

Higher Visibility, Greater Expectations

A.T. Kearney Indirect Procurement Survey, 2010



“**T**he procurement of indirect goods and services—do you mean paper clips, printer paper and temps?” “We just don’t have time. The spend isn’t big enough to justify the effort. It’s maybe 20 percent of our third party spend.” “We already have indirect goods under control. We’ve been sourcing office supplies for years.” Supply chain professionals have heard these types of questions and comments for years when discussing the benefits of managing the procurement of indirect goods and services more rigorously and systematically. But indirect procurement is not what it used to be.

Today far more people recognize the importance of indirect procurement as it now includes purchasing complex goods and services such as IT, marketing and advertising, facilities management, professional services, and maintenance, repair and operations (MRO). Indirect procurement typically accounts for 60 percent of third-party spend in non-manufacturing companies, more than 90 percent in the financial services industry, and sometimes 50 percent of spend in manufacturing organizations. But recognition is only the first step. While many companies do a good job of sourcing paper clips, far fewer manage complex indirect spend categories with the level of attention necessary to reap the potential benefits.

To identify how leading procurement organizations are managing the procurement of indirect goods and services, A.T. Kearney performed the 2010 Indirect Procurement Survey in which we queried procurement executives from 94 multinational companies who manage a combined global indirect spend of nearly \$134 billion (*see sidebar: Survey Approach and Definitions on page 2*).

The results present a mixed picture. Procurement organizations are becoming more influential within their companies, building stronger internal relationships and boosting performance. An increasing number of C-level executives understand how indirect procurement contributes to financial results (cost reduction and revenue growth), risk avoidance and value creation. And they acknowledge that the contributions can be substantial. As one leader said, “In our business unit, the chief procurement officer (CPO) for indirect goods and services has the same delivery targets as the CPO responsible for direct materials.”

Yet, in looking back at the results from our earlier survey—performed in 2007—some optimistic or aspirational predictions have not been fulfilled, or they took place more slowly or with less impact than expected. For example, the move toward outsourcing indirect procurement has been far slower than anticipated. Participants in the 2007 survey expected 40 percent of operational indirect procurement to be outsourced by 2010. The actual figure is 14 percent. Furthermore,

the outsourcing service providers of choice, which were predicted to be business process outsourcing giants such as IBM and Accenture, are actually category-specific managed service providers with a narrower mandate.

In another surprising finding, indirect procurement organizations are leaving money on the table by neglecting their most sophisticated tools. For example, rather than using advanced data analytics techniques such as predictive modeling

Survey Approach and Definitions

Following A.T. Kearney's initial survey in 2007, the 2010 Indirect Procurement Survey focused on how companies are becoming more efficient in the sourcing of indirect goods and services. The global survey team, comprising 14 consultants and analysts, have worked on hundreds of relevant client engagements. Participants completed a detailed questionnaire with more than 1,400 evaluation points spanning six different savings levers for the successful management of indirect spend: influence, automation, organization structure, tools and techniques, benefits measurement and key performance indicators. Participants included procurement and supply chain executives from 94 companies, representing 21 countries from North and South America, Western and Eastern Europe, and Asia Pacific.

Survey participant ratios are as follows (see figure):

- On average, 2.2 full-time employees work on indirect procurement activities per \$100 million in third-party spend.
- On average, 80 percent of third-party indirect procurement spend is spread among 14.6 percent of the supply base.
- On average, the equivalent of 0.4 percent of third-party spend goes to non-personnel related infrastructure costs to support the indirect procurement organization

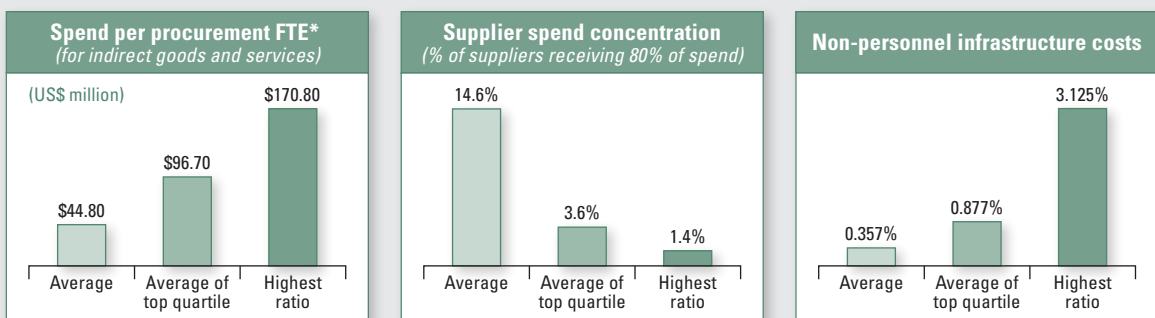
The following are definitions for the strategic, tactical and operational activities described in this paper:

- **Strategic activities.** These typically include business strategy development, supplier relationship management, stakeholder management,

participation in multifunctional development teams, process development, simplification and standardization.

- **Tactical activities.** These typically include routine supplier communication, interactions with internal users, monitoring supplier service, problem resolution, supply market screening, demand analysis, category strategy development, supplier selection, negotiation of contracts, process controlling, spend management, compliance management and supplier performance management.
- **Operational activities.** These typically include requisition-to-pay, order pacing and administration, order retrieving, order inspection, order registration, warehousing, change order management and financial reporting.

Figure: The survey highlighted several key ratios



*FTE is full-time employee

Source: A.T. Kearney Indirect Procurement Survey, 2010

to deliver useful future insights, many indirect procurement groups are merely analyzing data to track historical trends.

Further, benefits tracking remains a problem for procurement organizations as they still do not control where the savings go. Commenting on a chief financial officer’s response to the benefits reports, one survey participant explained, “Even in our strongly financially focused company, budget-holders still decide what to do with the funds created through sourcing their indirect products and services.” Without strict reporting and governance structures in place, the savings are often used in unintended ways.

It continues to be true that what companies track and report illustrates what they value. More than two-thirds of survey participants say their companies measure such financial and internal key performance indicators (KPIs) as addressable

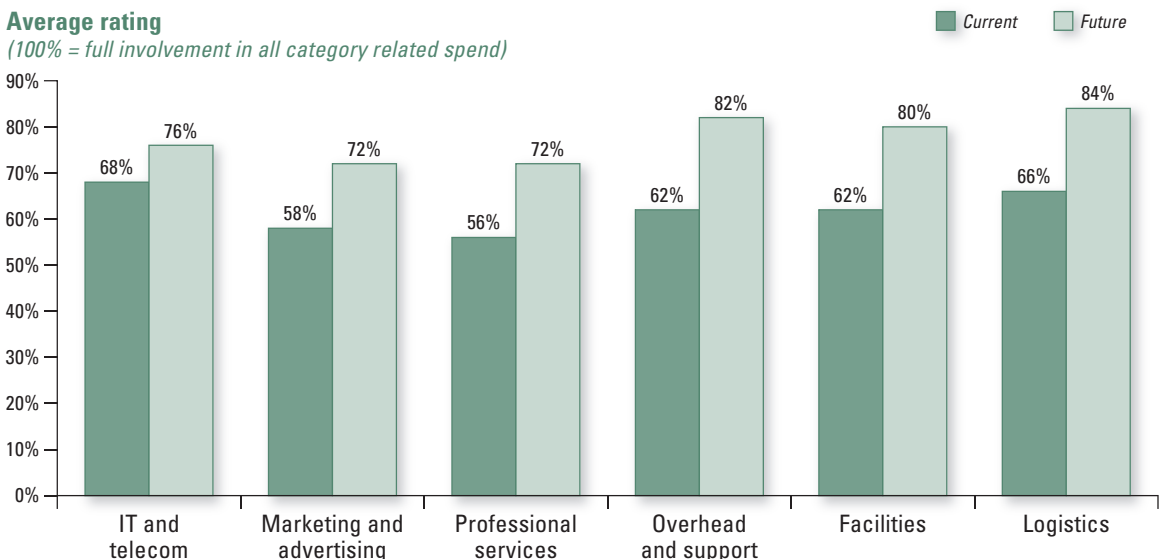
spend, identified savings and addressable categories. But less than half include compliance management metrics such as spend integrity or accuracy, supplier commitments, scorecards or reviews. This data, of course, not only helps with the realization and sustainability of identified benefits but also informs future supplier selection and negotiations.

In short, although once overlooked, indirect procurement organizations have come a long way and are increasingly recognized as having significantly more value to contribute.

Indirect Procurement: Influence on the Rise

Where is procurement most influential today, and where does it expect to be involved in the future? IT, telecom and logistics are the categories in which procurement is most active today (see figure 1). Procurement has the least amount of influence

Figure 1
Procurement’s level of influence by category



Source: A.T. Kearney Indirect Procurement Survey, 2010

on marketing and advertising, and professional services. Looking ahead, the greatest growth is expected in overhead and support, with facilities and logistics following closely behind.

Procurement's involvement has increased over time, as corporate boards consider business cases for procurement that are based on past successes. Growth within categories can reflect a move from

Indirect procurement organizations have come a long way and are increasingly recognized as having significantly more value to contribute.

simpler to more complex goods and services. In professional services, for example, procurement may have begun with temporary labor and expanded to address boardroom-driven expenses such as audit, legal and consulting.

Viewed regionally, procurement executives in developing regions and emerging markets expect to experience the most growth in influence. For example, Latin American survey participants expect to be involved in 84 percent of related spend decisions in the future; today they are involved in about 62 percent of such decisions. Survey participants from Korea, China and Japan; India and Southeast Asia; and Africa and the Middle East are close behind with forecasts of 20-point growth in involvement. Interestingly, procurement executives in North America have the highest level of involvement in current spend decisions at 68 per-

cent, and the lowest projected level of increase in the future, as participants expect to increase their involvement in spend decisions by just eight points to 76 percent.

There are many ways a procurement team can increase its influence in spend decisions—through internal marketing of proven successes, effective communication, and leadership support.

Indirect Takes Unexpected Turn

In the 2007 survey, the largest number of participants (45 percent) reported a mixed centralized-decentralized indirect procurement organization with responsibilities split along function or category lines. Furthermore, 44 percent of survey participants expected that model to prevail in 2010.

Now, fast-forward to 2010 and the most successful model is far different. Measured by realized benefits, the leading model is a central-led indirect procurement organization that collaborates across business units. Users of this model have achieved savings greater than 10 percent over the past two years in 47 percent of categories.

The model comprises a virtual team that works for the greater good of the organization. The head office collaborates with business units globally to come up with the optimal company solution (*see case study: Global Financial Institution*). Success requires procurement professionals to develop solid working relationships. Local leadership, support and expertise are particularly important when dealing with complex categories such as IT, marketing and advertising, and professional services. Voluntary collaboration is also essential if centralized contracts for such categories and arms-length mandates from the head office are to deliver on their promises.

CASE STUDY: Global Financial Institution

A global financial institution started its journey to build a world-class procurement organization. Following one of the world's largest mergers, the company was hampered by poor performance in almost all areas. Charting a three-year strategic road-

map, with more than 160 action points, the organization reached world-class status, as judged by two independent firms. Today, the organization sources (or resources) more than \$1.6 billion a year, with average year-on-year savings of more than

6 percent. Dedicated category teams work on a global scale, effectively collaborating as a business unit without borders, and most operational and tactical activities are either fully automated or supported by IT.

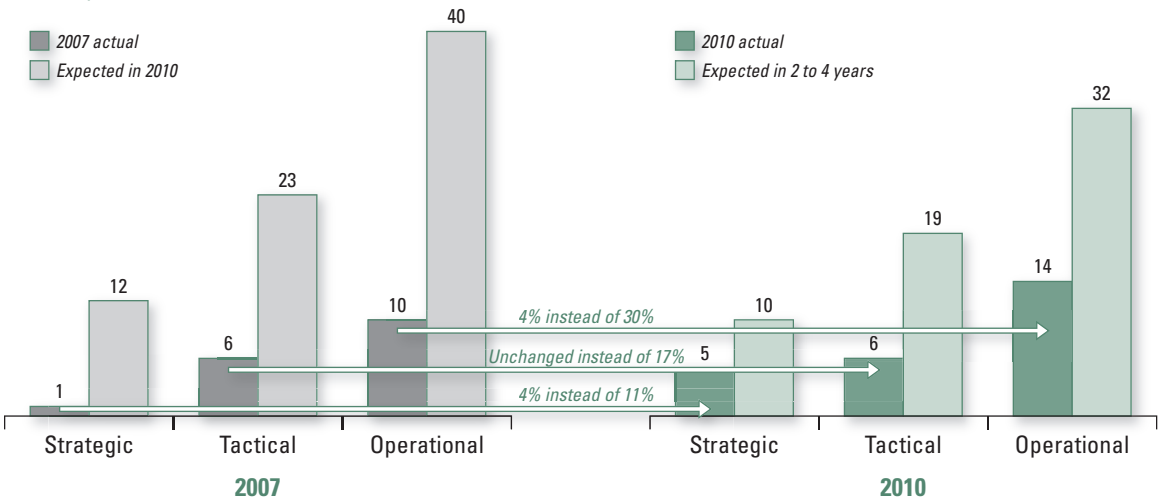
The move to outsourcing also took a different direction than predicted. Executives participating in the 2007 survey expected significant growth in outsourcing strategic, tactical and operational activities by 2010 (see figure 2). But the numbers show slow or no growth. Outsourcing of strategic activities was projected to grow from 1 percent in

2007 to 12 percent in 2010: the actual figure today is 5 percent. For tactical activities, 6 percent in 2007 was expected to reach 23 percent in 2010: The actual figure is unchanged at 6 percent. Finally, operational activity outsourcing was forecast to move from 10 percent in 2007 to 40 percent in 2010: The actual number in 2010 is 14 percent.

Figure 2

The move to outsource strategic and operational activities is slower than expected

Outsourcing of activities, actual versus expected (% of respondents)



Source: A.T. Kearney Indirect Procurement Survey, 2007 and 2010

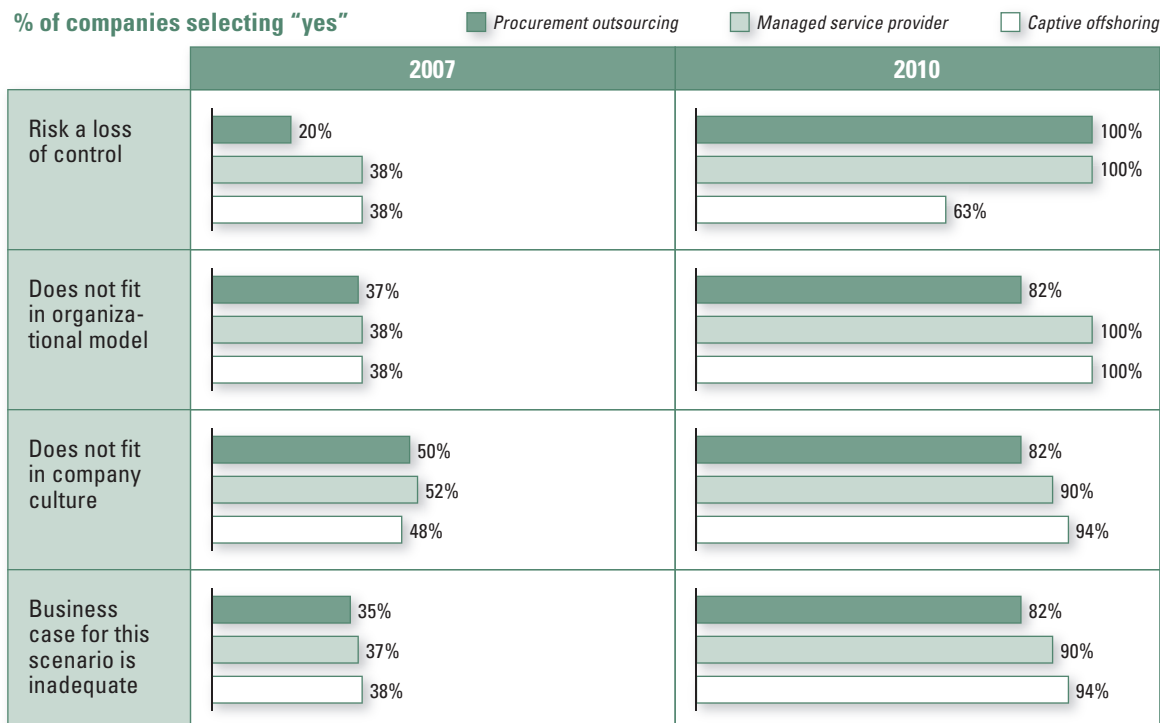
What explains these numbers? The potential failure of external service providers, as illustrated by the downfall of Satyam, exposed the risks inherent in handing over strategic activities to outsiders. Indeed, as figure 3 shows, risk has become the primary concern in deciding whether or not to outsource. In 2007, 20 percent of companies considering outsourcing, and 38 percent of companies considering the use of a managed service provider, were concerned about the risk of losing control. In 2010, the concern of losing control for both of these models jumped up to 100 percent. Furthermore 100 percent of 2010 participants say they will not select a managed service provider or captive offshoring model due to misalignment

with their existing organizational structure.

In addition, indirect procurement decision-makers are closely scrutinizing providers' capabilities and how they align with their organizations' often complex requirements. Advocates of outsourcing must present a compelling business case, which is becoming more difficult to develop as influencing factors such as labor arbitrage are producing increasingly lower returns. Furthermore, high unemployment levels in developed countries are making headcount reductions politically unpalatable.

When queried about the selection criteria for choosing outsourcing partners, 2010 participants report that a strong relationship and trust

Figure 3
Risk is primary concern in outsourcing decision



Source: A.T. Kearney Indirect Procurement Survey, 2007 and 2010

are the most important elements—more important than process competency. Category management expertise ties for second place, and the ability to deliver a total solution ranks third.

Although indirect procurement outsourcing has not developed as fast as expected, we should not assume that it will not do so eventually. In the meantime, however, someone has to perform indirect procurement duties. Once more the survey findings confound expectations. The 2007 participants relied heavily on centralized internal service providers for strategic, tactical and operational activities, but predicted that those levels would drop substantially in the near future. They thought that captive offshoring would increase. However, findings in the 2010 survey reveal the opposite: participants report an increase in centralized service provision across the board and less captive offshoring.

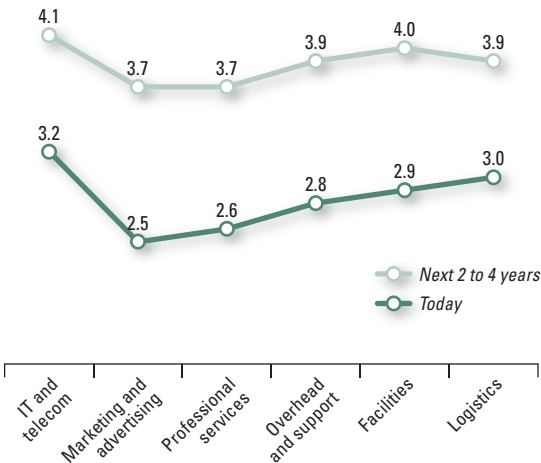
Repeating history, 2010 survey participants predict a decline in centralized internal service provision within the next two to four years. The rationale for centralized internal service providers—improved volume leverage, higher rates of compliance and increased transparency—may simply be too compelling to abandon, particularly given the risks of the alternatives.

More Automation on the Wish List

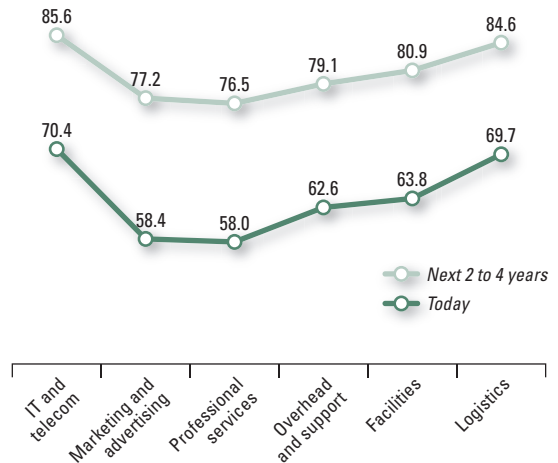
While purchase-to-pay (P2P) systems have been around for more than 10 years, they are not applied as widely as might be expected (*see figure 4*). One explanation may be that the tools are still evolving; another is the price tag. Even so, survey participants are aiming to use automated tools in line with best practices, as demonstrated by their ambitious tool deployment plans. They expect to increase the automation of spend management

Figure 4
Purchase to pay systems are still not widely applied

Level of automation by category
(average usage rating: 1 = low, 5 = high)



Level of spend coverage by category
(average % of spend)



Source: A.T. Kearney Indirect Procurement Survey, 2007 and 2010

CASE STUDY: North American Insurance Firm

To improve visibility and influence over purchasing decisions, a leading North American insurance provider began a two-year strategic journey to deploy the latest systems available covering requisition-to-pay (R2P),

contract management, supplier relationship management and eRfx. Today, the company has achieved what many other companies strive for—including visibility into 100 percent of its indirect spend across

the organization, an electronic central repository containing 80 percent of its current incumbent third-party contracts, and an eRfx tool that is also being used to source professional services such as legal.

by 60 percent, bidding and negotiations by 22 percent, contract management by 58 percent and supplier performance management by 78 percent. Behind this commitment to invest in automation lies a proven return on investment: the higher the automation levels across indirect categories, the larger the average savings (*see figure 5*).

The case study on the page illustrates the success story of a North American insurance firm, which is partly due to automating many of its tactical and operational activities.

Traditional Sourcing Trumps Advanced Analytics

Despite having an array of advanced tools and techniques at their disposal, there is a definite preference for tools that foster supplier competition—negotiations, issuing requests for information (RFIs) and requests for proposals (RFPs), and benchmarking prices. When applying analytics, the focus is usually on spend tracking and management, and less on modeling applications that have benefited the direct procurement side (*see figure 6*).

Advanced analytic capabilities, such as predictive modeling and optimization, can assist in

identifying opportunities in the more complex indirect categories that often require forward looking decisions and scenario analyses to identify maximum value. The application of advanced analytics requires not only a detailed understanding of and access to a robust data set, but also the knowledge and information to make calculated assumptions. As one of our clients said, “having the right analytic capabilities and tools on the team helped us to quantify the trade-offs in the category and to make fact-based prioritization and supplier selection decisions.”

A strong relationship and trust are the most important criteria when choosing outsourcing partners.

Nailing Down the Benefits: Tracking What Matters

Few people would be surprised to learn that 92 percent of our survey participants track cost reduction benefits linked to sourcing. Seventy-seven percent track cost avoidance, defined as reduction in the appreciation of costs previously

Figure 5

The higher the automation levels across indirect categories, the larger the average savings

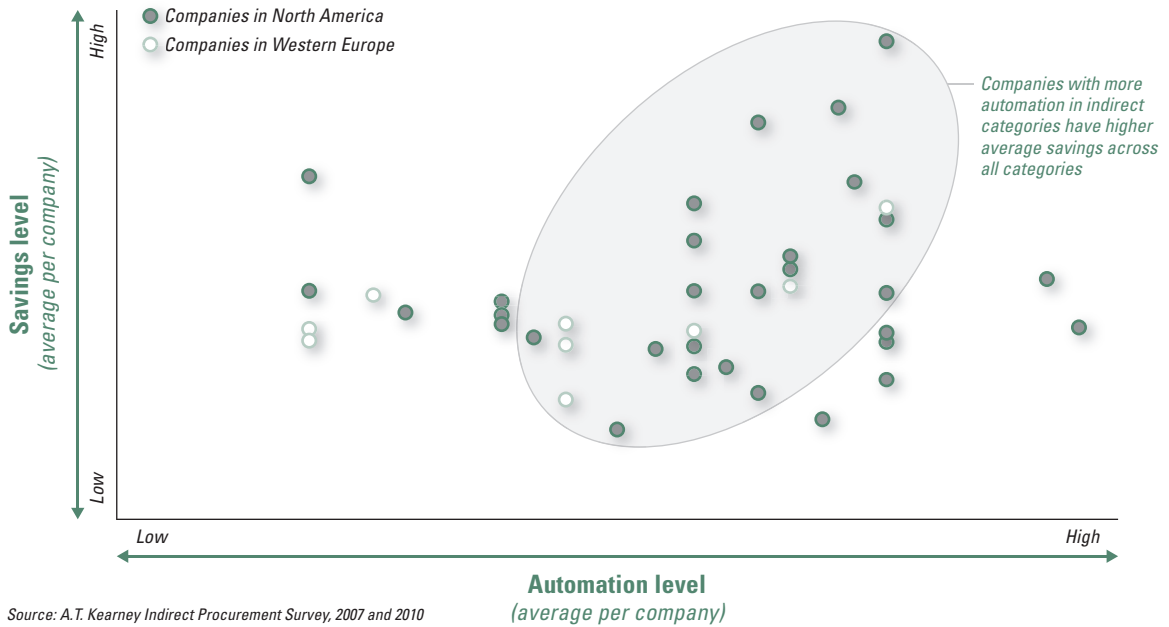


Figure 6

Analytics is currently focused on spend management but will evolve to more advanced analytics

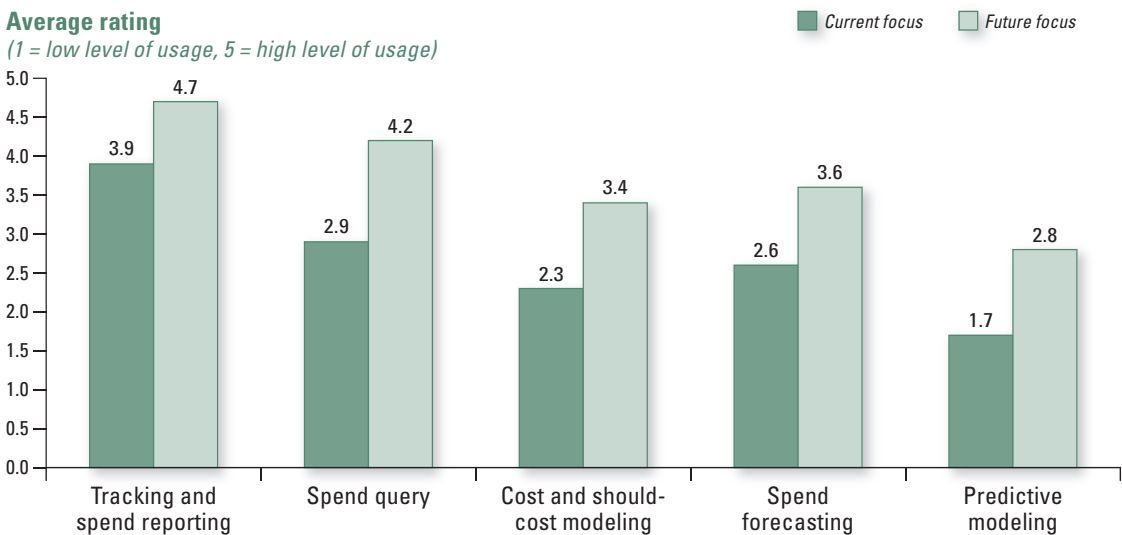
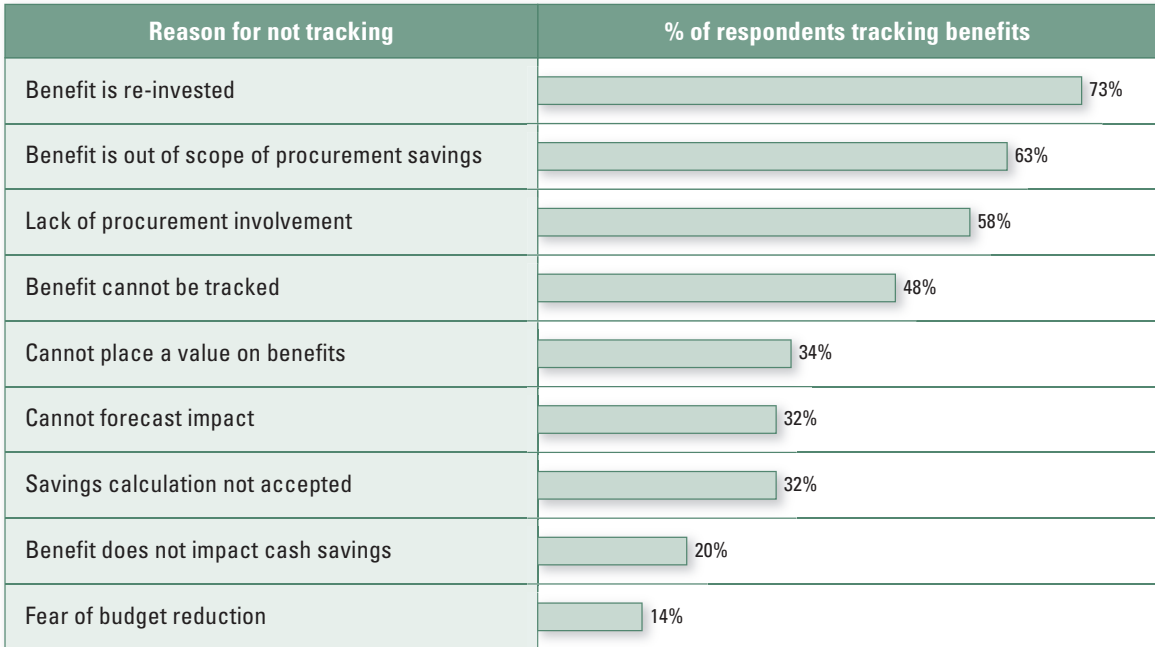


Figure 7

Control of savings and lack of procurement involvement are most common reasons for not tracking benefits



Source: A.T. Kearney Indirect Procurement Survey, 2007 and 2010

paid or budgeted, and 72 percent track rebates. Far fewer track other more subtle sources of benefits and value delivery—the kind that could allow procurement teams to expand their influence within the organization, such as income generation, innovation, tax and value-added-tax savings, commissions and litigation reduction.

Although it is possible to track cost reduction savings, corporate leaders are often reluctant to accept indirect procurement team’s interpretation of the results. Figure 7 presents the reasons why. Leading the list is the re-investment of benefits achieved. Without rigorous reporting and governance, savings may disappear back into the business before they are properly accounted for. In addition, procurement may not be credited with

the savings due to a lack of (or limited) involvement.

The latest thoughts in this area correlate the benefits measured with the investment requirements needed to deliver desired results. A new approach, Return on Supply Management Assets, or ROSMA[®], helps translate the business case into a language more recognizable to finance executives (see figure 8).

Measuring Performance: What Is Key In KPI

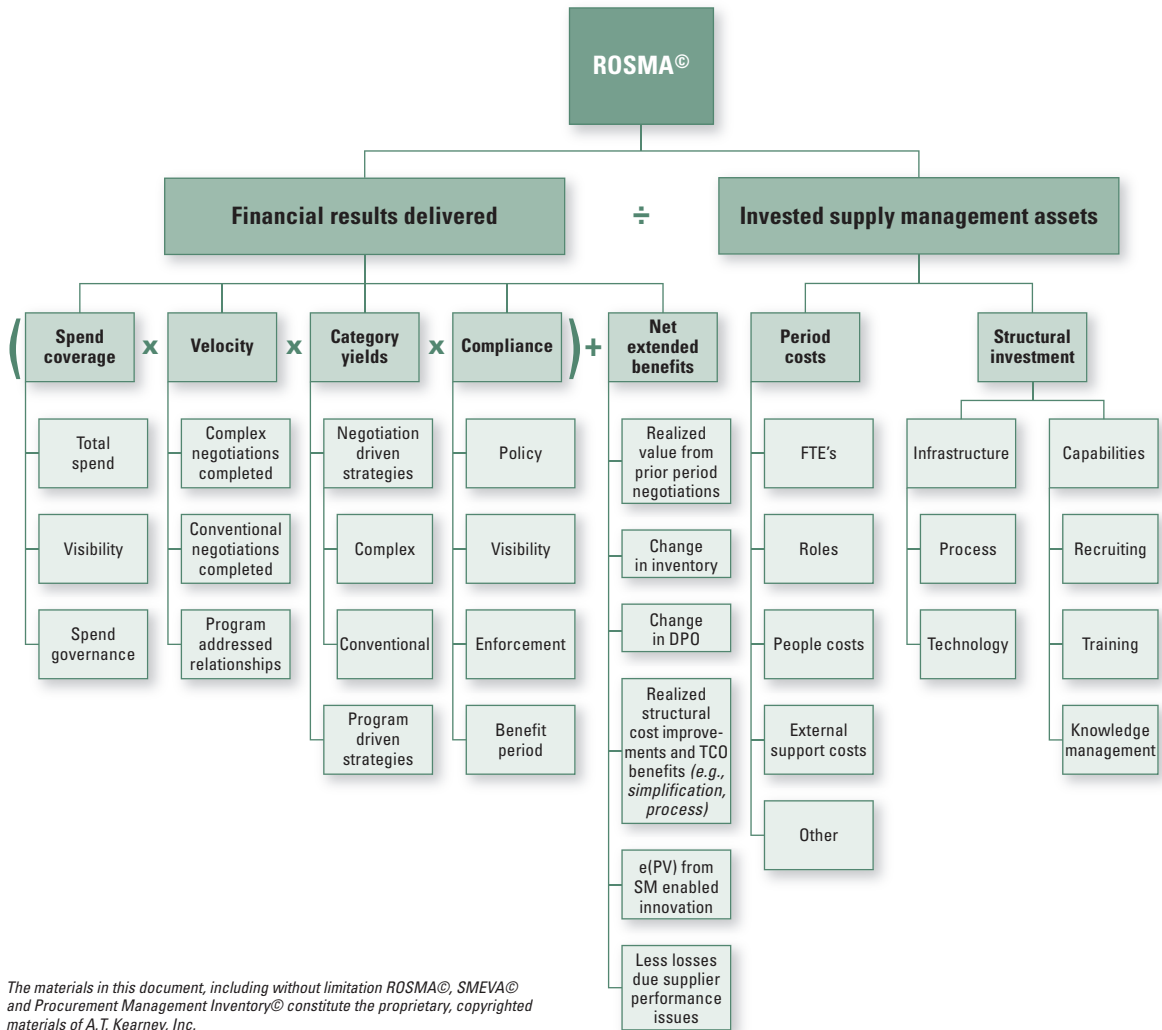
Our survey findings grouped performance indicators into three buckets: financial, internal and compliance. Participants follow financial KPIs more extensively than any other group. Eighty-three percent look at total addressable spend; 79

percent review addressable categories; and 75 percent look at annual expense reduction. The least popular financial KPI, annual capital cost reduction, still attracts 63 percent of participants. The top internal KPIs are savings, spend and categories under management, cited by 84 percent, 64 percent and 63 percent of participants respectively.

Fewer companies pay attention to KPIs

reflecting compliance management. While indirect procurement leaders consider compliance metrics regarding top suppliers relevant, other supplier-related metrics lie further down the scale. These priorities reflect missed opportunities. Indeed, effective supplier relationship management depends on data that more than half of survey participants do not collect.

Figure 8
Return on Supply Management Assets[®] (ROSMA)



The materials in this document, including without limitation ROSMA[®], SMEVA[®] and Procurement Management Inventory[®] constitute the proprietary, copyrighted materials of A.T. Kearney, Inc.

More Value to Contribute

Indirect procurement organizations have significantly more value to contribute. This message encapsulates the insights from every section of the survey. But what does this mean to an individual indirect procurement leader? How much more value can a particular organization deliver? If you

participated in the survey, you can evaluate the opportunities that exist for your organization. The 2010 Indirect Procurement Survey remains open through December 2010. To learn more about participating, please email Jan-Fokke Van Den Bosch, Simon Rycraft, Alec Bounds or Julia Trampel.

Authors

Jan-Fokke van den Bosch is a partner and vice president in the procurement and analytics division. Based in the Amsterdam office, he can be reached at jan.fokke.van.den.bosch@atkearney.com.

Alec Bounds is a consultant in the operations practice. Based in the Atlanta office, he can be reached at alec.bounds@atkearney.com.

Simon Rycraft is a consultant in the procurement and analytics division. Based in the San Francisco office, he can be reached at simon.rycraft@atkearney.com.

Julia Trampel is a consultant in the procurement and analytics division. Based in the Düsseldorf office, she can be reached at julia.trampel@atkearney.com.

A.T. Kearney is a global management consulting firm that uses strategic insight, tailored solutions and a collaborative working style to help clients achieve sustainable results. Since 1926, we have been trusted advisors on CEO-agenda issues to the world's leading corporations across all major industries. A.T. Kearney's offices are located in major business centers in 37 countries.

AMERICAS	Atlanta Boston Chicago Dallas Detroit Mexico City New York San Francisco São Paulo Toronto Washington, D.C.
EUROPE	Amsterdam Berlin Brussels Bucharest Copenhagen Düsseldorf Frankfurt Helsinki Kiev Lisbon Ljubljana London Madrid Milan Moscow Munich Oslo Paris Prague Rome Stockholm Stuttgart Vienna Warsaw Zurich
ASIA PACIFIC	Bangkok Beijing Hong Kong Jakarta Kuala Lumpur Melbourne Mumbai New Delhi Seoul Shanghai Singapore Sydney Tokyo
MIDDLE EAST & AFRICA	Abu Dhabi Dubai Johannesburg Manama Riyadh

For information on obtaining additional copies, permission to reprint or translate this work, and all other correspondence, please contact:

A.T. Kearney, Inc.
Marketing & Communications
222 West Adams Street
Chicago, Illinois 60606 U.S.A.
1 312 648 0111
email: insight@atkearney.com
www.atkearney.com

Copyright 2010, A.T. Kearney, Inc. All rights reserved. No part of this work may be reproduced in any form without written permission from the copyright holder. A.T. Kearney® is a registered mark of A.T. Kearney, Inc. A.T. Kearney, Inc. is an equal opportunity employer.

A.T. Kearney Korea LLC is a separate and independent legal entity operating under the A.T. Kearney name in Korea.

ATKEARNEY®

