

Purchasing and Payables Solutions - Reducing Expenses and Increasing Revenues with OpsTechnology

An Executive White Paper by
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Introduction and Premise

In a real estate context, purchasing isn't sexy. Few corporate executives have made their mark for astute procurement of goods and services, and fewer still in commercial real estate. In other corporate sectors though, the trade press is full of boasts about the huge savings generated through different e-procurement systems, spend management initiatives and greater executive awareness of the supply chain. As specialty procurement and spend management firms begin to focus on commercial real estate, many of us are looking at why we should focus scarce time and resources on this area.

The answer is three-fold. It costs \$15-19 per order to process an invoice¹ and this cost can be lowered. Also, there may be large cash savings available to any firm willing to pro-actively use their own data to better manage their purchasing process. Finally, any initiatives that produce efficiencies may provide more time for staff to focus on customer service and higher value-added projects that boost the bottom line.

The lack of attention to purchasing as a strategic function has left the area ripe for savvy managers to lead beneficial process changes. These changes may harvest significant sustainable hard-dollar savings and other, harder-to-quantify "soft" benefits. This white paper series looks at the process change and benefits brought to Camden Property Trust ("Camden") and United Dominion Realty Trust ("UDRT" or "United Dominion") through their adoption of OpsTechnology's web-enabled software for spend management. As with all process change efforts, not all of the benefits are strictly attributable to the software system. However, the adoption of the software was, except where noted, the catalyst for positive change - and the results are included as benefits.

Joshua Tree Consulting ("Joshua Tree") was asked to write this white paper to document the net return on investment for both firms, as well as to report any other benefits that have been realized.

The white papers are divided into four: the introduction which summarizes the results and methodology, and three more detailed papers that discuss the financial analysis, the process benefits and a fourth that provides additional resources to managers considering automating their purchasing functions, as well as suggesting other areas in which a multifamily firm may profit from focusing on the strategic purchasing function.

Because both of the firms studied are early adopters, their results may be atypical. Later adopters are likely to have the benefits of their experience, without having to do as much work to realized the same types of gains. At the same time, market dynamics may have given them "first-mover" advantage that other firms won't be able to duplicate.

This white paper series is not meant to be a statistical proof or representative sample, but rather a discussion of the limited amount of available information in an organized framework that can be adopted for one firm, or a hundred. This white paper draws on the extensive body of academic and corporate research that's been done. Sources are cited in the text, and suggestions for additional reading are provided in white paper four.

This white paper series was commissioned by OpsTechnology, Camden and UDRT. Camden has less than 1% equity ownership of OpsTechnology. UDRT has no equity ownership in OpsTechnology.

Quick Summary: The Bottom Line

United Dominion adopted OpsBuyer™ to meet its projected financial goals. Camden deployed OpsBuyer™ to bolster its goals of leadership in adopting technology, and to create efficiencies that rewarded its staff with process efficiencies and better information. Both firms forecasted their benefits differently. The Camden team looked almost exclusively at the soft benefits to their people and processes and the project's impact on their own team development skills. United Dominion was able to model their estimated financial benefits (expected IRR > 375%) and verify them with (unexpected) results. Not surprisingly, both firms successfully managed to reach the goals that they set for themselves, and realized significant "spillover" benefits as well. UDRT backed into large process efficiency gains, and Camden is reducing expenses and better able to take advantage of financial savings made possible through this efficient purchasing platform.

Hard Benefits

Financially, UDRT's project IRR exceeds 650%, the payback period for the initial expenses was 3 months and the annual cash savings represent 2.5% of the 2003 annual spend on deliverables. UDRT is realizing significant efficiencies in accounts payable that have helped to drive their electronic payment system and deliver payments sooner to their vendors. Although UDRT had already selected a group of preferred vendors with whom to consolidate their purchasing, they didn't expect most benefits from controlling maverick spending or hitting higher pricing break points. However, they found that the software helped to enforce compliance with the preferred vendors and approved products and services that they had selected. Even so, their primary benefits come from prompt payment discounts, error reduction and time savings in the field.

In other words, internally, UDRT counts their financial benefits as the sum of their OpsBuyer™ implementation with their separate spend management program. For the purpose of this analysis however, Joshua Tree Consulting adds the existing program benefits and the OpsBuyer™-derived benefits together and arrives at the benefits above. This is based on the assumption that for most adopters, the ability to create a robust spend management program without adding professional purchasing staff depends on having the compliance and management information that a web-enabled system can provide.

Camden realized labor savings in their accounts payable department of 2.5 FTEs, a cost that Joshua Tree Consulting estimates to be at least \$60,000 annually without benefits.

Soft Benefits

From the start, each firm pursued different goals. Camden looked at OpsBuyer™ as an opportunity to provide a time-saving benefit to all of the staff that touched the purchasing process. Their hope was that by creating more time in the day, more people could focus on tasks that provided a higher level of value to the business. Even so, they have been able to reduce corporate accounting headcount by 2.5 FTEs. Further, as they add vendors to the system, they are eliminating data entry work. This is beginning to give their accounting staff time to focus more on the purchasing efficiency of their highest cost items.

In the accounting department, OpsBuyer™ has reduced the workload in accounts payable batch processing from a five person effort, to something that one person can handle in fewer hours. At the property level, Camden associates report decreased time to order and an increased ability to schedule the cleaning and installation of flooring products. Having universal access to data and reports gives them an enhanced ability to track and manage warranties.

Camden has also been able to spend more time expanding their national purchasing program to include additional vendors. Benefits to a larger program mean larger discounts, fewer vendors to administer, etc.

Camden has also been able to take advantage of OpsBuyer™'s ability to restrict the catalog to Camden specified products. Shortly after the initial deployment, Keith Oden, President and COO of Camden Property Trust, noted his pleasure that only Camden's standardized tile pattern was available to Camden users.

United Dominion has paired the OpsBuyer™ implementation with another initiative to centralize the invoice processing in their corporate offices, and deliver them online through OpsBuyer™ to the community directors for approval. Although this required hiring three more FTEs centrally, UDRT estimates that it provides soft savings they estimate at 15 hours monthly at each site. This additional time created will help them realize their goals of enhancing their economies of scale, and empowering their associates to do more with the same number of hours in the day.

Furthermore, the system helps restrict which SKUs UDRT personnel are allowed to purchase within UDRT's customized OpsBuyer™ catalog. OpsTechnology's professional services team has customized UDRT's catalog such that only UDRT approved appliances are available from Whirlpool, Century Maintenance and Hughes MRO. UDRT has also limited the options from approved floor covering suppliers, eliminating the purchase of non-approved products.

OpsTechnology and OpsBuyer™

OpsBuyer™ is the product name for a suite of web-based software tools that help real estate firms better manage their procurement and spending. OpsBuyer™ connects the purchasers of supplies at a company to all of its vendors on the OpsBuyer™ system. And in turn, it can connect one vendor to its many customers. OpsBuyer™ makes this connection for the commercial real estate community over the World Wide Web. They provide the software to connect vendors and buyers of products such as appliances, flooring and MRO (maintenance, repair and operations) supplies, and of services such as carpet cleaning, plumbing and landscaping. The system stores all of the ordering, approval, invoicing and payment data in a central data warehouse which can be accessed by all password authorized viewers.

OpsBuyer™ and similar electronic purchasing products are aimed at companies that don't have the management information available to effectively manage their spending patterns. OpsTechnology's business model is to sell software licenses and to also to provide consulting services integral to the success of the software implementation. They do not attempt to profit from, or even to arrange large group purchasing consortia.

The system provides firms with a means of tracking and managing their purchasing patterns in real time. Similar to Amazon.com, the system allows a user to see a catalog of items, save favorites, create a shopping cart, order electronically, review past purchases, and make payments. Unlike a consumer purchasing system, the system gives users the ability to pre-code catalog items with general ledger codes, so that line items on invoices are automatically coded with a company's default general ledger codes. Further, OpsBuyer™ maintains property-level expense information from multiple vendors, matches invoices to purchase orders, provides a centralized means of managing purchasing policies and procedures, and integrates with a budget module,.

OpsTechnology, Inc., the creator of OpsBuyer™ is a San Francisco-based spend management solution provider that focuses on real estate companies and their suppliers. OpsTechnology creates electronic private trading networks for companies that want deeper integration with their existing suppliers.

What Is a Benefit, and How Is it Counted?

The key question for most analysts is how to begin to evaluate the benefits of a spend management system. Much of the existing literature is focused at Fortune 500 companies that are manufacturers or creators of products from raw parts. Simpler benefits models apply to real estate businesses whose purchasing is primarily maintenance, repair and operations (MRO) equipment, appliances and office supplies and capital replacement items. For real estate firms seeking to evaluate whether a spend management system is a worthwhile area to explore the main areas of analysis are:

1. Financial

- IRR on investment;
- Net present value of incremental cash flow;
- Payback period

2. Efficiency of current process

- Net expected error rate in processing purchase orders and invoices (after v. before);
- Net difference in days to pay (from invoicing to payment receipt) which may translate into greater prompt payment discounts;
- Potential time gained from efficiencies in coding invoices;
- Number of times a human inputs data or handles paper - thus creating the possibility of error;
- Potential time gained from streamlining the list of vendors used throughout the portfolio;
- Potential time gained from eliminating poorly performing vendors

3. Goods being purchased

- Commodity or standardized nature of goods purchased
- Frequency and timing of purchase
- Capital vs. expense items

4. "Soft" considerations

- The last time the purchasing function and process was comprehensively reviewed
- Whether vendor relationships have been recently examined, and pricing and performance evaluated for competitiveness
- Executive interest in examining the total cost of ownership for the most heavily purchased items
- The likelihood of the firm implementing better management of its inventory of in-unit appliances and amenities
- The firm's capacity at the executive level to manage a new project, and follow it through to receive maximum benefit
- Current workload and workflow of the staff that purchases and reviews orders of the properties
- Evaluating whether there exists addition revenue generating or cost reducing tasks that could be performed by staff who will realize time saving benefits from a new system and process

An independent, non-profit group recommends evaluating the "hard" financial benefits as well as the "soft" process and skills benefits and calculating them separately.² For too long, estimates of financial benefits have folded in non-quantifiable or highly questionable savings attributed to efficiencies, and based on the premise that employees could be fired and payroll reduced

proportionally to estimated savings. Impartial analysts typically take the view that savings can only be counted when it's "cash in the cash drawer." For the purposes of this white paper, we take the same view. Large, revolutionary improvements in efficiency such as the invention of the cotton gin, the steam drill or air freight have such a salutary and dramatic impact on efficiency that whole classes of labor are suddenly redundant. In most cases however, efficiencies are incremental improvements upon an existing workflow or system.

Soft benefits and process benefits can still be significant and worth counting. They provide useful indicators of where value will be created, and how the people who use an innovation perceive it. The success or failure of an innovation project is strongly tied to so-called "soft" considerations.

Additional Resources and Speculation on the Future

The detailed papers that follow this summary will detail some of the strong points and the frustrations that early adopters have in making a technology work. These details should not obscure the larger point that having new access to data will enhance managers' ability to manage their spending patterns. It may also allow new forms of analysis that are not possible today.

By way of example, Dell computer tracks the maker of every part in every computer. If calls to their service center indicate that a particular part by a single maker is faulty at a high rate, they switch suppliers without shutting down production. Faulty parts lower the net value of their products because they have to spend to repair them. Similarly, it may be possible in the future for property buyers and sellers to value a property in part based on the documented quality and expected life span of the specific materials, appliances, fixtures and systems in the property. Already, this goes on for major systems and for types of building materials. The industry is still a long way off from providing Total Cost of Ownership estimates on communities, as Consumer Reports does for cars. But with spend management tools like OpsBuyer™, the day may come.

Additional resources are available in the last white paper in this series including organizations, publications and articles that can assist multifamily executives in thinking through how to evaluate the investment decision in spend management technology. White paper #4 also provides a basic project outline to assist the spend management project manager in successfully managing their initiative.

Joshua Tree Consulting appreciates the enthusiastic cooperation and assistance of the staffs of Camden Property Trust, United Dominion Realty Trust and OpsTechnology in making this basic research available to the entire industry.

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Footnotes

¹ "A/P Department Benchmarks and Analysis 2003", Institute of Management and Accounting, 2003 and "Reducing Real Estate Accounts Payable Overhead", Glenn, P. Murray, Realm Business Solutions, Inc. March 2003.

² "Measuring E-Procurement Benefits", David Eakin, Government Procurement, August 2002.

About Joshua Tree Consulting

Joshua Tree Consulting is a niche consulting practice dedicated to the growth and success of the multifamily industry. We help our clients achieve success through studying and optimizing strategies and operational processes that are close to the heart of the business. Joshua Tree Consulting works on selected engagements in which it can add value through analyzing strategies for asset management, positioning and making better use of management information.

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About OpsTechnology

OpsTechnology develops software that saves money for real estate operating companies by improving their ability to manage and standardize Procurement, Purchasing and Payables functions. Founded in 1999 by real estate and technology industry experts, the company is backed by real estate operating companies and VC firms including SAP Ventures, Vortex Partners, Cohen & Steers, Equity Residential and Camden Property Trust. For more information visit www.opstechnology.com

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