

# How to Make Indirect Procurement Outsourcing Work Effectively

Cost-cutting is a goal of many procurement outsourcing deals. However, much larger benefits can be achieved by integrating functions across the source-to-settle cycle and standardizing on providers' processes and platforms.



**An exclusive report from BusinessWeek Research Services**

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## Executive Summary

- Procurement outsourcing burst onto the business process outsourcing scene with great promise. However, while early deals delivered tactical benefits such as procurement operations cost savings, many companies are still not realizing the more substantial advantages that can be gained.
- In early procurement outsourcing deals, service providers successfully identified savings, negotiated with suppliers and entered mutually attractive contracts. But they did not as consistently deliver benefits with more strategic value, such as more substantial spend-related savings, optimized processes and the ability to reposition staff on more strategic activities.
- Procurement outsourcers have successfully helped customers improve individual procurement functions, such as strategic sourcing, contract negotiations and operational procurement, but they need to connect these areas by designing and deploying integrated, end-to-end, sourcing-to-settlement procurement processes.
- Providers that are delivering optimum procurement outsourcing solutions typically offer processes based on best industry practices and have strong relationships with the software suppliers underlying their offerings to ensure effective design and execution of service delivery.
- Customers that have achieved long-term benefits from procurement outsourcing are consistently open to using their providers' standard processes and platforms. By doing so, providers can achieve the economic model they need to deliver innovation.

## Methodology

BusinessWeek Research Services (BWRS) launched a research program in late 2007 to determine the views of chief procurement officers and other C-level executives—such as CFOs and CEOs—on how companies can reap the long-term rewards of indirect procurement outsourcing. This includes substantial and sustained cost savings, optimized procurement processes, strategic decision-making and innovation from the service provider. The fact is, a number of early procurement outsourcing deals have not lived up to these promises, and the savings achieved have often been moderate. However, a new approach to procurement outsourcing arrangements and implementations, based on the lessons learned from early implementers, offers to more consistently deliver on these unmet promises.

This report is based on interviews with forward-thinking analysts and consultants, as well as leading procurement outsourcing customers, who discuss the strategic, financial and operational benefits that can be gained from procurement outsourcing and—most important—what needs to be in place to reap those rewards. The organizations included in the research for this report are:

- |                              |                             |
|------------------------------|-----------------------------|
| ■ Aberdeen Group Inc.        | ■ IBM Global Services       |
| ■ Accenture LLP              | ■ Infosys Technologies Ltd. |
| ■ Deutsche Bank AG           | ■ Telstra Corp. Ltd.        |
| ■ EquiTerra Inc.             | ■ The cc-Hubwoo Group       |
| ■ Everest Research Institute |                             |

Triangle Publishing Services Co. Inc. supported BWRS in the research, the in-depth telephone interviews and the writing, editing and production of this report. BWRS and the author of this report, Emily Kay, are grateful to all of the executives who provided their time and insights.

This research report was funded by a grant from SAP but was written independently of this sponsor. The editorial department of *BusinessWeek* Magazine was not involved in the project.

For more information about this project, please contact *BusinessWeek*'s Director of Primary Research at [chris\\_rogers@businessweek.com](mailto:chris_rogers@businessweek.com).

## Introduction

When procurement outsourcing hit the business process outsourcing world in the early part of this decade, many analysts recognized that it promised great benefits. According to Everest Research Institute, an outsourcing consultancy in Dallas, potential savings from procurement outsourcing can be nearly five times those derived from sourcing other business processes (see chart 1, “Procurement Outsourcing: Game Changer?” below).

That’s a compelling story when indirect spending represents 10 percent to 15 percent of a company’s revenues, equaling hundreds of millions—or even billions—of dollars, according to Accenture LLP, a global consulting and outsourcing firm based in Chicago. No wonder expenditures in this nascent market grew 35 percent in 2006, representing an annual managed spend of nearly US\$40 billion, according to Everest Research Institute.

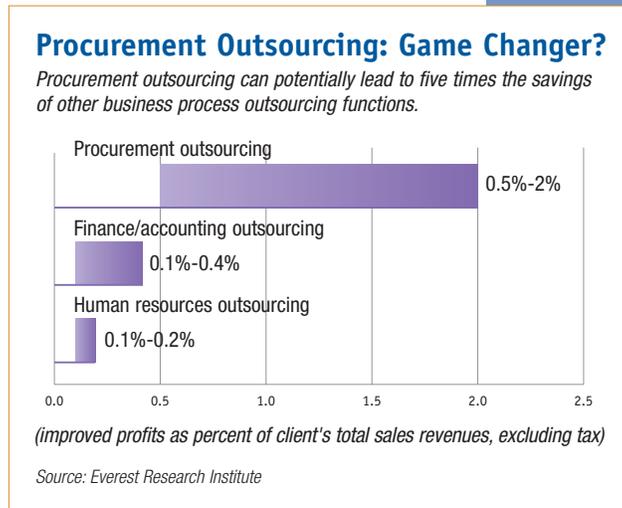
But companies seem to be wary of the promised cost savings, as growth in 2007 was relatively flat, according to Mark Craddock, engagement director at Everest Research Institute. Boston-based research services firm Aberdeen Group Inc. says that 40 percent of companies recently surveyed are currently outsourcing procurement or plan to do so (see chart 2, “Slow to Commit” on page 6). Those engaged in procurement outsourcing are wading rather than plunging into it, with only 10 percent farming out the full procurement process and the vast majority outsourcing just a piece of the cycle, according to Aberdeen. Many report that savings are often limited to specific aspects of procurement, such as the sourcing or operational phases of the procure-to-pay cycle, Aberdeen says. And according to EquaTerra Inc., an outsourcing consultancy and research firm in Houston, only about 5 percent of respondents in a fourth-quarter 2007 survey saw an increase in demand in procurement, which it estimates to be a \$1 billion worldwide market.

Despite the hesitation, nearly half the procurement professionals in Aberdeen’s survey said outsourcing is one important way of delivering the cost savings and process efficiencies they feel compelled to deliver to their organizations.

Procurement outsourcing customers are achieving direct savings of 5 percent to 20 percent, according to Everest Research Institute. What they’re missing is the makeover of the procurement function into a more strategic area—or what Bill Schaefer, vice president of supply chain managed business process services at business and technology services provider IBM Global Services, a division of IBM in Armonk, N.Y., dubs “a complex transformational kind of activity involving people, process and technology.”

According to Aberdeen, while 45 percent of enterprises said that lowering the cost of procurement operations is the key pressure driving outsourcing, those companies it terms “best in class” are shifting their focus from tactical cost-cutting benefits to the strategic advantages they can gain by using third-party experts. (Aberdeen uses two performance criteria to distinguish best-in-class companies: percentage of enterprise spend under management of the procurement organization and requisition-to-order processing costs. In its methodology, it classifies the top 20 percent of a sample as best in class, the bottom 30 percent as laggards and the middle 50 percent as average.)

Chart 1



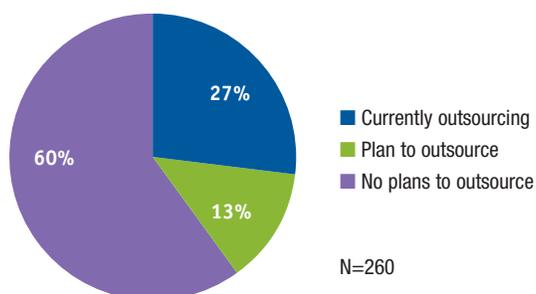
## Unclosed Gaps

In early procurement outsourcing deals, service providers successfully identified savings for their customers, negotiated with suppliers and entered into attractive contracts with their customers, according to Everest Research Institute's Craddock. A number of these deals fell short in their delivery of visible and sustained cost savings, optimized processes, strategic decision-making and the innovation that global organizations expect. "Upfront, they can deliver," Craddock says. "The problem is in execution."

Chart 2

### Slow to Commit

Over half of the respondents to a recent Aberdeen survey said they had no plans to outsource procurement.



Source: Aberdeen Group, 2007

Indeed, when companies opt to outsource procurement functions, they expect to see one or more of the following types of benefits:

- Substantial and sustained savings in the cost of services and products purchased
- Enhanced strategic-sourcing and decision-making abilities
- Increased spend leverage and control
- Improved contract compliance
- Reduced amount of spend that nonpurchasing staff handles

They also expect outsourcers to innovate their procurement practices and streamline operations by eliminating manual, duplicate and inconsistent processes (see chart 3, "Pressure Cooker" on page 7).

The disconnect can be traced back to unclosed gaps among the strategic sourcing process, the contract negotiation process and operational procurement activities. Procurement outsourcers have successfully helped customers improve these individual functions. But to generate optimum gains, they need to integrate these key areas. They need to facilitate controls and workflows that ensure enterprisewide contract compliance and connect these areas by designing and deploying technology-enabled and integrated, end-to-end, sourcing-to-settlement procurement processes.

Craddock offers an example that illustrates how these gaps have truly jeopardized expected gains: While analysts based the projected savings of procurement outsourcing on assumptions that everyone would follow contracted pricing, in reality outsourcers achieved low compliance and adoption rates.

List

### Filling in the Gaps

Missed opportunities in many enterprises' procurement operations fall into several categories:

- Fragmented spend across divisions and regions
- Lack of a global strategic-sourcing program
- Contract leakage as a result of out-of-contract spend
- Higher cost of procurement because of nonstandard processes
- Lack of a common technology platform to automate business processes

Source: Infosys Technologies Ltd.

"You have to put all the pieces together to make procurement work," IBM's Schaefer says. In other words, it's not as simple as buying new technology or hiring a consultant to source a strategic spend category, he says. Companies attain the true benefit by bridging the gaps among key processes (see list, "Filling in the Gaps" at left).

And that's where choosing the right service provider comes in. When providers can offer portfolios of standardized processes based on best industry practices and strong relationships with the software suppliers that support their offerings, they can deliver comprehensive procurement solutions. They do so by linking skilled procurement professionals with procurement processes through advanced but not necessarily bleeding-edge technology. To achieve the economic models their providers need to deliver innovation, procurement outsourcing customers also must be open to using the standard processes and platforms with which their providers work.

## Lessons Learned

The lessons learned from early adopters' accomplishments and missteps offer new outsourcing approaches that can help enterprises gain significant benefits across the entire source-to-settle procurement cycle. Take Australia-based Telstra Corp., which hired IBM in 2006 to revamp its procurement operations, involving billions of dollars in indirect spend.

"Telstra worked with IBM to establish a vision for how it wanted to transform its supply chain," says IBM's Schaefer, who worked closely on the Telstra makeover. "They're on a journey that included outsourcing as part of the recipe for success."

As part of a seven-year project to deliver millions in cost savings, IBM helped Telstra develop a renovation strategy that included outsourcing indirect procurement. IBM also performs sourcing, accounts payable, day-to-day purchasing, requisitioning and other procurement activities, and it provides a multiclient technology platform and standardized procurement processes. (See chart 4, "Best in Class Outsourced Processes," on page 8 for a list of processes that successful companies outsource.)

IBM's expertise in strategic sourcing of indirect procurement spend areas—including corporate travel, temporary labor and its IT solution—helps Telstra negotiate better deals for the more than AUD\$10 billion worth of goods and services the company purchases from some 9,000 suppliers across 30 spend categories. For instance, a single companywide view of vendor spend helps Telstra monitor compliance and savings. A Web-based system tracks purchasing authorization requests and reports them directly to Ian Wheatley, the company's executive director of procurement, who checks them monthly to detect gaps in existing contractual arrangements.

The result: Significantly improved compliance rates are driving savings. "We have a lot better control ensuring we're leveraging off our existing contractual arrangements," Wheatley says. "We can now track cost savings that we deliver in procurement back to the bottom line."

Telstra also standardized on some of IBM's own internal procurement processes, which IBM reconstructed in the 1990s. One such practice at IBM, which manages more than US\$45 billion of internal direct and indirect spend, is to focus on improving end-user compliance with the procurement process. "If end users feel satisfied with the value provided by procurement and it's easy to buy things, they'll do the right thing and not go around the procurement process," Schaefer says. In fact, pioneering its own centralized procurement operations helped IBM build its outsourcing business.

## Integrated Processes and Systems

To achieve successful procurement outsourcing, companies must recognize the need to tap advanced procurement technology to ensure consistent end-to-end functionality. Such operations include strategy, management of spend data and other key sourcing processes, procure-to-pay transactional services like day-to-day purchasing and accounts payable, catalog management and other procurement systems (see diagram, "Multiprocess Procurement Outsourcing Spans the Entire Procurement Process" on page 9).

Chart 3



Leading procurement executives understand the importance of integrating such data in a central repository to ensure that information about materials, products, customers, suppliers and assets is current, consistent and accurate, according to an Accenture report on outsourcing and procurement mastery.

“Programs have to affect the entire source-to-pay process,” says Greg Mark, senior vice president of global sales and account management with The cc-hubwoo Group, a Paris-based global provider of source-to-pay electronic solutions. “If you only benefit in one area, your program is not maximizing its total savings potential.”

Without a synchronized solution, it might have been difficult for Telstra to achieve long-term benefits from outsourcing. Working with IBM, the company was able to integrate procurement systems and applications. Before enlisting IBM, the company’s disparate and disconnected procurement systems and applications resulted in inconsistent use of policies and procedures and lackluster compliance rates. It also limited Telstra’s capacity to assess its total indirect procurement expenditure, hindered its ability to negotiate and leverage contracts, and was costly to maintain.

Telstra eliminated four unconnected payment and ordering systems when it moved to an outsourcing model. Now, along with several other IBM clients, it shares an infrastructure based on commercial procurement software and IBM’s own innovations and processes.

The results have been dramatic: The procurement transformation is on track to achieve its AUD\$500 million target over seven years, and Telstra now has an integrated platform for contract management, purchasing and accounts payable.

Centralized data access along with dashboard reporting and analysis capabilities help managers assess actual spend. “We’re getting a view of bypass, where people are not leveraging off the existing providers, and we can identify gaps in our existing contractual arrangements,” Telstra’s Wheatley says.

The end-to-end solution, which includes accounts payable processes, ensures procurement integration with the company’s back-end enterprise resource planning software. By automating procurement processes and eliminating duplication and paper-based procedures, Telstra attained consistent, companywide access to vendor spend. “We have more visibility of expenditure and demand,” Wheatley says. “We’re smarter about the way we go about procurement, because we have a single end-to-end view of what’s happening with any particular business.”

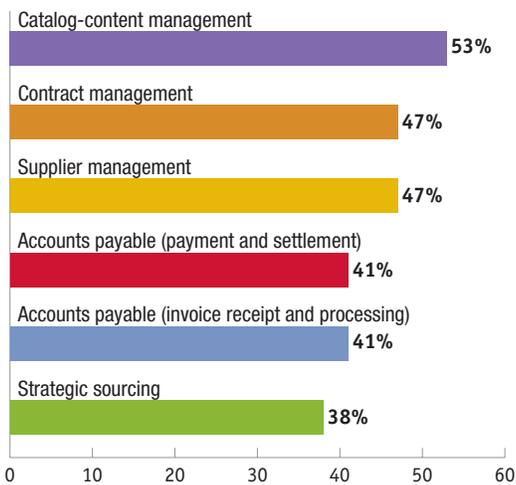
## A Transformative Experience

Standardizing systems, integrating processes and creating an end-to-end system also were key to Deutsche Bank AG. The Frankfurt, Germany-based financial institution offloaded its procure-to-pay (P2P) activities—including catalog-to-buyer enablement, supplier and change management, specs rationalization, catalog building, purchase-order processing and assisted spot-buying services—to Accenture in 2002. The bank decided early to retain control of strategic sourcing, according to an industry expert familiar with the transaction.

Chart 4

### Best in Class Outsourced Processes

The following are the procurement processes that organizations dubbed “best in class” by Aberdeen are outsourcing today:



Source: Aberdeen Group, 2007

After years of acquisitions, Deutsche Bank had grown into one of the world's largest banks, with some 65,000 employees serving more than 21 million customers in 74 countries. Decentralized purchasing operations resulted in some four million procurement transactions from about 200 businesses annually, according to a blog posting by Jeroen Voorhuis, senior manager at Accenture Ltd. in the United Kingdom. Managers bought directly from a host of suppliers and lacked standardized demand specifications and control of the procurement process. Limited access or ability to assess procurement data also hindered the bank's ability to negotiate beneficial contracts.

With the bank's CEO aiming to boost earnings by US\$1.5 billion over two years, and with bypass spend comprising some 85 percent of procurement costs, the bank had to cut enterprise-wide procurement costs and increase contract compliance. "It wasn't an ideal textbook situation," says the industry expert.

Under a seven-year deal, the bank handed over its core procurement processing platform, several supporting applications and functional responsibilities, according to Voorhuis. Accenture, which manages Deutsche Bank's relationship with its technology provider, integrated the bank's procurement applications with its technology platform.

The relationship helped Deutsche Bank streamline its vendor list, afford managers access to improved data for better decision-making, increase global contract compliance, reduce operational costs and gain end-to-end control of the technology-enabled purchasing process. "Accenture [will] continuously innovate all aspects of the solution—technology, processes and people—per requirements set out in the outsourcing contract," Voorhuis writes.

## Conclusion

The road to innovative procurement outsourcing can be filled with potholes. For some companies, the most successful route is to start small and grow. "Procurement outsourcing doesn't have to be a big bang," Everest Research Institute's Craddock explains. "It's easy to grow procurement deals in incremental, bite-sized chunks."

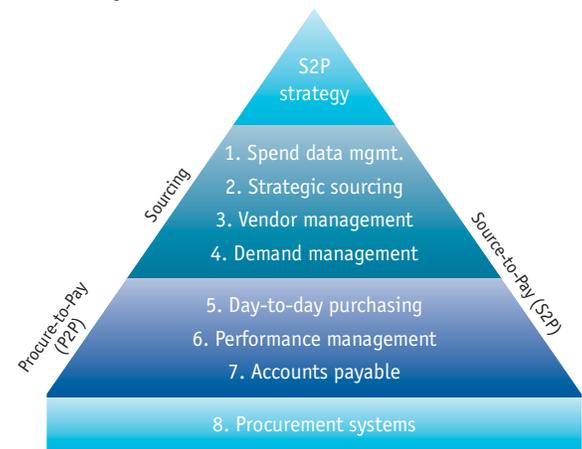
At the same time, companies dubbed "best in class" by Aberdeen are twice as likely to pursue a full source-to-settle approach rather than an incremental one. Another downside to the small, managed-services approach can be the lack of eye-popping outcomes. "To be really effective, procurement has to be seen as a big-change program that shakes up the whole business and brings hefty savings," Craddock says. "By doing one or two small test areas, you don't get a seismic shift."

Whichever path an organization takes, achieving sizable results is possible by connecting the various procurement areas through the design and deployment of integrated, end-to-end, sourcing-to-settlement procurement processes. Providers that are delivering optimum procurement outsourcing solutions offer processes based on industry best practices and have strong relationships with the software suppliers underlying their offerings to ensure effective design and execution of service delivery. Not an easy task, but early successes clearly show the potential is not out of reach. ■

Diagram

### Multiprocess Procurement Outsourcing Spans the Entire Procurement Process

*Many organizations are opting to outsource just one function, but end-to-end procurement outsourcing involves integrating the data of at least eight functions.*



Source: Everest Research Institute, 2006

# Generating True Value in Procurement Outsourcing

Business process outsourcing (BPO) has become a mainstream strategic tool for large organizations, and it is a very common option in enterprises' transformation toward shared services—a "G&A business model" innovation trend that has been largely driven by the availability of technology that makes distance irrelevant for the processing of administrative transactions. Reducing cost, improving process quality and controlling back-office operations better are key drivers for BPO, and despite the "horror stories" that the press picks up on from time to time, the usage of outsourcing is spreading fast.

However, BPO is a new management discipline that can only partially leverage the lessons learned from its predecessor, IT outsourcing. BPO is a more complex endeavor that requires better process understanding by both the service provider and the customer. It also requires an even more ruthless search for economies of scale, tight process optimization and access to lower cost pools—while minimizing disruption to business users. All of these aspects can be substantially enabled by technology, but superficial technology choices also can substantially hinder them.

## Realizing the Full Value of Procurement Outsourcing

Value generation in procurement outsourcing is triggered at the strategic sourcing level and secured by maintaining compliance throughout the procure-to-pay cycle. Most of the remaining savings come from controlling one-off purchasing and vendor payments and from cost avoidance as a result of demand management and reduced costs of enterprise procurement activities.

By fully using technology, companies can realize value in the following areas:

**Economies of scale.** The use of one integrated platform across the extended enterprise and related processes maximizes the chances for leveraging centrally negotiated contracts.

**Process optimization.** A single platform can support and consolidate sourcing and purchasing processes, as evident from the following examples:

- Compliance. A key aspect in securing procurement

savings, compliance is ensured in the purchasing and ordering process. This can be accomplished by leveraging the use of procurement cards, approval and other workflows, as well as data analysis and reporting based on standard procurement reports within the business intelligence component. Strategic sourcing savings are obtained by enforcing stronger compliance, as the customer converts results from sourcing events into contracts and catalog items from which requisitioners can choose.

- Poor performance in activities such as one-off purchasing and problems like high costs of demand management and enterprise procurement activities (such as the cost of the procurement organization) can be addressed with internally hosted catalogs that contain only approved purchasing items (both goods and services) and respective vendor contracts.

**Labor arbitrage.** Technology can help companies execute in a more controllable way, in remote locations, for instance.

Since 2004, SAP has deployed into BPO a very significant amount of dedicated resources, with the intent of understanding the market better and improving it together with customers and partner service providers. We believe "Powered by SAP" BPO providers know how to eliminate unnecessary costs through SAP-based automation and have the discipline to do so. But in achieving full value from a BPO contract, there is more than just cost incurred during ongoing operations. Our assertions are based on four main pillars:

**The most robust process software platform.** The SAP Supplier Relationship Management application is the leading procurement software solution—the most proven, comprehensive, scalable, integrated application across processes, used by hundreds of large enterprises worldwide. Its state-of-the-art architecture enables strong configurability to reflect the customer's uniqueness while limiting the typical risks of customization. Its multitenant service-oriented architecture is state of the art.

**The most standardized and best-practice deployments of procurement technology.** "Powered by SAP" providers ensure standardized deployment and proficient

## How Procurement Outsourcing Generates Savings



Source: IBM BTO indirect procurement discussion

use of SAP software. The result is viable, best-practice processes with flexibility to cater for the customer's specificities and uncomplicated future improvements.

**SAP's undisputed long-term viability.** SAP is a reliable and solid company with deep process and industry expertise and an unrelenting focus on process innovation. SAP solutions are further enhanced by the input and experience of thousands of customers and the largest BPO partner ecosystem.

**Unique support to BPO partners.** SAP provides ongoing, dedicated, BPO-specific support of select partners' services and platforms. We commit specific and specialized resources to each of our partners to help them provide the best service to the end customer. This is reflected in seamless design and operation of the BPO relationship.

Information technology is a key ingredient of operational excellence—together with people and processes—and not a silo. Examples of successful, radical joint IT-operations

organizations are increasingly visible. By the same token, the client's business executives should validate technology decisions, because the implications for them are substantial, and the provider—while being a knowledgeable advisor—should not be allowed to make decisions that inadvertently constrain the customer's future. Indeed, there is a clear trend showing that decisions about technology in BPO are increasingly considered important and taken jointly by the customer and the service provider.

This is not to say that clients should unduly distort the provider's standards. And, interestingly, in an increasing number of cases, the software vendor is brought in to support both parties in making those choices. Rather, it should ratify and fully embrace them after a qualified discussion, which would build the foundation of stronger change management cooperation.

—Dr. Christian Baader, Vice President of BPO, SAP AG  
—Gianni Giacomelli, Head of Global BPO Strategy and Marketing, SAP AG

More information can be found at <http://www.sap.com/services/bpo>

