are strangers no more. Not only are both groups trying to put past stereotypes behind them for good (e.g., finance viewing procurement as a back-office, transactional function), they are starting to find ways of working together in new areas as well. Depending on industry, company sophistication and internal reporting structures, procurement VPs and CPOs still face a range of current challenges in becoming a strategic partner to the CFO in the same way that business unit, sales and other finance leaders do as well in today's environment. Procurement, for example, is usually not capable of providing short-term cost reduction leverage in the same way that staffing reductions, debt renegotiation and other immediate opportunities can provide (procurement ROI, while quick, often takes quarters, not weeks or months, to achieve). But this is starting to change as procurement and finance begin to collaboratively tackle a range of new opportunities and more closely coordinate procurement and payables strategies to streamline function and enhance cash flow visibility. Using each area's primary expertise in having finance measure vendor risk and performance and procurement negotiate term structure is just one example how efficiently both groups can apply resources to tackle a common objective.

Understanding where procurement and finance are headed in consort requires a quick appreciation for where both groups - and executives - have been in recent years. If anything, each group's individual journey and climb up the corporate ladder is what is driving the convergence of the two rather than a forced coming together. The timing, given the current recession, is an accelerator of the trend rather than the cause. Consider how many finance executives spent much of the last decade taking on additional responsibility inside their organizations. As the number of chief operating officers (COOs) has declined in the Global 2000, CFOs and their direct reports have taken increasing responsibility for overseeing many of the operational and cost elements of the business. Finance leaders have also taken greater interest in the role of technology inside many companies, directing their teams to get actively involved in the G/L and even operational modules of ERP implementations. Finance organizations that have led these efforts have often done so as an extension of projects designed to improve operating efficiency and effectiveness such as shared services (e.g., A/R), centers of excellence, etc. An even greater measure of the degree to which many finance leaders have operationally matured is their own perceived value to the business. Indeed, finance executives have come to view themselves as more strategic overall - CEOs in training, in many cases. Clearly, for some organizations this "keeper of the books" and "keeper of the strategy" roll overstates the duality for CFOs, but in many others, it has become a fair picture and description what CEOs and Board of Directors have come to expect from their financial leadership.

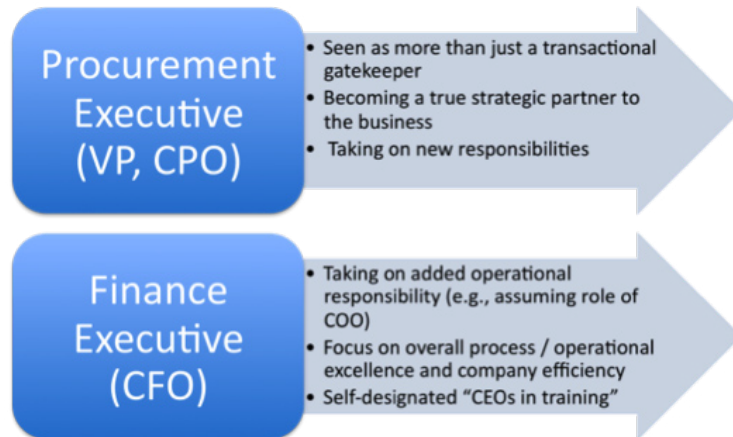


Figure 1: The Evolving Role of Top Procurement and Finance Executives

Procurement has traversed an equal distance in the past decade, but its leaders have travelled on an entirely different path (in some cases which has led them to report to forward thinking CFOs). Just as finance executives have gotten closer to CEO and board-level strategy, procurement organizations - at least those that have become most effective at delivering the highest savings levels - have gotten closer to the business and customers they serve. By extending an olive branch to work hand-in-cost-reduction-hand with constituents throughout their organization, the best procurement leaders have become true partners and service providers to the business - rather than simply gatekeepers or a back-office function. In the best of cases, these efforts have created game changing headlines and earnings reports, thanks to the creation of seven, eight and even nine figure annual savings numbers from cost reduction initiatives. Functional and process automation and analytical efforts such as e-sourcing, P2P, contract management and spend analytics often made many of these returns possible throughout this timeframe - or at least served as a platform in more ways than one to enable change. In many cases, though, procurement efforts that have focused on indirect (e.g., non cost-of-goods-sold (COGs) items and services) spend areas alone have come up short of expectations or short of capturing executive attention and interest when finance team members have not been actively involved.

With the global recession deepening, many executives are beginning to listen more to benchmark performance numbers that show the types of savings that are possible from tighter coordination of the procurement and finance functions. Year after year, benchmarking firms such as Hackett continue to quantify the exponential saving benefits that can accrue through better, functionally coordinated, efforts. Consider, for example, the types of returns that enhanced straight-through processing automation and change management can bring around to the accounts payable function. By tying tools and processes together in this area, procurement and finance can together reduce maverick spending, better leverage existing contracts and lower operating costs. These types of collaborative savings efforts are difficult to ignore. For many companies, necessity - in the form of declining sales volumes, rising business risk and the rising cost of capital - is driving procurement and finance to work more closely together. Through focusing on such strategies as driving better working capital management, procure-to-pay savings implementation, organizational (and supplier) compliance and overall spending visibility and supplier relationship management efforts, procurement and finance are starting to come together, taking joint ownership of opportunities that can mean the difference between staying in the black versus taking a turn into the red.

2. In it Together: Procurement and Finance

Inside most companies, there is no question about it - procurement and finance are in this thing together. What "this thing" is in today's economy might vary by industry. For example, in capital-intensive businesses or for those companies where the cost of capital has risen precipitously, working capital management might take priority. In certain manufacturing sectors, collectively insuring continuity of supply might become the first order initiative. But in all cases, one issue is abundantly clear - the goals of finance and procurement are increasingly aligned. Part of the reason is that the metrics that company directors and shareholders like to measure corporate investments such as return on investment (ROI), return on net assets (RONA) and return on investment capital (ROIC) are a perfect gauge to measure the returns from the types of process and technology investments that procurement and finance can make together. In contrast, CIOs and IT departments have fallen hook, line and sinker for the total cost of ownership (TCO) tragedy that traditional enterprise software companies and consultants like to propagate. TCO, in contrast to financial driven metrics, is not an earnings investment lever. Rather than contributing to hard-dollar returns, TCO is about minimizing the cost to run a system - not the value the system can deliver. The fact that CFOs and CEOs are increasingly focusing more on the bottom line in today's environment is driving them away from such measures as TCO. And it's about time.

There are other factors bringing procurement closer to finance and the rest of the business. Procurement and operations executives are, for the first time, being viewed as potential grooming areas for future company leadership - which requires developing close working relationships with the finance organization. Corporate advancement, however, is only a single element driving this collaboration. As important, the business headlines demand that procurement join forces with finance to better manage working capital. Consider how Southwest Airlines, one of only four global airlines with an investment grade credit rating, was recently forced to pay 10.5% and put up 17 jets as collateral as part of a recent bond offering. Aside from collateralization backing the bonds, the rate alone represented double the percentage it paid in 2004 in a similar offering. Clearly, in this environment where debt financing is expensive and challenging to come by, gaining greater visibility and control over working capital is not just beneficial - it is essential. Unlike governments in the current economic crisis, companies no longer can afford simply to run the printing presses.

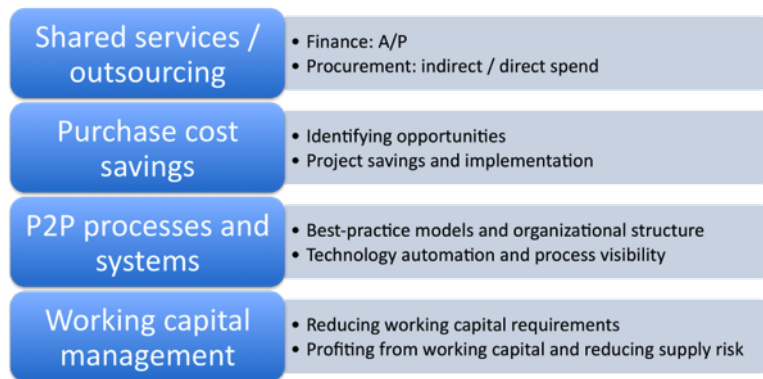


Figure 2: Opportunities for Procurement and Finance Collaboration

In addition to improving working capital management in today's environment, procurement and finance must operate in the same life raft together, a jointly piloted vessel, supporting the entire ship that it is moored to. Within this precarious craft, the two groups share additional common goals: the need to achieve rapid savings, the need to monitor / control external risk factors and the need to take full advantage of technologies and processes that enable greater

transparency and opportunity. To unlock the relationship potential between procurement and finance, a number of organizations have already started to collaborate in a range of areas. These include:

1. Shared services / outsourcing (of A/P, indirect and direct materials)
2. Purchase cost savings identification and implementation
3. Purchase-to-pay (P2P) processes and systems
4. Working capital management

Shared services and outsourcing are already helping a number of procurement and finance organizations to improve operating efficiency and effectiveness. Our experience suggests that those companies that focus on the A/P and P2P areas will achieve the best returns by first addressing and automating as much of these processes as possible before migrating to a shared services or outsourcing environment - which requires tight finance and procurement collaboration. A traditional "lift and shift" approach that targets returns just from labor efficiency/throughput and cost will always sacrifice savings and also has the potential to introduce additional performance and security risk, especially in an outsourced or offshore environment. Indirect procurement outsourcing and category ownership focused on either individual categories (e.g., office supplies or IT hardware) or a broader collection of spend areas (i.e., the entire indirect procurement function) offer significant saving opportunities through joint collaboration as well.

Procurement and finance organizations can also achieve substantial returns by targeting programs that make identified savings from other initiatives (e.g., strategic sourcing) stick. In this regard, the key becomes insuring that paper-savings drop to the bottom line rather than simply looking good in a PowerPoint presentation. Finance and procurement collaboration in enterprise level budgeting and planning is critical to make sure that identified savings numbers have an impact on actual budgets. We have also observed leading procurement and finance organizations collaborating together on process-based supplier management opportunities including buying groups and rebate programs that enable the business to act as an aggregator of separate divisions and/or groups of suppliers for materials and services.

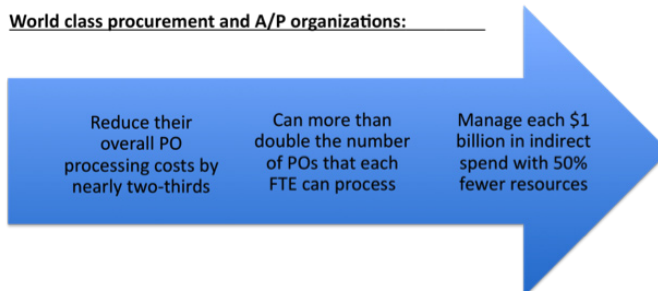


Figure 3: Getting to World Class Performance (Source: Hackett)

For many companies, procurement and finance collaboration targeting P2P processes and systems often yields the most rapid, tangible savings results of any technology-based coordinated efforts. P2P systems enable a range of hard dollar cost reduction benefits by reducing off-contract purchases, lowering purchase volume in general, improving operating efficiency, increasing PO throughput per FTE and bringing greater spend under management and lower contract rates. Hackett benchmarks suggest that world class P2P efforts yield significant results for companies (compared with average performers). These benchmarks

show that world class organizations are able to lower PO process costs by nearly two-thirds, can more than double the number of POs each FTE can manage and can reduce by nearly half the number of FTEs required to manage each billion dollars of indirect spend. But these benefits are just the start of P2P's collaborative benefits. Such efforts can also help companies reduce risk by building greater visibility into purchasing and payment controls, enhance company-wide and supplier compliance and can even serve as a foundation for companies to profit from supplier relationships through advanced discounting and supply chain finance strategies.

Regardless of whether or not companies have balance sheets that could see them through a twenty-year downturn or are dependent on credit lines and other debt capital to finance month-to-month requirements, just about every organization today is taking a close look at working capital management. It is in this area that procurement and finance can often derive the largest impact by collaborating. In the past decade, as companies have bought more and made less - "buy" also applying to the delivery of services as well - they have gained greater potential control over working capital. But only a minority of organizations has taken full working capital advantage of moving from fixed to variable asset structures based on their own specific needs (which may evolve over time). For example, an organization with a strong balance sheet may opt to offer discounts to suppliers based on their need to be paid within a specific window, tailoring the discount percentage to a market rate and the supplier's credit worthiness and ability to borrow from traditional sources. Given the spreads in today's market between what a company can earn in a money market account or short-term government or investment grade debt security versus the rate at which a bank will loan to suppliers, this discount can amount to an historically high market spread (e.g., 15-25% APR) with absolutely no risk to the lender, i.e., the buying organization. As one executive we spoke to recently put it: "this is the only license we have to print money." By the same token, companies that do not have as strong a balance sheet can leverage procurement and finance collaboration efforts to standardize on extended payment terms and/or working with a third-party to finance early payment for those suppliers that are willing to take a discount.

3. Accelerating the Partnership

Without question, procurement and finance collaboration can help companies thrive in the downturn through better working capital management, cost reduction and risk mitigation strategies and approaches. But to maximize the likelihood for success - not to mention rapid returns - it is critical to target the right programs based on organizational priority levels and the potential savings and value they can create for the business. At the same time, it is just as important to enlist the support of all areas of the business in the initiatives so that finance and procurement are seen as a collective agent of positive change rather than a collective adversary to the status quo. This type of internal marketing requires both proverbial "carrots and sticks" as well as making sure that everyone feels the impact through budget modification based on the results of the program. It also requires organization to define metrics and measurements to quantify program returns as well as to segment responsibilities. But most important of all, it requires technology and process automation that can rapidly drive results versus the type systems and process paralysis that marked so many ERP implementations for years.

Technology should serve as much more than an enabler in this case. It should cement a foundation for savings enablement and spend control while also acting as a compliance platform for monitoring and managing internal and supplier-directed processes (e.g., invoice processing and accuracy). Perhaps most important, technology must provide a level of visibility and spending insight that enables overall business accountability and measurement, bringing procurement, finance and other operating divisions and corporate functions together. To help bridge the functional gaps and collaborative requirements that the right solutions can provide it is essential to first select the initiatives that an organization wants to go after, many of which we have discussed in this whitepaper.

4. Final Considerations

Our own customers' results suggest the importance of investing in both upstream and downstream P2P, putting particular emphasis on invoice automation and control, an area that all too often is an afterthought for IT or procurement-led P2P initiatives. Our experience also suggests that for companies that implement the right set of processes and supporting technology, invoice automation approaches that minimize time-intensive invoice-handling tasks and drive management by exception approaches often becomes the glue that binds not only procurement and finance collaboration and spending visibility, but also the key enabler of specific business strategies that target working capital management improvements and implemented cost reduction efforts. This is why it becomes so critical for companies to choose the solution that is right for their business requirements rather than simply those that fit into the box of capabilities that an ERP or alternative provider can offer today. In other words: buy what you need, not just what someone wants to sell you based on a prior or IT-driven relationship.

When choosing the right partner, look for solution providers that can bridge the functional, culture and process gap between finance and procurement - a partner that can get both groups on the same page. Technology companies that have experience working with individual functions are unlikely to fully appreciate and deliver capabilities and insights that can truly take both finance and procurement organizations at all levels of maturity to the next level of performance. At Basware, we have spent over two decades helping to bridge the process and functional gaps between procurement and finance in countries around the world. If you are curious to learn more about what we have learned about bringing finance and procurement closer together, we would welcome the opportunity to start a conversation.

To find out more about how Procurement and Finance can benefit from collaboration, please contact juha.hakamies@basware.com



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