Spend Lifecycle Management[1]

A comprehensive approach to increase business profit

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Spend is alive! Just like any plant or animal, its life goes through different phases. Understanding this is key to designing and implementing the necessary strategies to increase companies' profits. That is, spending has a past, a present and a future.

The profit of companies is generated by two factors: an increase in income or a decrease in costs and expenses. The current competitive environment requires companies to make systematic efforts to both increase their sales and reduce their costs and expenses. This joint effort will maximize the profit that will maintain the viability, at least economically, of the business.

The commercial areas are responsible for implementing strategies and tactics to increase sales. The Purchasing areas are responsible for doing the same to optimize costs and expenses.

This article presents a management model whose main objective is to optimize the costs and expenses of a company at all stages of its life. I call this model "Spend Lifecycle Management".

The SLM model states that spending has 3 important moments of the spend:

Figure 1. – Moments of spend

Past (Yesterday)

There are a series of activities that occur before an expense materializes. These activities are mainly associated with the authorization process. There are as many ways to authorize an expense as there are companies in the world and therefore, we cannot necessarily speak of best practice. Authorization processes are even related to the company's culture which is reflected in its policies and procedures.

However, whatever the specific approval process, there are some general principles that we must consider. The past of the expense is the right moment to validate whether it is justified to incur it.

Present (Today)

Once the expense has been authorized, the next step is to execute it, that is, to materialize the purchase of the good or service.

The key process associated with this moment is Buying the good or service.

Future (Tomorrow)

Once the expense was generated, its life does not end there. It is important to have processes that ensure that the negotiated expense had materialized correctly. That is, what was negotiated was paid and the most important thing is to ensure that the data record is generated correctly so that we can carry out a subsequent analysis of the expenses and identify opportunities for improvement.

In each of these stages of the life of the expense we can apply practices to manage it. The practices are nothing more than a set of methodologies and techniques that allow us to ensure that during the spending life cycle we are doing everything possible so that we optimally spend what the company requires to materialize its business objectives. It is about ensuring that every dollar spent in the company is justified and the correct amount is paid to the correct supplier.

To manage spending at each of its moments, 3 practices are used:

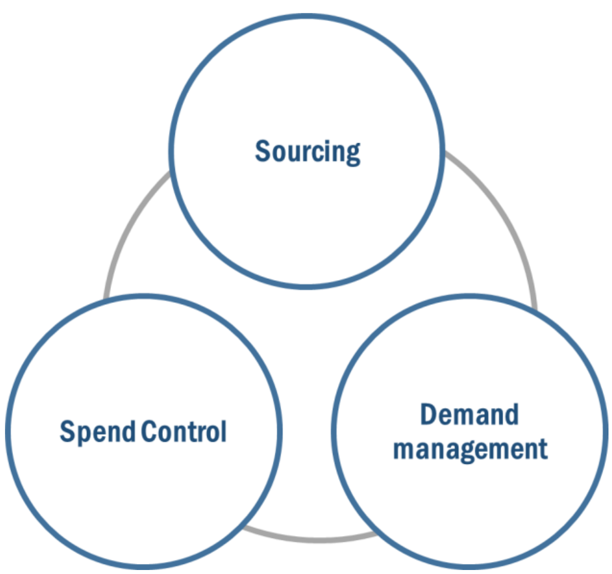


Figure 2. – The 3 Spend Lifecycle Management practices

If we combine these practices with the moments of the expense, a matrix is generated in which we can define actions aimed at managing the expense optimally.

	Past *yesterday*	Present *today*	Future *tomorrow*
Sourcing: - Estrategic - Tactical	– Spend Analysis – Requisition	– Negotiation – Selection	– Compliance – Anticipation
Demand management	Historic consumptions	New policies and procedures	Impacts measurement
Spend control	Budget	Autorization	Evaluation

Figure 3. – Spend Lifecycle Management matrix

By carrying out all these activities in each component and each moment of the expense, your organization ensures that you are maximizing savings and consequently increasing the profitability of your business.

We are going to divide the Sourcing practice into two parts. This is because there are sourcing processes of a different nature: strategic and operational. More and more companies separate the way they organize themselves to execute these two types of processes. Various studies have shown that more benefits are generated when differentiated Sourcing teams are created with the necessary skills to execute each type of process.

Organizational component	Strategic Sourcing	Tactical Sourcing
Process	Spend, market, prices analysis, negotiation, contract	Requisition, quotation, purchase order, receive
Structure	Usually two or three levels: managers, senior coordinators and junior coordinators	Centralized for some categories and decentralized for others
Technology	eSourcing platforms	P2P platforms
Main goal	Savings, risk management, innovation, sustainability	Efficiency and internal customers satisfaction

Figure 4. - The organizational components of Sourcing

I. A.- The Practice of Strategic Sourcing

1) The Past of Strategic Sourcing

Ensuring sustained business profitability is one of the main responsibilities of every manager and is one of the most complex challenges facing organizations today.

To apply this practice, it is necessary to develop the ability to obtain and analyze information on the organization's expenses. The set of procedures and tools that allow us to carry out these two important activities is known as Spend Analysis.

Bartels and Pohlmann define Spending Analysis as "the process of collecting, purifying, classifying and analyzing spending information with the purpose of reducing sourcing costs, improving efficiency and tracking the company's disbursement of money."

Applying Spend Analysis best practices will allow your organization to:

- Improve visibility of your organization's spending to identify savings opportunities
- Know the purchasing categories that generate the highest expenses to design better negotiation and relationship strategies with strategic suppliers
- Have reliable information that allows you to avoid subjectivity in decision making
- A good part of the work of carrying out an adequate analysis is having visibility over the expense and being able to always answer the following questions: Who spends? What do you spend time on? How much do you spend? Who do you spend it with? When do you spend it?

It seems that all these answers are already available thanks to the number of companies that have sophisticated financial and accounting systems, however, in practice a simple accounting report is not enough to have the necessary information to make a good Spend Analysis.

The criteria that are used to classify a company's expenses for accounting purposes are different from the criteria that we need to apply to carry out a Spend Analysis. The analysis requires data that could be classified in various ways and that answers the questions raised above. It is very likely that the data required to answer these questions is dispersed in different systems within the organization or has the reliability and accessibility required to perform a quality analysis.

A clear example of this situation is the typical "General Services" account in which we find a mix of products and services that are not related to each other and that cannot be used as an analysis tool by buyers of the organization.

To have quality information, it will be necessary to apply Spend Analysis procedures so that each payment is recorded in specific purchase categories and has associated information that allows buyers to respond: How much was spent? In what category? Who generated the expense? Who was paid? When was it purchased?

Carrying out an adequate Spend Analysis presents important challenges. The Aberdeen Group, through one of its investigations, has identified the following:

- Dispersed information sources: data is in multiple systems throughout the organization
- Incomplete and imprecise data: the detailed information needed to make an adequate Expense Analysis is found in unstructured data within ERP's and other systems

- Inconsistent supplier information: within the same company, a supplier can be named in different ways, for example: IBM, IBM, Intls. Business Machines, etc. All these types of disparities must be sorted out so that a company can clearly understand its spending.
- Inconsistent product and service name information: the same product may appear under different names in the company's systems. These systems also often describe and classify the same product in different ways. A company must address these disparities and classify information according to a consistent taxonomy and with the level of detail necessary for it to be analyzed.
- Manual data cleaning and classification processes: Most companies continue to rely on spreadsheet applications and manual processes to consolidate, classify and analyze the information. These activities are responsible for 12% to 15% of the sourcing cycle and consume 30% to 50% of a category manager's time.
- Insufficient experience in purchasing categories: correcting misclassified data requires mastery and expertise in product and information attributes. Many companies delegate the work of data cleaning and classification to IT staff, who do not have all the experience and knowledge that such work requires. Aberdeen Group study reveals that nearly 30% of spend information is incorrectly classified and categorized into “miscellaneous” or “miscellaneous” accounts, further complicating efforts to analyze and understand company spending
- Limited analytics capabilities: Identifying spending patterns, trends, and savings opportunities requires analytics. This study found that nearly 90% of companies still use spreadsheet applications as their primary analysis tool. This limits the sophistication of the analysis that can be performed. Aberdeen Group estimates that not having these Spend Analysis capabilities costs businesses $260 billion in lost savings opportunities.

Some data that we can collect to understand the past of strategic sourcing are:

- Purchase volume history (quantity and amount)
- Suppliers who have delivered the product or service to us
- Trading methods used
- Signed contracts
- Dates on which the product or service is usually negotiated

2) The Present of Strategic Sourcing

Once we understand the background of the negotiation of products and services, the next step is to develop a methodology that allows the company to ensure the best price in the purchase.

Strategic Sourcing methodologies were developed in the late 1980s and early 1990s. Its origin was mainly due to the need that companies had to ensure that they could extract the maximum possible value from the relationship with their suppliers and thus improve their performance in an increasingly competitive world.

These methodologies began to be used mainly in the purchase of products and services that represented the main expense of the company, generally the expense of raw materials and packaging. Today it is applied in a wide variety of purchase categories or families, whether direct, indirect or capital expenditure.

The main objective of applying this type of methodology to the purchase of certain products and services is to increase the value received from the company's suppliers. That is, some of the value indicators of the client company improve because of establishing a commercial relationship with a supplier. The value indicators that are most frequently used are: savings (reduction in the purchase price), mitigation or elimination of risks, innovation, reduction of environmental impacts or generation of social well-being and increased process efficiency.

Virtually all strategic sourcing methodologies involve the execution of the same activities and only differ in how they are grouped into phases or stages. Generally, all methodologies include these 3 stages:

a) Spend profile analysis
b) Market analysis
c) Quote, negotiation and contract

This methodology will be executed for each of the purchasing categories that have been identified as strategic and that the market characteristics allow for generating competition between suppliers.

a) Spend profile

Much of the analysis carried out in this first stage is covered with what was discussed in the previous point, the Past of Strategic Sourcing. Since it is now time to analyze the present, it is important to answer questions such as:

- Who are our current and potential suppliers?
- How much are we going to spend in this particular year? (volume and amount)
- What are the specifications of the current product or service?
- What is the cost structure of the product or service?

As we will see later, payment transactions to suppliers are the main source of information. In other words, the Future of the Operational Sourcing process will allow us to accumulate the necessary data to answer many of the questions we ask ourselves at this stage of the Strategic Sourcing process.

b) Market analysis

Once the purchase need has been clarified, the potential suppliers who would be able to supply the product or provide the required service are identified.

To comply with this stage of the methodology, it is necessary to identify which would be the potential suppliers, determine which will be the criteria under which they will be qualified or evaluated, define a mechanism through which the information provided by each supplier will be validated and finally carry out a comparison. objective between suppliers and determine which ones would advance to the next phase of Quotation and Negotiation.

It is very important that Market Analysis processes are equitable and transparent for all suppliers. To the extent that providers perceive that they are participating in a fair and equitable process, to that extent they will respond to the request for participation.

Market Analysis is usually carried out by analyzing various types of information provided by suppliers: written information, consultation information and physical evidence.

To obtain written information, a document called Information Request is prepared. This document is sent to all potential suppliers and contains all the information that would be required to determine whether a supplier is able to provide the product or service. Typically, the structure of this document is divided into sections: financial information, commercial information, technical or operational information and legal information. All this information that is received physically or electronically can be validated through consultations with the supplier's current clients and a visit to their physical facilities.

The result of this stage is a document that reflects the rating that each supplier obtained in its evaluation and its relative comparison with the rest of the suppliers. The decision at this stage for the team in charge of the process is to define which suppliers are considered certified to advance to the next phase of the methodology.

c) Quotation, negotiation, contract

This is the third and final stage of the strategic sourcing methodology. In it, the request for a quote is made to the suppliers who were certified. Likewise, the best strategy to negotiate with these suppliers is defined.

The first step in this stage is to prepare the Request for Quotation (RFQ). This document defines and communicates to all prequalified suppliers what are the requirements of the product or service to be acquired. It should include product or service specifications, delivery and service requirements, evaluation criteria, pricing structure, and financial terms and conditions. As in the previous stage, it is important that during the quotation process equitable treatment is given to suppliers, this includes avoiding information asymmetries between suppliers and that the information that is shared with any of them is shared with the rest of the participants.

Once the suppliers' quotes have been received and validated, the Sourcing team must determine what is the best strategy to negotiate prices. This includes analyzing whether it is convenient to hold an electronic sealed envelope, auction or whether it is preferable to close the process through face-to-face negotiation with suppliers.

Senior executives must be informed of the final selection to obtain their approval. It is also important to communicate to winning and losing suppliers about the results of the negotiation process.

The last phase of the methodology corresponds to the formalization of the negotiated agreements, either through the preparation and signing of a legal contract or any other mechanism that the company uses for these purposes.

3) The Future of Strategic Sourcing

In the case of Strategic Sourcing, what we call “your future” basically corresponds to two relevant activities:

- Carry out the transition plan: this applies in cases where a change of supplier is required because of the new negotiation.
- Monitor supplier performance: it is important to define some indicators that allow measuring supplier performance. In this way it is guaranteed that the selection made was correct. The cost of poor supplier performance can negatively affect the savings achieved or even lead to a larger loss.

I. B. - The Practice of Operational Sourcing

1) The Past of Operational Sourcing

Generally, there are two origins in the generation of an expense: derived from a Purchasing Plan or derived from a purchase requisition.

a. The Purchasing Plan

For certain types of materials, it is possible to anticipate the purchase need. The instrument used to estimate these needs is the Purchasing Plan. The systems that usually carry out this plan are called MRP (Material Requirements Planning).

The Purchasing Plan details all the materials, ingredients, goods that are required to manufacture a product in a given time. For example, the Purchasing Plan of a company that manufactures sauces will include ingredients such as: pepper, salt, tomatoes, garlic, and onion, among others. For each of these ingredients, the necessary quantity to purchase is specified, considering current inventories and supplier delivery times.

Although the Purchasing Plan is typically used for direct materials, there are also Purchasing Plans for some indirect materials, usually for those that are associated with maintenance plans for machinery and equipment.

b. Requisitions or Purchase Requests

For those materials whose need we cannot anticipate, companies use purchase requests or requisitions.

While there are many ways to organize this purchasing process, the best practice suggests establishing rules for authorizing these requests.

The authorization process

There are normally two types of ways to configure the authorization process for a purchase request and both can be done separately or combined.

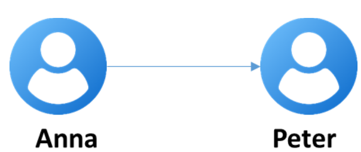
The first way to configure an approval is with a hierarchical criterion. That is, a person's purchase request must be authorized by their boss. Usually, maximum amounts are established that each position in the company structure can authorize. This criterion generates a sequence of authorizations called Approval Chain for certain purchases.

An example of a hierarchical approval chain would be the following:

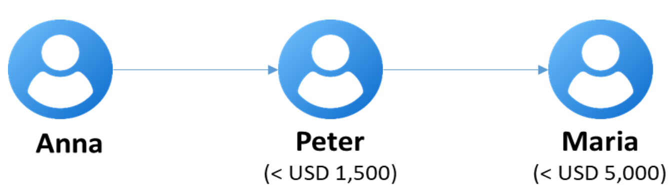
Ana joined the company recently. For her to perform her functions, she requires a laptop. On his first day of work, his boss, Pedro, tells her that she must place the purchase request for the laptop.

Ana enters the purchasing system and completes a requisition for a laptop. The system automatically tells Ana that her order is in the authorization process.

If the laptop has a price of USD 1,000 and Pedro can authorize purchases of up to USD 1,500, the approval chain for this request requires that only a single person (Pedro) approve.



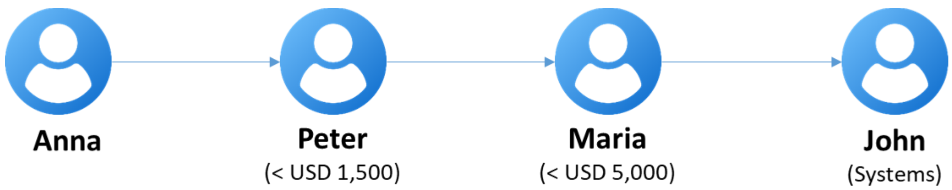
Now, let's assume that Ana is going to work in the Business Intelligence area and therefore requires a laptop with certain characteristics that makes its price USD 2,000. Since Pedro can only authorize purchases of up to USD 1,500, the request will be required to be authorized by Pedro's boss (María) who can authorize purchases of up to USD 5,000. In this case the approval route would be:



The second way to configure the approval of a request is by the type of product or service to be purchased. In the previous example, the approval of the purchase of the laptop could be made by a person from the Systems area regardless of whether this person is Ana's boss or not.

It is common for companies to establish authorization rules that combine hierarchical criteria and by type of product or service.

Following the previous example, an approval chain that combines the two criteria would look like this:



There are other criteria that can be used to configure approval chains. Other areas can be included such as Accounting, Finance, Budget. It all depends on the degree of control you want to have in approving the expense. It is important to be aware that, the greater the number of approvers, the time it will take to authorize an expense will be greater and with this the risk of affecting user satisfaction and the operation of the processes that require the product or service.

Once the requisition is authorized, the purchase order is generated. This is a document that is sent to suppliers to formalize the acquisition of the product or service. The purchase order is considered a commitment and therefore is the milestone that separates the expense's past from its present.

The quoting process

At some point in the authorization process it will be necessary to confirm the price of the good or service, as well as determine which supplier(s) the purchase order will be placed with.

Usually, the purchasing areas intervene in most of these approval chains because they are responsible for carrying out the negotiation. However, there may be cases where the most efficient thing is to allow the user area to carry out the negotiation.

Some criteria to determine the above are:

- Negotiation requires mastery of technical issues. For example, the negotiation of legal services could be carried out by the Legal area of the company because they know the different collection schemes of law firms and may have greater sensitivity to what the market price of these services is.
- The type of product or service has low or zero negotiation margins. For example, rates for public services such as water, electricity and gas

It is important that when making the decision as to which products and services the purchasing area negotiates and which it does not, these agreements are included in a Policy that can be shared and communicated to the entire organization.

Usually purchasing policies establish that most negotiations must be carried out or approved by the Purchasing area. This makes it possible to standardize criteria, standardize processes, have a single point of contact for suppliers, among other benefits.

One way to make quoting processes efficient is by creating catalogs. A catalog is nothing more than a list of products and services that have already been negotiated with suppliers for a certain time, usually a year.

In the example of Ana and her request for a laptop, let's assume that the purchase of the laptop requires the intervention of a buyer. The purchasing process would be as follows:

The activities in green are carried out by a Buyer and are usually the ones that take the most time because it requires sending information, answering questions, receiving quotes, preparing comparative tables of equipment specifications and prices, among others.

If you have a catalog of laptops, it means that these supplier search and quoting activities were carried out previously, usually by the Strategic Sourcing team, and therefore the buyer's intervention is unnecessary. The user could directly select the laptop from a catalog (where there is already a supplier and a defined price) and in a few minutes go to the approval process.

2) The Present of Operational Sourcing

Once the purchase order is sent to the supplier, there is not much to do to avoid the expense. Normally the purchase order is considered a commitment once the supplier confirms and accepts it.

In the event that a purchase order must be modified due to a change in price, volume, delivery date or any other condition, a new agreement must be reached with the supplier, and this entails a negotiation process that may take time or generate some risk.

The activities that typically occur once the purchase order is generated are:

- Monitoring the delivery of the product or service
- Reception of the product or service
- Supplier invoice processing
- Payment to supplier

In each of these activities, inconveniences could occur that generate some negative impact:

- That the product or service is not delivered on time
- In the case of products, the requested quantity is not delivered. In the case of services whose scope is not adequate
- That the quality of the product or service is not what was agreed upon
- Failure to provide the necessary evidence to process the payment
- That there are errors in billing
- Failure to meet the promised payment date

It is the Buyers' responsibility to ensure that this stage of the process is fulfilled in accordance with the requirements negotiated with the supplier to ensure user satisfaction.

3) The Future of Operational Sourcing

Once payment is made to the supplier, it can be considered that the expense has finally materialized. We can no longer do anything to avoid it, unless there is a subsequent refund due to non-compliance. There are materials whose quality validation is carried out after receipt, and it is in these cases where there could be a rejection due to quality after payment has been made. But usually these are exceptions. Normally the product received is an expense incurred.

Now, there is still a lot to do with the information we can obtain from all the purchase transactions that were recorded. Spend Analysis is a critical activity to feed processes such as Strategic Sourcing where achieving better negotiation is directly related to the degree of information it can have but in the Spend Lifecycle Model© we consider the spend analysis part of the past.

One activity that can be carried out as part of the future of the operational sourcing process is Customer Satisfaction. Asking the internal users that made the requisition to rate the performance of the purchasing area is important to identify opportunities to improve the process.

II. The Practice of Demand Management

Companies must implement Demand Management programs as a complement to the execution of the strategic sourcing methodology which ensures that the price of products and services is in accordance with what could be called a "fair" market price.

Now, saving on the purchase price is not the only way to save. If a company had planned to buy 1,000 computers and after a detailed analysis of this need it is determined that 900 are required, it can be said that there was a saving in the expense that the purchase of 100 computers that were not really needed would represent. Demand Management is the set of methodologies and techniques focused on ensuring that the organization consumes the optimal amount of goods and services that allow it to operate efficiently and meet its business objectives.

It involves applying certain analyses that allow identifying the optimal volumes of products and services that the business requires without affecting its execution capacity.

If companies manage to combine their Strategic Sourcing strategies (to optimize the purchase price) with Demand Management strategies (to optimize the purchase volume), they can ensure that they are making the necessary efforts to maximize savings and therefore generate an important impact on increasing business profitability.

Demand Management seeks to answer some questions that every executive in the Sourcing and Finance area should ask themselves:

- Are the various areas of the company requesting the necessary number of inputs to operate efficiently and not more than necessary?
- Will the specifications of the products and services be those that are really needed?

About the volume demanded

Every organization must apply strategies aimed at ensuring that the purchase volume is adequate. It is common for some areas of the company to request products and services in quantities that exceed those needed. For example, the marketing area could request the printing of 10,000 flyers to promote a product, when in fact 6,000 would be enough to carry out the campaign.

In this case, there must be processes and policies that allow the Purchasing area to determine the appropriate purchase volume and thus prevent the company from incurring unnecessary expenses.

About the volume consumed

Demand Management not only seeks to optimize the volume of purchases that are requested and made from third parties, but also the volume of products and services that are consumed internally in organizations, which will ultimately influence the purchase volume. For example, the amount of paper, office supplies, phone calls, trips, among other items. Optimizing this consumption also generates quantitative benefits for companies. The strategies that must be applied to optimize this consumption are even related to cultural aspects of the company's personnel.

About specifications

As part of the process of validating the needs of internal customers, the Purchasing area has the responsibility of ensuring that the specifications of the products and services are fair and necessary to meet business expectations. This validation serves to ensure that an over-specification is not being incurred, that is, requesting a product or service whose characteristics go beyond or exceed the needs or a sub-specification, which means that we are purchasing something that will not comply. with expectations.

Usually, over-specification leads to paying higher prices for products or services that have features that are not going to be used. On the other hand, under-specification may cause satisfaction from a price point of view, but it will surely generate problems that are more costly than the benefit.

For example, given the need for a group of Systems Analysts to have computer equipment that has a computing capacity greater than the standard, it is important to understand how many analysts are going to perform tasks that take advantage of this additional capacity and avoid giving them all analysts have high computing capacity, when only some of them are going to take advantage of it.

Demand Management applies techniques and methodologies that allow optimizing the volume of products and services required to efficiently operate the business and is a necessary complement to achieving business profitability objectives.

1) The Past of Demand Management

The starting point to define a correct Demand Management strategy is to analyze the past consumption of various inputs and services.

There are spending categories where a reduction in purchase volume can have a relevant impact on the generation of savings. Identifying these categories is key to focusing efforts on those that have greater optimization potential. For example, today the cost of a telephone call is much lower than in past years and therefore reducing consumption in the number of calls would not necessarily have a high impact on reducing spending.

2) The Present of Demand Management

Once consumption is analyzed, ideas must be proposed to reduce consumption. For example, if the company hires a printing equipment rental service at a cost per printed page rate, we know that a reduction in the volume of printing will generate a reduction in expenses. There are various actions that can lead to a reduction in the number of impressions. Some of them are:

- Publish a consumption report by person or by department
- Limit the number of impressions per person
- Define a policy for the types of documents that can and cannot be printed (for example, no printing of emails or personal documents is allowed)

One or more actions can be implemented at a time. Sometimes actions have different degrees of complexity in their implementation and that leads to having to choose one action over another. In this case, you can start with the easiest actions to implement that have a relevant impact and leave the actions with less impact and high implementation complexity for later.

It is also common that the initial scope of the actions is implemented in pilot projects with a limited scope and once they are proven to work, they are expanded.

Indicators must be defined that allow measuring the impacts of the implemented actions. If these are positive, policies must be created or updated that formalize the new procedures that must be followed by the organization's collaborators.

3) The Future of Demand Management

There must be monitoring mechanisms to ensure compliance with the policies. The future of the practice of demand management is defined by all those actions aimed at ensuring that the rules of behavior that were defined are met and quantifying their benefits.

There are internal or external factors that may generate the need to change the rules. Policies are “living” documents that must be constantly reviewed and updated, especially in an era where there are constant technological advances that allow us to increasingly automate controls and even replace the demand for a product or service or reduce prices to such an extent. level that the reduction in consumption becomes practically irrelevant.

III. The Practice of Spending Control

The third practice that we can use to optimize the company's spending is by controlling its materialization. The lowest expense that can be achieved is that which is justifiably avoided.

1) The Past of Spend Control

It is impossible to talk about past spending without referring to the budget process. The budget is a useful tool for managing spending if it is implemented correctly. Since we are preparing a budget, we are thinking about what products and services we will need to meet business objectives and also the financial impact of the goals of sales and spend.

Authorized Budget vs. Budget to execute

Often the budget ritual is carried out based on the previous year's budget, adding an estimate of inflation. The principle behind this methodology is that we will do the same as last year, only more expensive. The most efficient way to avoid this perverse ritual is to distinguish between the authorized budget and the budget to be executed.

The authorized budget is the one that is defined at the end of each year and that establishes estimated spending amounts for the products and services that will be acquired during the following year. Now, the fact that there is an authorized budget does not mean that we must spend it and for this it is important to define processes that allow us to confirm that materializing the expense is justified.

Expense Owners

One way to increase control over spending is to work under the concept of Spending Owners. It is particularly useful in companies that work under Business Unit structures.

On the one hand, each business unit can determine how much it is going to spend in each of the areas that typically confirm it (IT, HR, Marketing, etc.) and in turn, expense owners are defined for each of these areas in a cross-countable manner.

This matrix structure allows spending budgets to be defined with two different criteria: one that allows us to know whether a specific business unit is meeting profitability objectives or not and another with which we track the spending of each function that makes up the business. Spending Owners are accountable for the execution of their budgets, just as directors are accountable for their respective businesses.

	UN1	UN2	UN3	UN4	TOTAL PER AREA
SYSTEMS					$
HHRR					$
CAPEX					$
MARKETING					$
OPERATIONS					$
TOTAL PER BUSINESS UNIT	$	$	$	$	$

Figure 5. - Budget control matrix

One of the ways to control budget execution is to establish Spend Committees. The main function of this committee is to review, before the spend materialize, to define actions that can optimize it, delay it or even eliminate it.

2) The Present of Spend Control

It is common for companies to control or influence different types of spending in different ways. Usually direct expenses, which represent the highest percentage of expenses, have greater control by the Purchasing area and there is less control or influence over Indirect Expenses.

In manufacturing companies, direct expenses (raw materials, packaging) are generated through structured processes and are justified by a demand, production and materials plan. Indirect expenses are generated by requests from each person in the company who requires a product or service. Its justification is based mainly on each user's perception of what they require to work and usually it is not as planned an expense as direct expenses.

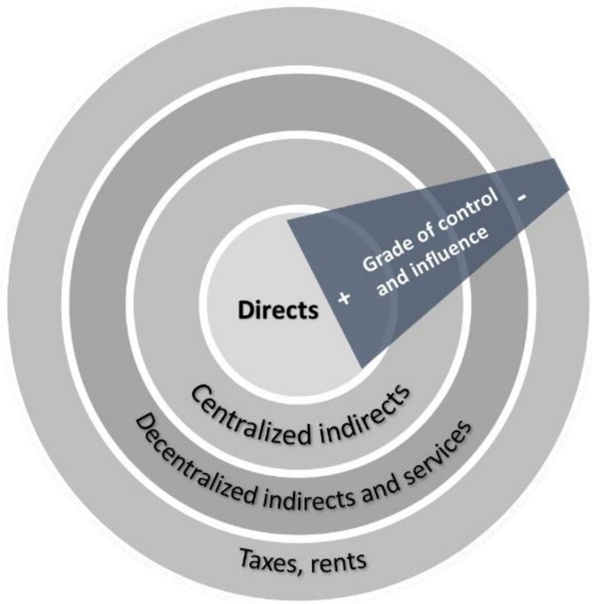


Figure 6. - Degree of influence on spending

The degree of control that each company decides to have overspending depends on these factors:

- The relevance of the expense
- The degree of power or authority that the executives of the areas have
- The degree of trust that exists between the areas

On the relevance of spending

Policies tend to establish that the greater the amount of Spend, the greater the control required in the approval process. This does not necessarily mean that a higher amount requires the approval of more people.

The evolution of technology has allowed processes and controls to be automated. Thanks to this, the necessary authorizations can be made to ensure good control of spending without the need to add many people to the approval chains.

On the degree of power or authority of executives

Management style can be a factor that determines the degree of control required to exercise overspending. It is common for company managers to differ in opinions on this. The Director of an area could establish that his work team is authorized to review and authorize expenses, and another Director may believe that it is best that all expenses should be authorized by him. The policy definition processes will have to be capable of generating consensus that allows defining a company position regarding the degree of control that is desired to be established.

About the degree of trust between the areas

This is possibly the main factor that determines the degree of control that each company has in its expense management processes. Companies with a low level of trust between their areas will tend to define more restrictive and bureaucratic policies. On the contrary, companies with higher levels of trust will have more agile approval processes.

3) The Future of Spending Control

Once the expense is authorized, it is very likely that it will materialize. However, this does not mean that the work of controlling this has ended.

There are three processes that must be executed:

- Validate compliance with the negotiated agreement (in English, Compliance)
- Update budget estimates
- Reconciliations

Compliance with agreements

To consider negotiations to be successful we must ensure that the agreements are fulfilled. For this, companies must design mechanisms that allow them to validate and confirm that suppliers are complying with commercial conditions, whether they are in a contract.

Update quotes

It must be recognized that at the time budgets are prepared, there is not all the information necessary to make the best estimates. For example, if in October 2023 we prepare the budget for the purchase of raw materials, it is likely that, for some products, such as strawberries or sugar, we will have a fairly precise idea of the prices at which we will buy in 2024, but for products such as of tinplate, the margin of error is greater because the main raw materials with which they are manufactured are negotiated in the month of September 2024.

If we recognize that it is natural for a budget to have a margin of error, it makes sense that the budget review process allows us to frequently ask ourselves the question: will we really spend what we planned? and if it is determined not to, we make the corresponding adjustments as frequently as necessary.

One of the biggest mistakes in budget management is assuming that they are “written in stone” and cannot be changed. It is preferable to have mechanisms that reflect reality as negotiations materialize than to manage the business based on information that is no longer valid.

Reconciliations

For certain types of expenses, a pre-approval process may not be possible. Indeed, best practice dictates that all expenses must be supported by a purchase order, but in some cases, this is difficult to achieve because we do not know all the information required to prepare the purchase request.

In these cases, the expense authorization process occurs after the product or service is invoiced. Now, this does not mean that we are going to automatically pay what the suppliers bill. In these cases, it is important to have reconciliation processes that validate that what is being billed was delivered or executed.

The organization for the management of the Spend Life Cycle

In general, there are three ways to organize to manage a company's expenses: Centralized, Decentralized or Mixed.

Centralized organization

In these cases, any purchase request generated by any company collaborator will be managed by the Purchasing area.

Decentralized organization

Under this organizational model, any area has permission to manage its own purchases.

Mixed Organization

In this case, part of the expense is managed centrally and another part decentralized. There are numerous criteria to determine which part of the expense is managed in one way or another, but the most common are:

- Technical knowledge: when the negotiation requires participation of experts in certain field
- Amount of expense: expenses of a certain amount are allowed to be managed directly by areas other than Purchasing
- Non-negotiable: in the case of expenses that cannot be negotiated, they are allowed to be managed by other areas

Depending on each type of organization, the Purchasing areas have different degrees of control over the process, and this forces them to perform different roles.

In cases where the Purchasing area has full control of the expense, it is responsible for the execution of the processes and therefore for the results generated by them.

When the control of the Purchasing area is partial, which typically occurs in mixed organizations, the role that can be assumed for those expense categories that it does not manage is to define a guide of best practices that the other areas must follow.

When the degree of control of the Purchasing area over expense management is low, it can assume a consulting role. In this case, the area responsible for the expense may or may not follow the Purchasing suggestions.

Control over spend	Role of Procurement
Total control	Execute the process
Partial control	Guide the process
Influence	Suggest the process

A technique to apply the Spending Life Cycle model

The following technique is very useful to ensure that each of the company's expenses, or at least the main ones, are being managed optimally.

The steps to apply this technique are:

1. Identify a spend category and ask the question "How can we optimize the Spend Lifecycle of the category (insert *category name)*?"
2. Prepare 3 questions, one for each element that makes up the expense: its price, its volume and the expense itself.
3. For each of the previous questions, develop new questions that, when answered, automatically answer the previous one.

As you can see in Figure 7, this technique forces us to think about different ways to optimize spending at each stage of your life.

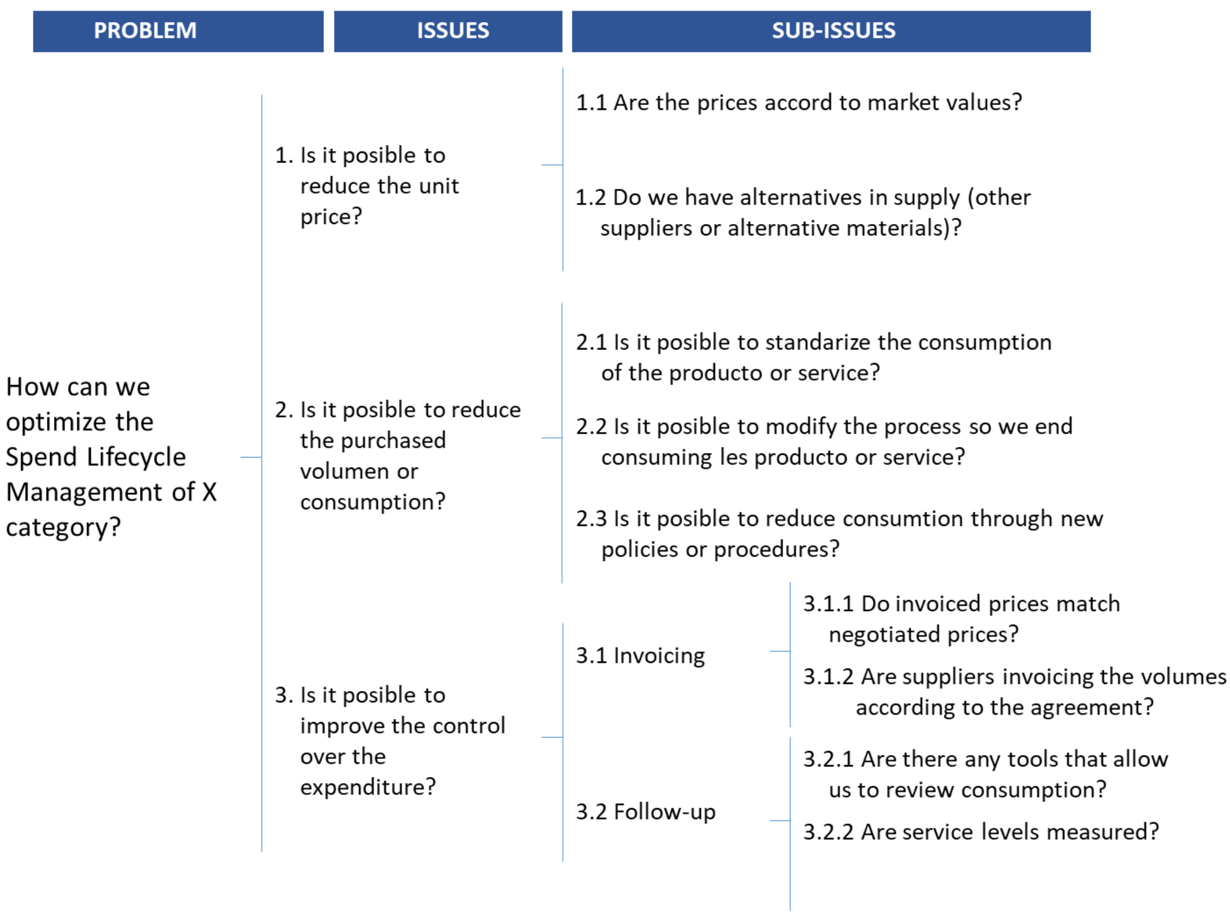


Figure 7. - "SLM Question Tree" Technique

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