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## Overview

Procurement needs to be examined from a finance perspective – how the proper management of extended global supplier networks and strategic supplier relationships can help organizations minimize costs, lower risk and utilize working capital more effectively.

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# The Finance Perspective on Procurement

“You get what you pay for,” is a common sense principle that guides buying decisions for consumers and businesses alike. It presupposes a direct relationship between the quality of a product or service and its price. But unfortunately, the relationship between quality and price is rarely as predictable as it ought to be. And the people who manage corporate supply chains know that only too well.

As companies slowly emerge from the recession, there remain significant gaps in the alignment between finance and procurement, two seemingly obvious corporate partners. AMR Research reports that of 78 organizations they surveyed in 2009, only 52% of procurement departments actively collaborate with their companies’ finance organizations. And in another survey of more than 800 firms conducted by a spend management company, 31% rated the relationship between procurement and finance as weak or non-existent.<sup>1</sup>

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*“31% rated the relationship between procurement and finance as weak or non-existent.”*

- AMR Research

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This disconnect has serious implications for how procurement is funded, and how its performance is measured. In business as in the consumer world, we are always seeking the highest quality at the lowest price and there is always tension between the two. Smart decisions on purchasing require agile, ongoing analysis of both sides of the spend/quality equation. And this level of analysis demands closer cooperation between finance and procurement.



Analysis of spend and supplier performance can create a more transparent way of helping organizations manage and evaluate that performance, delivering dependable, accurate assessments of an increasingly extended global supply network, while allowing for a volatile, high risk business environment.

## A Supply Chain Is Only as Strong as its Weakest Link

Supply chains are never static. And the supply chain itself is just one link in a chain of business processes that must work together smoothly for organizations to succeed. If one key component from one supplier is defective or not delivered on schedule in a just-in-time manufacturing process, the repercussions can be disastrous. In fact, according to the Corporate Executive Board's Procurement Strategy Council, "20% of a company's market value can be instantly destroyed by supplier infractions committed across the extended supply network."<sup>2</sup> This thought alone should give finance and procurement executives insomnia.

In addition, supply chains are often highly fragmented with multiple vendors. And each company that represents a link in that supply chain is subject to its own competitive pressures and market forces. Thus, each supplier's own financial health needs to be scrutinized.

So, in these still-difficult economic times, corporate finance offices are growing increasingly aware of the importance of rigorous supply chain management. Finance professionals are asking themselves how to gain greater predictability in their spend and how to assess risk in extended global supplier networks.

But beyond these more macro-economic business issues, there is an acute tension between procurement and finance. On the one hand, procurement is always looking to take advantage of available pricing discounts by nurturing relationships with suppliers to get the best possible terms. But this takes time. And while good for margins, such an approach can be bad for cash flow. In addition, there must be a balance between flexibility and centralized control—between giving employees the autonomy to work with familiar local vendors, and the economies of scale that enable a large organization to achieve cost efficiencies.

If departments and business units are free to buy their own supplies locally, a company could end up paying higher prices for basic supplies and services. However, if purchase and distribution are controlled too rigidly, the organization may end up with a burdensome, bureaucratic ordering process, and frustrated employees who are tempted to go outside approved channels just to get the job done. This is especially true for global operations where shipping involves significant time and cost.

On the other hand, finance has immediate cash priorities, the need to delay payments and continually negotiate discount terms, which produces a less flexible purchasing environment but manages working capital more effectively.

The real obstacle, however, to finance and procurement working together is procurement's difficulty in effectively executing its cost-saving strategies and measuring its success in financial terms.

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*"Less than 10% of procurement departments... do an "excellent" job of projecting, implementing, and tracking their cost saving initiatives."*

~ Aberdeen Group

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## The Finance Side of Supply Chain Risk

In a survey of CFOs and CPOs (Chief Procurement Officers), the Aberdeen Group said that "procurement by its own admission fails to implement 21% of the savings identified from its sourcing efforts."<sup>3</sup> Aberdeen also found that:

- 34% of companies have no formal process for measuring procurement savings.
- 36% of companies calculate savings on a case-by-case basis.
- Less than 10% of procurement departments, in the opinion of CFOs, do an "excellent" job of projecting, implementing, and tracking their cost saving initiatives.

The challenge for procurement is to drive greater predictability into operational savings in supplier performance and spend. This requires powerful analytics to make the operations of procurement more accessible and transparent for finance—both to help finance appreciate the nuances of supplier relationships and to connect spend and supplier management to finance’s planning and budgeting processes.

## Procurement and Finance – Working Together

Although finance may recognize that the procurement organization has taken steps to gain operational efficiencies and lower costs, the finance group is typically not involved in the planning phase of these efforts. Because of this, the role of finance is often limited to that of auditing the activities of procurement. And the procurement organization, in turn, devotes time to documenting its results that would be better spent seeking out new ways to improve those results.

Procurement professionals need to enhance their ability to manage spend and performance, and then measure and report on the results so that the value of their efforts is recognized.

Research firm AMR has identified several best practices that can help finance and procurement professionals to work together to set goals and measure results.<sup>3</sup> Here we will discuss just three of the best practices that pertain to systems and solutions.

## Improve “spend visibility” to identify and document successful, ongoing initiatives

“Spend visibility” refers to the ability of an organization to gain a clear view of supply-related spending apart from the total overall spending of a department or business unit. This is where procurement analytics come in. Analytics provide both finance and procurement organizations with a clear picture of current spending, opportunities for savings, and the effects of procurement activities on working capital.

## Use “sourcing technology” to find additional savings quickly

The business axiom “what’s measured gets managed” applies to procurement as it does to most other business processes. Supply chain management technology or “sourcing technology” allows savings from procurement initiatives to be measured and tracked. And savings can be realized fairly quickly once the measurement process shows what should be managed and how.

## Support procurement’s supplier and inventory policies by showing clear financial benefits

When the procurement organization succeeds in finding cost savings, their efforts may conflict with other parts of the business. For a variety of reasons, other departments—sales, logistics, or operations—may challenge procurement in their efforts to reduce costs. This is where procurement needs the help of finance to “measure the working capital success over time as the practice is implemented.” No doubt the first attempts at just-in-time manufacturing were met with skepticism by operations managers who were accustomed to stockpiling inventories of parts and components. So procurement may need the help of finance to create a complete and compelling business case for the economies that procurement hopes to achieve.

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*IBM Cognos 8 Supply Chain Performance Procurement Analytics helps companies maximize their purchasing power by analyzing buying patterns by item and vendor contribution to total spend.*

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## Powerful Analysis Tools for an Ever-Changing Supplier Landscape

To implement the practices discussed above, there is no better solution than IBM Cognos 8 Supply Chain Procurement Analytics. This packaged application gives organizations visibility into spending and supplier performance by incorporating reporting and analysis capabilities that answer key procurement questions about price/quality balance and supply consistency—among others.

IBM Cognos 8 Supply Chain Performance Procurement Analytics helps companies maximize their purchasing power by analyzing buying patterns by item and vendor contribution to total spend. It helps the finance organization evaluate adherence to contractual terms and determine the cost of non-compliance. It also identifies opportunities for procurement departments to consolidate or redistribute purchasing by evaluating the performance of individual buyers and buyer/vendor relationships.

Using a standard business model, IBM Cognos 8 Supply Chain Procurement Analytics delivers cross-functional reports that different departments can use to analyze their own spend and financial performance. For example, the core business model of IBM Cognos 8 Supply Chain Performance Procurement Analytics can be extended to IBM Cognos 8 Financial Performance Analytics for a more integrated, transparent assessment of supplier spend using insights from accounts payable, receivables and general ledger reporting and analysis. And the solution adapts to dynamic business change quickly and easily, enabling organizations to add, modify, and analyze new information to ensure continuously relevant reporting.

## Benefits for Finance, Procurement—and IT

While the procurement and finance organizations are the primary beneficiaries of IBM Cognos 8 Supply Chain Performance Procurement Analytics, the solution also benefits IT. It offers standard, self-service reporting and analysis, and streamlines the configuration of report changes through an intuitive point-and-click process, eliminating much of the coding, customizing and interpreting of data normally required in a solution this powerful. Thus, business users have access to continuously relevant reporting content that can adapt to changing business and market conditions – delivering lower total-cost-of-ownership through more sustained application manageability.

And because supply sources are diverse, IBM Cognos 8 Supply Chain Performance Procurement Analytics reflects the diversity in data sources by providing the flexibility and adaptability to source heterogeneous data from a wide range of systems for consistent, “apples-to-apples” analysis.

## Quality and Price in Optimum Balance

IBM Cognos 8 Supply Chain Performance Procurement Analytics gives organizations the ability to manage both the business and the finance sides of procurement more effectively. It helps manage spend, establish continuity in the supply network and take advantage of strategic, long-term supplier relationships that lower costs and improve margins.

Ultimately, this solution helps you make sure that the ever-present tension between quality and price balances out in your favor so that you get what you pay for – and more.



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#### Endnotes

<sup>1</sup> Mickey North Rizza, *Procurement and Finance Groups Unite! The Best Practices for Success*, AMR Research, November 2009

<sup>2</sup> Corporate Executive Board, Procurement Strategy Council, <https://psc.executiveboard.com/Public/Default.aspx>

<sup>3</sup> Andrew Bartolini, *The CFO's View of Procurement: Same Page, Different Language*, Benchmark Report, Aberdeen Group, November 30, 2007



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