

Procurement Outsourcing



Companies are taking a cautious approach to outsourcing their procurement functions.

Procurement Outsourcing or Business Process Outsourcing...

As a consequence of the downturn in the financial climate it comes as no surprise that there has been much talk about Procurement Outsourcing, commonly recognised as part of Business Process Outsourcing (BPO).

For many organisations the idea of BPO is something that they may have had on the back burner but not pushed ahead with, given a) the plethora of other initiatives that they are diverted by; b) it wouldn't seem to be the best time to consider new strategic directions or investments and c) what would BPO do that's different from other investments in technology and Shared Services?

Back in April 2004, the Aberdeen Group described how a sample of 750 supply-chain executives showed that 43% outsource certain procurement processes or spend categories, with larger, more-experienced enterprises showing a greater propensity for outsource. Another 15% said they planned to outsource procurement functions in the following three years.

According to the report average benefits included an 18% reduction in prices paid for goods and services and a 25% decrease in procurement administration and automation costs.

At the start of 2008, a follow up benchmark study recognised that, from a cautious approach 4 years earlier, Procurement Outsourcing was becoming more accepted as a viable strategy for procurement performance improvement. Findings indicated that 40 percent of enterprises from a study of 260 were expected to engage in procurement outsourcing in the next two years.

It noted that 'Top performing enterprises are more likely to leverage third-party expertise in the form of outsourcing. Top performing companies realise strategic benefits such as gaining supplier and market intelligence and streamlining operations, while also delivering cost and process savings.' It was further reported that 'Best-in-Class' enterprises are excelling in many performance metrics, demonstrating:

- 8.3% savings due to sourcing efforts from outsourcing operational and strategic sourcing

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Aberdeen Group

- 30% lower costs to process requisitions than all other companies
- 55% rate of compliance to contractual agreements

They did counter this, however, by saying that fewer procurement outsourcing deals were struck in 2007 as companies moved away from 'big bang' contracts towards more 'phased approach' engagements.

Why Procurement Outsourcing Now?

There is a growing realisation that the quality of any organisation's procurement activity has a profound effect on overall performance as this directly impacts the bottom line. However, for many organisations, both public and private sector, growing Procurement so that it takes on more corporate responsibility remains as work in progress. The organisations that are demonstrating this potential, for example through the development of Shared Services understand that the more that they do, the greater the exposure.

In the public sector, despite strong backing from central government for Shared Services as a major deliverer of savings, developing wisdom is of a need to start small. It is becoming clear that the timescale for realising real benefits is much longer than the 2-3 years originally envisaged. Shared Services initiatives typically deal with the entire range of business support – Finance, HR and Procurement and so it can be hard not to dilute the business case in such a major undertaking. Savings are not yet fully substantiated and costs have been found to be much higher than predicted and in some cases clearly out of control.

Not that there is anything wrong conceptually with Shared Services. A major success factor is a strong programme wrap around with hands on leadership from within the organisation. Sadly, despite some pockets of good practice emerging, maintaining this can be far from easy. Motivators and imperatives amongst participants are different and progress can be bogged down in power struggles, gaps in capability, failure to see the bigger picture, lack of focus, poor risk management, not being able to manage interdependencies and a lack of clarity. Shared Services deals essentially in the transactional

and is unlikely to combine long term benefits with the increased short term flexibility and agility that is called for now.

The fact is that to have a chance of actually delivering savings, Shared Services partners need to be joined up at every stage and committed to a common commercial strategy. Getting agreement at every level to every key decision and development in principle is one thing - in practice quite another. For every key development the risks become more likely to materialise and agreement takes longer and becomes more difficult. This is hard enough to manage internally across large organisations. To do so and also offer it as a service to other organisations can be a bridge too far.

The idea of getting rid of the transactional to concentrate on the strategic has not materialised in the way that was envisaged as the commercial organisation's responsibility is more than ever for all commercial related activity. So, while passing transactional activity to another part of the organisation (like shared services) can be an operational reality, abdication of responsibility for it is not. In fact, as organisations become more commercially aware, so the expectation is for them to exert even greater control on expenditure. This certainly seems to be the message in the Office of Government Commerce's Procurement Capability Review (PCR) programme, which evaluates government department's procurement capability in a 'World Class' commercial context.

So What Now?

With the increased focus on cost and compliance, the procurement function is expected to not just provide value for money but be properly commercial in terms of value creation and competitive advantage. Organisations realising the cost and difficulty of creating a world class procurement function in-house, increasingly consider outsourcing. There are a variety of reasons, typically the potential to leverage economies of scale and improve underperforming or non-core tasks, poorly managed spend categories and other activities. Organisations seek reduced supply and operational costs, improved compliance and enhanced performance and cycle times.

Of course, outsourcing the procurement function does not necessarily mean a complete transfer of control but more likely engaging third-party services. This helps with the 'fear factor' that comes with abdication of control and the risk of exposure this brings with it. It is now predicted that the demand for outsourcing will grow and reports show that the outsourcing of procurement operations is growing faster than that of traditional areas such as IT, Finance and HR.

At a simple level procurement outsourcing can involve migration of infrastructure, people, technology, systems and supplier management. A step further and more complex procurement-related processes can involve for example, transferring procure-to-pay (P2P) and requisitioning. At a more advanced level, value-added functions such as strategic sourcing might be transferred. The Aberdeen Group benchmark report recommends that enterprises should start by carefully evaluating current process and technology capabilities to establish a baseline and identify outsourcing needs, and then focus on strategic advantages that can be gained in addition to tactical, cost-cutting results.

In the public sector, of all of the things competing to fill the savings void potentially left by Shared Services, Procurement Outsourcing is perhaps least likely to be flavour of the month. There remains a legacy from the 1980's of the vision of a couple of thousand consultants reporting to ministers and buying in all of the functions needed to administer government policy. Whilst not dead, this lies mortally wounded. Accountability demands that there has to be a permanent responsible presence. The risk associated with maintaining a significant intelligent client capability having TUPE'd out your core expertise remains a salutary lesson to this day from the major outsourcing deals of the 1990s.

Why Would the Concept of Procurement Outsourcing Receive Any Degree of Enthusiasm?

Firstly, because there are opportunities to help organisations reduce outgoings to offset the cost of the credit crunch. Many organisations and service providers know that successfully delivering a system is no guarantee of its optimal use or of realising benefits. However, it is possible to cut costs and deliver better results by managing delivery of a procurement service based around but not entirely upon solutions thus 'Software as a Service' (SaaS) needs to go to the next level of adding value.

Finance Directors invest and are entitled to assume that benefits flow. Outsourcing procurement mitigates against a major risk – that of being dependent for benefits realisation upon the client's internal capability. It gives the outsourced service provider more control over client behaviours (including key decision making). It also allows them to work directly with the client's other service delivery partners rather than at arm's length. It would however be expected that the main Commercial capability would remain within the department.

What Might an Outsourced Procurement Function Look Like?

Basically there are no limits. However what goes into a successful Procurement Outsourcing function is based entirely upon what the organisation understands to be its situation and what it sees as its goals.

Of course many organisations theoretically already have the components as core or value added services from existing contracts. However this is a long way from offering a complete service for a specified time with clear benefits in terms of targets and accountability. The beauty for the provider of Procurement Outsourcing services is that it increases the sphere of influence and

control in the client organisation leaving them free to do what they are supposed to be there for. For the client organisation, there is a real opportunity to focus on the vision and strategy with an assurance of what will happen operationally. In effect this should be the best of both worlds – retaining the in-house ownership of the strategy with outsourced procurement and operation of procurement systems.

Risk and Reward

Unlike other contracts, with Procurement Outsourcing it is possible to be more explicit about volumes and benefits. A typical commercial model might be the cost of providing the service plus a share of the savings directly attributable. The provider will put in a platform and organisation that is fit for purpose and the nature of the arrangement minimises the risk to the ROI from other third party providers and system integrators blowing the business case out of the water. Clearly the provider is incentivised to deliver optimal savings to maximise the relationship and ultimate benefit to themselves.

Probably the biggest benefit to the Procurement Outsourcing provider is that they can set about the business of effecting improvements unhindered by the client organisation's culture, protocols and internal capability. For the client the benefits are manifold - reduced headcount, additional expertise and flexibility (without increasing headcount), focus upon strategic and value adding activity, transfer of risk, reduced transaction costs and retention of overall control. It is vital of course that as part of the arrangement, client and provider agree on each element. For example, transferring risk cannot equate to moving around inefficient processes and people.

Who to Outsource To?

There are relatively few players in the market with a track record of providing a comprehensive PO service and fewer still who are not sourcing or transaction 'centric'. This is slightly surprising given that a large number of organisations have no recognised procurement capability. Up to now, the creation of procurement hubs or centrally managed frameworks has filled the void. The Comprehensive Spending Review (CSR07) has to some extent changed things in the public sector. Certainly there is a real 'more for less' imperative out there. Generally we can expect to see more entrants to this space particularly amongst consortia who are able to leverage their core capabilities. It is essential to be able to provide end-to-end source-to-pay (S2P) capability and providers with this should think about how they could shape their offering.

How to choose a Partner?

There are relatively few of players in the market with a track record of providing a comprehensive PO service and fewer still who are not sourcing or transaction 'centric'. This is slightly surprising given that a large number of organisations have no recognised procurement capability. However this need not be a deterrent. Up to now the creation of procurement hubs or centrally managed frameworks has filled the void. However now there is a real 'more for less' imperative out there. Generally we can expect to see more entrants to this space particularly amongst providers who are able to leverage their core capabilities. Outsourcing to an experienced marketplace provider provides instant access to a ready made trading community and rapid return in terms of savings opportunities, market intelligence, spend visibility and compliance.

It is essential to regard Procurement Outsourcing as a partnership, critical to which is engagement with service providers to get and

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share ideas and develop the basis of the deal and contract. This needs to be agreed directly between the client and service provider, rather than through a third party. Providers need to have a strategic mindset – they may not be engaged in strategic activity but would be part of an overarching commercial strategy and must think in those terms.

There must be a clear and aligned benefits realisation model, both evidence based and provable. It has to line up with priorities and targets. It also has to be achievable – there is no room for the concept of the provider as just an ‘enabler’. The buck stops with them.

The provider needs to have the requisite skill set on tap. There is a big difference between scalability and ‘crossing that bridge when we come to it’.

All the necessary commercial and legal arrangements must be in place. There also needs to be a clear understanding of the terms of reference to the nth degree from strategic direction to the PPM arrangements. There must be robust governance arrangements in place and the provider must be able to work with them.

The events of recent months demonstrate that organisations have to be able to operate in a dynamic environment and cannot effect change at the pace determined by their internal machinery. This underlines the need to plan long term but to be agile and effective in the short term. An example from the Public Sector is advice to

Departments from the centre that smaller businesses supplying to government should be paid in 10 days to counteract the effects of the credit crunch sending them to the wall. Government demonstrates that it understands that this could accelerate millions of pounds into the SME community. However this assumes that the impact on invoice processing resources can be managed. Similarly the European Commission has invoked a reduction in the timescales of an accelerated restricted procedure. Again a logical move but assumes the capability of both the contracting authority and the bidder to respond within the timescales and to have the electronic capability that this relies upon. For an outsourced procurement function this would be a matter of contract and delivered within terms agreed with the client (or variations to those terms) including how additional costs would be met. This would have the effect of delivering a change to the terms of doing business in a way that would assure that the economic impact is delivered in a controlled and timely fashion.

We should by now have recognised that the world does not revolve around ourselves, no matter how big or influential we believe ourselves to be. Procurement Outsourcing has the potential to move commercial operations up several notches. It is something that organisations in both the public and private sectors need to think carefully about if the lessons of the last few months are not to be learned the hard way in the New Year.

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