

basware

Research  
Summary

# The Cost of Control

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## Executive Summary

Supply chains form the backbone of many businesses today, and lots of the high profile business failures in recent months can be, at least in part, attributed to financial fractures within the supply chain. An unrelenting focus on cost cutting and uneasy relationships between finance and procurement professionals further combine to create an environment where supply chain risks, if left unchecked, can threaten company stability.

The Cost of Control survey, commissioned by Basware in association with IESE Business School (Europe) and the Kelley School of Business (USA), explores how the relationship between finance and procurement functions is symptomatic of wider operational strengths and weaknesses. It also evaluates how the management of financial and procurement processes affects wider business performance. The study is based on the views of 550 financial directors and CFOs from large enterprises around the world.

### The key findings of the Cost of Control survey can be summarised as follows:

#### **Despite a high risk economic climate, CFOs in organisations struggle to recognise the importance of closely managing supply chains through procurement**

- Only 28% of respondents believe that procurement has a significant impact on financial risk exposure
- Risk analysis (39%), margins growth (39%) and other strategic goals are all sacrificed in place of bottom line cost reduction (64%) as a strategic priority

#### **Finance underestimates the strategic value of purchasing and the supply chain to business performance**

- 52% of financial decision makers think purchasing is becoming a more strategic function, although 36% believe it is still largely administrative
- Only 29% of respondents describe procurement as a function that has a positive impact on enterprise growth

#### **Businesses are experiencing efficiency gaps in data capture, automation and integration across purchasing and finance functions**

- On average, only 42% of indirect spending is captured
- Only 50% of the processes supporting purchasing are automated
- Less than half (46%) of CFOs consider that purchasing and finance functions are integrated effectively

#### **Satisfaction with cost saving strategy is influenced by levels of process automation within businesses**

- Businesses with highly automated\* purchasing processes are more likely to consider that purchasing and finance have maximised savings in the past 12 months (68%) than those with lower levels of process automation [58%]
- Satisfaction of 'delivering on cost saving targets' increases from 47% in low automation businesses to 62% with high automation businesses

\*High automation - Businesses that stated the percentage of purchasing processes that are automated is above 50%. Low automation - Business that stated the percentage of purchasing processes that are automated is below 40%

The Cost of Control report explores the complexities of supply chain management during unprecedented economic difficulty from the perspective of those who actually hold the corporate purse strings. The report concludes by highlighting how the perception of procurement and its impact on financial operations and risk are in need of review.

A lack of automation and integration, coupled with an absence of importance associated with risk and profit in relation to the purchasing function, are sources of concern. The degree to which any of these weaknesses is present within a business will influence the achievement of strategic cost cutting and efficiency goals. However, it appears that only an exclusive minority of companies are currently in a position where the impact of these issues can be avoided. For the rest, there are evident opportunities to achieve cost saving improvement by bringing areas of financial systems and the supply chain under greater control.

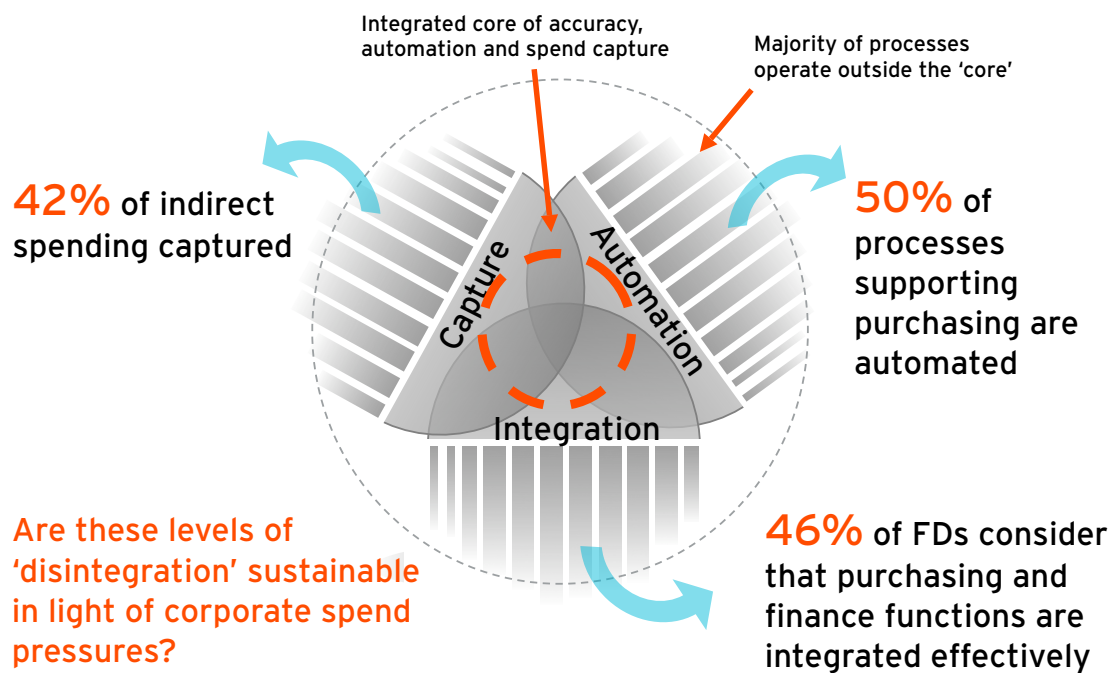


Figure 1: Levels of data capture, automation and integration show room for improvement

## Research Approach

The Basware Cost of Control research features insight from 550 CFO and CFO level respondents, across USA (100 interviews), UK (100), Scandinavia (100), Germany (100), Spain (50), Benelux (50) and France (50). Interviews were conducted by telephone during May and June 2009.

The research is endorsed by Professor Adrian Done of Barcelona's IESE Business School and Mark Frohlich, Professor of Operations Management at the Kelley School of Business in Indianapolis.

The research was conducted by Loudhouse Research, an independent research agency based in London.

## Cost cutting pressures

The economic downturn has seen companies uniformly throw the spotlight on cost cutting in order to survive, let alone thrive. Figure 2 shows that cost reduction looks set to continue dominating strategic priorities for businesses into 2010 - with 64% of respondents focused on reducing direct costs and 60% looking at reducing indirect costs.

This cost cutting trend is consistent across company size and regions. Further results shown in Figure 2 suggest that CFOs are putting growth and profit issues firmly down the list of importance as priorities such as risk analysis (39%), maintaining / improving margins (39%) and increasing profits (37%) are significantly diminished alongside cost reduction imperatives.

There are regional differences particularly in the focus on boosting profitability. Specifically, Scandinavia (46%), the US (45%) and the UK (44%) are seen to be focusing more than other regions on boosting profitability although interestingly, the US is also one of the most aggressive cost cutters (71%). At the other extreme, France (12%) and Spain (10%) are the least likely to be looking at boosting profitability, remaining fixated on reducing costs (France: 82%, Spain: 72%).

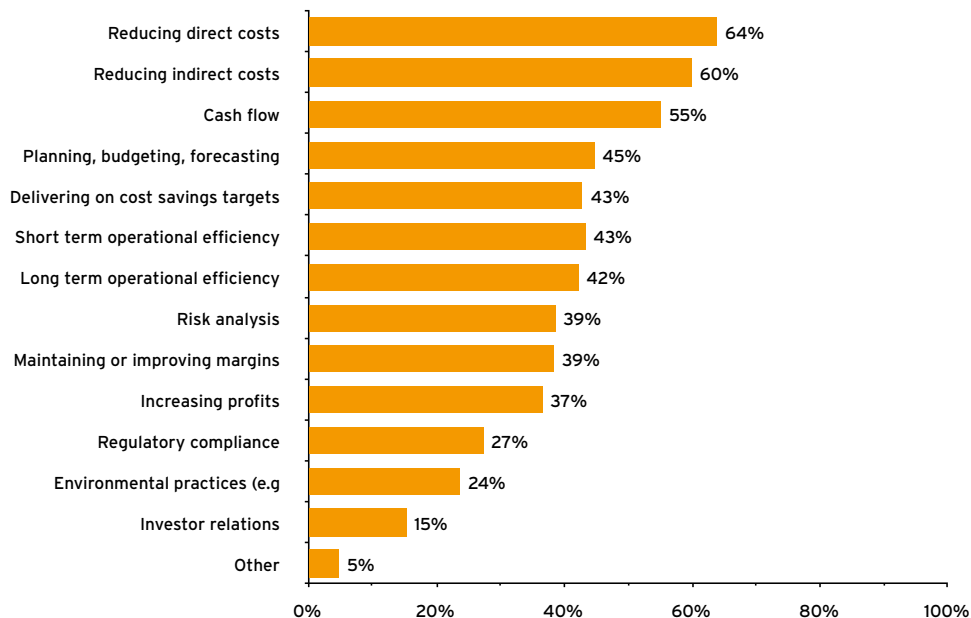


Figure 2: Main priorities for CFOs in next 12 months

## Cost cutting challenges

CFOs were asked to specify the most significant challenges affecting finance now compared with 12 months ago. Figure 3 shows that whilst strategic priorities were very much skewed in the direction of cost cutting, when it comes to challenges, perceptions vary and a far more evenly distributed "worry list" emerges.

Exploring the top five concerns amongst CFOs reveals a situation where finance is tasked with identifying and realising cost savings whilst grappling with increased supplier risk, a lack of spend visibility and a realisation that maybe technology could help.

There are some regional differences with spend visibility higher on the radar of companies in Benelux (52%), Spain (48%) and Germany (40%), whilst the US is more challenged by increased supplier risk (46%) and a need to automate more quickly (44%) than other regions.

The fact that spend visibility and increased supplier risk top the list of CFO challenges shows that organisations are still being challenged by complex strategic issues. Areas identified for further cost cutting over the next 12 months are shown in Figure 4. It is worth noting that the 'salary' and 'headcount reduction' feature heavily in the CFO priority list and that these areas are typically outside the remit of the purchasing function. Employee cuts will also yield a more immediate and tangible saving than materials savings. If rationalising the labour force is a major factor in reducing cost, this could have an impact on the way that purchasing is incorporated into strategic cost reduction decision making.

Enhancing spend visibility is clearly critical in the cost cutting weaponry, providing intelligence to what could otherwise be a fairly rudimentary process. Alongside this, a reliance on hundreds or thousands of suppliers coupled with recent news headlines, such as the demise of General Motors, has thrust supplier risk onto the front page for many CFOs.



Figure 3: Most significant challenges affecting finance now compared to 12 months ago

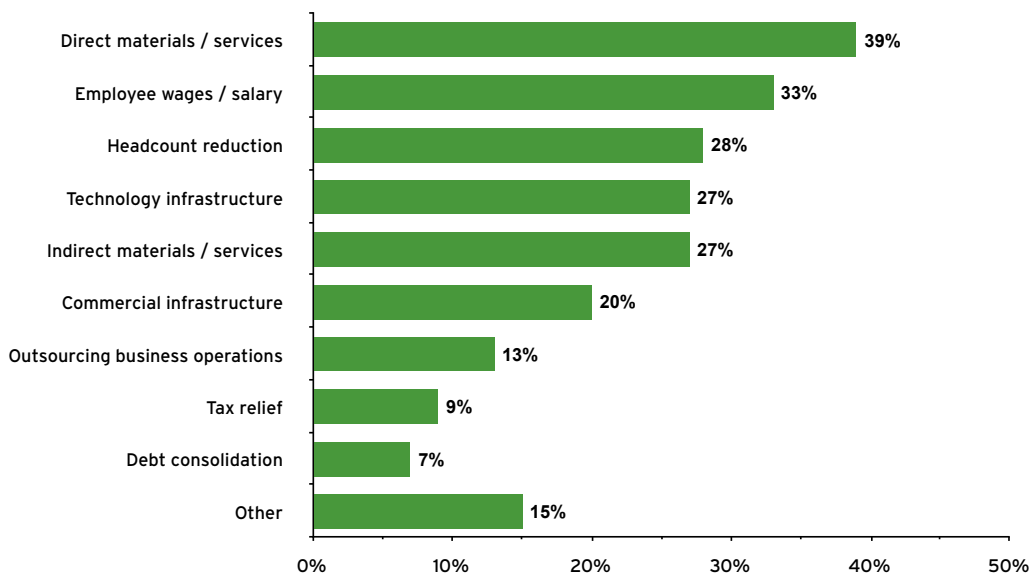


Figure 4: Key area of savings for CFOs in next 12 months

## Perceptions of finance on purchasing

CFOs generally acknowledge that the job of the Chief Procurement Officer (CPO) is getting more difficult (61%), although there are distinct regional differences, as shown in Figure 5. This viewpoint is most commonly expressed by those in the US (77%), the UK (69%) and Scandinavia (66%) and less so in France (30%) and Spain (36%).

Procurement's role and reporting structure within the organisation varies widely from reporting directly to finance (27%), having limited interaction with finance (17%), to both finance and procurement being represented in cross functional teams (22%).

The latter [cross-functional] represents the most dynamic and sophisticated arrangement, but interestingly in these cross-functional set ups, 75% of CFOs consider that the job of CPO is getting more difficult - higher than the average of 59%. However, where procurement reports directly to finance, a more traditional model, the percentage reduces to 54% - lower than the sample average.

This suggests that current cross functional set-ups are less than efficient at removing purchasing challenges. Of course, it may be that cross-functional models are simply a product of complex organisational structures, meaning that purchasing pressures are greater by default. However, company size and reach have no significant bearing on the nature of reporting structure, suggesting that the structure itself is an influence on the way procurement functions.

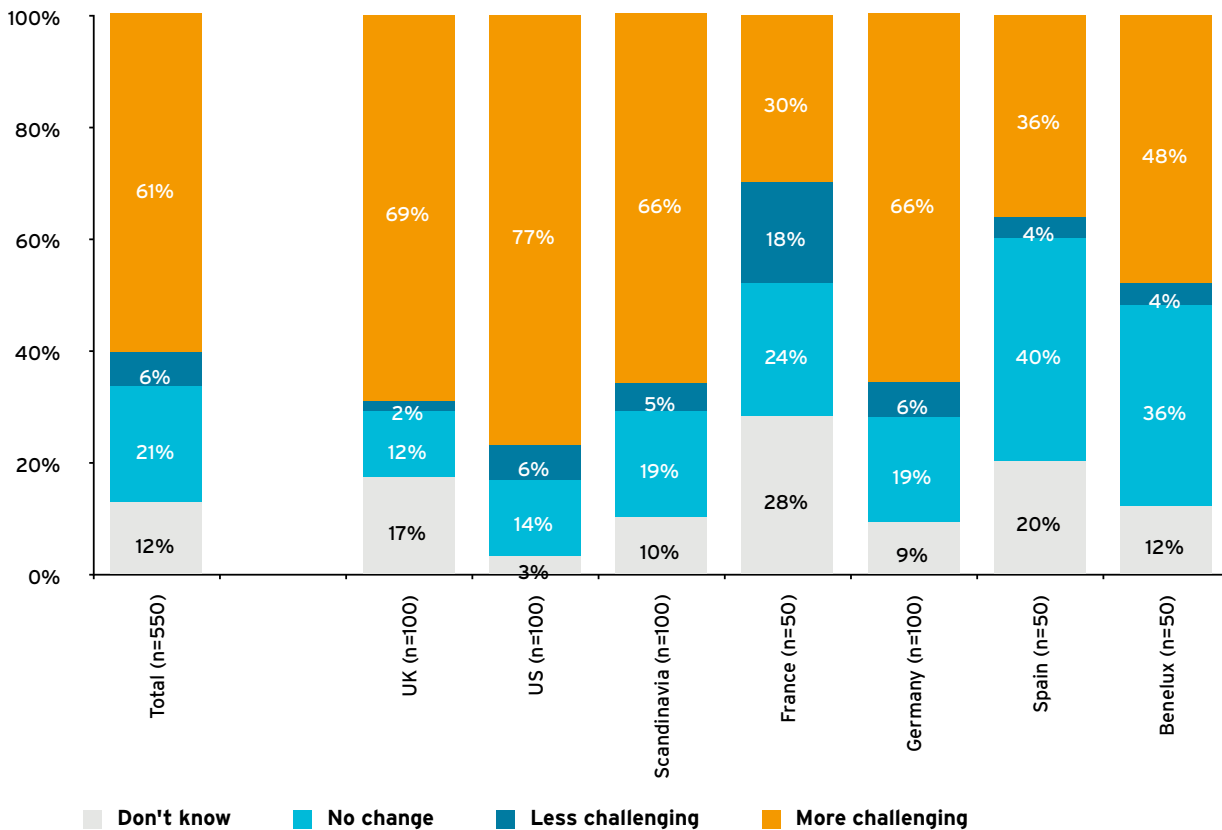


Figure 5: Perceptions of whether the role of CPO is more or less challenging than 12 months ago

## Purchasing impact on finance objectives

Although half of CFOs (52%) consider that procurement is becoming more strategic, only 27% believe procurement has a positive effect on profitability or growth [Figure 6]. Furthermore, in only 17% of organisations, the CPO or Head of Procurement has a place on the Board of Directors. With the spotlight firmly on them, there has never been a better time for procurement professionals to stand up and be counted.

Unfortunately, as shown in Figure 7, there is something of a gap between what is expected of procurement departments (importance of various procurement objectives) and what is being achieved (satisfaction with procurement performance) according to CFOs.

Although satisfaction with procurement's contribution to strategic objectives remains consistent at around 50% across most areas, CFOs consider the procurement objectives of "identifying cost savings opportunities", "curbing non essential spending", "delivering on cost savings targets and negotiating better prices from supplier's" to be more important than others, and it is in these areas where satisfaction gaps appear.

This is not to criticise the role of purchasing for an absence of performance in these complex and more impactful areas of corporate strategy. It is more likely the case at an organisational level that the systems and structures supporting these efforts are not sufficient to enable a more productive / impactful execution of strategy against these goals.

	Total (n=550)	UK (n=100)	US (n=100)	Scand. (n=100)	France (n=50)	Germany (n=100)	Spain (n=50)	Benelux (n=50)
Procurement is becoming more strategic	52%	51%	50%	50%	44%	57%	44%	64%
Procurement is still largely administrative	36%	36%	33%	48%	18%	34%	46%	34%
Finance and procurement are tightly integrated	30%	39%	26%	24%	28%	32%	28%	32%
Procurement has a positive effect on enterprise growth	29%	30%	25%	40%	18%	36%	18%	22%
Procurement has a positive effect on enterprise profitability	27%	28%	34%	35%	22%	28%	10%	14%
Procurement focuses primarily on short term cost savings	18%	23%	18%	18%	16%	17%	8%	18%
The head of procurement / CPO has a place on the Board of Directors	17%	15%	10%	21%	4%	11%	36%	28%
Procurement does not always demonstrate how it adds value to the business	10%	15%	8%	3%	10%	14%	4%	16%

Figure 6: Which of the following would describe the procurement department within your organisation?

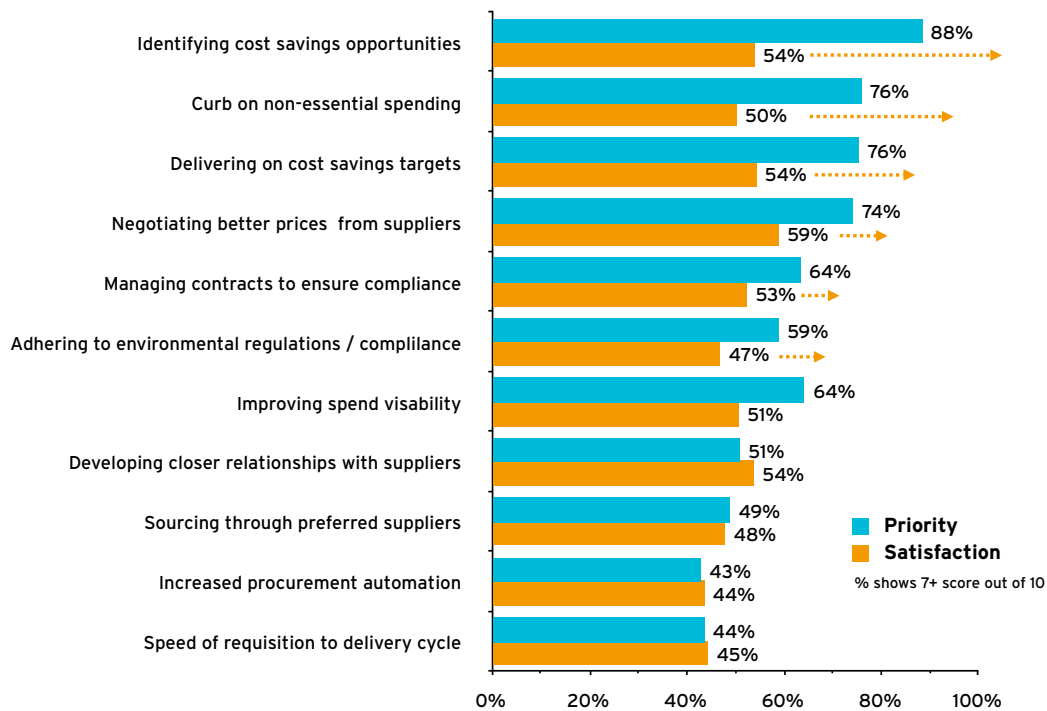


Figure 7: Gap between importance of financial objectives and satisfaction with procurement department in terms of contribution to these goals

## Supply chain risk

Although procurement has been seen to be somewhat disconnected from finance in terms of both strategy and process, Figure 8 shows that the performance of the procurement function is deemed by CFOs to have a direct impact on the levels of financial risk to which companies are exposed. Only 28% of respondents globally consider that procurement activity impacts financial risk to a notable degree [7+ score on a risk scale of 1-10] This is higher in the UK (34%), US (36%) and Benelux (38%) regions, but considerably less in France (18%) and Spain (20%).

The credit crisis is causing supply chains to become increasingly subject to disruption and the risks associated with procurement and managing supply lines are assuming greater significance.

Figure 9 highlights the significant risks threatening finance strategies within companies. Supply stability emerges as a major concern for CFOs (41%) whilst 19% are experiencing the risks associated with a shrinking supplier base and 21% are grappling with regulatory change risks. These are external risks that organisations can only control to a limited degree. Of greater concern is the scale and variety of risks that emerge through shortcomings in internal systems and processes, areas which can be brought under control by organisations.

The challenge is how best to balance the potential negative effects of risk against the cost and benefits of risk management strategies - as clearly for some, the investment associated with better managing risk will be seen to be at odds with cost cutting initiatives.

Spend visibility is one area that arises not only as a challenge for the coming year for CFOs but also as a significant risk to financial strategy more generally (24%). Spend information is of increasing interest to CFOs, and there is an evident need for the finance and procurement functions to collaborate more effectively to improve the quality and availability of this data. The fundamental consideration is why the issue of insufficient visibility of financial information refuses to go away?

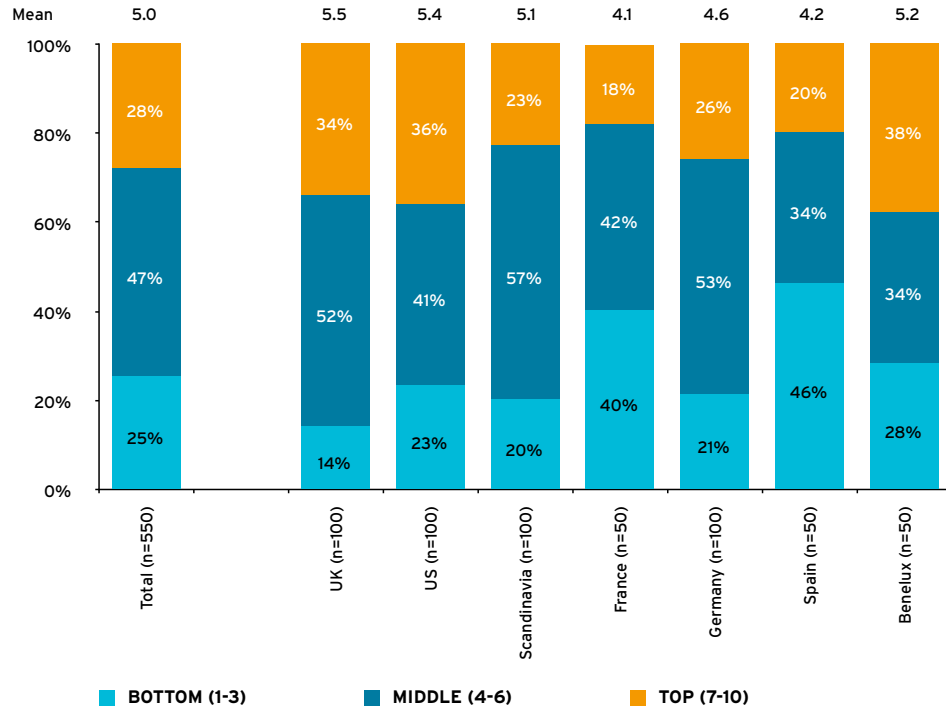


Figure 8: Extent to which procurement considered to impact level of financial risk organisations are exposed to

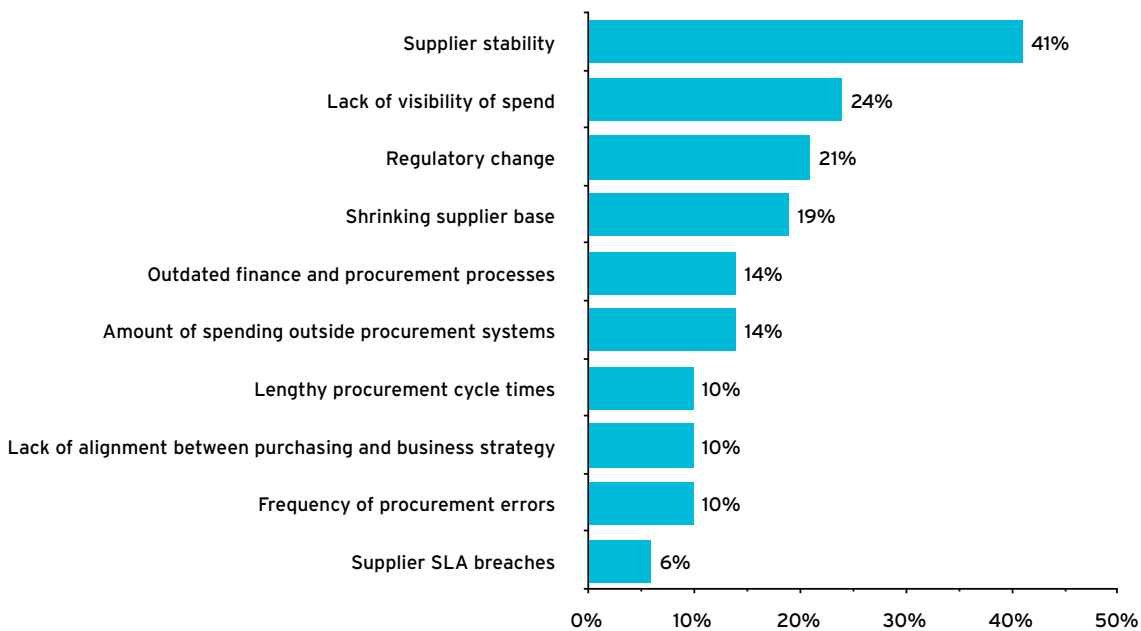


Figure 9: Biggest risks with regard to financial strategy

## Spending integration

There is a vast array of technology now available to automate various elements of the supply chain and to integrate these processes into the wider finance function, bringing some level of co-ordination and certainty to the table. Figure 10 shows the extent to which companies across the different regions have automated their procurement processes varies widely with the US (41%), the UK (40%) and Benelux (40%) ahead in the automation stakes. Further data from the research shows that, across all companies, on average only 50% of purchasing processes are automated and just 42% of indirect spend is captured by PO systems. This means that more than half of spend is “in the wild”, not measured or managed in any real sense.

When dealing with automation in more detailed areas of invoicing and purchasing, there is further evidence of room for improvement. Figure 11 which illustrates the varying extent to which key purchasing processes are automated. Contract life-cycle management (34%), contract matching (33%) and travel and expenses (35%) are notable areas that experience a lack of automation.

As stated, when asked what the general level of automation is within company-specific purchasing systems, the mean average was 50%. This average stands up when looking at the specific areas automation shown in Figure 11. Invoice processing and supplier transactions show higher levels of automation and also represent more straightforward areas of processes infrastructure, whilst contract matching and life-cycle management fall below 35%. The absence of automated systems illuminates the challenges of data visibility and supplier risk stated by respondents. In short, purchasing systems leave many aspects of financial operations beyond the reach of meaningful access.

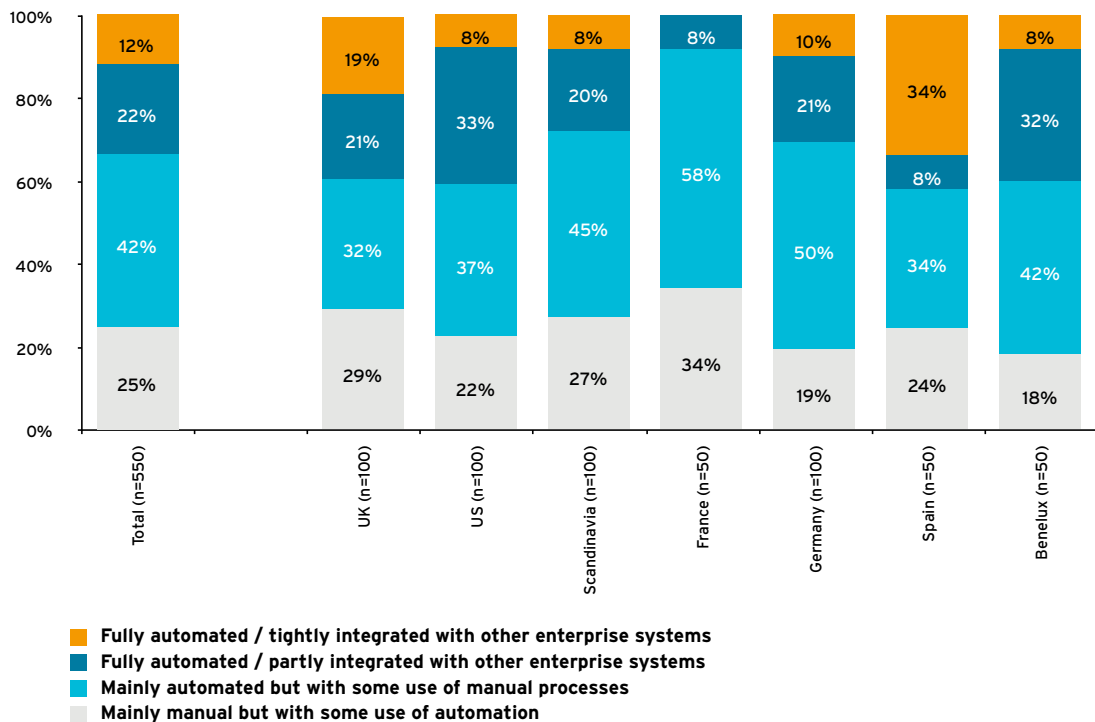


Figure 10: Extent to which procurement processes are automated with other enterprise systems

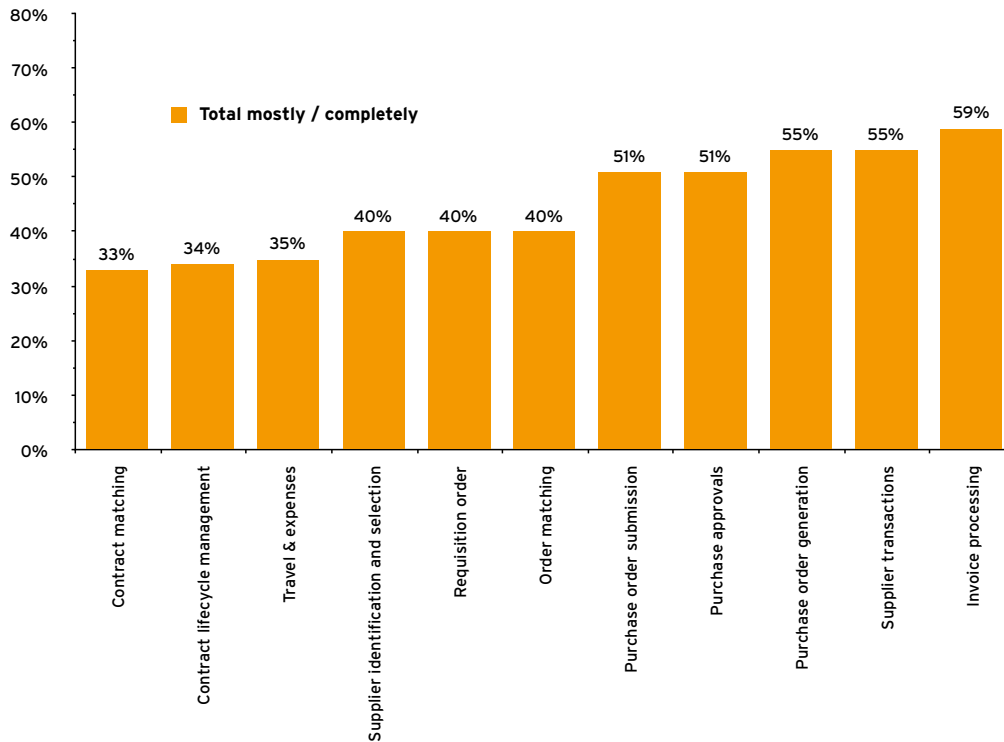


Figure 11: Levels of automated purchasing processes across purchase and pay functions

## Automation links to best practice

The Cost of Control survey shows a notable relationship between levels of automation and improved performance by procurement departments through the eyes of FDs. The charts take the satisfaction scores shown in Figure 12 and breaks them down by high and low levels of (purchasing) automation. In this case, businesses that state automation levels are above or below 50%.

Figure 12 shows that there is likely to be a greater perception of integration between the finance and purchasing functions where more than half of procurement processes are automated (a leap from 37% to 55%).

Furthermore, FDs are more likely to be satisfied with the combined savings efforts achieved by finance and procurement when there is more automation in place.

Figure 13 further expands on the impact of automation across a range of different areas within the procurement function, showing across the board that automation is bringing about better performance. This is particularly notable in areas of high strategic importance where procurement shortcomings have previously been exposed such as delivering on cost savings targets (47% low automation; 62% high automation), developing closer relationships with suppliers (48% low automation; 60% high automation) and improving spend visibility (46% low automation; 55% high automation).

As discussed, automation is clearly not the answer to everything, but from an FD perspective, the higher the degree of automation, the better procurement is seen to perform. Investing in technology at this time may not be an attractive option, but the ability to achieve greater cost savings, through improved visibility and control, and to better mitigate supply risk should prove a motivating factor in addressing automation challenges amongst large enterprises.

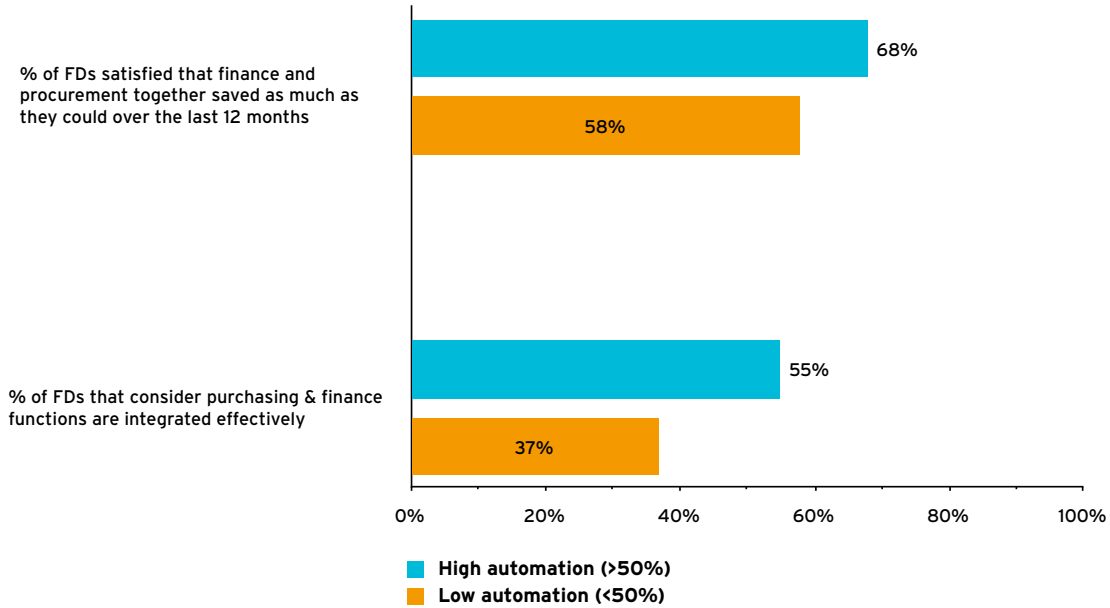


Figure 12: Impact of automation on levels of FD satisfaction with cost savings and extent of integration

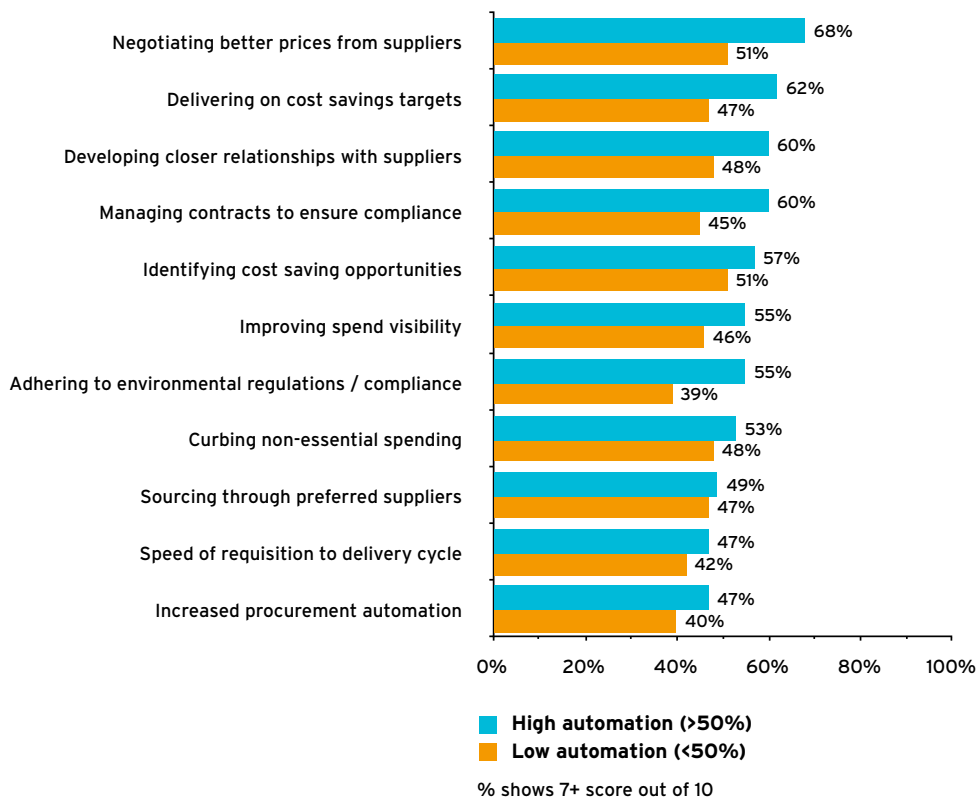


Figure 13: Impact of automation of FD satisfaction with procurement's performance on key objectives

## Conclusion

The downturn has shown CFOs the devastating impact of what can happen when an array of strategic, financial and operational risks change and converge. In a positive economic cycle the force of upward growth and expansion can anesthetise the pain of operational shortcomings. Difficult business environments for buying organisations are seen to have a knock on effect across lengthened supply chains, often corresponding

to an increase in supply risk. For many businesses the hypothesis of supply chain collapse is becoming a much closer reality that threatens commercial operations.

Furthermore, the economic downturn has seen companies focus all efforts on cost cutting in an attempt to survive, let alone thrive. Many CFOs see the primary responsibility of the procurement department in the current climate as reducing the costs of purchased goods, materials and services, and in turn procurement professionals are feeling the pressure.

With cost cutting having been a major focus for the last 6-12 months, the question arises of how much extra cost can realistically be squeezed out of businesses if tired methods of identifying and realising cost savings continue to be employed? Furthermore, focusing wholeheartedly on hasty cost cutting measures to the detriment of wider organisational imperatives may in fact weaken a company's position once a recovery begins.

Many of the challenges and priorities faced by CFOs boil down to procurement issues, yet it appears that the strategic relevance of purchasing is neglected in many scenarios. If purchasing was a window on the supply chain, it would seem that CFOs are looking elsewhere for signs of daylight among economic storm clouds. The need to combine forces and share information for the greater organisational good has never been more acute.

## Recommendations

In response to the issues identified in the research, Basware has provided the following considerations for tackling the challenges of financial operations and the supply chain:

### Functioning integration

Evaluate to what degree the interdependence of purchasing and finance is best served by the existing integration within the business. An assessment of the operational framework created between 'buyers' and 'billers' provides the basis for understanding where improvement can be made.

### Capture and automate

Data capture and automation should be seen as highly synergistic improvement measures. Exploring the benefits of one in exclusion of the other is a flawed approach to resolving process efficiencies, yet often systems are streamlined and automated without sufficient consideration to how this impacts data capture and visibility. Conversely, efforts to improve data capture can create significant disruption to workflow and processes when executed in isolation.

### Complete the risk picture

All businesses have the capacity to assess problems and their potential outcomes. This can be via sophisticated analysis tools or more mundane methods. However, purchasing and supply side operations must form an integral part of any risk decision if an accurate picture of opportunities and threats is to be created in order to achieve cost saving goals.

### Continual cost measures

The complexity of supply chain infrastructure means that short term benefits and savings are hard to realise. This means that tactical process and cost efficiencies must be combined with the longer-term cycle of infrastructure change. It is important to implement technology changes that can support and realise continual cost measures across distinct cost saving activity.

### Satisfying strategic needs

Whilst automation of, for example, contract negotiation and spend processes can have a positive effect on the ability of businesses to meet financial goals, the vast majority of businesses still have significant opportunities to automate further. All efforts to address this should ensure that links between infrastructure change and the realisation of strategic cost cutting goals are defined from the outset of any future projects.

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