

Strengthening the procurement finance relationship

KEARNEY

Embedding finance in the procurement leadership team can help align the organization's goals and the way business performance is measured.

Procurement plays a crucial role in managing the supply chain for many industries where purchases and outsourcing are a significant part of both costs and the value that a company creates. The procurement leaders are moving away from a traditional focus on negotiating purchases and focusing on converting supply market value into product value.¹ Although many procurement functions are able to lower costs and capture savings, few can show how procurement makes the business more competitive, thereby creating a trust deficit and reducing the strategic importance of procurement.

A mature and effective procurement function delivers value in a variety of ways. To effectively launch strategies that reduce costs and create value, forward-thinking procurement functions pay attention to regulatory and compliance frameworks and to controlling and measuring their performance in terms that are meaningful for the company's performance, including in profit-and-loss statements and on balance sheets. At the same time, procurement must also manage and improve the supply chain to align it with the business strategy. This requires widening the focus of procurement and adopting fresh approaches beyond traditional negotiations.

In this article, we discuss our innovative approach to making procurement more effective by aligning the function with the organization and its business performance parameters.

Reorganize procurement by embedding finance

Finance has the power to contribute much more than it typically does to procurement's effectiveness. In our work with a variety of companies, we have seen leading companies treat finance as an integral part of the procurement leadership team.

A strong relationship between finance and procurement is built on four pillars:

Procurement strategy

- Align a firmwide procurement strategy with the overall business objectives.
- Review relevant strategies across spending areas, including commercial, demand management, and technical specifications.
- Finalize and align initiatives, either category-specific or across categories.

Compliance and market intelligence

- Ensure compliance with regulatory frameworks, including taxation and other local laws, and offer input into vendor management strategies.
- Monitor economic and political situations, and understand the implications for the procurement strategy.

Budgeting and interlocks

- Have firm leadership determine procurement's budget with productivity-based targets for functions, net income targets, and global spend reduction in specific categories.
- Have a detailed initiative pipeline to meet targets.

Savings methodology and validation

- Define the measurement of savings-related metrics (cost savings and cost avoidance as well as non-savings-related metrics, including cash benefits, management of supplier risk, and supplier quality).
- Reconcile savings with the profit-and-loss statement, including the impact of volume and foreign exchange rate.
- Sign off on benefits.

¹ To read more, see [A procurement imperative for the CEO](https://www.kenyon.com/procurement-imperative-for-the-ceo) at www.kenyon.com.

A robust procurement finance team can create a wealth of value by playing four roles (see figure 1). The underlying theme across all four roles is to embed finance as a business partner within procurement. However, the exact structure can vary based on the organization’s unique requirements and capabilities.

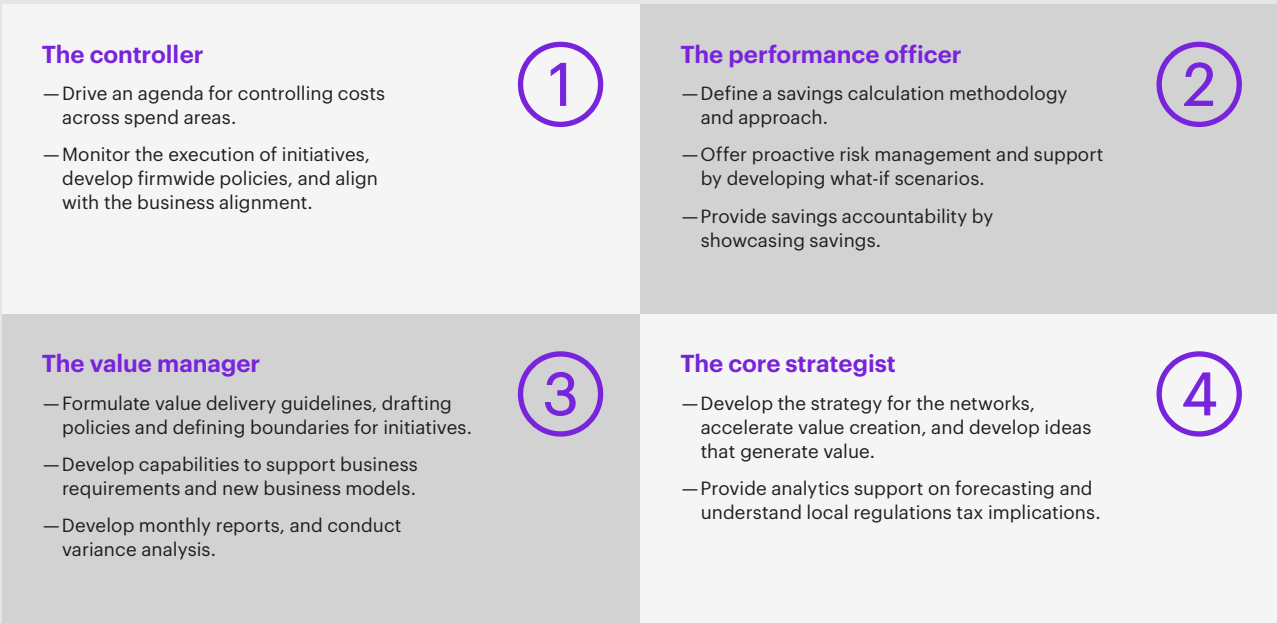
Three best-in-class examples reveal how organizations can intensify the finance function’s engagement with procurement (see figure 2 on page 3). Both global consumer products companies have a senior finance role embedded in their procurement teams. In the global commodity player, the factory finance controller role has no formal reporting links to procurement but is tightly coupled with procurement for factory-level initiatives and validating the savings, driven by the company’s focus on manufacturing and operations.

Ideally, the lead finance business partner reports to finance leadership (a group or business unit chief financial officer) to bring organizational performance into focus and align it with procurement. The finance business partner organization should extend beyond the corporate level to align with the country and function matrix for true integration at all levels.

This creates an array of benefits, including the following:

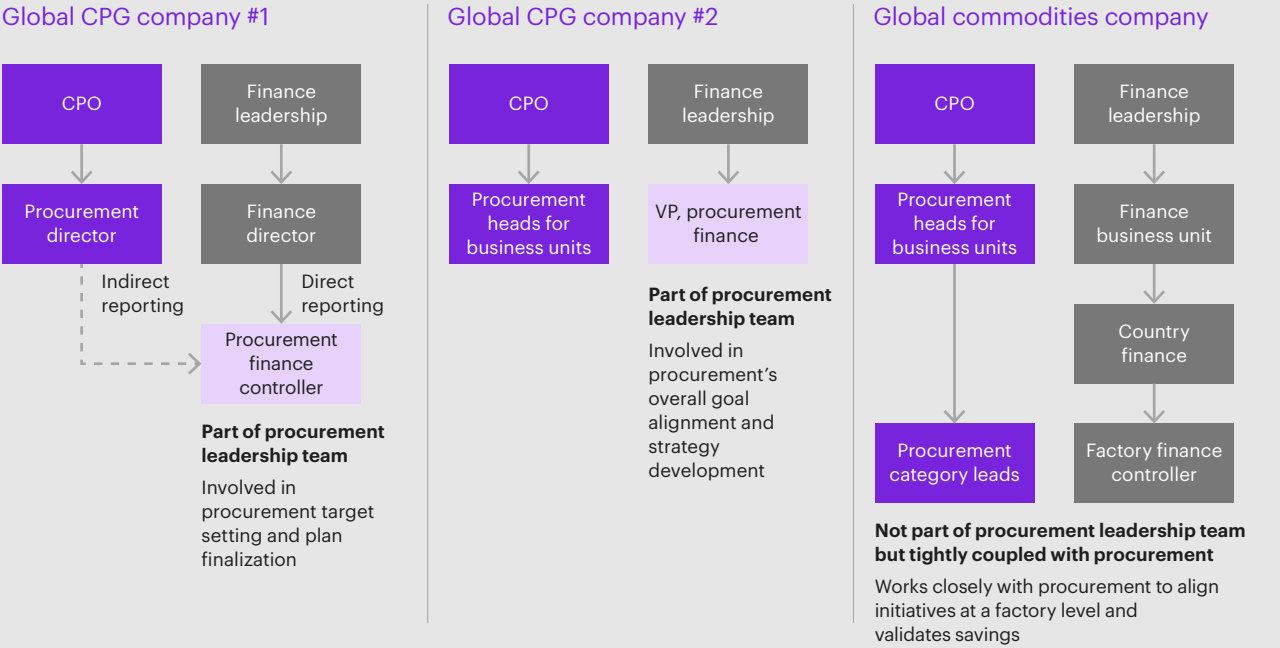
- Enables trust between finance and procurement since finance plays a role in strategy development and joint target setting
- Accelerates the process of baseline and savings validation since both finance and procurement have a joint target
- Improves communication and transparency on savings accruals and the pipeline
- Creates better inputs to procurement regarding environmental variables that impact its performance and improves compliance in taxation and accounting

Figure 1
Leading procurement finance functions play four roles



Source: Kearney analysis

Figure 2
There are a variety of models for embedding finance within the procurement function



Note: CPG is consumer packaged goods; CPO is chief procurement officer; VP is vice president.
Source: Kearney analysis

Managing the complex budgeting process

The procurement finance business partner can smoothen the connection between procurement and finance to finalize budgets with embedded targets to validate the savings later on.

Below are examples of how the leading companies are managing the process:

Global CPG company #1

- Regional and global finance create a net income improvement forecast to identify targets for the year at a country level and a business unit level.
- Procurement finance reconciles the bottom-up view of savings initiatives in the pipeline at a country level and a business unit level, and a final target is identified through leadership discussions.
- Procurement finance reviews and updates the targets every quarter based on sales forecasts and commodity prices.

Global CPG company #2

- All functions are given productivity targets, such as reducing procurement spending by 2 percent. This is embedded in the budget at the beginning of the year.
- The target value is then allocated to all business units, and the procurement finance business partner works closely with respective functions to identify pipelines.
- The function and the procurement finance partners deliver the targets as this is their joint key performance indicator.

Global commodities company

- The finance team embeds well-defined and quantified initiatives into the budget.
- Procurement provides forecasts of savings at an initiative level.
- At the budgeting stage, finance does a sense check for the large initiatives in terms of value and timing.
- The annual pipeline includes initiatives that are budgeted as well as those that are beyond budget.

Validating savings is often the most complex, time-consuming process in the chain.

Managing the savings validation process

Validating savings is often the most complex, time-consuming process in the chain, driven by the complexity of measuring true savings, capturing it in the profit-and-loss statement, and signing off on the credit to be provided to the procurement organization.

Below are examples of how the three leading companies are validating savings:

Global CPG player #1

- Business finance is responsible for validating savings, and procurement finance acts as a liaison.
- Local procurement tracks the key metrics and reports to local business finance to actualize the savings.
- Procurement uses a tool to give real-time visibility to finance.
- If there is a big gap between the forecast and the bottom-up view, finance pushes a budget cut to countries to close the gap.

Global CPG player #2

- Business finance is responsible for validating savings. This team prepares the guidelines for estimating the savings, which the chief financial officer validates.
- Validation is done in two stages: when the initiative lands and starts accruing and when the initiative is actually accruing.
- Savings are typically reported on a monthly basis.

Global commodities company

- The business unit chief financial officers are responsible for final sign-off during actualization. However, once validated by procurement finance, it is generally not questioned.
- Procurement finance is responsible for pipeline tracking, savings validation, and profit-and-loss tracking, including variance analysis of volume, mix, rate, and consumption.
- A monthly communication by procurement finance—a value delivery drumbeat—is used to update all business units.

How to get started

There are three imperatives for embedding finance within procurement:

Tailor the organization’s design. Design the ideal finance business partnering organization based on the organization’s maturity and unique requirements. Cascade the matrix business partnering structure from the corporate level down to the local or country level.

Select the right business partner. Begin by clearly defining the roles. This will need to be augmented with an onboarding and training plan to equip the business partner with the right technical, functional, and behavioral skills.

Go digital. Focus on sustainability by defining a tight governance mechanism. Use digital extensively to enable it, with digital tools such as pipeline management and forecasting.

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