Raising the Bar for Values and the Balance Sheet

Financial responsibility results in improved value and bottomline savings that help an organization realize its strategic goals.

By Mary Siegfried

No other department spends as much of an organization's funds as supply management, which means that practicing financial responsibility throughout the supply chain is of paramount importance for supply management professionals. As one of ISM's seven *Principles of Social Responsibility*, financial responsibility involves following applicable financial standards and requirements, applying sound financial practices, ensuring transparency in financial dealings as well as actively promoting and practicing responsible financial behavior throughout the supply chain. In many ways, financial responsibility strikes at the heart of an organization because a financially responsible supply management department can directly affect the organization's bottomline and help ensure that it reaches its strategic goals. (See the box on page 31.)

To understand the principle of financial responsibility in supply management, this article will examine what financial responsibility means to supply management professionals, how it is practiced and tracked in an organization, and the impact the Sarbanes-Oxley Act (SOX) will have on the concept of financial responsibility.

In a baseline study about the seven *Principles* published by ISM in April 2004, the highest-rated activities were those relating to financial responsibility and ethics. The study also found that financial responsibility is a well-established principle in supply management, along with ethics and safety. Those findings do not surprise Gerry Bundle, C.P.M., A.P.P., supply manager for California-based Calpine Fleet Ops. The recent high-profile corporate and accounting scandals may have put the issue of financial responsibility on the front pages, but Bundle says it has been in the forefront in supply management's standards of conduct as far back as he can recall.

"Financial responsibility has always been a consideration in supply management because supply managers are protecting the assets of the company," he says. "The bottomline impact in profitability is in supply management." As a member of ISM's Committee on Social Responsibility, Bundle says financial responsibility is about more than protecting assets. It is also about "ensuring transparency and visibility to financial transactions that take place as part of supply management activities."

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Lisa M. Ellram, Ph.D., C.P.M., C.M.A., a professor of supply chain management at Arizona State University in Tempe, says financial responsibility in supply management equates to being fiscally responsible with an organization's funds. Ellram, the Bebbling Professor of Business in ASU's W.P. Carey School of Business, says being financially responsible means more than just getting "the best deal" for the organization, it means getting the best value. That's one of the challenges supply professionals face because cost cutting often pushes supply managers toward price over value "and that can hurt the organization in the long run."

Emphasizing value while managing risk in the supply chain is a sound financial process, explains Steve Smiley, vice president of purchasing and materials management for Nellson Nutraceutical in Irwindale, California. "I believe the second most important mission in supply management is to drive continuously improving value for money while managing key risk areas of business," he says. It's financially responsible for supply professionals to manage risk in areas such as supply availability, price risk, hedging, currency exposure and insurance while striving to increase and improve value.

Art by Jason Steed

But Smiley believes the key challenge in the area of financial responsibility is to "implement sourcing strategies which enable our organization's strategic plan." That, he says, "is the single most important thing that we have a financial responsibility to do." Every department or function in an organization has a role to play in making the organization's strategic plan work. If all of the functions, including supply management, support the strategic plan, it all comes together as a financial success for the organization.

While financial responsibility is not about financial success, supply management professionals agree that such success often is a result of implementing financially sound and responsible policies. Calpine's Bundle says the concept of financial responsibility forces supply managers to look at processes and assess what is working and what is not, to deal fairly with suppliers in a financial sense and to protect the organization's assets — activities that often make an organization more financially sound. "But it still all comes down to ethical standards," he notes.

Karen Smith, global supply chain financial leader for Phoenix-based Phelps Dodge, saw the link between financial responsibility and success play out recently when the organization focused its attention on the supply chain. Smith says when the price of copper dropped in 2001, Phelps Dodge, the world's largest publicly held copper producer, turned to supply chain management in an effort to control costs. That focus, coupled with changes in the supply chain leadership, prompted the supply chain group to perform a comprehensive review of its processes and standard operating procedures at every site within the organization.

"We went to every business operation and reviewed what they were doing as opposed to what was on paper," Smith says. "From there, we figured out the gaps in the procedures and policies and decided on the best practices that we wanted to implement globally." She says they were surprised at the extent of the differences among business operations and quickly saw ways to standardize procedures in conjunction with cost-savings efforts. "There were no bad practices, just different practices among groups that made the system less efficient," Smith explains. In one instance, the mining company went from seven different supplier scorecards to a single supplier scorecard process. After these reviews, supply management rolled out a list of standard operating procedures from all business operations. This was an initial step to implementing clearly defined goals that were aligned with their cost-saving and process-improvement strategies.

"We also measured the extent of supply-chain managed spend and gauged the opportunity to increase the value of supply chain at each business unit. And we made it clear that involving supply chain at the start of a need was not a control mechanism; rather, it was a critical part of financial responsibility. With more spend visible, we had the ability to leverage the spend, focus on two or three suppliers and negotiate better discounts," she explains. In a commodity-based organization such as Phelps Dodge, where the price of the commodity can't be controlled, financial responsibility lies in applying sound financial practices.

"For us, it was just the right time to become more financially responsible on processes, and the end result was improved value

In Brief: The Financial Responsibility Principle

This is the third in a series of seven articles detailing ISM's *Principles of Social Responsibility*. The *Principles* are the result of an ISM initiative to promote excellence in social responsibility assisting in the implementation and continuous improvement of supply management organizations and professionals.

Social responsibility is defined as a framework of measurable corporate policies and procedures and resulting behavior designed to benefit the workplace and, by extension, the individual, the organization and the community.

This month's article details the *Principle* of financial responsibility; ISM encourages professionals to:

1. Become knowledgeable of, and follow, applicable financial standards and requirements
2. Apply sound financial practices and ensure transparency in financial dealings
3. Actively promote and practice responsible financial behavior throughout the supply chain

The following audit questions related specifically to financial responsibility can be used by an organization to determine if it is moving forward, aspiring to industry best practices and seeking information from others.

1. Does your organization educate employees about appropriate financial responsibilities? Is there a process in place that promotes and acknowledges employees who, through their actions, demonstrate a strong commitment to financial responsibility?
2. What corrective action and compliance processes exist?
3. Has your organization and have your suppliers implemented fiscal policies, financial management systems and accounting controls that help ensure fiscal responsibility and long-term viability?

A financially responsible supply management department can directly affect the organization's bottomline and help ensure that it reaches its strategic goals.

in the supply chain and a savings of millions of dollars for the organization," she notes.

The global supply chain group at Phelps Dodge also implemented supply-chain financial cost modeling. When suppliers notify the organization of price increases, for example, Smith says the model defines the potential components of that price increase. "We use publicly available data as well as information from the supplier to examine cost drivers rather than blindly accepting price increases," she says. "This information helps us be better prepared to negotiate with the supplier.

"Again, this is not about control, it's about value. We want to be knowledgeable consumers about the goods and services we purchase by asking the right questions and looking at the right data," Smith says.

Tracking financial practices is an integral part of a financially responsible supply management organization, professionals point out. Tracking as well as transparency of financial dealings helps ensure that responsible practices are being followed. Smith says her supply chain organization has monthly meetings for the supply chain leadership to track goals that have been set around cost savings and processes. Metrics such as savings on processes and inventory are tracked on performance charts called red bar charts. "It is a simple ranking of the business operations against the goal. The red bar is at the goal — you are either above the bar or below it," Smith says. "Everyone has the same goals and processes. Everyone knows what is important. It is a healthy competition — a way to show what the goal is and where we are making progress."

ASU's Ellram says financial responsibility can be tracked by examining an organization's payment cycle for suppliers — a very basic process that can tell a lot about an organization's responsibility. "If good controls are in place, suppliers will be paid in a reasonable amount of time. Some companies purposely send invoices back to suppliers, saying some information is not clear. That is very bad for supplier relationships."

Ellram says some supply organizations are including accounts payable under the supply umbrella in an effort to better control payment. "But in the very least, supply must have good communication with accounts payable so everyone understands what it takes to get an invoice paid. It must be clear who is responsible when there is a problem."

A single, cross-functional ERP system helps in tracking financial responsibility, according to Calpine's Bundle. It provides transparency across the organization, he says, "because what I do in supply management can be seen by the people in treasury. If everyone is on the same ERP, we have one version of the truth."

Smiley of Nellson Nutraceutical says a proactive method of ensuring sound financial tracking and transparency is to involve financial managers from both the supply organization and the supplier early on in the purchasing process. It can be valuable, he says, when supply managers are trying to take costs out of the supply chain because both the receivable and payable sides come together and can work on financial issues from the start.

A good relationship with an organization's financial department also is important in ensuring financial responsibility. Bundle says the two departments are "joined at the hip" because they share many services. For that reason, supply management professionals believe that good communications between finance and supply management must be maintained to keep an organization running smoothly and responsibly.

Ellram explains that supply management must work closely with finance on a day-to-day basis, not just on specific projects. "I also believe finance and supply must work together to make sure that supply management's numbers are credible. When you are reporting on yourself, others are less likely to believe it. That's where finance comes in as an objective third party."

Being financially responsible does not stop at an organization's front door but continues through the supply chain, especially with its strategic suppliers. Supply managers say they expect their suppliers to be financially responsible and believe it is incumbent upon them to check into a supplier's responsibility.

Some tools supply managers use to determine if a supplier is being financially responsible include:

- Asking suppliers specific questions during the selection process regarding their relationship with their financial department, payment policy terms with other suppliers, and plans for long-term capital investment
- Talking with the managers responsible for various financial controls during a site visit
- Checking out Web sites such as Dun & Bradstreet and the Securities and Exchange Commission's EDGAR database for public companies
- Examining public records such as court judgments, bond ratings and corporate credit reports to evaluate relations with other suppliers

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Financial Responsibility Survey Results

ISM's social responsibility survey compiled the following responses about the *Principle* of financial responsibility. The survey was part of the first-ever social responsibility report for supply managers by ISM. This data can be found in the box below.

Following are some specific comments about financial responsibility offered by supply managers who participated in the survey:

- "We have a very active relationship with our finance department."
- "We look at short- and long-term financial situations of all suppliers."
- "We manage our financial responsibility through weekly budget reports, budget report-outs, period reports and quarterly reports."
- "We pay our bills on time (15 days) and work with our supplier to maintain a very good paydex rating."
- "The evaluation of a vendor's financial responsibility is a key factor in determining overall vendor responsibility and fitness to do business with the organization."
- "All financial activities are captured and reported on the purchasing system. This information is audited and reviewed to make sure financial responsibility is maintained to the company's standards."

Extremes of Spectrum of Responses for Financial Responsibility

	Total Number of Responses for the Statement	To No Extent or Almost No Extent		To a Good, Great or Very Great Extent	
		Number	Percent	Number	Percent
Is knowledgeable of, and follows generally accepted financial standards and requirements	951	25	3%	837	88%
Actively promotes responsible financial behavior throughout the supply chain	951	59	6%	738	78%

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- Checking on overseas suppliers by accessing the federal government sites that list companies on the U.S. watch list for terrorist or money-laundering ties

As Bundle explains, "If my organization is committed to the *Principles of Social Responsibility*, I want to do business with organizations that are like-minded. If my supplier expects me to pay on time, surely I expect them to do the same right down the line."

There is little doubt that the Sarbanes-Oxley Act (SOX), signed into law on July 30, 2002, will positively affect financial responsibility and even provide a good framework for continued financially responsible policies and behaviors in supply management and throughout an organization. (For more information on SOX, see the *Inside Supply Management®* articles, "The Impact of Sarbanes-Oxley Act on Supply Management" in the April 2004 issue and "Sarbanes-Oxley and Corporate Governance Coming Your Way" in the September 2003 issue. Visit www.ism.ws and type "Sarbanes-Oxley" into the Quick Search box.) Supply managers agree the intent of the act is positive, although many admit the execution is time-consuming and expensive.

SOX is broad corporate reform legislation that requires, among other things, that CEOs and CFOs make certain quarterly certifications and annual assertions about the presentation of financial statement information and the existence and design of internal controls. There also are certain sections that directly affect supply management's internal process controls and timely reporting of material events that impact financial reporting.

Ellram says SOX is all about control and checks and balances. "It is making sure you have people who are doing what they are authorized to do, that you know who is making decisions, that they are responsible and that everyone understands the potential financial outcome." Most supply professionals agree that their processes have improved and will continue to improve because of Sarbanes-Oxley. They agree it increases the organization's level of integrity, accountability and financial responsibility.

Phelps Dodge's Smith says financial responsibility will always be a goal of supply management professionals. "That is because financial responsibility means using our skill set in the supply chain to obtain the most value for the company. What we want is the best economics for the overall organization." ism

ISM's SR Web Site: www.ism.ws/sr

ISM is committed to becoming the central repository of information in support of all matters related to social responsibility. The following resources can be accessed through the ISM Web site at www.ism.ws/sr:

- *Principles of Social Responsibility*
- The accompanying supply management audit for the social responsibility *Principles*
- Links to other social responsibility related Web sites (for example, financial responsibility Web sites include The Business and Financial Ethics Internet Resource Center, Clear Profit, Financial Executives International and AICPA Antifraud & Corporate Responsibility Resource)
- Social responsibility articles and research
- ISM's Committee on Social Responsibility
- Ways you can foster social responsibility and show your support for the ISM *Principles*