

Indirect procurement outsourcing – why, how and when



UPS Supply Chain SolutionsSM

"Our procurement system yields the maximum value for office supplies but not for MRO purchases."¹

Indirect procurement outsourcing is a hot topic in corporate America. Companies have realized that the procurement initiatives of the 90s and early 2000s did not deliver the level of cost competitiveness promised, so they have begun to look at outsourcing to deliver on those promises. Over the last 10-15 years, companies have struggled with new technology adoptions, cycles of centralization and decentralization, employee empowerment, and a myriad of other tools, strategies and analyses, attempting to lower the costs associated with the purchase of these non-core materials and services. Through indirect procurement outsourcing, the corporate world can finally achieve substantial cost reductions while turning these low performing assets into a competitive advantage.

For shrewd buyers of procurement services, the benefits are clear: lower spending on indirect goods and services and improve procurement effectiveness. Procurement service providers can offer lower prices to their clients through aggregated spending, and through improved access to an assortment of suppliers. Procurement service providers can also improve procurement effectiveness through access to best-in-class practices and technologies and to deep category expertise across the total spend. Service providers additionally lower procurement operating costs by leveraging their employees across clients, and access to the latest tools and methods allows providers to transfer the work to lower-skilled labor.

For companies interested in Indirect Procurement Outsourcing, the path to benefits is not always clear. The service provider landscape is confusing at best, raising the “Buyer Beware” warning flag. They come from many different backgrounds resulting in a cloudy map of skills and capabilities:

- Recent startups with procurement outsourcing as their sole vision
- IT outsourcing behemoths that have invested in developing key skills in procurement
- Specialists that concentrate on one or two categories of spend.

¹Dalski, Dave. “Giving the process and the provider their due,” White Paper: Procurement Outsourcing.

The keys to unleashing the value of procurement outsourcing are first, clearly understanding your company's costs and capabilities, and second, in finding the right partner with the right blend of skill and expertise to match your company's situation.

e-Procurement disappointments

e-Procurement brought some solid benefits through process automation and reducing maverick buys, but it has also left a lot of room for improvement in significant spend reductions and in process effectiveness.

The business case for e-Procurement and indirect spends is clear: indirect spending is a large portion of the overall corporate buy, and the ability to improve the bottom line through cost reduction dwarfs the impact on revenue that is needed to achieve the same result. Indirect spend can comprise between 30 and 60 percent of the average company's spending². For companies in the professional and financial services industries, indirect spend can comprise virtually all the total spend dollars. Therefore, sourcing professionals are constantly challenged to improve the bottom line because of their ability to impact the profit margin versus what is required to achieve the same effect focusing purely on revenue growth. Consider a company with a 10% profit margin before taxes, every \$10 in revenue translates into \$1 of profit contribution, that wants to increase profit contribution by \$1. It can either cut costs by \$1 or increase revenue by \$10. This simple example illustrates why sourcing professionals receive the brunt of meeting short-term financial targets rather than relying on the ability to increase revenue.

A 2002 Gartner Dataquest survey showed that a third of the respondents expect to increase their procurement outsourcing budgets during the next 24 months.²

The positive effects of e-Procurement on indirect buys are also clear. Through easy-to-access online catalogs, "Maverick" buys have been reduced and replaced with lower priced contract buys. The automated processes have also allowed employees to self-serve, reducing the involvement and associated cost of in-company intermediaries to complete transactions. e-Procurement has also improved visibility of spend categories and amounts, allowing further cost reductions through focused attention.

Unfortunately, for most companies that have embraced e-Procurement, the benefits left on the table are also clear. e-Procurement only provides access to suppliers that are e-enabled, possibly limiting the breadth and depth across the spend categories needed. As a result, maverick buys persist alongside e-procurement implementations. Additionally, e-Procurement has some effect on buyer power through aggregating the spend by category, but

² "Gartner: Procurement Outsourcing may be an alternative to e-procurement", *EDP Weekly's IT Monitor*, December 9, 2002.

A recent survey of US and European firms found that nearly half of the companies surveyed were considering outsourcing a portion of their procurement functions within the next 3 years. An additional 22 percent reported that they currently outsource some aspect of procurement. 43 percent of respondents indicated they were attracted by cost reduction and the opportunity to focus more time on categories retained in-house to outsource non-strategic processes, including indirect spend categories.³

it does not provide the added advantage of aggregating spending with other companies with similar needs. e-Procurement is also a transaction vehicle, so it does not provide access to best-in-class practices or deep category knowledge and has a heavy reliance on costly catalog creation and maintenance.³

What is procurement outsourcing?

Procurement outsourcing is the complete or partial transfer of the business processes, infrastructure, and resources associated with purchasing materials. Companies today already outsource a large portion of their indirect costs through providers of travel, security, janitorial, and confectionary services. Procurement outsourcing refers to the processes and infrastructure associated with purchasing all indirect costs including contracted services:

- Supplier qualification and selection
- Supplier e-enablement
- RFQ/RFP
- Transaction management
- Payment fulfillment
- Contract management

Procurement outsourcing is not a black and white decision. There are many options available depending on how much responsibility the potential client is willing to transfer to the service provider. At the basic level is the transfer of a technology platform or the purchase of procurement functionality through an ASP. In this situation, the company is retaining most of the higher value functions like supplier selection and management, and there is minimal risk assumed by the service provider. At the other end of the spectrum is an empowered service provider that has ownership of specified metrics (cost reductions, service levels, etc. and flexibility in how to meet them.

Why outsource indirect procurement?

The arguments for outsourcing procurement are a combination of traditional Business Process Outsourcing (BPO) rationale as well as procurement specific reasons. There are several traditional arguments for outsourcing any business process or asset: 1) lack of in-house competency or expertise; 2) achieving economies of scale on an underutilized asset; 3) accessing lower workforce rates. Indirect procurement is often decentralized which makes it harder to build in-house competencies or expertise in any given category of spend. Additionally, purchasing is often just involved in the transaction aspect, as a “middle-man” between end users and suppliers, further

Transactions &
Technology

Service
Provider



³ “Procurement Outsourcing Poised to Double, Accenture Survey Finds,” *Berlin Business Wire*, Nov. 3, 2003.

hindering deep knowledge within the purchasing organization. The decentralized nature of indirect procurement also opposes the scale needed at the single company level to justify investments in best-in-class tools and solutions. This scale hurdle also hinders the adoption of tools and technology that allows using lower-skilled labor in procurement tasks. Indirect procurement outsourcing can solve these problems for corporations by providing expertise across spend categories, economics of scale in best-in-class technologies and solutions, and access to lower-skilled labor.

Range of benefits of Indirect Procurement Outsourcing:

- 10-18% of dollars spent on indirect goods and services
- 0-15% of procurement operating costs

Outsourcing of indirect procurement has other benefits specific to procurement:

- **Scale of purchasing** – A service provider can aggregate the buys across their clients for a category and negotiate lower prices for their clients
- **Access to suppliers** – A service provider can introduce a client to a multitude of approved suppliers through their networks of customers
- **Access to more economical labor sources** – Since service providers aggregate some very specific business processes across companies, they are in a better position to find ways to move those processes offshore or to lower domestic cost-base environments.

Who are good candidates for indirect procurement outsourcing?

All companies are good candidate for indirect procurement outsourcing. Very few companies have the magnitude of spend required across indirect spend categories to enjoy the scale and buyer power benefits of an outsourced solution. Professional and financial services organizations have even more to gain than the physical goods and services, since their entire spend is on indirect materials and services; the entire procurement organization is therefore a non-core and non-strategic asset. Building a competency in this function is not only challenging, but arguably a strong distraction for management. Product-focused companies also have a strong argument for outsourcing indirect materials as their procurement competencies are usually only developed for direct raw materials, components or systems.

Procurement Outsourcing Landscape

The procurement outsourcing marketplace is a confusing environment. The good news for companies interested in outsourcing their procurement processes is — there are plenty of companies willing to take on the work. The bad news for companies is — there are so

many companies with different skills and offerings in the marketplace that selecting the right provider is a real challenge. A flock of companies have entered the BPO market, from many different directions⁴. The graphic on the right attempts to break down the myriad of offerings into three distinct categories:

Procurement outsourcing landscape		
Transactions & Technology	Processes	Procurement Management
Services Offered Use provider is software to execute transactions for the client	Services Offered Increase process efficiency; reduce costs and/or improve service levels	Services Offered Increase procurement effectiveness; introduce best practices
Transaction Focused	Category Specialists	Comprehensive

1. **Transaction focused providers** – These are primarily software companies that provide automation and analysis tools and services.
2. **Category specialists** – These companies that focus on one or a few indirect buy categories. One good example is in printing services, where companies like htprint and Cirqit offer consulting and outsourcing services to manage the entire print procurement process.
3. **Comprehensive service providers** – There are two major groups within this category: business process outsourcers and procurement specialists. Business process outsourcers are large companies like EDS, Accenture and IBM Global Services that initially focused on IT outsourcing but have moved on to HR, finance and procurement business processes, among others. On the other hand, procurement specialists are relatively young companies with a short but strong track record of successfully running large portions of indirect and direct buy for clients. ICG Commerce, Alliente and Threecore are excellent examples of this category.

There are companies that cross the boundaries of these definitions, like group purchasing organizations which act as procurement intermediaries in the healthcare industry. These companies often give their clients access to purchasing power and some of the other benefits of the comprehensive service providers.

Keys to Success

The key to a successful execution is in selecting the right partner. This implies deep knowledge of the company’s needs, as well as capabilities of the prospective outsourcing partner(s). Companies wanting to get the most out of their outsourcing activity have to clearly identify the scope and goals of their outsourcing activities prior to finding the right candidate. There are many different dimensions on which to evaluate potential partners:

⁴ Banham, Russ, “Keys to Successful BPO Relationships,” <http://www.CFO.com>, September 03, 2003.

- **Expertise** – Does the potential partner have category expertise in the categories to be outsourced? Do they have best practices employed across the categories?
- **Technology** – Which tools are deployed? How much automation will the new processes have? Where will the work be done?
- **Services** – What kind of attention will be given versus spend? Will a company benefit from aggregated spending? What kinds of analysis of spending patterns will be conducted? What types of decisions will be made on the analysis? Is there global support? What languages will be supported by customer service? Is the service provider willing to guarantee response time or sign a Service Level Agreement (SLA)? What level of supplier management will the outsourcer provide?
- **Supplier network** – Will the service provider increase or decrease the number of suppliers by category? How will the service provider determine which suppliers are adequate to satisfy the company’s requirements?
- **Savings** – Who provides the lowest source-to-pay solutions and can sustain the savings over time?
- **References** – Does the potential service provider have adequate references for the magnitude of processes and categories to be outsourced?

Levi Strauss⁵

“We were a new organization with limited resources in terms of people and systems, with an immediate need to cut costs and abundant opportunities to do so. Speed to savings was our primary objective. ICG Commerce offered an integrated solution that could be implemented quickly, including:

- Rapid, high-quality spend-visibility tools and services
- Affordable source-to-pay technology
- Relevant category expertise
- Great people
- Flexibility and intelligence to mold their offerings to our unique culture and needs

ICG Commerce has proved to be a good choice. Procurement is now an established function at Levi Strauss & Co.; we use ICG Commerce to augment our organization, continuing to tackle new categories and manage existing ones.”

Susan Shipley, Vice President, Corporate Procurement

⁵ Source: ICG Website: <http://www.icgcommerce.com>

Results:

Within the first 12 months, the consulting firm had fully outsourced its procurement operation to ICG Commerce. All told, the firm exceeded its original savings goal of \$60 million by 20 percent. With new sourcing and purchasing technology in place and optimal supplier agreements implemented, the firm achieved an astonishing 100 percent adoption. And the seamless transition of resources was completed flawlessly, providing the company the advantage of focusing on core competencies and growth opportunities.

AVAYA

“We view ICG Commerce’s established processes and strategies for managing indirect spend as an enhancement to our internal processes,” said Joe Siciliano, Senior Manager of Global Procurement Operations for Avaya. “The procedures and measurements they have in place to increase compliance and improve supplier performance are expected to play a role in achieving our savings targets.”⁶

⁶ “ICG Commerce Enters Into Procurement Business Process Outsourcing Agreement with AVAYA,” Press release, February 23, 2004, or ICG Website: <http://www.icgcommerce.com>

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