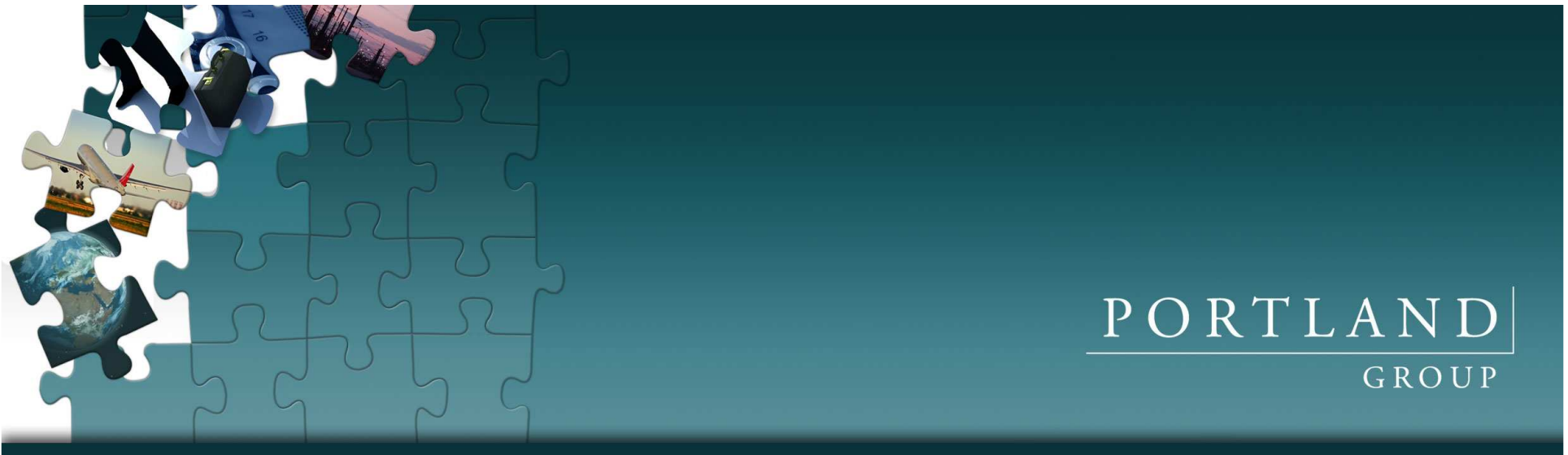


Your First Performance Measures For Senior Management

Catherine Thompson
Director, Procurement Services

Presented at CIPSA Performance Measurement Conference June 2006



PORTLAND
GROUP

Your performance measures express your undertakings to the organisation and the proof that you are delivering on them

- Follow the KISS principle
- Manageable (volume; ease of compilation)
- Expressed in a way that's meaningful to the organisation
- Auditable
- Convey or enhance the messages you want the organisation to hear about you

“the unexamined life is not worth living” (Socrates, 469BC)



The metrics you select will be a compound of your reasons for measuring and the measurement features you want to draw attention to

- Mount a case for expanding your team or its coverage
 - Defend your team and/or budget by showing a measurable worth
 - Improve the organisational status of your function
 - Measure departmental progress towards its goals
 - Demonstrate the efficiency of your transactional utility
 - Ensure your deliverables are aligned to corporate objectives
 - Complement regulatory or risk management regimes
 - Create better organisational leverage for your deals
 - Underpin a pay-for-performance or incentive plan (yours or your clients')
 - Better capture soft "value add" activities of your function
- 
- What do you want to highlight (or veil)?
 - What activities you currently perform, would like to, or would like to relinquish?
 - What audience are you targetting?
 - What behaviours do you want your audience to exhibit?



The ways in which you measure non-financial contributions will reflect the focus of your function, its maturity, and the industry sector in which you operate

- **Timeliness** (incidence and cost of delays to business activities due to late delivery)
- **Quality** (ppm defects, delivery in spec, service life, MTBF, client satisfaction)
- **Management information reporting** (ability to produce MIR on the cost base and monitor key vendors and corporate behaviours)

- **Transactional** (volumetrics such as PO & invoice volumes, cycle times such as req to PO)
- **Stock & Inventory** (stockouts & associated costs, \$ value of inventory, \$ value of obsolescent stock, % VMI, cost of carry, turns, backorder management, DIFOT)
- **Customer focus** (GM by product line, first time fill rates, warranty returns)
- **Vendor base** (active vendors, % contracted, % accredited, payment terms)

- **Risk** (the benefit of something not happening; how well risky events are managed)
- **Spend coverage** (cutouts, capex and project spend)
- **People development** (attraction & retention of high performers)
- **Internal Audit** or other benchmarking results (to internal norms or external standards)
- **“Balanced scorecard”** of soft measures such as client satisfaction, leadership, project management skills, though survey or post project reviews
- **“Business partner”** (coaching and teaching, producing documentation for non-buyers to rely on, “value chain” work)
- **CSR** (climate neutrality, pro bono work, environmental audits, community engagement, MWOB, fines etc)



CAPTURING PROCUREMENT'S FINANCIAL CONTRIBUTION

Financial contribution is the single most common success measure for Procurement functions, and it remains the biggest bone of contention between the function, its clients and Finance

- “They are nice people and they seem to do a good job, but there’s nothing really to prove it”
- “It’s all about the price with those people, they don’t factor in the need for strong relationships with our vendors and the quality of our goods & services will suffer in the long run”
- “Any time anyone saves money around here they claim it, even if it’s something they just assisted us to do”
- “It’s all paper, we never see the actual savings”
- “The benefits are there but they are not as big as they are claimed to be”
- “Why do I need a procurement department in the long run? Once you’ve done all the big deals you’ll run out of work”

Procurement v CFO
case study



Most of your ongoing spends will be tracked through category based reporting

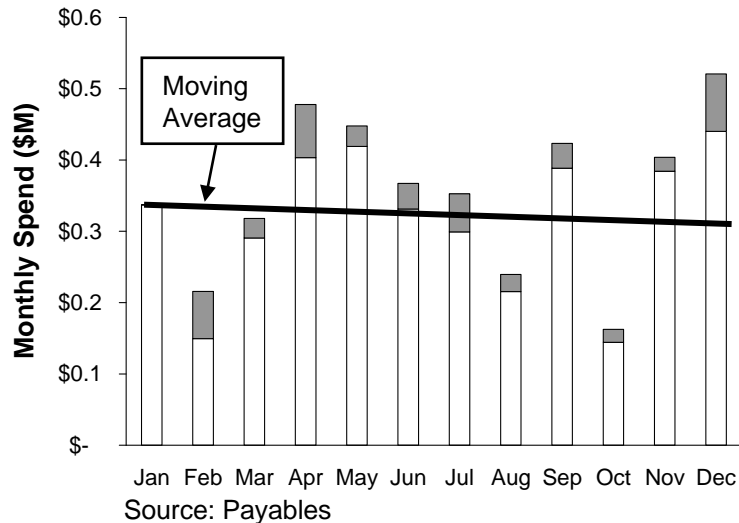
- Measures are inherently simple:
 - Are the overall \$ up or down from our forecast?
 - What's impacting this? Volume, leakage, vendor price compliance, market forces?
- This data can be compiled from a variety of sources and some collation will be required:
 - Payables
 - PO (though extensive no-PO processes in many firms make this an incomplete data source)
 - Expense reimbursements
 - Petty Cash
 - Corporate and T&E cards
 - Other corporate systems (claims management, Payroll, trading systems)
- A variety of spend segmentation tools can be recruited:
 - Industrial strength software
 - Vendor line item level reporting
 - Payables download into spreadsheet or database



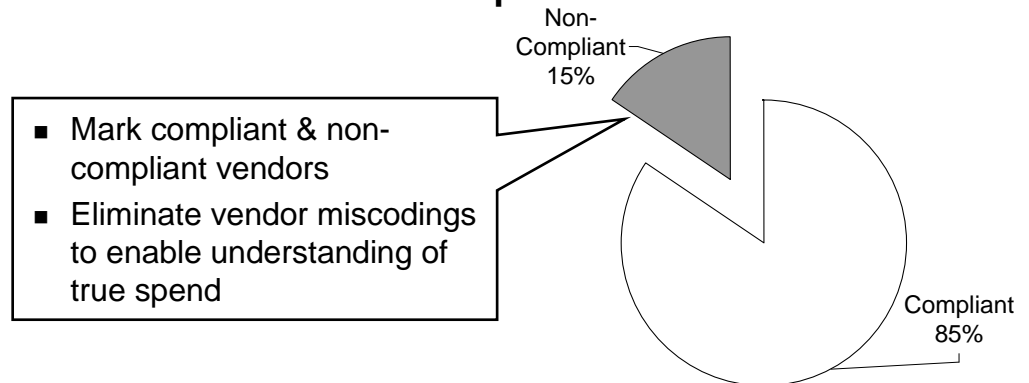
CONSTRUCTING A SPEND CATEGORY DASHBOARD

The key measurement points within a spend category are spend trends, compliance to preferred vendors, and the nature and quantity of goods and services provided

Commodity Spend Analysis



Compliance to Preferred Vendors



Non-Compliant Vendor	Description	Invoice No.	Amount
Vendor A			
Vendor B			
etc			

Source: Payables

Top Items/ Users

Top Items	Description	Units	Extended Unit Price

- Differentiate between on & off contract items

Source: Preferred vendor electronic invoicing
Categories: Office supplies, Travel, Print

Top Users	Description	Units	Extended Unit Price

- Determine what is being bought
- Determine who is buying it

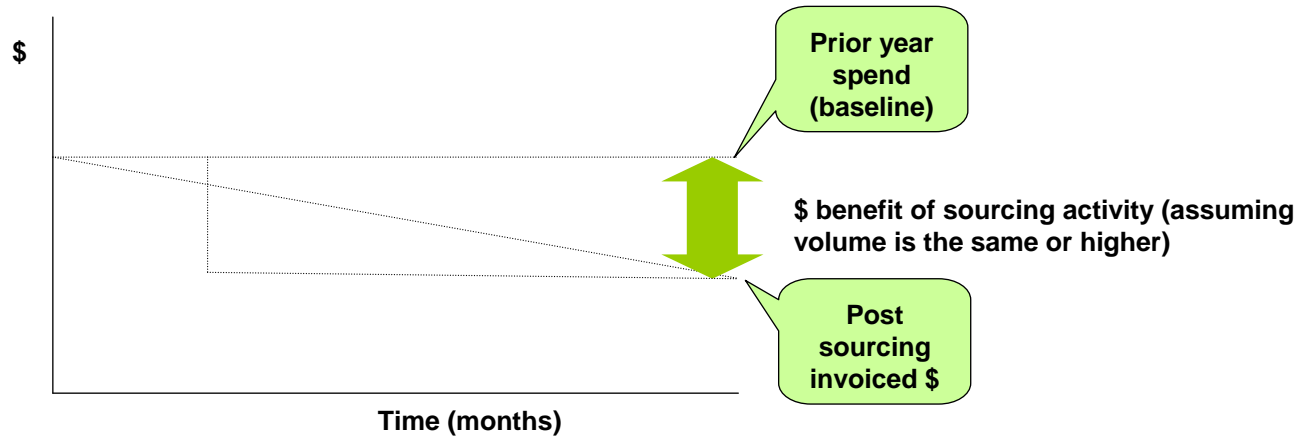
Source: Manual manipulation of vendor data
Categories: Travel, Telecoms, Recruitment



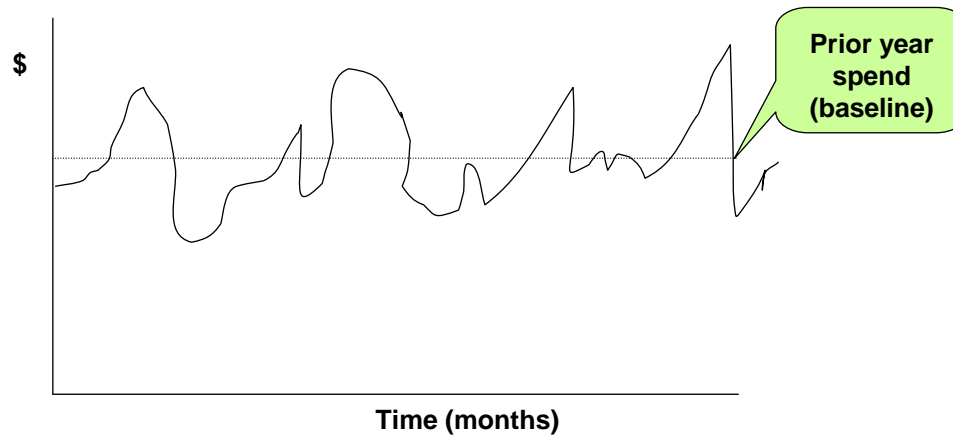
HOW THE BUSINESS SEES THE WORLD AROUND IT

Whilst category level reporting is useful, it does not express the worldview of the individual cost centre or business unit

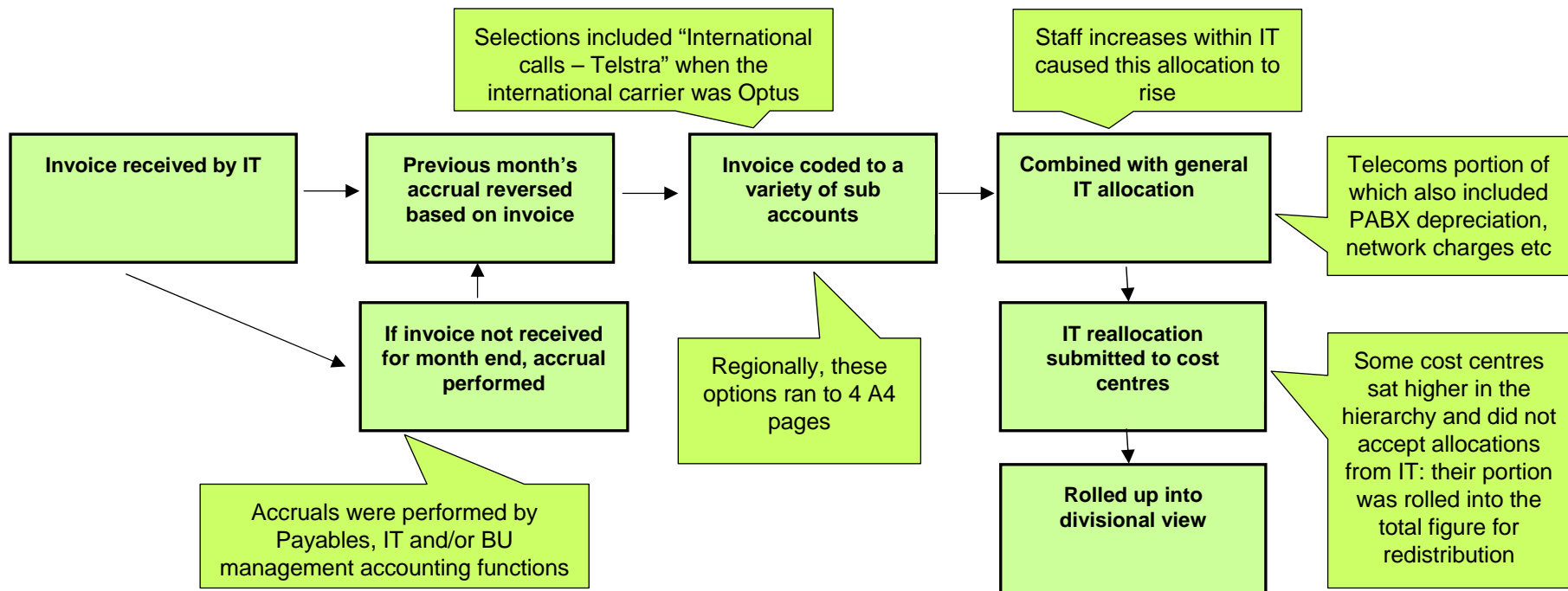
My assumption:



The P&L:



Miscodings, accruals, reversals, reallocations and rollups can bury your contribution deeper than Chernobyl



- Your stakeholder rarely cares about the organisation-wide benefits shown in your category reporting
- The P&L is the map of the world for each Division or Business unit
- If your benefits are not visible on this map, they do not exist



Improving the quality of data entered to corporate systems is the only way to prove financial benefits to your stakeholders

- Ensure you have agreed in advance how your category will be coded to the GL and appear in the P&L
- Standardise GL sub-account categories (most organisations will not change the primary chart of accounts)
- Initiate measures to ensure coding accuracy:
 - Get vendors to pre-code their physical invoices
 - Increase use of electronic invoicing to eliminate keying and coding errors
 - Code centrally
 - Ensure that any stamps etc prompt to code correctly



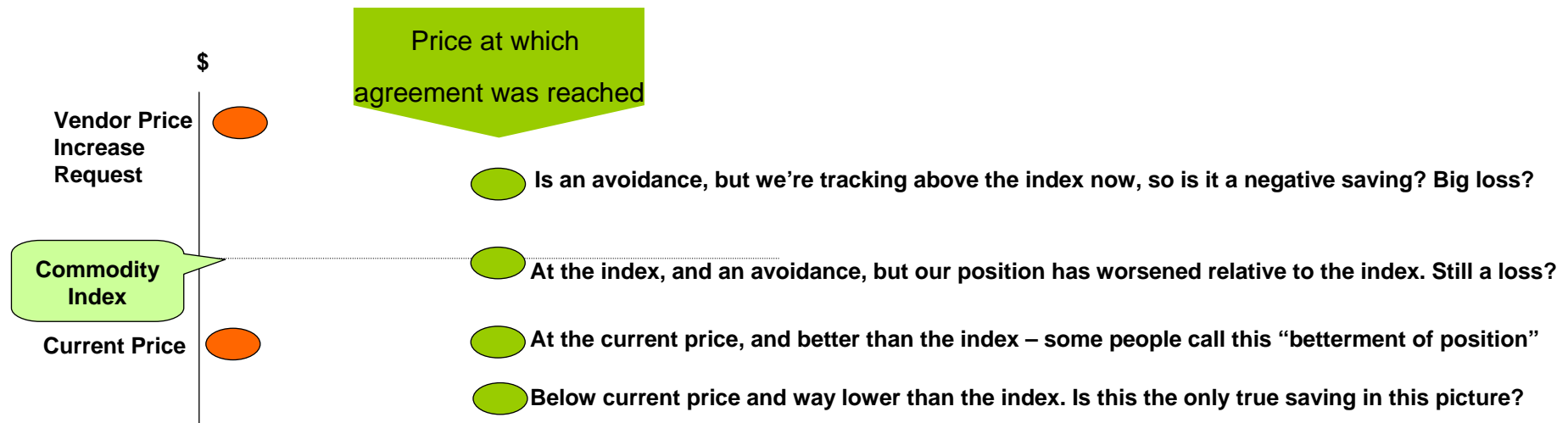
AGREEING FINANCIAL MEASUREMENT GROUND RULES

You will need to establish a common language with your audience in order to agree on your contribution

- Typical definitions

Saving	Provides a positive bottom line impact (e.g. reduced unit pricing; continuous cost improvement programmes)
Avoidance	Minimises or entirely avoids a negative bottom line impact (e.g. challenging cost increase requests; increasing throughputs without increasing costs)

- But life's not that simple:



You will need to actively set rules for treating more complex financial considerations, as these can also erode the trust of your clients

- “Negative” contributions and how you treat them
- Term over which benefits are calculated (term of agreement? First full year of benefit? Until we next re-source?)
- As a corollary, how “annuity revenue” is treated (in full? Discounted? Effect of periodic price variation clauses? Effect of market movements?)
- Benefit basis for spends with no historical baseline (lowest bid? Preferred vendor start price to settled price? Budget?)
- “Identified” v “delivered” benefits
- Where one benefit impacts or negates another (e.g. a lower price for reduced payment terms)



You can achieve maximum impact by highlighting what your \$M contribution really means to your organisation

- Impact on Budget
 - “Budget flexibility” - allows business to do more of what it wants to do
 - Global Budget cuts - useful where volumes are known and the category is steady state
- Departmental Rol
 - Payback
 - The Nirvana of “10x”
 - Provides incentives for the function and the individual (in the manner of sales targets)
- Share Price Improvement
 - “If we can do this, it will be worth 5-10% on our share price”
- Bottom Line Impact
 - “With a 20% gross margin, we would need to sell another 5x widgets to make an equivalent financial impact through sales”
- Working Capital Reduction
 - Reduce debt interest
 - Free cash up for new investments



Don't let them languish in the filing pile! Your metrics can be put to other good uses

- Senior Management adopts your reporting as part of their periodic bulletins or presentations to staff
- Compliance is improved without the necessity to be the Fun Police (reporting is posted to the intranet)
- Reporting is layered with informal, anecdote driven education (e.g. corporate card controls)
- A category driven “bag of tricks” is developed to counteract the down cycles in your industry
- Category reporting feeds into tactical budget setting, and from there strategic budget setting and the alignment of targets and incentives



The budget is your first opportunity to capture potential costs, and provides the means to measure expected and achieved cost performance at cost centre level

- Clean up the accruals and reallocation processes
- Improve expense budget accuracy and process
 - Adopt zero based budgeting
 - Agree metrics which can be used to compare performance or justify budget increases (e.g. revenue growth vs costs)
- Introduce monthly cost centre level budget variance reporting and justification for elements > $\pm 10\%$ of expected
- Ensure this includes FTE variance reporting
- Introduce expense budget specific incentivisation for cost centre managers (current incentivisation is overwhelmingly on nett result)
- Tie these to your own targets and incentives



Your performance measures express your undertakings to the organisation and the proof that you are delivering on them

- Follow the KISS principle
- Manageable (volume; ease of compilation)
- Expressed in a way that's meaningful to the organisation
- Auditable
- Convey or enhance the messages you want the organisation to hear about you

