

# The Role of Finance in Procurement



In a traditional business structure, procurement and finance are two separate departments, working alongside one another within the organization. While this works, it isn't the most efficient and effective way to handle operations.

Though the two business functions are different, the relationship between the two is highly intertwined. The procurement function is about spending the money well, and the finance function is all about keeping the balance sheet in the black.

For the best possible outcomes, the two departments must work together and align their goals. Organizations that allow the departments to function as partners give themselves a competitive advantage and often see improved business performance.

## The Role of Finance in Procurement

Finance sets spending limits for procurement, and procurement aims to save money when and where possible through both cost savings and cost avoidance measures. Using an automated procure-to-pay, or P2P system to connect procurement to back office functions, from purchase requisition all the way through invoice processing helps to improve efficiency and mitigate risk. Finance is able to pay for everything procurement orders and receives, and procurement

is able to use three-way matching to ensure the items they order are what they receive, and what they receive is what they pay for.

Finance provides spend management reports, revenue reports, and other critical data that demonstrates overall company health. Procurement should use these reports to facilitate day-to-day decision-making processes, along with budgeting and financial planning.

## **The Financial Supply Chain**

Businesses tend to focus most of their attention on the physical supply chain and fail to recognize the attention they should place on the financial supply chain. It is, after all, the reason there's enough cash flow to keep the business operating. The financial supply chain is what keeps the bills paid so you can continue to order supplies, have power, internet, and water in your facility, and keep employees paid so they continue coming to work every day. As costs continue to rise, it becomes just as important to manage working capital and cash flow as it does to manage supplier relationships.

*Integrating the physical supply chain with the financial supply chain means taking time to identify weak links in both. Any weakness in either finance or procurement can easily threaten both chains.*

With an automated P2P network and collaboration with procurement, the finance department moves from being in charge of sending payments out to a strategic role in business operations. Not only does the entire system become more efficient because there's less room for error and missed invoices, but the greater visibility and real-time budgeting insights allow teams to be proactive.

## **CPO and CFO Collaboration**

When the Chief Procurement Officer and Chief Financial Officer collaborate on the P2P system, everyone has access to the information they need, when they need it, from end-to-end. Both procurement and finance can easily look into the status of any purchase order or invoice, at every stage of the journey, from initial request to approval, receiving, and payment.

Finance can use the information to make sure they're getting all possible

discounts and increase profits by securing early discounts through early or on-time payments. Procurement can use the information to know which supplier relationships are the best, so they can continue to place orders with the vendors that save the company money and provide high-quality materials and services.

## **Ways to Make Sure Procurement and Finance Work Together**

### **Procurement Should Demonstrate Return**

Beyond working together on technology surrounding the P2P system, the procurement department should be willing to demonstrate the return on investment their actions provide. By showing the finance department positive impact of their choices - whether it be in the form of cost reduction, cost avoidance by mitigating risk, or other achievements, the two departments can work much better together.

### **Establish Clear Responsibility Parameters**

To facilitate better collaboration between procurement and finance, it's essential to establish clear parameters as to who is responsible for what. Key activities should be assigned to one department to take the lead, based on team strengths. This ensures no one is left fighting over who leads what and everyone gets credit for the role they play.

### **Consider Each Department's Point of View**

When it comes to spend management, finance often looks at it from the accounts payable perspective. This means they're more focused on accounting issues surrounding the budget, accurate cost recording, and invoice processing. Procurement, on the other hand, looks at it as maintaining compliance with an approved supplier list and negotiated contracts, while managing maverick spend. Encourage members of the procurement teams and financial services to see issues from both points of view. Understanding each other's point of view is important to keeping goals aligned, as procurement can work toward contracts and deals with suppliers that not only add value but provide cost benefits such as more flexible payment terms, and risk reduction, which is generally a high

priority for finance. And finance can help procurement understand the importance of efficient supplier onboarding, for example, to ensure those suppliers get paid on time and reduce fraud risk.

## **Discuss and Agree on Cost Savings Reporting Standards**

When procurement uses the term “cost savings” typically, it means they’re seeing a decrease in price. When finance hears that term, they’re expecting to see a reduction in expenses compared to the previous year’s statement. There are many price reductions that aren’t reflected on income statements, which can lead finance to be wary of procurement’s claims. Agreeing on the standards and terminology makes it easier for the departments to work together.

## **Set Financial Goals Together**

Finance sets the expense limits and goals, but if those goals involve community purchases, they may not have the same knowledge as procurement does. Finance may have no idea about how wildly commodity prices fluctuate and end up creating nearly impossible financial limitations for procurement. By working together, your business can avoid setting unrealistic financial goals.

## **Develop a Balanced Inventory Approach**

The finance department often uses the inventory line on the balance sheet as a performance indicator. Without understanding the nuances of inventory the same way procurement does, it’s easy for them to feel like procurement is wasting money on items that just sit on a shelf in the warehouse. Procurement knows additional inventory is often necessary to operate through supply interruptions and demand spikes. Collaboration in this area ensures a balance between working capital strategy and operations management.

## **Discuss Cash Flow Strategies Together**

When credit is difficult to obtain, it’s common for finance to push for better payment terms - better for their company, but not the vendor. Though 90+ day payment terms make it easier for your business to manage cash flow, they aren’t ideal for your vendor, because they too, have cash flow issues to consider.

Procurement understands this makes supplier management more difficult because it strains relationships, and often leads to price increases in compensation for the lack of prompt payment. In some situations, it may even mean some suppliers refuse to do business with your company, so while it sounds like a good option on the surface, it can have serious unintended long-term consequences.

If you're currently operating in a silo structure where procurement and finance have little to do with one another, smooth collaboration won't happen overnight. Encourage the CPO and CFO to come together and discuss ways the two departments can help make one another's lives easier, and then begin implementing strategies, starting with P2P automation.

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