Why Procurement Must Help Fundamentally Rethink and Improve RONA (Part 1)

Author : Pierre Mitchell

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Return on net assets (RONA) is a popular enterprise valuation metric. It simply divides net income by “assets” (fixed assets and working capital). For procurement organizations, improving RONA is obviously a more balanced scorecard than just cost reduction because it also includes top line improvements, capital expenditures and working capital. Heck, it even includes interest expense and taxes. This may be a bridge too far for most procurement groups to impact — and in this case you can use RONABIT (removes interest expense and tax expense). This is also true when using return on capital employed (ROCE), which also measures the right hand side of the balance sheet.

The challenge here, of course, is expanding procurement’s scorecard to formally recognize this broad set of value-creating activities. If you don't measure KPIs beyond cost, it’s hard to invest your time and effort in any supply management activities that don’t contribute to just cost reduction. We’ve formally benchmarked procurement organizations’ levels of formal performance measurement for more than a dozen value streams, and it dramatically goes down as the level of strategic impact goes up. It is specifically for this reason, though, that using an enterprise metric like RONA (or EVA, CFROI and many others) is so important. More specifically, it allows:

- A "composite" metric that procurement and the budget owners can focus on, thereby helping to create alignment from the onset
- The composite metric to be broken down into lower-level composite metrics. For example, ROCE can be broken down into gross profit as a percentage of revenue and also expenses as a percentage of revenue. The latter is a great one for procurement to “plug into” via supplier spending as a percent of revenue.
- The ability to make tradeoffs with the stakeholders (e.g., a cash-cost tradeoff in something like early-pay discount capture)
- A common language and “set of books” that can be used to engage finance
- A burning platform for changes such as the variabilization of fixed assets and the move to everything as a service (XaaS)

So, use an enterprise metric wherever you can to get broader explicit alignment to those in the business, especially during planning and budgeting, when you can bring more techniques and tools, pull more levers and add more proven value.

But there is more to this story than just using an enterprise valuation metric. Like the title suggests, we need to rethink it and not just adopt it. More specifically, we need to broaden the definition of "assets” and how we manage those assets within the supply chain and in the “sharing economy.” Stay tuned for part two of this series.