

# Strategic Sourcing for Indirect Spend

An expert analysis piece from ProcServe's Head of Business Development, Paul Clayton

Strategic sourcing can deliver significant cost and efficiency benefits in both direct and indirect supply chains. However, whilst many organisations have achieved this for their direct supply chains, they failed with their indirect goods and materials. Why?

This is primarily because organisations don't know what they spend, with whom, when or how. This is despite the fact that significant investments that have been made in eProcurement, eSourcing and spend analysis/management tools. So what has gone wrong?

In our work with organisations in both the government and private sectors, the common theme is that their eProcurement environments are not able to deliver the basic data required to use a strategic sourcing approach.

The provision of accurate content in a timely fashion linked with the use of electronic transactions for all parts of the procurement process are the keys to delivering this data. We believe that on-demand supply chain infrastructures are best placed to deliver this data, providing quick-win benefits and enabling strategic sourcing approaches for indirect supply chains

## **Content (and connectivity) is king**

The motor manufacturers were using strategic sourcing years ago for their direct supply chains; in fact many people claim that the whole approach was started by General Motors in the 80s. The reason they could use this approach is that they knew exactly how many widgets went into a car, where they bought them from and at what price - they had big manufacturing and Materials Resource Planning (MRP) systems that held the information. However, even today whilst these companies that can tell you how many washers they buy, they cannot tell you how many PCs they buy.

The fundamental building block to be able to employ a strategic sourcing approach to any commodity is data. You have to know what you buy, from whom, when and at what price, before you can even begin to think about employing this approach.

A properly implemented eProcurement environment can help achieve this, but only if it has the capability to deliver this basic data. The components needed to achieve this are:

- A purchase-to-pay tool to capture your demand
- A correctly coded catalogue of goods and services
- Integration to your suppliers for electronic purchase orders and invoices
- A data warehouse for management information.

The two most difficult to achieve are properly coded catalogues and supplier integration into the procurement process.

## **Supplier adaptation**

That's not a mistype. Supplier adoption is hard work and there is no silver bullet to the process. For supplier adoption to be successful, suppliers and their customers have to learn to adapt.

The first thing to remember is that suppliers are businesses too with their own system and processes. The introduction of any new IT system to an organisation can be a painful experience, but today suppliers are receiving an increasing number of requests to provide electronic catalogues and integrate their back-office systems to their customers' eProcurement systems. They, like you, have limited IT budgets and have to prioritise their activities to suit.

eMarketplaces have received some bad press over the years, but ultimately they represent the only long-term option for supplier integration for indirect expenditure. They provide pre-populated environments with suppliers pre-enabled and - depending upon the commercial model chosen, offer the least cost and fastest route to adopting new suppliers as they are more likely to want to integrate with something that has the potential to connect them to many customers rather than just one. There are obvious parallels in the direct supply chain, where the EDI Value-Added-Network providers still dominate rather than every customer and supplier directly interconnecting their systems. At the end of the day, it comes down to working with your suppliers to help them adapt to electronic trading and making sure that they get benefits too.

## **Coding - how low do you go?**

The coding of products and services is important in two areas. Primarily it ensures that the management information is useable. Additionally, it makes these products and services comparable by the users making the purchasing decisions. However, coding catalogues for an eProcurement system is, to be polite, problematic.

Firstly, you need to decide on a coding scheme/standard that is capable of meeting your needs in terms of breadth and depth ie it covers a broad enough range of products/services to a sufficient level of granularity. Secondly, you have to get the items in your catalogues coded. You can ask your supplier to do this or do it yourself, either way this is a significant piece of work which, in our experience is actually best left to the suppliers - as they will know more about their products/services than you. Finally, you must decide to what level of granularity you want the products and services coded. This is a difficult balancing act between the need to have sufficient granularity to make meaningful and beneficial sourcing and procurement decisions versus the effort that it will take to code the products/services. For most organisations, the granularity required will vary between product groups.

## **eSourcing - a dangerous habit?**

It is important to note that when we talk about an eProcurement environment to enable strategic sourcing above, we do not mention anything about eSourcing (eTendering, eAuction and

eEvaluation) and spend analysis/management tools. These tools can without doubt provide obvious cost benefits and process efficiencies - everyone loves to watch the prices plummeting on a reverse auction (particularly the Finance Director). However, they can lead to complacency, for example, spend analysis and management tools can only provide you with educated guesses as to what you should or do spend your money on if the basic data is not there. There is no doubt however, that once a properly implemented Purchase-to-Pay environment is in place, then they can provide substantial benefits to the sourcing process.

## **Supplier performance**

Finally, there is the underutilised contract management system. Most organisations today are using these sophisticated tools as a document repository for T's & Cs and the closest they get to contract management is enabling you to work out how much of a rebate a supplier owes you from the amount you have spend with them (this data normally being extracted from the general ledger). An eProcurement environment where suppliers are fully integrated can unlock the potential of contract management tools as you will be able to track:

- What you ordered (purchase order)
- What the supplier agreed to send you and when (purchase order response/fulfilment advice)
- What you actually received and when (goods receipt note)
- What you were charged (invoice)
- When you paid and how much (remittance advice/credit note)
- Managing a contract will not generate benefits, using contract management to help improve supplier performance will.

## **I've seen the future, and it is Bright**

As eProcurement systems and in particular, eMarketplaces become more sophisticated, how people use these systems to support their business process will also evolve. Today already we are seeing a small number of users looking at how eProcurement systems can be used to change their core business processes.

The diagram below represents how we are seeing this evolve. Starting on the left with basic procurement process workflow, moving through the more complex supplier integration of today's more advanced eMarketplaces through to genuinely differentiating business processes underpinned with sophisticated eProcurement and eCommerce infrastructures.