INDIRECT PROCUREMENT:

Too Many Missed Opportunities

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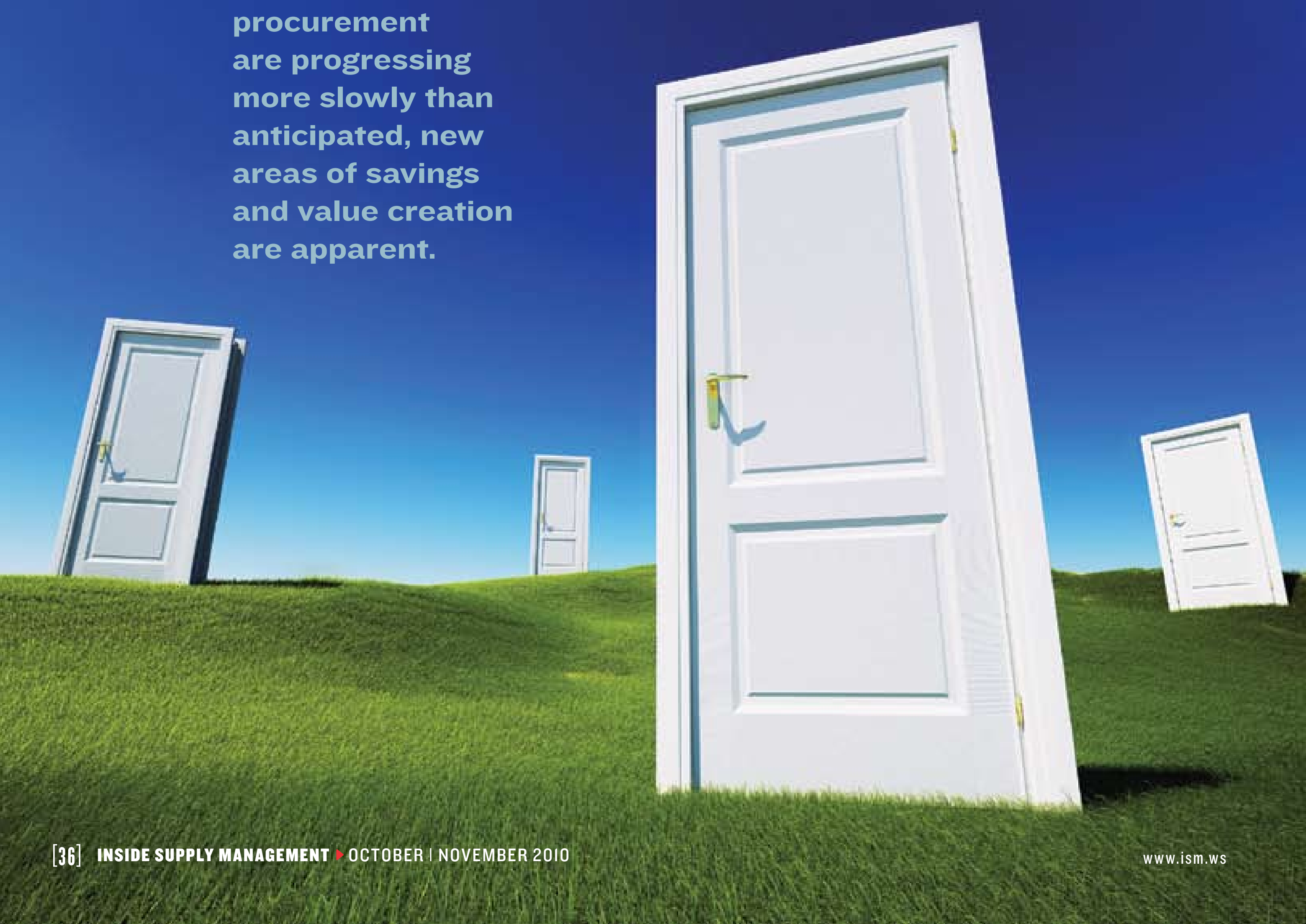
While the expected trends in indirect procurement are progressing more slowly than anticipated, new areas of savings and value creation are apparent.



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) supplies. Indirect procurement typically accounts for 60 percent of third-party spend in nonmanufacturing 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 supply management organizations are managing the procurement of indirect goods and services, A.T. Kearney performed the *2010 Indirect Procurement Study,* which queried procurement executives from 94 multinational companies who manage a combined global indirect spend of nearly US$134 billion.

Hits and Misses

The results present a mixed picture. Procurement organizations are becoming more influential within their own 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 says, "In our business unit, the 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 study — performed in 2007 — some optimistic or aspirational predictions have not been fulfilled, or they occurred 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 study 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 surprise 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, to deliver useful future insights, many indirect procurement groups are merely analyzing data to track historical trends.

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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 study participant explains, "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 study 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. These data, of course, not only help with the realization and sustainability of identified benefits, but are also informative for future supplier selection and negotiations.

In short, while once overlooked, indirect procurement organizations have made much progress and are increasingly recognized as having significantly more value to contribute. However, opportunities remain where savings can be attained and value accrued.

Capitalize on the Opportunities

While the study indicates that procurement professionals are taking strategies in indirect purchasing to the next level, those efforts may need to be realigned with where the overall value exists. Traditional sources of savings bear fruit, but the greater opportunities lie in automation, analytics and core KPIs.

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. One explanation may be that the tools are still evolving; another is the price tag. Even so, study 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 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.

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.

Advanced analytic capabilities, such as predictive modeling and optimization, can assist in identifying opportunities in the more complex indirect categories, such as facilities management and professional services, which often require forward-looking decisions and scenario analyses to identify maximum value. The

INDIRECT BEST PRACTICES

In the analysis of the results from the A.T. Kearney *2010 Indirect Procurement Study*, there were several companies that employed best practices across multiple important elements of indirect procurement to take their results to a new level of success. What follows are two short case studies summarizing these success stories.

Global financial institution. While the 2007 study indicated a hybrid centralized and decentralized indirect procurement model, the structure has evolved over the last three years. Today, indirect procurement organizations are largely central-led, with a head office coordinating the indirect efforts across the enterprise. This is proving to be a successful strategy for many organizations, with respondents reporting more than a 10 percent savings in nearly 48 percent of their indirect categories.

The following case study illustrates the savings being achieved within a central-led indirect procurement model.

Case study: 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 dimensions of the organization. Charting a three-year strategic roadmap, with more than 160 action points, the organization reached world-class status, as judged by two independent firms. Today, dedicated category teams work on a global scale, effectively collaborating as a business unit without borders, where their most operational and tactical activities are either fully automated or supported by IT. The organization (re)sources more than US$1.6 billion a year, with average year-on-year savings of more than 6 percent.

North American insurance company. Automation tools continue to remain a "want" rather than a "have" for many indirect procurement organizations. While price is certainly a factor, as these tools evolve, supply management professionals are determining which tools are best aligned with their indirect strategies. In essence, the variety of tools available in the marketplace is an investment barrier for organizations. However, the study reveals that over the next two years, indirect procurement organizations are planning to step up their efforts to implement automated tool sets into their procurement processes. In fact, purchase-to-pay systems are expected to be applied to more than 75 percent of the spend in all indirect categories.

The case study below highlights one company's transition to an automated tool set and the significant efficiencies achieved.

Case study: 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 e-Rfx. 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 e-Rfx tool that is also being used to source professional services, such as legal.

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 says, "Having the right analytic capabilities and tools on the team helped us quantify the trade-offs in the category and to make fact-based prioritization and supplier selection decisions."

Measuring performance: What is key in KPI? Our study 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, such as diversity (MWBE) spend, supplier joint process improvement programs and tracking of supplier commitments, lie further down the scale. These priorities reflect missed opportunities. Tracking and measuring joint process improvement programs, for example, can help deliver further benefits in the areas of innovation, complexity reduction and demand management. Tracking supplier commitments ensures that contracted value is sustained through the life of a supplier-buyer relationship. Indeed, effective supplier relationship management depends on data that more than half of study participants do not collect.

More Value to Contribute

Indirect procurement has become much more important as procurement organizations become more involved in complicated indirect categories. Although much progress has been made by indirect procurement organizations, there is significantly more value to contribute. We encountered this conclusion across every dimension of the A.T. Kearney *2010 Indirect Procurement Study.* **ISM**

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