

Out with the old

Handing your procurement functions over to a third party to source and manage can make a huge difference to your organisation's efficiency, but only if you get it right, argues Haydn Jones



J OHN MAYNARD KEYNES WAS SPOT ON with his observation that ‘the difficulty lies not in the new ideas, but in escaping the old ones,’ and it still holds true today. New ideas are not the problem. The greatest challenge is overcoming the legacy thinking. And this is certainly the case for procurement outsourcing. The very suggestion of outsourcing the procurement function will often either be met with a wry smile from the enlightened few or treated with deep suspicion by the conservative majority.

This kind of response is hardly surprising. For many, outsourcing is perceived as either a mechanism to create huge value or as a potent threat to job security. For functions such as desktop support and payroll, many companies are well past the early adopter phase and are more comfortable with outsourcing as an approach. The business cases are clear and they are supported by a wealth of real-world examples with plenty of satisfied customers.

But for a function like procurement, the applicability of outsourcing as a mechanism to create value is less obvious. This is largely because procurement outsourcing is wrongly seen as a mechanism for reducing the headcount costs within the purchasing function. Given the relatively small savings generated by a headcount-driven business case for such an

Outsourcing support functions is here to stay, with evidence suggesting that more and more CEOs will be looking in particular to outsource their indirect procurement function in the future. Couple this with the increasing awareness of the value locked up in the procurement process, and the mixed progress that has been made over the last five years in areas such as addressing maverick spend, the implementation of straight-through order processing techniques and managing supplier relationships, and you’ll conclude that procurement functions will be increasingly compelled to make greater progress in addressing these specific points.

None the less, procurement functions have made some headway in the last few years by employing new approaches for negotiating contracts that use strategic sourcing, electronic RFX tools and e-auctions. These are all excellent ways to generate potential savings, but unless the new contracts are used to the fullest extent over the term of the agreement, you will only realise a fraction of the savings potential.

Maximising sourcing savings depends on minimising maverick spend and ensuring that suppliers adhere to the new pricing schedules. To minimise maverick spend you need an intuitive order-capture tool that gives people who buy goods or services access to the relevant framework agreements. This should be underpinned by a change management programme and company policy to fundamentally alter the purchasing behaviour of the company. Finally, to make sure that suppliers abide by the new pricing schedules, the three-way match process needs to operate across all categories, not just the simple ones like office supplies.

While it’s not rocket science, deploying and running an intuitive order capture capability, supported by an efficient and automated straight-through procure-to-pay process, is no trivial undertaking. For a typical organisation there are likely to be more than 100 unique category ordering processes



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undertaking, as compared to a major IT infrastructure outsource, the value created won’t be compelling.

However, procurement outsourcing offers much more than just savings from headcount. It has the potential to provide the skills and technology necessary to rebuild the procure-to-pay process, in addition to providing access to an on-demand strategic sourcing capability. The failure to fully appreciate what procurement outsourcing can offer is understandable, given that it remains an emerging concept with few mature examples that demonstrate the real value that can be created.

supporting the indirect spend that will need to be re-worked and mapped to a standard process. This should be supported by suitable technology and managed on a day-to-day basis. All of this needs to be interfaced into the finance systems.

Finally, making sure that the three-way match is working for all purchased goods and services requires a high degree of focus. The range of skills required to build this kind of world-class purchasing process will include process design, re-engineering, project management, systems interfacing, technology implementation and change management. These ►

◀ are specialist activities that require a group of dedicated experts, which are generally not found in the average procurement function, nor should they be.

The cost of failing to get the purchasing process right is significant. Savings from reducing maverick spend alone can represent 5 to 7 per cent of third-party supplier spend. Moreover, a well-managed and comprehensive strategic sourcing programme can yield savings of 5 to 15 per cent of supplier spend, depending upon category difficulty and market dynamics. Finally, the hidden cost to the organisation of having a complex, convoluted and sometimes maddeningly frustrating buying process can be immense. It erodes the credibility of the procurement group, both inside and outside the company, not to mention the pointless wasted hours that are consumed in dealing with endless queries and manual interventions associated with purchase orders.

Some companies have been brave and have made valiant efforts to fix their procure-to-pay process, but with limited success. This is largely because they underestimated the level of complexity involved in the project and believed that it had a pure technology focus with a scope limited to procurement alone. The reality is that the scope of the project extends from order capture at the employee's desk, all the way through to payment release. This means that it must include functions such as IT, finance, facilities, HR and marketing, each of which is dependent on orders for goods or services to be managed on a timely and efficient basis. The breadth of functions that need to be involved also means that effective sponsorship is required, ideally at board level, to ensure that the initiative has the support necessary to guarantee success.

Outsourcing responsibility for the procure-to-pay process to a third-party specialist offers a clever and attractive solution. It means that the outsourcer can deploy whatever is necessary in terms of the specialist skills needed to correctly implement the right technology and resources required to re-engineer category processing to maximise process effectiveness. The outsourcer can assume responsibility for hosting, maintenance, support and development of all technology associated with order processing, potentially through to payment release. The outsourcer will be able to leverage their own processing infrastructure and experience from previous clients to ensure that best practice is deployed across the whole process. Working closely with the client company, the outsourcer can execute a change programme to fundamentally alter the purchasing culture of the company and support the implementation of policies to enforce behaviour.

It also means that the outsourcer can make use of resources located in low-cost countries to reduce processing costs even further. Transformation costs will be borne by the outsourcer and will be recovered over the term of the agreement. This means that the outsourcer carries the bulk of the risk. It is also possible for benefits delivery to be underwritten by some kind of bond. Most of the benefits from this kind of transformational outsourcing will flow from raising compliance through deploying an easy-to-use process, and not from headcount reductions and process efficiencies.

Procurement outsourcing also offers access to an on-

HOW TO GO ABOUT IT: THE BASICS

- 1** Procurement outsourcing is a form of transformational outsourcing that enables a company to leverage third-party expertise from the outsource provider to rebuild the entire procure-to-pay process.
- 2** The scope of a procurement outsourcing agreement can include strategic sourcing, ad hoc purchasing, invoice processing, technology hosting and maintenance, purchasing card support, helpdesks and travel and expenses processing.
- 3** Procurement outsourcing creates value through implementing world-class sourcing techniques and by deploying high-quality order capture and processing methodologies to raise compliance.
- 4** The outsourcer assumes full responsibility for the whole procure-to-pay process, reducing processing costs by sharing a common infrastructure across different clients, with performance being underwritten by a bond.
- 5** A critical first step in any procurement outsourcing project is to undertake a diagnostic to capture the basic parameters to establish whether there is a viable business case.
- 6** A procurement outsourcing project will involve many different functions across the company, and will need board-level sponsorship.
- 7** Procurement outsourcing is an emerging approach, with growth forecast at a rate of approximately 25% for the next five years.
- 8** As with any outsource arrangement, it is vital to make sure that the culture of the outsource provider is aligned with that of the client organisation, or there will be unforeseen problems in implementing the solution. It is important that cultures are complementary rather than opposing.

demand strategic sourcing capability. If there is a need to source categories, either as part of a one-off sourcing exercise, or as part of a more comprehensive sourcing programme, then this can be undertaken by the outsourcer. For non-strategic indirect categories such as office supplies, desktop technology and peripherals, software and furniture, responsibility for sourcing and long-term management of these categories can be transferred across to the outsourcer.

Realistically, there is no need for any company to maintain a group of specialist buyers who focus on re-negotiating the contracts associated with non-strategic categories. The techniques for managing them are well understood and can be undertaken more efficiently by an external specialist.

There is an argument, however, for limiting the sourcing activities of an outsourcer in some of the more strategically important categories. For example, many of the marketing categories are highly sensitive and can have a direct impact on revenue. This means that to source them effectively, it is necessary to have a good understanding of the underlying business and have strong relationships with business unit heads. Given the risk to revenue or business continuity, a company may be reluctant to transfer responsibility for sourcing some of these more business critical categories to an external third party. As such, the services provided by the outsourcer for these kind of categories can be limited to processing and administrative support alone.

Introducing sourcing as one of the services provided by the outsourcer means that they can deploy their own sourcing techniques and technologies, such as auctions, to reduce the sourcing lifecycle, and in some cases leverage combined purchasing volume into the marketplace.

At present, only a few companies are truly capable of delivering global large-scale outsourced procure-to-pay services, combined with a consulting-grade strategic sourcing capability. Their balance sheets are strong enough

to be able to support the level of investment required for a major procurement outsourcing initiative. They are stable organisations with a strong service delivery-focused culture and are used to dealing with different cultures. They are accustomed to managing the risks associated with large projects, and have access to a wide range of resources. Finally, if the project runs into the ground they can generally be relied upon to pull the stops out to get it back on track.

In terms of market size, IDC estimates that worldwide procurement outsourcing related spend amounted to \$445 million in 2004 with a forecast growth rate of around 25 per cent over the next five years, reaching \$1.4 billion by 2009. With this rate of growth, competition between the major providers is fierce. This offers opportunities to negotiate highly competitive deals for those companies willing to pioneer this form of transformational outsourcing.

In deciding whether procurement outsourcing is a viable approach for your company, it is critical to have clear understanding of how well your procurement function is operating. This means capturing basic metrics such as order volume, cost per order and levels of compliance. It is also



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necessary to identify the savings that could be realised through undertaking a comprehensive sourcing programme. Understanding the benefits will allow a business case to be developed. The decision to outsource is then driven by an honest assessment of whether you believe a third party could realise greater benefits in a shorter period of time than your own company could.

The value of building an effective procurement process is clear: you lock in the savings from strategic sourcing through tracking and managing compliance. Moreover, much of the technology is available to build a world-class solution. But companies have struggled with the complexity, scope and the extent of cultural change associated with the procure-to-pay projects they have undertaken. The use of a specialist third party that provides the necessary skills and resources through outsourcing to build an effective process, means compliance and sourcing benefits can be realised quicker, with the risk for non-performance being carried by the outsourcer.

Although procurement outsourcing is an emerging approach with only a small number of examples to show so far, there is a significant amount of interest in what it offers. Only time will tell if companies will embrace it as an alternative approach for unlocking the huge value that a world-class procurement function can provide. ■

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