

# RECONCILING SOURCING PERFORMANCE AND P&L

NECESSARY, POSSIBLE AND PROFITABLE!

Many CFOs share the same issue: 4 out of 5 are facing difficulties reconciling the savings generated by initiatives on external spend and the financial impact on the P&L. Why? It just appears too complex and too resource-consuming to invest in. Yet, the supposed complexity shouldn't serve as an impediment, knowing that external spend accounts for 30 to 80% of the total cost-base... and as much of the cost optimization opportunity.

The absence of a shared objective between Procurement and Operations impacts a company's performance: Business Units conservatively account for only part of the savings potential in their budget - at most 50% - resulting in a limited mobilization from their team and, therefore, lower savings outcomes. A self-fulfilling prophecy...

On the other hand, companies with an effective tracking process show a 30% better performance than their competitors.

Setting up a reconciliation mechanism is possible and profitable, if the following key principles are followed:

- Define the level of precision needed by the organization
- Create relevant, but distinct savings tracking, between Procurement and Finance
- Rely on a comprehensive organizational system
- Approach the implementation from a practical perspective

## ADAPT THE LEVEL OF PRECISION

It all depends on the current level of credibility of the existing performance on the external spend.

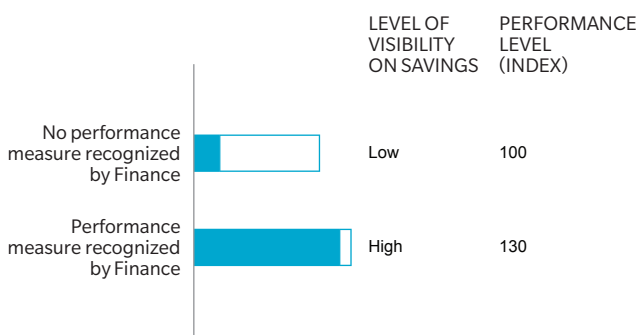
Some companies, already convinced by the value of the actions conducted by their team, settle for simplified savings tracking not necessarily recognized by Finance. However, fewer companies make that choice since the 2008 crisis.

On the way to reconciliation, there is some leeway: for example, a major European distributor created a detailed accounting tracking for each cost center (level 5) as this was necessary to prove the realization of the savings to store directors and get their buy-in. A French national telecom operator decided, rightfully, to only track savings in budgets (level 4) despite the hundreds of millions at stake.

## DISTINCT BUT HOMOGENEOUS TRACKING BETWEEN PROCUREMENT AND FINANCE

It is natural that Procurement and Finance would follow different performance objectives. For example, if Procurement adapts its purchasing strategy to face an increase in commodity costs, Finance will only notice it has maintained constant spend. The answer is to set up separated systems relying on the same management rules (data source, baseline, frequency etc.) and the same calculation rules. In today's service era, the buyers use accounting data and rules established by Finance to define the economic impact of all their savings. This same information is used by Finance, only accounting for the actions with a net P&L or cash-flow impact.

**EXHIBIT 1: A MEASUREMENT SYSTEM, RECOGNIZED BY FINANCE, NOT ONLY IMPROVES THE VISIBILITY BUT ALSO INCREASES THE LEVEL OF PERFORMANCE GENERATED BY PROCUREMENT INITIATIVES**



Source: Oliver Wyman data & experience

## COMPREHENSIVE RECONCILIATION PROCESS

The reconciliation process is organized around three keys components:

- A target, relying on practical and validated actions plans, in order to ensure their credibility and actionability?
- An integrated tracking system of the actions and their savings (SATT©) in order to provide a shared, auditable and up to date source of all the action plans
- An accounting process that allows for a clear integration of the actions' performance impact

## PRACTICAL IMPLEMENTATION

Many organizations struggle with the complexity, or the supposed complexity, of reconciliation. However, the efficiency is increased by the empowerment of all the stakeholders and a rational management of the actual stakes.

First of all, all the stakeholders need to be involved and their respective roles well defined:

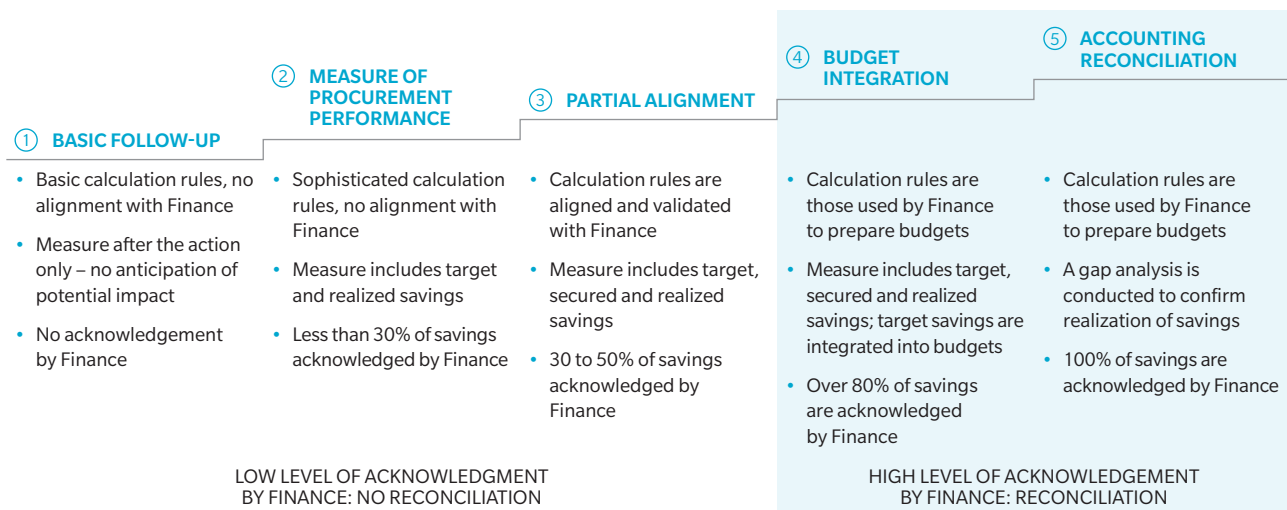
- Procurement needs to provide the hypotheses on the external market and efficiently implement the actions
- Operations need to define the hypotheses on the business side, validate the impact of the initiatives on the P&L and control them
- Finance needs to determine the calculation rules, provide the initial data and pilot the overall process

Then, organize a controlled delegation and management of what is at stake:

- Ensure that the people in charge of implementing the actions are also responsible for tracking the associated savings, so that the analysis of hundreds or thousands of actions is completed by multiple individuals only responsible for several actions each
- Systematically analyze the 20% of actions representing 80% of the actual financial impact and only target a few of the remaining actions

The companies looking to improve their procurement financial performance consider reconciliation to be the cornerstone of a sustainable and reinforced collaboration between internal stakeholders. The principles are clear but rely on a true transformation of roles and responsibilities and the strong engagement of all parties that the tools and systems, as useful as they are, cannot provide.

### EXHIBIT 2: DEGREE OF MATURITY OF ORGANIZATIONS ON EXTERNAL SPEND SAVINGS RECONCILIATION



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