

The Master CFO Collection

Volume 5

Partnering for performance

Part 1: the CFO and the supply chain

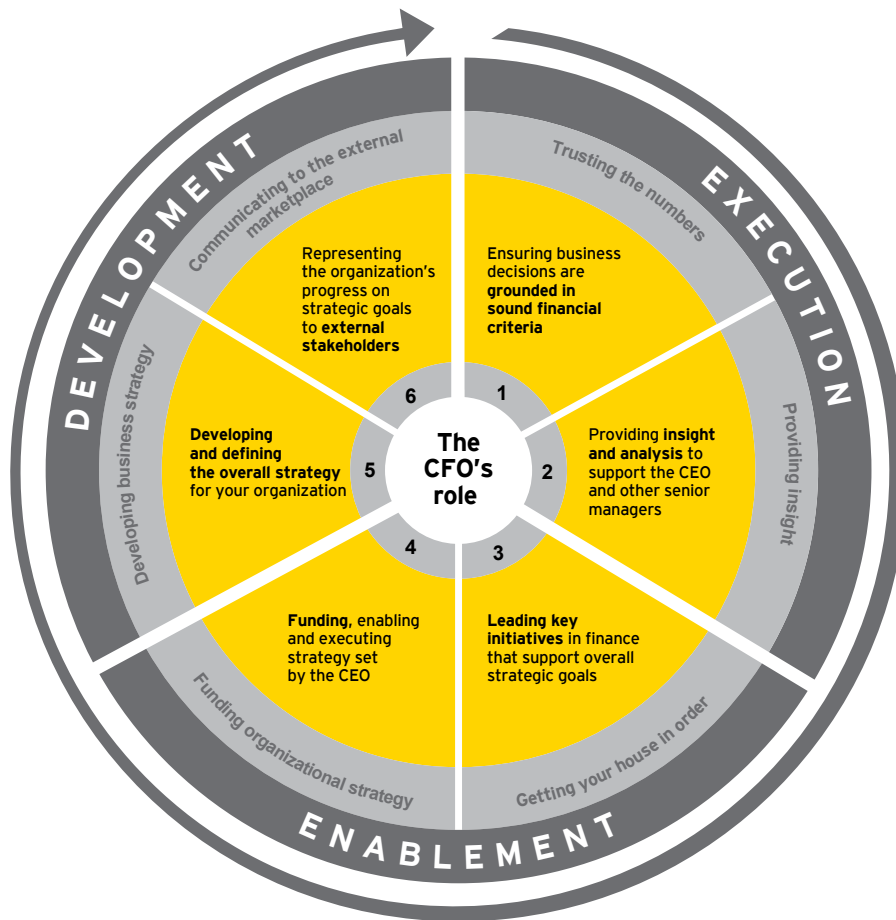


EY

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The CFO's role

We believe these six segments represent the breadth of the CFO's remit. The leading CFOs we work with typically have some involvement in each of these six – either directly or through their team. While the weighting of that involvement will depend on the maturity and ambition of the individual, the sector and scale of the finance function and economic stability, they are all critical to effective leadership.





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The background of the page features a dramatic, high-contrast image of two acrobats performing a handstand against a cloudy sky. The acrobats are silhouetted in black, with their bodies forming a large, inverted 'V' shape. The sky is filled with soft, white clouds, creating a textured, ethereal atmosphere. In the lower-left corner, the dark silhouette of a metal railing or staircase is visible, adding a sense of depth and structure to the composition.

The Master CFO Collection provides insights on events and experiences that CFOs encounter as part of their role. *Partnering for performance* is a series within this collection that explores the contribution that CFOs can make by working in a business partnering relationship with different functional areas of the business.

In Part 1 of this series, we examine business partnering in the supply chain, and explore how CFOs and heads of supply chain can collaborate to achieve superior financial performance. Our findings are based on a survey of 423 CFOs and heads of supply chains globally, and a series of in-depth interviews with CFOs, heads of supply chain and EY professionals.

We are grateful to all participants in this study. In particular, we would like to thank the following finance and supply chain leaders who readily shared their insights in a series of interviews:

Mutlaq Al-Morished, Executive Vice President for Corporate Finance, SABIC

Giacomo Baizini, CFO, Evraz

Tony Barclay, CFO, Fisher & Paykel Healthcare

Simon Coombs, E&P CFO, Reliance Industries

Alistair Davidson, Head of Staff, IKEA

Simon Dingemans, CFO, GlaxoSmithKline (GSK)

David Gosnell, President, Global Supply and Procurement, Diageo

Marc Gross, Chief Supply Chain Officer, Heineken

Matt Hiltzinger, CFO, USG

Michalis Imellos, CFO, Coca-Cola Hellenic

Anthony Maddaluna, President of Global Supply, Pfizer

Dierdre Mahlan, CFO, Diageo

Jim Muse, Head of Supply Chain, Fisher & Paykel Healthcare

Philippe Pédone, CFO, Galeries Lafayette

Giangaddo Prati, CFO, Barilla

The basis of this study¹

The results of our survey were analyzed to compare:

- ▶ The perspectives of finance leaders with those of supply chain leaders.
- ▶ The perspectives of respondents from companies where a business partnering relationship is in place between the CFO and the supply chain, with those where the CFO fulfills a traditional finance role.

For the purposes of this study, “business partnering” refers to a highly collaborative, enabling and supportive relationship between the CFO and other functional areas of the business. A “traditional” finance relationship emphasizes core finance responsibilities, such as accounting, reporting and controls. We asked respondents to identify where their relationship with their finance or supply chain peers sat on a five-point scale between being primarily a traditional finance role (ranking 1 on the scale) and primarily a more enabling, collaborative business partnering role (ranking 5 on the scale). We have characterized those who selected 1 or 2 as having a traditional finance relationship and those who selected 4 or 5 as having a business partnering relationship.

¹ The survey was conducted in collaboration with Longitude Research. See page 36 for further details on survey demographics.

Executive summary

When cost reduction leapt to the top of the corporate agenda at the height of the financial crisis, supply chains – which typically hold a large proportion of many companies' costs – were one of the first places that CFOs turned to for savings. Cost efficiency has since remained high on the corporate agenda but, as companies get used to navigating ongoing economic uncertainty, financial market volatility, the impacts of globalization and an unrelenting pace of change, the supply chain has taken on a new strategic significance. A supply chain strategy that is aligned with the broader corporate and financial goals of the business is essential. An efficient supply chain that enables companies to respond to new market-growth opportunities is also paramount. As such, the role of the supply chain leader has become more prominent, and they now often sit on executive boards as peers to the CFO.

Meanwhile, the CFO's role has also been transformed. Leading CFOs' contributions now go far beyond the traditional finance remit to encompass a strong strategic and commercial focus.² In order to do this effectively, CFOs are collaborating more closely with other internal functions – not just from a monitoring, reporting and risk management perspective, but also as supporters and enablers of performance.

The result of this convergence is that CFOs and supply chain leaders are working increasingly together to understand, analyze and address supply chain issues. In companies where a business partnering model is established, CFOs are drawing on their unique, fact-based view of the organization to identify and solve business problems, and provide insight to deliver more informed decision-making. Together, CFOs and supply chain leaders are creating alignment between strategy, finance, tax and operations, unlocking hidden value within the organization and strengthening financial performance.

In this report, we examine the benefits a growing number of CFOs are realizing for their organization as they increasingly partner with the supply chain leader. We also explore what business partnering means and how, in practical terms, the CFO can collaborate with the supply chain leader to improve corporate performance.

Business partners are in the minority, but collaboration is growing

Only 26% of finance executives and 21% of supply chain executives say that the CFO's contribution to the supply chain is primarily based around an enabling, collaborative business partnering role. However, 70% of CFOs and 63% of supply chain leaders say that their relationship has become more collaborative over the past three years.

The business partnering model relates to growth and strong financial performance

Companies with evidence of strong business partnering between the CFO and the supply chain leaders report better results than those with a traditional finance model in place. They are more likely to report closer alignment between finance and the supply chain functions, and a mutual understanding of key risks and opportunities. Business partnering models have a stronger association with growth. Among business partner respondents, 48% report earnings before interest, taxes, depreciation and amortization (EBITDA) growth increases of more than 5% in their company over the past year, compared with just 22% of those with a more traditional relationship.

The US, South Korea and Singapore take the lead

From country to country, there are significant differences in the proportion of supply chain leaders and CFOs with a business partnering relationship in place. While the US, South Korea and Singapore top the list, Western Europe makes up the tail,

² *The DNA of the CFO: a study of what makes a chief financial officer*, EY, 2010.

with all respondents from France, Germany, Italy and Spain continuing to operate around a more traditional model. In the UK, however, business partnering is well established.

Analytics can be a powerful tool to drive a stronger business partnering relationship

Asked whether data and analytics present CFOs with a significant opportunity to drive a more collaborative, business partnering relationship with the supply chain, an overwhelming 85% of business partners agree. Robust information and insight are central to any business partnering relationship. CFOs' access to financial information from across the business allows them to create a credible "single version of the truth" to drive decisions and performance measurement.

Four key opportunities to business partner

We identify four focus areas where the CFO has an opportunity to enhance performance through business partnering with the supply chain:

- 1. Creating consistency across the supply chain, the business and corporate strategy:** companies where a business partnering relationship between the CFO and supply chain leader is in place report much stronger alignment between the supply chain and broader strategy. They also report better end-to-end visibility across the supply chain. This is crucial to a company's ability to plan, align manufacturing capacity with demand, improve the efficiency and effectiveness of operations, and fine-tune the supply chain operations as a whole.
- 2. Supporting and challenging investment choices:** business partner CFOs support and challenge investment choices throughout the cycle, from idea formulation through to managing an asset's performance, retiring it or reinvesting in


it. This also extends to larger investments in the supply chain, which might include M&A transactions. In particular, business partner CFOs help to set the right growth priorities and pace of growth; they support and challenge the rationale for new investment, and they apply data analytics to support and challenge business decisions. They also ensure that tax is considered as part of operational decisions.

- 3. Monitoring and enhancing performance:** the CFO's perspective across the whole organization, and their position as a trusted advisor, enable them to play a vital role in helping to standardize the language, measurement, tools and key performance indicators (KPIs) across the organization. However, many finance leaders admit that they need to do more to align KPIs and ensure that they are driving behavior that meets the needs of the broader organization, not just the specific function.
- 4. Managing risk and business continuity:** business partner CFOs take a strategic, long-term approach to risk management, which involves not only direct suppliers, but also secondary and tertiary suppliers. The CFO also has the opportunity to work with procurement and treasury to determine the extent to which risk is owned and managed by the company, and to what extent it is pushed further down the supply chain.

The typical business partner

CFOs and supply chain leaders are most likely to take a business partnering approach if they've been in their role for less than five years. They are also most likely to be found in the US, in a technology company with over US\$1b revenue, and EBITDA growth of 5%-10% in the last year.





A new relationship between finance
and the supply chain?

A new relationship between finance and the supply chain?

The supply chain is a critical driver of both top-line and bottom-line performance. Through a complex web of processes and relationships, effective supply chains allow companies to meet the demand for their product, keep costs to a minimum and maintain a balance between agility and resilience. In recent years, however, it has become increasingly challenging to juggle these priorities. Pressure on margins has become more intense, complexity has grown and the pace of change has continued to increase. This means that the relationship between the supply chain and senior finance leaders has become more important than ever. Today, many supply chain leaders have been elevated to the top echelons of the corporate hierarchy, with a seat on the executive board and significant influence on strategic decision-making.

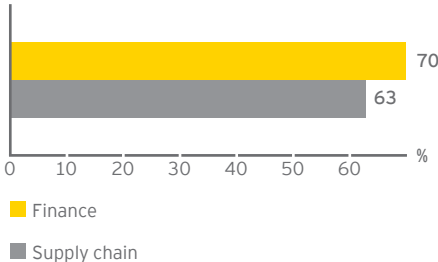
This elevation of the supply chain has coincided with a re-evaluation of the CFO position. Many finance leaders are moving beyond the traditional responsibilities of monitoring, reporting and controlling to play a more forward-looking and commercial role. This includes working closely with other functional areas as business partners, supporting their decision-making through insights and financial impact analysis, and helping them to identify and manage risks and optimize performance.

This changed dynamic creates a prime opportunity for CFOs and the supply chain to work together to make significant performance improvements across the entire business. By applying rigorous insight and measurement to supply chain decision-making, CFOs can improve alignment between corporate strategy, sales, marketing and operations.

Among many other factors, the company's executive management structure will influence the nature of collaboration between the CFO and the supply chain. For example, some CFOs' contribution to the supply chain may be more through partnership with the COOs, when such a role exists, than directly with the head of supply chain. However, in a survey of CFOs and

heads of supply chain, there is strong evidence that relationships between CFOs and heads of supply chain are becoming closer. Among CFOs, 70% say that the relationship has become more collaborative over the past three years, while the proportion among supply chain heads is 63% (see Chart 1).

Chart 1
Over the past three years, what change has there been to the relationship between the CFO and head of supply chain in your company? (Shows "much more collaborative" and "a little more collaborative" responses)



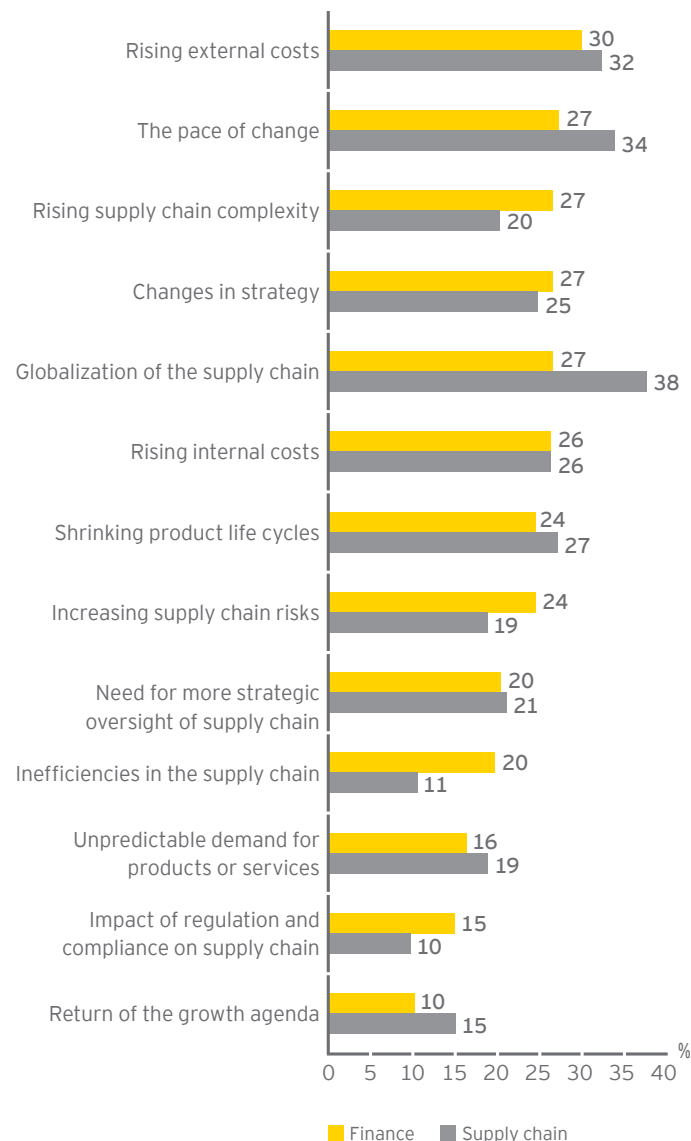
“CFOs should be taking active steps to align the finance organization with the manufacturing and supply chain to make sure that finance is right at the heart of that discussion,” says **Simon Dingemans, CFO of GlaxoSmithKline**, a pharmaceuticals company. “From my point of view, the supply chain is a very high priority in terms of shaping the operations of the company to support the strategy, but also to make it more efficient and agile.”

Mutlaq Al-Morished, Executive Vice-President for Corporate Finance at SABIC, a petrochemicals manufacturer, agrees. “A collaborative relationship between finance and the supply chain is of paramount importance,” he says. “Finance should never be a policeman just throwing a report over the fence and telling the business it’s their problem. We should be helping the supply chain to work toward a solution, not just identifying problems.”

Rising external costs, globalization and the rapid pace of change drive a more collaborative approach

Asked what has influenced the need for a closer relationship between finance and the supply chain, finance respondents point to external costs as the number one factor while, for supply chain executives, it is among the top three (see Chart 2).

Chart 2
Which of the following factors have been most influential in creating the need for a closer relationship?



Globalization also looms large, particularly for supply chain respondents. Global supplier relationships create significant complexity, but also bring huge potential to optimize performance by reducing costs and driving economies of scale. Global companies also need to realign themselves to meet demand surges in emerging economies while, simultaneously, managing flat growth in the developed world. “Meeting the needs of this highly diverse global customer base demands constant innovation as well as huge variety and choice,” says **Andrew Caveney, Global Supply Chain and Operations Advisory Leader at EY**. “It also introduces even greater complexity, and requires companies to re-evaluate traditional supply chain configurations.”

Fluctuating demand, shrinking product life cycles, volatile exchange rates and a constantly shifting risk landscape mean that companies need a highly responsive and flexible supply chain to be confident that they can deliver the right products to the right place at the right time. Equally, many sources of competitive advantage are now temporary at best. Rising labor costs, particularly in core manufacturing hubs, mean that many price arbitrage opportunities may be reaching their limit.

Growth opportunities are now more fluid and dependent on non-traditional markets. “Companies are operating in a world in which tried and tested approaches will no longer be sufficient,” says **Mark Yeomans, Leader of Supply Chain Strategy, Europe, at EY**. “Growth is taking place in non-traditional markets and channels, many of which have unknown risks. Capturing this growth will require new models and collaborative approaches to leadership.”

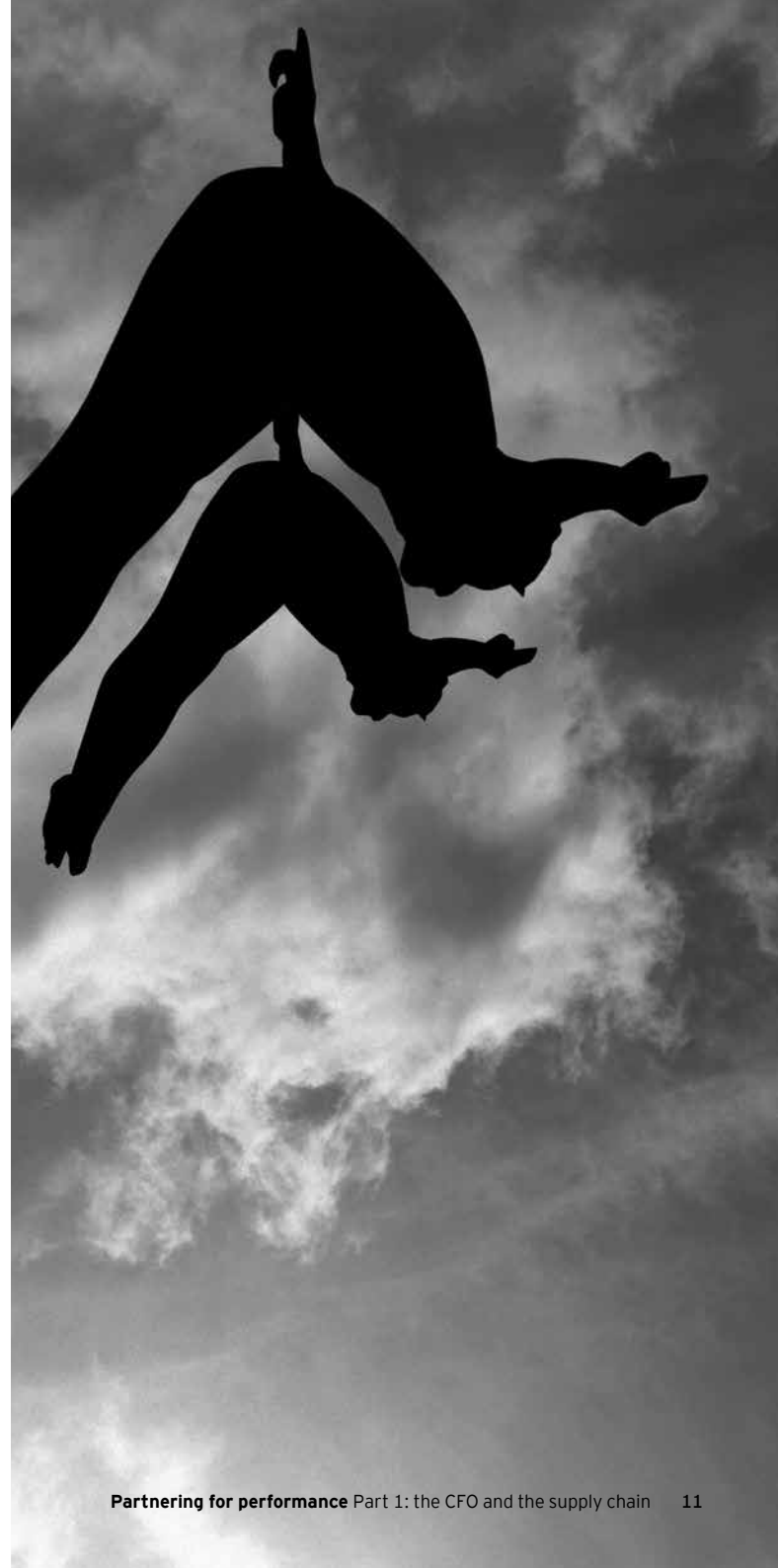
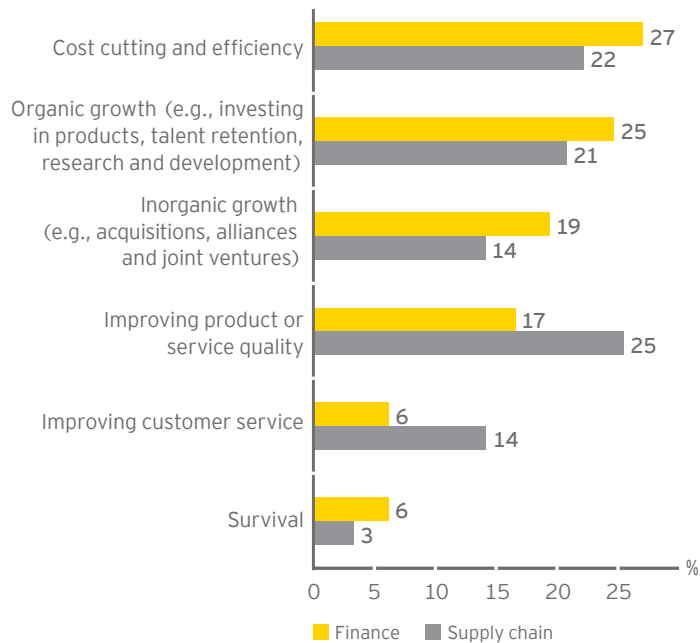
Companies’ existing structures and processes present an opportunity to improve alignment and efficiency. Over the years, many have invested in the supply chain in a piecemeal fashion by bolting on extra capacity to meet new demand, introducing new outsourcing relationships or obtaining new capacity as a result of M&A. Supply chain functions, including procurement, manufacturing and distribution, are often poorly connected and rely on disparate interpretations of data and manual processes that are often inconsistent. In turn, the supply chain itself is frequently not integrated with the commercial side of the business. This leads to difficulties in matching demand with supply, and an uneven flow of inventory from manufacturing through to the customer.

Bringing different perspectives to problem solving can lead to breakthroughs

A cross-functional relationship between finance and the supply chain can be the catalyst for addressing these issues. “Breakthroughs in business performance occur when looking at the business or supply chains from an end-to-end perspective,” says **Brian Meadows, Americas Leader of Supply Chain and Operations at EY**. “When operations are aligned with strategy, and organizational functions are aligned with operating strategy, innovation breakthroughs occur. These breakthroughs can drive greater productivity and can help the business performance exceed customers’ expectations. Without this alignment, performance improvements tend to center on functional improvements. A “partnering” mentality is a core cultural attribute behind innovative breakthroughs, where the success of your colleagues is as important to you as your own success, with everyone focused on delivering the customer promise.”

CFOs' and supply chain leaders' different perspectives on business challenges can be a source of conflict or, in a business partnering dynamic, create a fruitful environment for problem solving. CFOs, for example, cite cost cutting and efficiency as the single most important priority for the next three years, while supply chain leaders cite improving product or service quality (see Chart 3). In reality, both are important, and it is only by bringing the two functions closer together that the right balance can be struck.

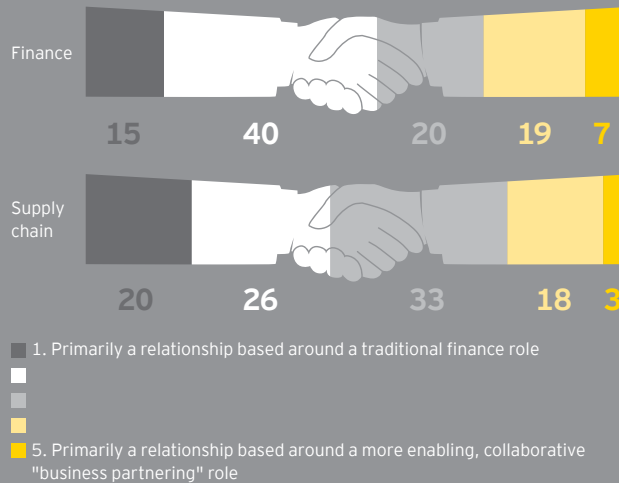
Chart 3
Which of the following do you see as the single most important priority for your business over the next three years?



Who are the business partners?

The term business partner has become increasingly common to describe a more collaborative, enabling and supportive relationship between finance and other functional areas of the business. Business partnering is not universal – indeed, companies that have established this model between finance and the supply chain are still in the minority. Among our respondents, **26%** of finance executives and **21%** of supply chain executives say that the CFO's contribution to the supply chain is primarily based around an enabling, collaborative, business partnering role. **55%** of finance executives and **46%** of supply chain executives say that the CFO's contribution to the supply chain is primarily based around a traditional finance role. The remainder considers they strike a balance between the two.

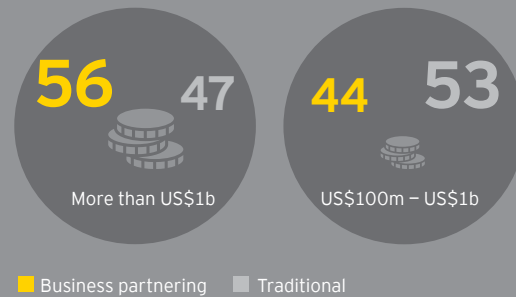
Chart 4
Where on the spectrum from 1 to 5 (see legend below) would you place your relationship with your CFO/ head of supply chain (%)?



Revenue

In companies with higher revenues, there is a higher incidence of a business partnering relationship. Fifty-six percent of business partners work in companies with more than US\$1b annual revenue.

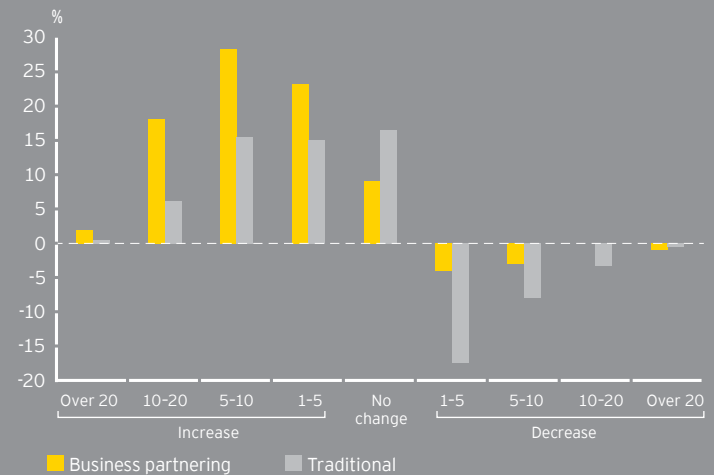
Chart 5
What is your company's annual revenues in US\$ (%)?



Growth

Companies that have a business partnering model in place tend to have higher EBITDA growth.

Chart 6
How has your company's EBITDA changed over the past 12 months?

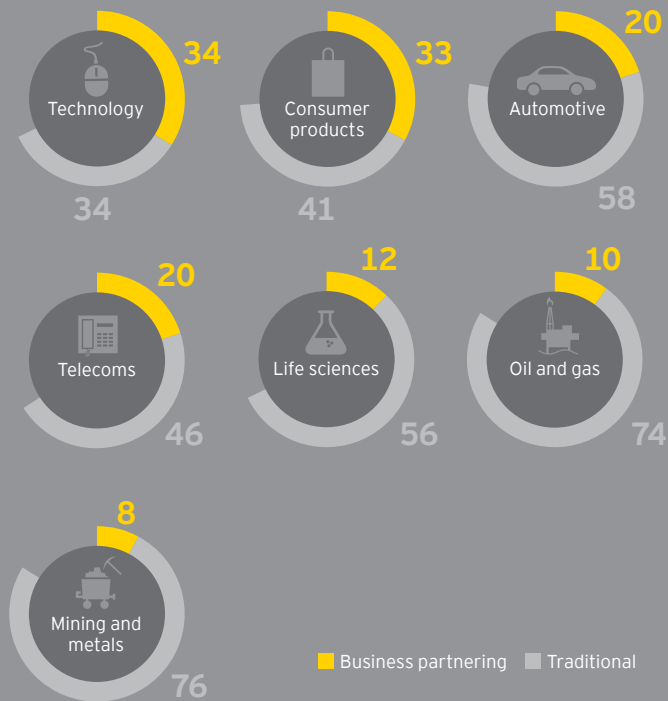


Sectors

Technology, consumer products and manufacturing tend to have a strong business partnering emphasis. However, in heavy industry, mining and metals, and oil and gas, it is less established.

Chart 7

What is the primary industry for your company (%)?



Geography

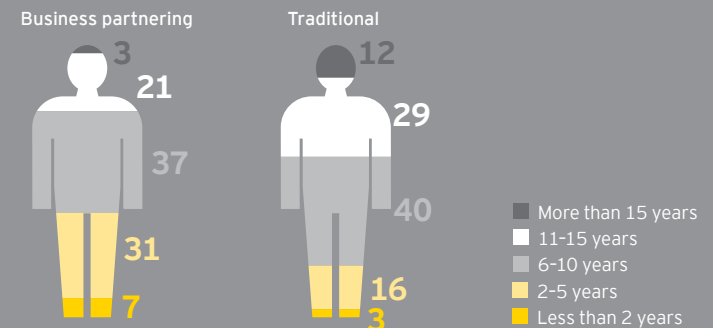
The countries in our survey where business partnering is most established are the US, Singapore, South Korea and the UK. The story in Western Europe is very different. In France, Germany, Spain and Italy, no respondents from our sample describe the relationship between the CFO and the supply chain leader as being one built around business partnering. This was also the case in Argentina and Russia.

Time in role

Business partners are also more likely to be relatively new to their role.

Chart 8

How long have you been in your current role (%)?





Business partnering yields rich returns

Our research suggests that business partnering is associated with stronger financial performance. Among the business partner respondents, 48% report EBITDA growth increases of more than 5% over the past year, compared with just 22% of those with a traditional relationship (see Chart 5). Although a company's financial performance will inevitably be determined by a multitude of factors, a business partnering relationship between the CFO and the supply chain leader seems likely to contribute. Equally, higher growth may enable greater investment in the resources required for business partnering. This can create a "virtuous circle" in which business partnering and higher growth can reinforce each other. "In a growth-oriented company, you need to have deep and transparent conversations about how that growth will be achieved, and that requires a robust partnering approach," says Mr. Meadows, Americas Supply Chain and Operations Leader, EY.

Business partnering facilitates deeper insight across a range of business challenges

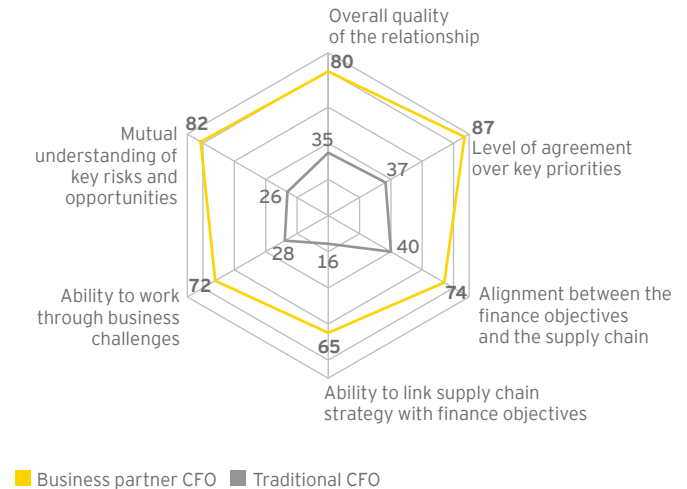
A business partnering relationship between finance and the supply chain can help build a more integrated, end-to-end perspective across finance, operations and the commercial functions. At companies where a business partnering relationship is in place,³ CFOs and heads of supply chain report a much more productive relationship across all key metrics measured. For example, 80% of business partner CFOs report a good or very good overall relationship with the head of supply chain, compared with 35% of traditional CFOs. They also report stronger agreement over key priorities, better alignment between finance objectives and the supply chain, and a mutual understanding of key risks and opportunities (see Chart 9a). We see similar sentiment in a comparison between business partner and traditional heads of supply chain. In the supply chain function, 100% of those

in business partnering relationships rate the overall quality of the relationship as positive, compared with 23% of those in a traditional relationship with finance. And more than 90% consider both the level of agreement over key priorities, and the mutual understanding of key risks and opportunities, to be positive, compared with just 18% and 26% respectively of those in a traditional relationship (see Chart 9b, over page).

It is also worth noting that in a comparison between CFOs and supply chain leaders that, identify themselves as being part of a business partnering dynamic, the supply chain leaders have a more positive view of the relationship as a whole. But in the more traditional dynamic, CFOs have a consistently more positive view of the relationship than their supply chain peers.

Chart 9a

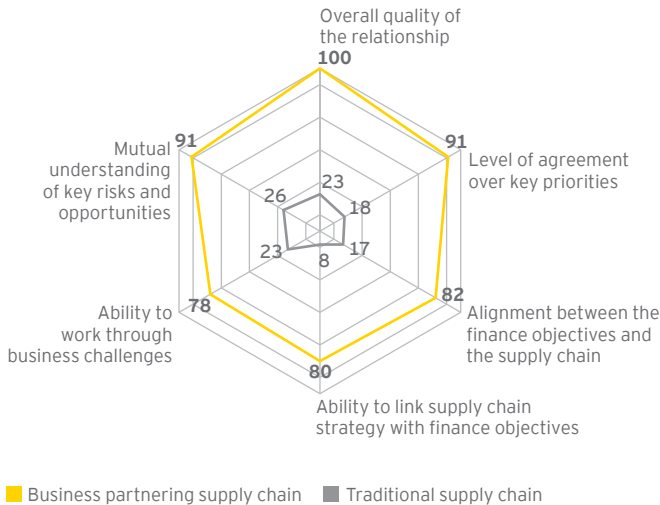
How would you rate the following aspects of the relationship between the CFO and head of supply chain (%)?



³ See section "The basis of this study" on page 3 for an explanation of how the business partner and traditional respondents are defined.

Chart 9b

How would you rate the following aspects of the relationship between the CFO and head of supply chain (%)?



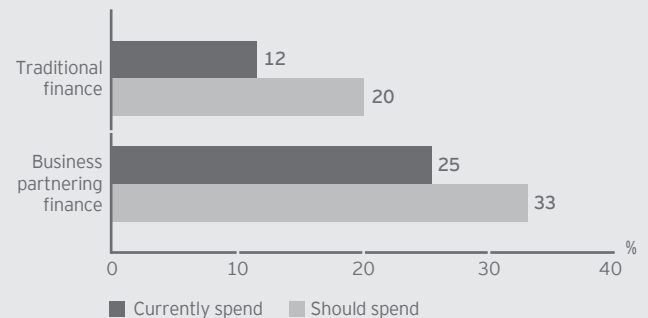
Teaming takes time

An effective, collaborative relationship between finance and the supply chain demands time, resources and commitment. Among our sample of CFOs, business partners say that they spend 25% of their time with the head of supply chain, whereas those with a more traditional relationship spend 12%. Both, however, agree that this is not enough: the business partner CFOs think that they should be spending one-third of their time on the supply chain, compared with 20% for the traditional CFOs (see Chart 10).

Spending more than one day a week with the head of supply chain may be unrealistic, but it does illustrate the importance of the relationship. The consensus, even among business partner CFOs who already dedicate a lot of their time to supply chain issues, is that this is an aspect of the business that deserves more attention.

Chart 10

What proportion of your time do you currently spend working with the head of supply chain, and what proportion do you think you should spend?



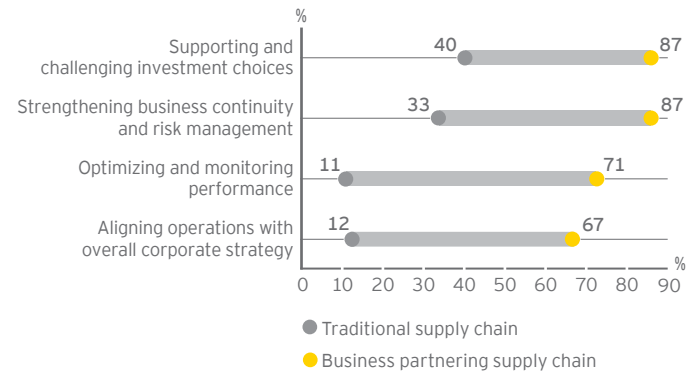
Business partnering is a two-way street

Both CFOs and supply chain leaders need to work hard in order to make a business partnering relationship work. CFOs need to demonstrate that they can make a valuable contribution beyond their traditional finance role, and heads of supply chain need to build trust through transparency. “If I can deliver the cost benefits to the business that the financial community has asked us, then it helps to reinforce the relationship,” says **Marc Gross, Chief Supply Chain Officer at Heineken**, a brewing company. “By establishing a very good relationship with finance, the supply chain gets the support it needs.”

Asked about the quality of the support that they receive from the CFO, heads of supply chain in business partner organizations are much more likely than those in traditional finance relationships to report they are happy with their relationship with the CFO. For example, 87% of heads of supply chain in business partner relationships say that they receive good support in strengthening business continuity and risk management, and in supporting and challenging investment choices. This compares with 33% and 40%, respectively of those in traditional finance relationships (see Chart 11).

Chart 11

How would you rate the quality of support that you receive from the CFO across the following areas?



Business partnering between the CFO and the supply chain improves:

- 1 End-to-end visibility across finance, operations and commercial
- 2 Alignment across objectives and priorities
- 3 Ability to work through business challenges
- 4 Overall financial performance
- 5 Collaboration at a strategic level
- 6 Understanding and management of risks and opportunities
- 7 Quality of investment decisions



A black and white photograph of a person's silhouette flying a kite against a cloudy sky. The person is on the left side of the frame, and the kite is visible as a dark shape against the lighter clouds. The sky is filled with various cloud formations, creating a textured background. The overall mood is dynamic and active.

Business partnering in action

Business partnering in action

Where business partnering between the CFO and the supply chain is happening, our survey indicates a clear link to good business outcomes. However, 55% of finance executives surveyed say their relationship with the supply chain is still based around a more traditional finance role, which suggests that the shift to a more collaborative relationship may be difficult. In this section, we look at four areas where the CFO's unique skills and perspective can enable them to improve corporate performance by partnering with the supply chain. We compare the perceptions of CFOs and supply chain leaders in business partnering relationships to identify the opportunities that yield results, as well as the areas of tension.

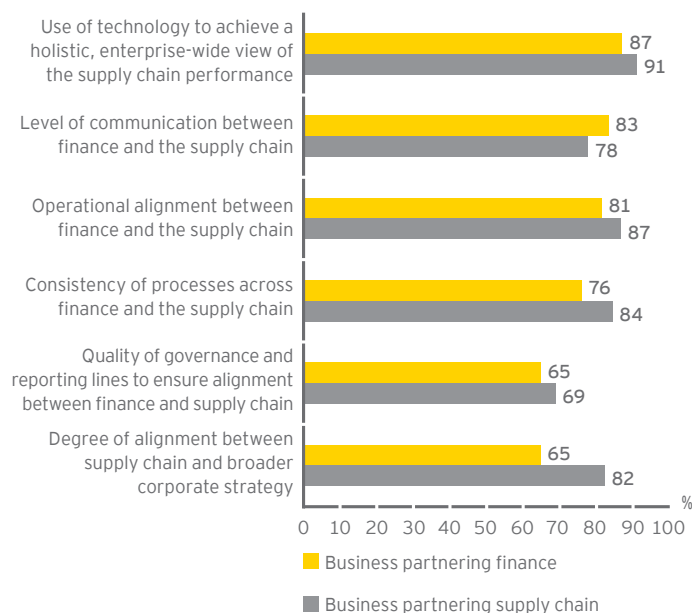
1. Creating consistency across the supply chain, the business and corporate strategy

A business partnering relationship between finance and the supply chain offers the opportunity to break down functional barriers and establish a clear line of sight between corporate strategy, sales and marketing, and the operational side of the business. By creating greater end-to-end visibility across the organization, companies can strengthen planning, align manufacturing capacity with demand, and improve the efficiency and effectiveness of operations.

"There is a strong connection between helping the supply chain to achieve financial targets and fulfilling our long-term financial objectives," says **Michalis Imellos, CFO of Coca-Cola Hellenic**. "Ensuring that there is congruence between what the supply chain function aspires to, and how this aligns and enables the business strategy, is of critical importance to achieving our long-term strategic goals."

The majority of CFOs and heads of supply chain in a business partnering relationship surveyed are in agreement that there is good or excellent alignment between the supply chain and broader strategy across all key metrics measured (see Chart 12).

Chart 12
How would you rate the following aspects of alignment between the supply chain and broader corporate strategy?
(Shows 1 or 2 ratings on a scale from 1 "excellent" to 5 "poor")



Building end-to-end visibility improves the quality of decisions

The CFO's access to numbers from across the business, and their broader view of the day-to-day operations, gives them a different, and perhaps more neutral, perspective in interpreting data. This position enables them to produce a fact-based, single version of the truth for the whole business. Eliminating information silos also helps to defuse arguments over which set of numbers to believe. "Having consistent data and systems frees up individuals to have a more constructive dialog about the value they can bring," says **Simon Coombs, E&P CFO of Reliance Industries**. "They are no longer fighting over which version of the truth is right."

Mr. Dingemans, CFO of GlaxoSmithKline, agrees. "If every part of the supply chain has its own data, then you have lots of debate over comparability," says Mr. Dingemans. "An integrated supply chain depends on data standardization, data comparability and simplification. This means that people can see a total cost picture, which is what drives commercial behavior."

CFOs also bring an element of consistency to the way that decisions are evaluated, which can build trust throughout the business. Greater involvement from finance as a link, often alongside the COO, between commercial and operations, for example, can help to provide confidence that decisions are being made from an informed standpoint. "Once we have a good idea of how much product we are going to sell, we can build a strategy around that and optimize our manufacturing footprint to deliver it," says **Matt Hilzinger, CFO of USG**, a building supplies company. "As a CFO, it gives me comfort to know that we've got some science behind this and that the recommendations being put forward are analytical, fact based and not based on someone's theory or emotional view of the industry."

As an objective broker between different functional areas of the business, the CFO has an important role to play in building stronger bridges. Consider the relationship between R&D and manufacturing as a case in point. “For a long time, manufacturing has not had a voice in defining a new product, and it’s always been assumed that it will simply be able to translate ideas from R&D into products,” says **Stan Brown, a Partner at EY** in the US. “But by giving manufacturing a voice, you can enable decisions that affect the efficiency with which products are made, creating equal or greater consumer benefit at a reduced cost point. CFOs can play an active role in creating an internal structure that enables and promotes this more collaborative behavior.”

At the pharmaceuticals company Pfizer, a strong relationship between the commercial and operational sides of the business helps to create a careful balance between efficiency and responsiveness in the supply chain. “The supply chain is a large part of the financial structure of the company because we are responsible for both product supply and inventory, which represent a significant portion of both the Profit & Loss (P&L) statement and the balance sheet,” says **Anthony Maddaluna, President of Global Supply at Pfizer**. “Our focus is on delivering products to satisfy customer demand that meet our exacting quality standards at the best cost of goods, and doing so while balancing required product supply and inventory. We strive to ensure we are not consuming excess cash in inventory and, at the same time, ensure we have the right inventory in our supply chain to fulfill orders and drive revenue.”

Better integration between the commercial and operations teams also means that objectives can be aligned more closely. “If you have accountability and management in one place, then you can also drive one P&L and one set of numbers,” says Mr. Dingemans. “That can be very effective in making the commercial business more responsive and more understanding of the consequences of their actions.”

A partnership between finance and key functions within the supply chain, such as procurement, helps to ensure that the right objectives are being met. “Procurement reports into the CFO, but we have a dedicated procurement team focused on the global supply chain,” explains Mr. Maddaluna, President of Global Supply at Pfizer. “Purchased materials and goods represent a significant portion of cost of goods sold, so they play a key role. Regardless of reporting relationship, the procurement team is integral to our success and the working relationship is seamless. It is a true partnership in terms of what we need to deliver and how we deliver it. Cost is important; however, quality and compliance are essential. Procurement fully understands this.”

An effective sales and operations planning (S&OP) process is vital to ensure alignment and minimize debate between different functional areas. If the company has too much stock, for example, the CFO and supply chain leader need to understand why – it may be due to over-forecasting, underselling, change in the market or the wrong price. The S&OP process can help to reveal the drivers of performance in the supply chain and facilitate a stronger partnership between finance and the supply chain. Although CFOs have not traditionally been at the heart of S&OP planning, they have the opportunity – through business partnering relationships – to play a more central role.

Misaligned incentives in the supply chain

An integrated planning model that links finance, sales and operations in a transparent and accountable way helps to overcome some of the misaligned incentives between different parts of the business. Below are some examples of actions that can result in misalignment, along with their unfortunate implications:

Action

The sales team underestimates demand in forecasts so that it can demonstrate that it has beaten its targets.

Operations pushes as many products through the supply chain as it can reduce unit cost of products manufactured.

Sales and marketing maintain a high number of product lines to increase customer choice.

Cost-reduction incentives drive procurement to purchase low-cost parts.

The finance team puts the supply chain under pressure to reduce working capital to improve financial performance.



Implication

Operations plan for less capacity and, when the real demand hits, they are unable to meet it.

Inventory builds up, increasing working capital and reducing visibility and overall efficiency.

Servicing the product lines, some of which are likely to be unprofitable, increases cost and inventory complexity and reduces profitability.

Poor-quality parts cause problems in manufacturing when they fail.

The supply chain reduces production and trims inventory levels, which leads to stock-outs and poor service levels.

2. Supporting and challenging investment choices

Investments in the supply chain are among the largest and most important that any business makes, and the CFO's role in supporting and challenging these decisions is vital. Companies must invest in and maintain manufacturing capacity, distribution networks, inventory and the raw materials that are used in the manufacture of products. An effective supply chain also needs significant investment in people, technology and processes to ensure that it runs smoothly and can serve as a source of competitive advantage.

In traditional financial management, the CFO and their team serve as the gatekeeper for investment and resource allocation. They set budgets, determine appropriate returns for investment and capital expenditure, and manage trade-offs between resource allocation across different functional areas of the business.

Business partner CFOs retain these responsibilities, but also play a much more active role in supporting investment choices. They get involved across the entire investment cycle, from formulating the idea through to managing an asset's performance, retiring it or reinvesting in it.

"Every function is trying to maximize its investment allocation, and the CFO needs to act as the business integrator by combining and balancing these different requirements to find a solution that is strategically correct for the company, thereby maximizing the value creation," says **Giagaddo Prati, CFO of Barilla**, a food manufacturer. "By having clear and shared strategic priorities, using a common language and fixing precise rules at the outset around the ratios and paybacks we need to approve investment, we minimize tension and help to focus attention on execution."

In a traditional finance relationship, discussions around investment and capital expenditure can frequently be sources of tension. But in a business partnering relationship, the supply chain is more closely aligned with corporate strategy, and the projects they requests usually are too. "When the supply chain has a real understanding of and alignment with corporate strategy, greater value is generated from capital investment decisions," says Mr. Caveney, Global Supply Chain and Operations Leader at EY. "The supply chain is in a better position to know what the organization needs to produce, and can start to direct capital investment to building the right capabilities in line with that strategy. That conversation becomes much more efficient, because all the key constituents are participating."

Data analytics are a catalyst for better business partnering

An overwhelming 83% of finance business partners and 87% of supply chain business partners agree that data and analytics present CFOs with an unprecedented opportunity to drive a more collaborative, business partnering relationship with the supply chain.

"There is a tremendous opportunity for CFOs to take ownership of analytics, because there is no one in the organization with complete responsibility for it," says **Andy Rusnak, Americas Enterprise Intelligence Practice Leader at EY**. "Finance leaders need to think differently about the data over which they have control. There is no reason why you wouldn't apply the same rigor, control and analytical capability across all of the data that the organization produces and view your role as somebody who sits down and pushes value from that data into the rest of the organization."

But the sheer proliferation of data raises its own challenges. One is how to narrow down the datasets that the company considers important and convert it into useful information for decision-making. For Mr. Rusnak, the key is to take a driver-based performance approach. “CFOs need to really understand what drives value for the organization and focus on that,” he says. “That makes the CFO’s challenge not one of ‘how do I aggregate every little piece of data that ever existed?’ but ‘how do I get the organization to understand what’s important?’”

Make-versus-buy decisions

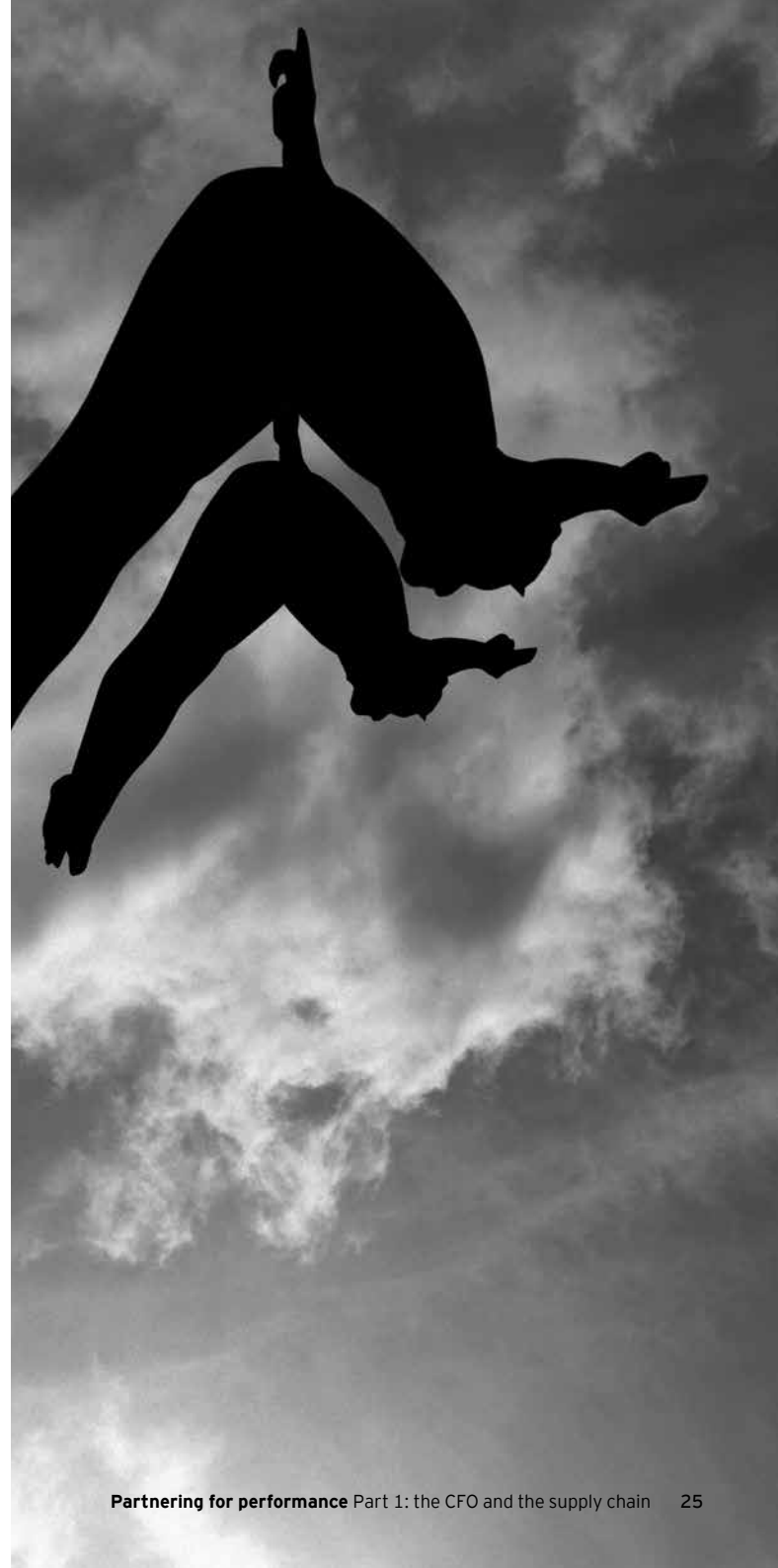
When a company is considering investment in the supply chain, the CFO can bring a risk perspective to that conversation and force a transparent discussion about investment choices. Consider a “make-versus-buy” decision, in which the company is deciding whether to build manufacturing capacity or buy it in through a contract manufacturing (CM) arrangement. Working with their supply chain partners, CFOs need to ask themselves the following questions:

What does our future demand look like? If it is volatile, would CM help us to access capacity and meet unexpected demand?

If demand looks as if it is declining in a particular market, can CM act as a downside hedge to enable volumes to be reduced without having to retire fixed capacity or leave it idle?

Where are our existing manufacturing assets? If they are in a high-risk area, can CM capacity in another location help us to manage the risk of supply chain disruption?

If input prices are volatile, could a fixed price arrangement with a CM help us to mitigate some of our risk exposures?



3. Monitoring and enhancing performance

Business partner CFOs go beyond monitoring performance to play an important role in defining and driving the behaviors that will support organizational goals. One way they do this is by helping to standardize the language, measurement, tools and KPIs across the organization. “CFOs have a unique skill to bring together different parts of the organization that may be at odds with each other or may not have a great mechanism for open communication,” says Mr. Brown, Partner at EY in the US. “They provide a single point of reality and, when you combine that with a more collaborative relationship, you can start to have transparent, high-value conversations.”

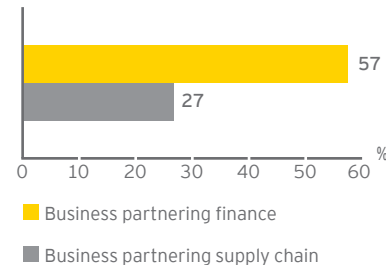
Business partners see room for improvement in setting KPIs and targets to drive the right behaviors in the supply chain, with 57% of those in finance and 27% of those in the supply chain saying that they need to do more here (see Chart 13). “Technology and the supply chain are the two main drivers to support the growth of our business,” says **Philippe Pédone, CFO of Galeries Lafayette**. “This means we need to have the best KPIs in order to be more efficient on these two aspects that support the business.”

When finance is less involved in the supply chain in a more traditional relationship, there is a danger that it will apply targets, in areas such as working capital, that do not take the realities of the function into account.

“You can’t just dictate terms or arbitrarily put working capital goals in place that aren’t achievable,” says Mr. Hilzinger, CFO of USG. “Finance can establish that working capital is important and ensure that there are consistent definitions in place, along with objective measures to show whether or not we are achieving our goals. But it is then up to the supply chain to figure out what they can do to meet those objectives.”

Chart 13

Do you agree that you need to do more work to ensure that the KPIs and targets set for the supply chain are driving the right behavior? (Shows “agreed strongly” and “agreed”)



Ensuring that there are consistent definitions for measures, such as working capital and tax, across the business is central to driving the desired behaviors. “It’s extremely important that you develop consistent definitions for KPIs, so that groups come together and set those KPIs from a leadership perspective and let them cascade down through the organization,” says **Jim Muse, Head of Supply Chain at Fisher & Paykel Healthcare**, a medical devices company.

The CFO’s neutral position within the supply chain means that they can evaluate trade-offs between different targets and give a perspective on which course of action will deliver the best overall benefits. Consider, for example, an initiative to increase service levels or fill rates in the supply chain. Increasing them from, say, 95% to 96% would benefit customers, but it would also require increasing inventory. “The CFO can add a valuable perspective to this discussion by evaluating the impact of increased service levels on other metrics, such as working capital,” says **Sean Ryu, Supply Chain Leader for Asia Pacific at EY**.

With the right definitions in place, the leadership team can make a decision about the most important metrics to drive throughout the organization. When teams are incentivized on too many different metrics, the result can be confusion and lack of clarity around what the real priorities of the organization are. “Over time, reporting becomes more comprehensive, everything is being measured and what is lost is the focus on what is most important.” says Mr. Meadows, Americas Supply Chain and Operations Leader at EY. “A great area for a CFO to build a strong working relationship with the head of supply chain is in the area of performance management. They can help align operational objectives to the business strategy, in order to determine the most critical measures to monitor strategy execution.”

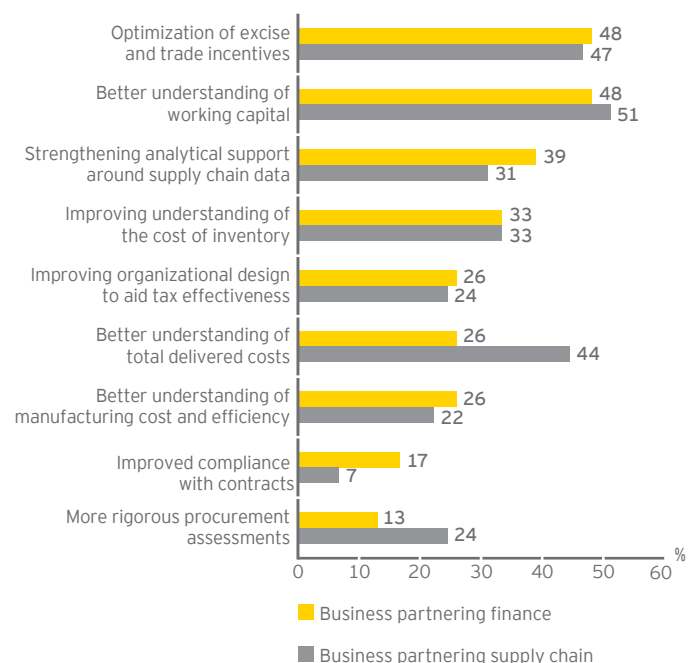
More broadly, CFOs can play a pivotal role in benefits realization – the process of determining whether the intended outcomes of a particular investment are actually achieved. CFOs can help to set the right expectations, provide a clear understanding of the resources required to achieve a particular benefit and ensure that the benefits – which may not always be easily quantifiable – are fully understood.

Tax incentives, customs, excise and trade incentives can improve bottom-line performance

Twenty-six percent of business partner CFOs and 24% of business partnering supply chain executives see improving organizational design to aid tax effectiveness as one of the top three opportunities for the CFO to play a greater role in the supply chain (see Chart 14).

Chart 14

In which of the following areas do you see the key opportunities for the CFO to play a more active role in the supply chain?



Joost Vreeswijk, Tax Effective Supply Chain Management Leader, at EY for Europe, Middle East, India and Africa (EMEIA), says, “When a company is designing its supply chain and operating model, the CFO can make sure tax is brought into the equation early. If tax is left as an afterthought, the consequences can be severe. We have seen instances where make-versus-buy decisions and location choices have had to be completely revised due to the late inclusion of customs and indirect tax effects.”

At a strategic level, the CFO also plays a fundamental role in ensuring integration between the different elements of the operating model. Mr. Vreeswijk adds, “Traditional operating models encompass business processes, transactional flows, organizational structure and cost-effective location choices. But the CFO can also ensure that the direct tax, indirect tax, transfer pricing and legal entity layers are also integrated to the model. This helps improve the alignment between tax and the business, and can also significantly boost shareholder value. These days, competition between peers ultimately comes down to one operating model versus another, and the CFO’s role in getting that operating model right is crucial.”

Although tax should never be the ultimate driver of operational decisions, it can be an important influencer that can yield significant bottom-line benefits. One CFO we spoke to said, “Finance should not lead the charge in terms of operational decisions, but if there is a choice between one country and another that both work operationally, then we need to be involved in that decision and make sure that tax considerations are taken into account. Of course, we have a clear responsibility to our shareholders to try to maximize returns for them, but that also has to be done in the context of risk.”

Creating value through a centralized procurement operating model

The role of procurement within organizations is shifting from one of cost reduction to a broader goal of value creation. In addition to maintaining a low-cost base, procurement functions are tasked with achieving operational excellence, managing key risks, sourcing sustainably and collaborating across the value chain.

Achieving these varied goals requires the right procurement operating model. For a growing number of companies, this means a more centralized approach in which they can leverage skill and scale, build new capabilities, manage risk and make better decisions. This helps to deliver demonstrably enhanced, measurable procurement value propositions and related value outcomes for the business.

Diageo, for example, has taken steps to centralize procurement to drive economies of scale and consistency across the business. “Although we have local procurement teams, they now form part of a centralized group,” says Mr. Gosnell. “We have category managers at the center who set strategies and manage contracts globally. So if an executive wants to buy a flight locally, they can do that through a portal, but it rolls up into the central procurement model.”

The centralization of procurement can also have important tax benefits, in terms of reduced direct and indirect tax costs and improved free cash flow. Companies need to factor tax into the decision-making process. Tax-effective procurement operating models have a proven track record of being flexible, business-driven solutions. They can also lead to reductions in the effective tax rate that may be as high as 2%.

More broadly, companies can also start to think about how the centralization of procurement forms part of a broader approach to shared services implementation. A growing number of companies are re-thinking their approach to shared services, moving from a narrow, function-specific approach to a multifunctional model, as EY explored in its recent report *Delivering tomorrow’s companies today*.⁴ To add value and optimize costs, these companies are developing a single, unified global business services organization that is capable of managing end-to-end processes across different business functions, including not just procurement, but also human resources (HR), finance and a range of other activities.

⁴ *Delivering tomorrow’s companies today*, EY, 2013

Similarly, the CFO can ensure that government incentives – such as customs, excise and trade incentives – are taken into account in investment decisions. This, alongside a better understanding of working capital, is the number one opportunity to contribute to supply chain performance that business partner CFOs identify (see Chart 14, page 27). “As well as being the gatekeeper, the CFO should be part of the strategic vision for investment in the supply chain,” says **Matthew Andrew, EY’s Tax Effective Supply Chain Management Leader in Asia Pacific**. “Particularly in a region such as Asia, where there are so many free-trade agreements, incentive arrangements and other tax, regulatory and financing factors to consider, choosing a location for procurement, sales or distribution hubs is far from straightforward. The choice has to be right operationally, but CFOs need to be involved to consider the impact that incentives and other regulatory issues might have on returns from that investment.”

Working capital remains an opportunity for performance improvement

Despite many companies having focused intensely on reducing working capital over recent years, there remain significant opportunities for improvement. According to EY’s recent report *All Tied Up*,⁵ the leading 2,000 US and European companies still have up to US\$1.3t of cash unnecessarily tied up, which is equivalent to nearly 7% of their combined sales. In other words, for every US\$1b in sales, the opportunity for working capital improvement is, on average, US\$70m.

“To improve working capital performance, companies need better visibility and control,” says **Jon Morris, EMEIA Working Capital Advisory Leader at EY**. “Finance needs to be more closely involved in demand planning, and that depends on having better information so that you can get a better picture of working capital and make the right decisions.”

Improving visibility across the supply chain also helps to optimize working capital efficiency. With better information flowing through the system, a more accurate picture of demand can be created. “To really get at the working capital challenge, we have been working to make our supply chains much more flexible and able to operate on shorter lead times. This is delivering much better responsiveness to the demands of the commercial organization, and allows us to hold less stock against the inevitable changes in their requirements and still improve overall service levels,” says Mr. Dingemans.

Giacomo Baizini, CFO of Evraz, argues that finance leaders need to take care when pushing for working capital reductions to ensure that there are no unintended consequences. Evraz has a US\$600m maintenance budget, and this requires getting spare parts to the right places at the right time so that repairs can be made. Equally, however, an excessive inventory build-up of spare parts can itself cause problems by tying up working capital unnecessarily. “You need to be careful when you push to reduce working capital because you can get to the stage where you don’t have the right spare parts in stock, and it then takes months to repair a piece of equipment,” says Mr. Baizini.

The CFO’s role is crucial in striking the balance between improving working capital and managing operational and reputational risk. “It takes effort to get this balance right but, ultimately, it’s worth it,” says Mr. Morris. “Companies that achieve top-tier working capital performance send a strong positive message to the capital markets. They are likely to be rewarded with a higher valuation in comparison to their peer group.”

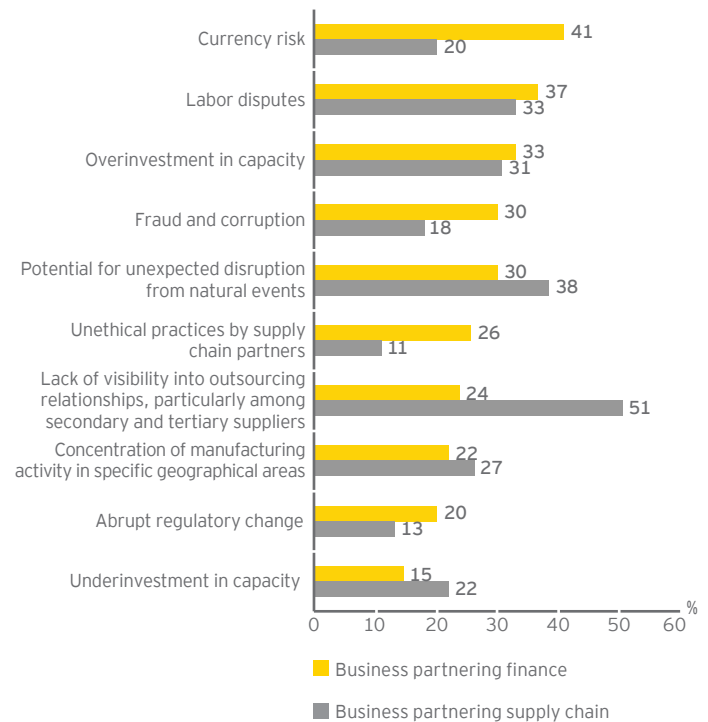
⁵ *All tied up*, EY, 2013.

4. Managing risk and business continuity

Business partners and supply chain business partners agree that mitigating risk is one of the biggest contributions that CFOs can make to the supply chain. But in a complex global supply chain, identifying key risks is a significant challenge. Most large companies rely not only on primary suppliers, but on secondary and tertiary layers as well. With operations happening at several layers removed from a company's direct control, it can be challenging to understand exposures and ensure that these risks are mitigated.

CFOs and heads of supply chain have different perspectives on supply chain risks. While both are concerned about labor risks, business partner CFOs' other preoccupations are about currency risk and overinvestment in capacity. Business partner heads of supply chain, however, are most concerned about lack of visibility into outsourcing relationships and the potential for unexpected disruption from natural events (see Chart 15).

Chart 15
Which of the following do you see as the biggest risks to the supply chain?



To some extent, it helps that finance and supply chain executives are thinking about risk in different ways, because it ensures that there is better coverage of the key exposures that the company is likely to face. **Paul van Kessel, Global Risk Leader at EY**, argues that companies need to conduct more frequent monitoring of high-risk indicators, and ensure that they have the ability to respond quickly when the unexpected happens. “By executing more quickly, they can reduce their financial loss, minimize the impact and perhaps come out of some of the situations in a stronger position than their competitors,” he says.

Regulatory risks will be high on the CFO’s agenda. In 2012, for example, the US Securities and Exchange Commission (SEC) issued a rule to implement disclosure requirements regarding “conflict minerals” as part of the Dodd-Frank Act. Conflict minerals refer to those that originate from the Democratic Republic of the Congo, where armed groups are using the proceeds of the sale of these minerals to finance regional conflicts. This affects any SEC issuer, including foreign issuers, that manufactures or contracts to manufacture products where conflict minerals are used. Industries likely to be affected include electronics and communications, aerospace, automotive, jewelry and industrial products.⁶

Tax risk is another important – and increasingly severe – risk category. Disagreements between taxpayers and tax authorities, as well as between tax authorities in different jurisdictions, as to the appropriate tax treatment of the supply chain operating model can have serious financial consequences if not managed carefully.

Risk exposure should align with risk appetite

As the board-level sponsor of risk management, the CFO also plays a vital role in ensuring that risks taken by the business are in line with the company’s overall risk appetite. This should include ensuring that there is a careful balance between having a lean supply chain and one that is resilient and can withstand shocks. Although efficient, lean supply chains are more susceptible to disruption, and this can have severe financial, as well as business, impacts. “The balance between lean and resilient is a difficult one to strike,” says **Alistair Davidson, Head of Staff at IKEA**. “When you overfocus on keeping costs low, then you might not invest enough in making sure you have a stable environment in which to work. And if you go completely over the top on stabilizing the environment, you are probably going to be giving up on part of the cost feature. So it’s a permanent struggle to strike that balance.”

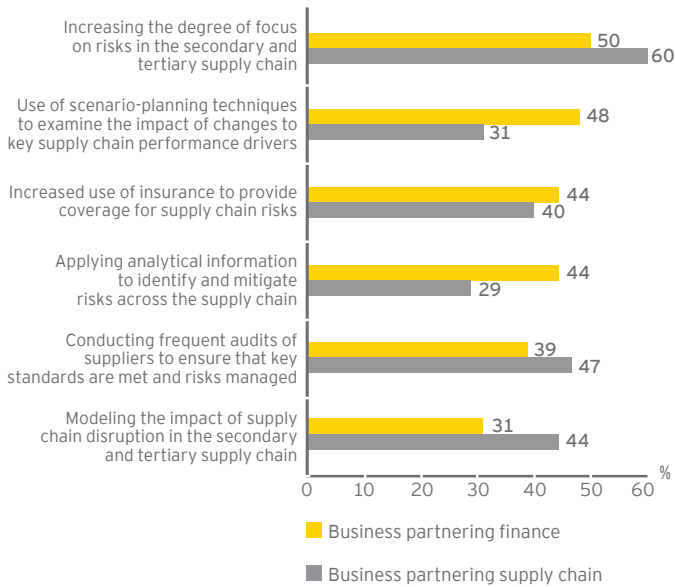
Working together mitigates risks

By becoming more engaged in the supply chain, business partner CFOs can look more deeply at exposures and assess whether they are being mitigated. When asked about their key risk management priorities, business partners highlight risks in the secondary and tertiary supply chain as a key area of focus. This is also the number one area of focus for heads of supply chain in business partnering relationships (see Chart 16).

⁶ *Conflict minerals: What you need to know about the new disclosure and reporting requirements and how EY can help*, EY, 2013.

Chart 16

What do you see as the key priorities to ensure that supply chain risks are appropriately managed in your business?



Gaining visibility and control over secondary and tertiary suppliers requires significant levels of time and investment. Although companies will always find it difficult to get the same degree of control over their external suppliers as they do over the internal network, they can put processes in place to get as close to that as possible. This involves having quality indicators in place and tracking them carefully so that, when issues do come up, the company is able to deal with them quickly.

Take a holistic view of risk, with clarity over who owns what

Companies also need to adopt an enterprise-wide view of risk and ensure that a gap does not emerge between accountability for operational and financial risks. “Risk is a global topic, and you can’t chop it up into different functional pieces because it doesn’t work,” says Mr. Davidson, Head of Staff at IKEA. “It has to be built around an overview – that you’re going to look at as a team – of how those risks emerge. Clearly, I’m going to take a higher level of responsibility for the foreign exchange risk and the purchasing head is going to take a higher level of responsibility for the purchasing prices. But we all sit together and look at it in a holistic way.”

Owning risk, rather than pushing it down the chain, can be a safer long-term strategy

Leading companies are also looking to gain greater visibility and control over financial risks in the supply chain. Prior to the financial crisis, many companies would have been happy to push the management of risks, such as commodity price volatility, onto their suppliers. They would negotiate fixed contracts with their supplier base and, if the price of raw materials increased or currency rates changed, it would be the responsibility of the supplier to absorb the consequences.

More recently, however, some companies have recognized that, rather than mitigating risk, this approach simply transfers it elsewhere in the supply chain. In addition, it is often then borne by smaller companies that are less able to manage the risks effectively. The effects of this approach became painfully clear in 2010 and 2011, when a significant spike in commodity prices meant that many smaller suppliers could no longer absorb the increases under their fixed contracts and fell into bankruptcy.

With the supply of components or products abruptly cut off, many companies suffered severe financial damage as a result.

Craig Kennedy, Partner at EY in the UK argues that, rather than passing on hedging risks to suppliers, large multinationals should assume that risk themselves because they are better placed to manage it. “To take on more risk is not a bad thing if you can manage it in a more efficient way,” he says. “If companies can hand responsibility of these risks to their treasury or procurement functions, not only is that team better resourced and more knowledgeable about how to manage these risks, they can also make the process more cost-efficient by aggregating trades and benefiting from economies of scale.”

Knowledge of your suppliers' risks is power to manage it

More broadly, better flows of information and improved collaboration with third-party suppliers can help to identify risks early and avert the possibility of supplier failure. In addition to relying on backward-looking credit ratings and other financial information, companies need to be more proactive and put in place processes to identify the risks of supplier failure and ensure that mitigation plans are in place. “By sitting down with their suppliers and discussing the planning process in a more collaborative way, companies can build stronger relationships, reduce risks and ensure a smoother flow of inventory through the supply chain,” says Mr. Morris, EMEIA Working Capital Advisory Leader at EY.

Better risk management through hedge optimization

For several years, the International Accounting Standards Board has been working on a new standard on general hedge accounting, which forms part of Phase III of IFRS 9. The aim of the standard is to give companies the ability to form stronger links between their risk management activities, the rationale for hedging and the impact of hedging on financial statements. But with a final standard yet to be issued, it seems likely that the effective date for that standard is likely to be pushed back until 2018.

For now, companies need to adhere to the current accounting rules. But the way they are written means that there are significant penalties associated with certain derivatives. In essence, these derivative contracts are seen as trading positions, rather than legitimate risk management tools. Given that the penalties associated with these positions can introduce significant P&L volatility, many treasurers choose to avoid more complex derivatives altogether or take out accounting hedges to offset the impact caused by their economic hedges. Either way, the result is that they tend to select derivatives on the basis that they work favorably from an accounting perspective, rather than provide an optimal risk management solution.

Hedge optimization aims to resolve this dilemma by assessing a company's current exposures and derivative positions, and then determining an appropriate set of contracts that will minimize P&L volatility. This might involve decomposing trades into two or more synthetics, or exploring other options to optimize hedging portfolios and ensure that they are correctly designated for accounting purposes

Ten steps for CFOs toward a business partnering relationship with the supply chain

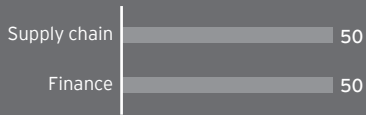
Take the pulse of your relationship with the supply chain. How collaborative is it? Is finance perceived as a gatekeeper or policeman? If so, these steps will help you to put the relationship on a more collaborative footing to drive higher performance.

- 1 Make time for the supply chain.** Business partner CFOs spend an average of one day a week working with the supply chain or on supply chain issues.
- 2 Allocate finance resources to the supply chain.** Determine whether the right finance resources are in the right places to enable a business partnering relationship. This may require a combination of “embedding” finance executives within the supply chain function and closer collaboration with the main finance function.
- 3 Review the S&OP process.** Your involvement can help to build stronger bridges between the commercial and operational sides of the business, and ensure that their objectives are aligned.
- 4 Ensure business decisions are driven by a data-based single version of the truth.** Discourage multiple interpretations of master data by different functional areas. Position finance as the owners of the data.
- 5 Support investment decisions.** Business partner CFOs are involved throughout the investment life cycle, from choosing an asset for investment through to managing its performance, retiring it or reinvesting in it.
- 6 Help drive supply chain performance through an integrated operating model.** Ensure that the direct tax, indirect tax, transfer pricing and legal entity layers are integrated to the model.
- 7 Focus the supply chain on the metrics that matter.** KPIs should consistently encourage the behaviors and outcomes that drive value.
- 8 Identify performance incentive misalignment.** Performance incentives across functional areas should be consistent and should support the broader business strategy.
- 9 Consider centralizing business functions.** Centralization of functions, such as procurement, can reduce costs, enhance risk management, streamline processes and increase tax efficiency.
- 10 Look deep in the supply chain for risks.** Risks that lie in secondary or tertiary layers are more difficult to manage, but they can be just as damaging.



Survey sample information

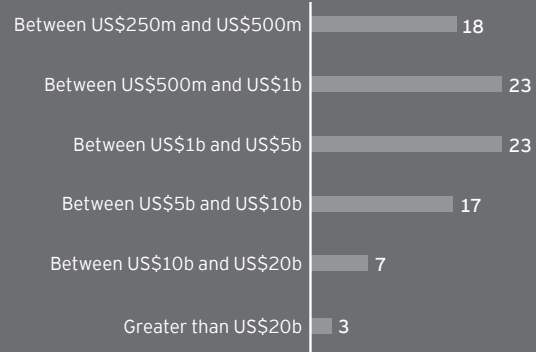
Job title (in %)



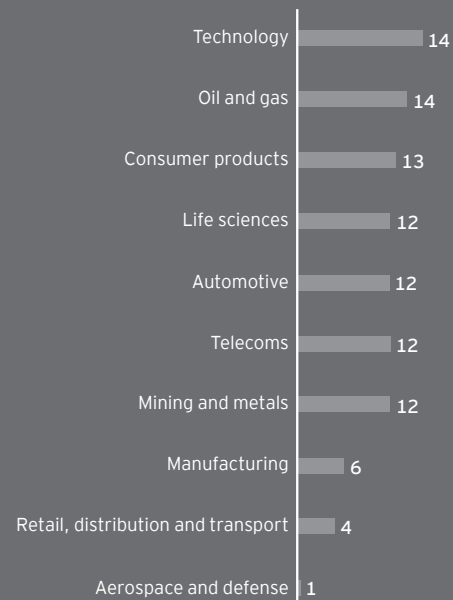
Location in which respondent is based (in %)



Company revenue (in %)



Primary industry (in %)



Other titles for CFOs

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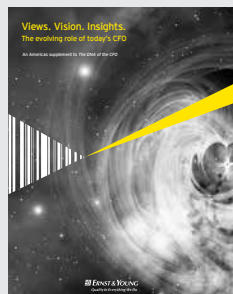
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For further information on these titles and our program of investment in CFOs, please visit www.ey.com/cfo or contact Katherine Brinkley on katherine.brinkley@fr.ey.com or + 33 1 46 93 56 12.

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