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BUSINESS EFFECTIVENESS

Procurement reporting alignment

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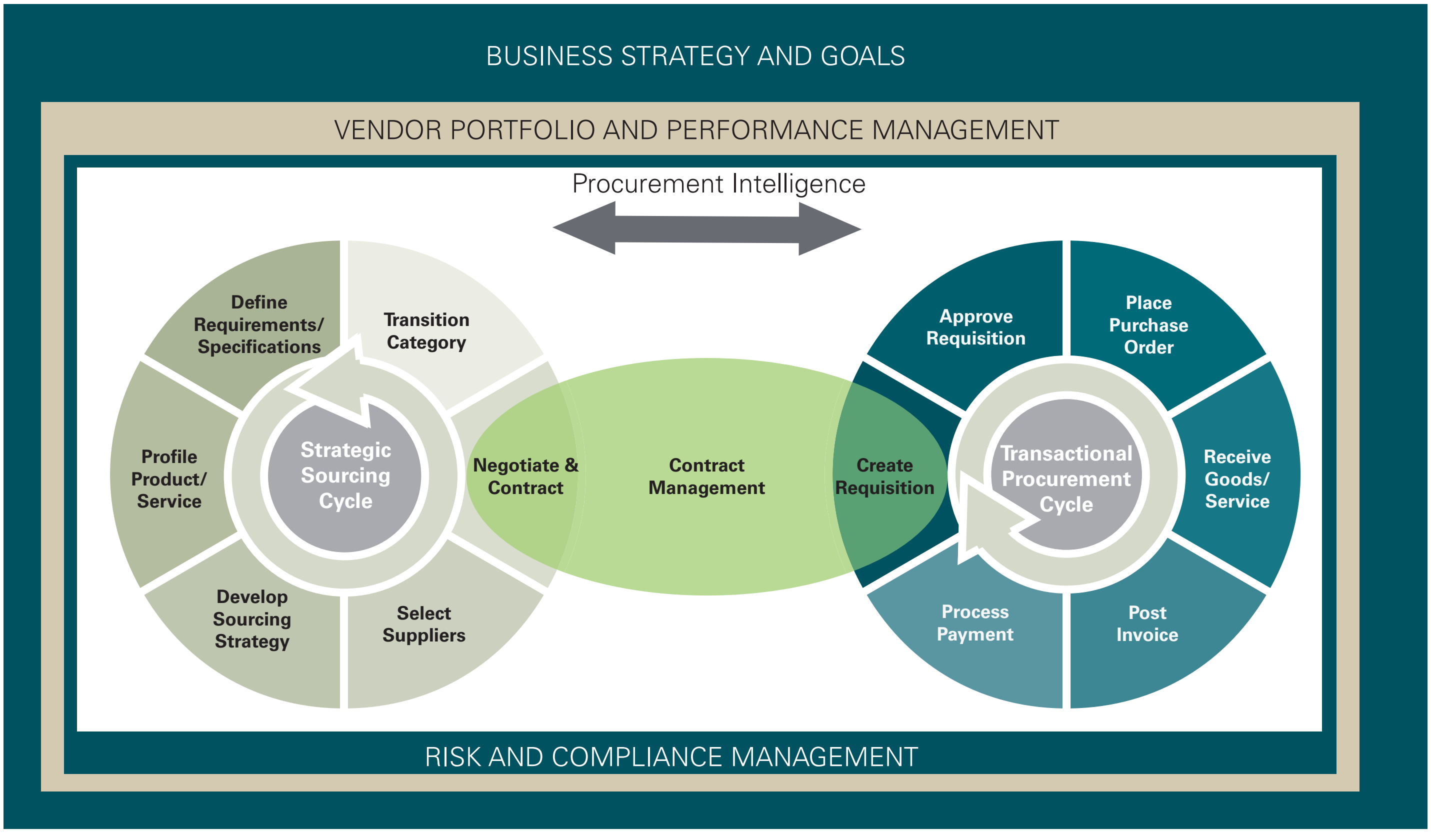
Procurement as a function is on a journey toward greater importance and influence. As it evolves beyond its transactional and back office roots, the department is becoming a strategic player focused on total value delivered including supporting revenue goals, reducing total cost of ownership, and improving quality and integration of supply. However, when discussing procurement's reporting alignment, it is important to consider what Chief Procurement Officers (CPOs) are responsible for in leading procurement organizations.

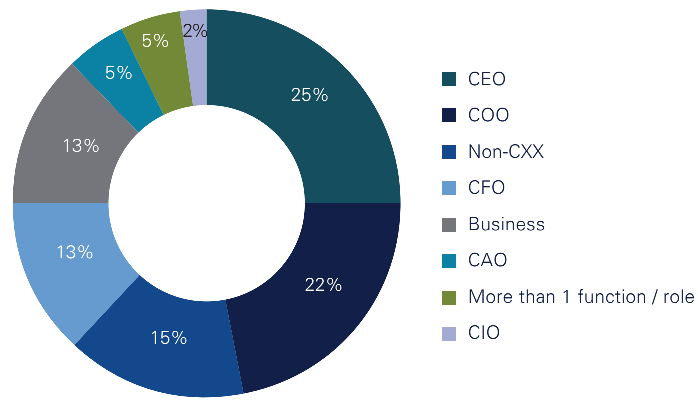
CPOs and procurement departments have been taking on increasing enterprise responsibility of the end-to-end source-to-pay process. The following is an illustration of what that encompasses.



Procurement reporting alignment reflects how the function is perceived within the organization and if it is positioned to become a competitive differentiator that delivers greater value to customers and shareholders. It is important because it facilitates:

- Ability to influence and strategically partner with appropriate departments and lines of business
- Enterprise focus to maximize total value and drive consistency
- Rigor in measuring value delivered—provides both hard and soft value to the company
- Identifications and management of appropriate enterprise controls for procurement and supply chain risks
- Procurement efficiency and standardization
- Talent development and retention

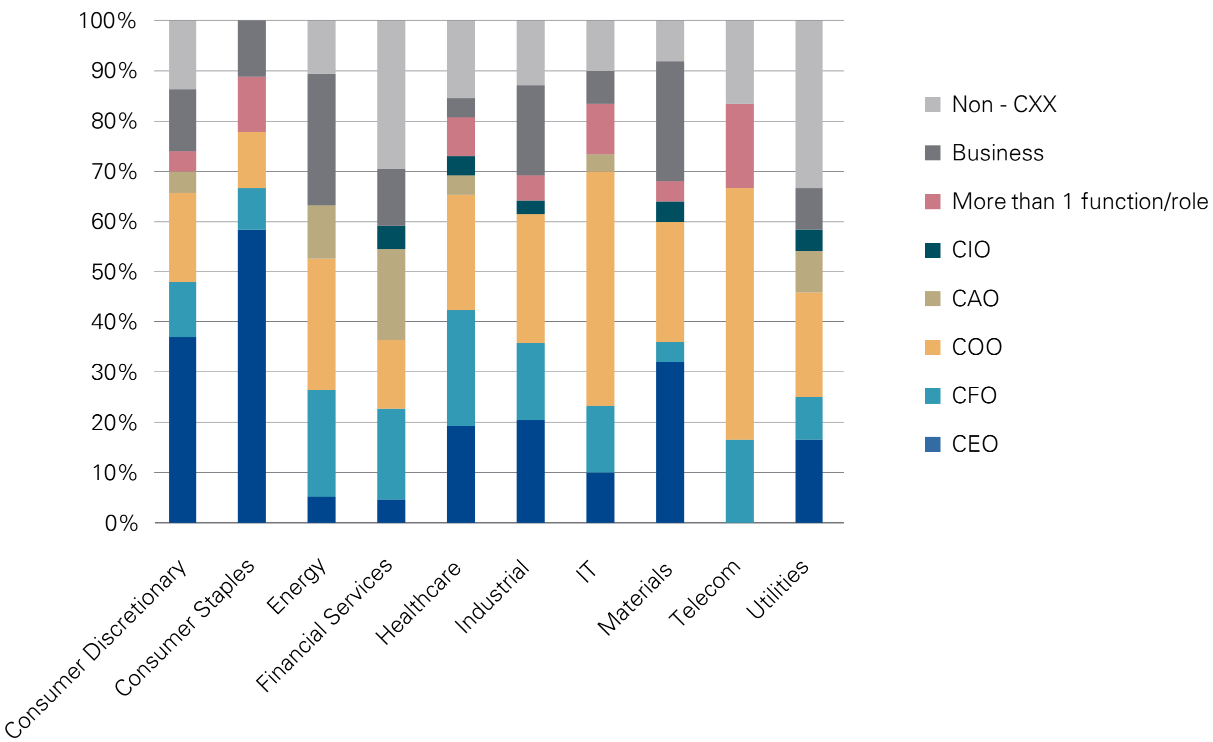
In recognition of the function's increasing relevance, we find that there is a trend toward elevating the level of reporting of the department head directly to a C-level executive. However, there is no clear "standard" as to whom the procurement leaders report within companies. The answer varies by industry and business model, and is influenced by factors such as corporate strategy, culture, organizational model, and leadership preferences.



Based on KPMG LLP (KPMG) research completed in 2011 (sample size of 322 FORTUNE 500 companies), approximately 25 percent of FORTUNE 500 CPOs report to the Chief Executive Officer (CEO), and 22 percent report to the Chief Operating Officer (CCO).

For the top 20 percent of FORTUNE 500 companies in their respective industries (based on 2010 annual net profit margin), 78 percent of those CPOs reported to a C-level executive. To whom the CPO reports by itself is not a major driver of overall company success; however, KPMG's research suggests that it is a key enabler to set the right conditions for success.

The following chart provides additional information broken out by industry sector on whom the CPO reports to in FORTUNE 500 companies.



The following are some observations regarding CPO and procurement alignment by industry:

Industry	Observations
Consumer discretionary	• 37% of CPOs report to the CEO—the second largest percentage of any industry group (other than consumer staples industry) reporting to the CEO • 18% of CPOs report to the COO
Consumer staples	• 58% of CPOs report to the CEO—the largest percentage of any industry group reporting to the CEO • 11% of CPOs report to more than one function/role
Energy	• 28% of CPOs report to the COO • 28% of CPOs report to a business leader
Financial services	• 30% of CPOs report to a non-C-level executive at the company—the second largest percentage of any industry group (other than utilities industry) reporting to a non-C-level executive • 19% of CPOs report to the CFO • 19% of CPOs report to the CAO—the largest percentage of any industry group reporting to the CAO
Healthcare	• 23% of CPOs report to the COO • 23% of CPOs report to the CFO—the largest percentage of any industry group reporting to the CFO
Industrials	• 26% of CPOs report to the COO • 21% of CPOs report to the CEO
IT	• 47% of CPOs report to the COO—the second largest percentage of any industry group (other than telecom industry) reporting to the COO • For the majority of top performing IT companies (on 2010 annual net profit margin ranging from 15% to 29%), CPOs report to a C-level executive
Materials	• 32% of CPOs report to CEO • 24% of CPOs report to the COO • 24% of CPOs report to a C-level business leader
Telecom	• 50% of CPOs report to COOs—the largest percentage of any industry group reporting to the COO • Remaining telecom companies have CPOs reporting equally to the CFO, have more than one CPO function/role, and have CPOs reporting to a non-C- level executive
Utilities	• 33% of CPOs report to non-C-level executives at the company—the largest percentage of any industry group reporting to a non-C-level executive • 21% of CPOs report to COOs

As a company looks to better understand where the CPO and procurement should report, there are some key questions a company should consider, such as:

- What is the amount of direct and indirect spend supply chain/ procurement is responsible for?
- Are you a services-based company? Many service-based companies have CPOs or head of Vendor Management reporting to various C-level executives including the CFO and CAO.
- How much strategic partnering is required with various C-level functions across the enterprise?
- What would be the top and bottom line financial impact if there was a lack of responsive procurement and supply chain support to the various C-level functions?
- How much of supply chain's scope spans from source to pay?
- What percent of active spend under management does supply chain support?

As a general guide, if procurement has a significant impact with the financial top and bottom line, the more likely it should report directly to the CEO or COO.

In addition, the optimal procurement reporting alignment should be determined by the four key considerations: enterprise focus, customer proximity, demonstrable value, and business partner. The diagram below describes the potential key benefits of each.

Enterprise Focus

- Ability to view third-party expenditures and conduct spend analysis across the different departments
- Allows Procurement to negotiate enterprise-wide contracts and maximizes buy-in from the field
- Enables monitoring of purchasing behaviors and consistent enforcement of policies and controls across the company
- Facilitates harmonization of processes across the enterprise

Customer Proximity

- Facilitates strategic partnering and alignment of goals with Procurement's internal customers
- Drives frequent interaction and better understanding of expectations between Procurement and its customer
- Allows Procurement to be more responsive to the business
- Drives early involvement of Procurement in the business planning cycle

Demonstrable Value

- Emphasizes Procurement's focus on the total value picture including risk, service, quality, etc., rather than "cost"
- Formalizes the rigor and structure around benefits tracking and ensures credibility when reporting benefits
- Enhances the ability to expand Procurement's traditional role of cost-lever into impacting the top-line
- Increases process efficiency and thorough hand-offs

Business Partner

- Reinforces Procurement's role as a business partner rather than a corporate policeman
- Helps change the perception of merely being a back-office administrative and tactical function
- Enables Procurement to better articulate its contribution to increasing shareholder value
- Allows Procurement to attract and retain skilled professionals

Understanding the potential benefits and risks of where Procurement is aligned can help with a company's decision. The following table summarizes the pros and cons of different reporting structures:

Potential Benefits and Risks on where Procurement is aligned

	CEO	COO	CFO	CAO
Benefits	Helps enable greatest visibility to what's going on across the enterprise	Helps enable good visibility within operations	Sourcing savings would be validated by Finance and be a more authoritative account of procurement achievements	CAO is neutral ground that creates clear separation of approving budget, approving suppliers and contracting with suppliers
	Provides greatest ability to influence across the company	Provides moderate ability to influence across the company	Facilitates healthy division with the business to help avoid conflicts of interest	Helps enable good visibility within administrative functions
	Helps enable greatest focus on overall company value rather than focus in one or two specific areas (e.g., cost)	Helps enable moderate focus on overall company value rather than focus in one or two specific areas (e.g., cost)	Helps improve enforcement of policies and procedures	Helps enable moderate focus on overall company value rather than focus in one or two specific areas (e.g., cost)
	Provides greatest opportunity for departments to collaborate closely on planning and budgeting	Provides moderate opportunity for departments to collaborate closely on planning and budgeting	Helps enable end-to-end (P2P) efficiencies	Helps enable influence across indirect and corporate spend categories
Risks	If Accounts Payable is kept under CFO, this could lead to lack of end-to-end efficiencies (P2P)	If Accounts Payable is kept under CFO, this could lead to lack of end-to-end efficiencies (P2P)	Can create optics of a corporate function rather than a strategic business partner	Reinforces perception of Procurement as a back-office administrative function rather than a strategic business partner
	May make it difficult to broaden the influence across indirect and corporate spend categories	May lead to lax policy compliance due to tacit conflict of interest in enforcing rules with internal customers if they are in the same group	May drive more of a singular focus on cost rather than more holistic value including risk, service, quality, etc.	If Accounts Payable is kept under CFO, this could lead to lack of end-to-end efficiencies (P2P)
			May distance many internal customers leading to misalignment with business needs and reduce responsiveness	May distance many internal customers leading to misalignment with business needs and reduce responsiveness

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In conclusion, the discussion around where Procurement sits within an organization is fundamentally about collaboration versus control. The collaboration lens is around how Procurement can best understand and serve its internal customers. The control lens deals with how Procurement can best control and manage its third-party spend across the organization. Where Procurement should reside is a function of the maturity of the group and the immediate challenges facing the company. And just as there is no one right reporting structure, keep in mind that this is an ongoing and evolving process: the answer that is right for the long-term may not necessarily be right in the short-term.

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