

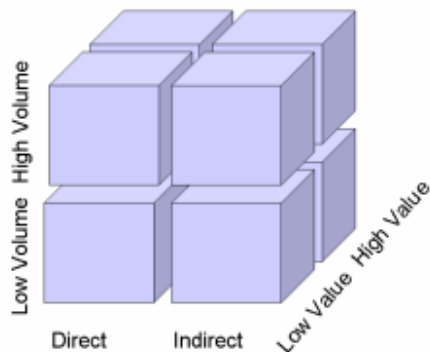
A Perspective on Procurement

Peter Green

There have been a lot of studies into the effectiveness and the cost of business procurement and the figures show a vast variance between average performance and best practice - with huge implications for the bottom line.

For example, according to the Hackett Group, average-performing companies spend over ten times more money in processing each purchase order when compared with best practice companies. Most of the research is centred on large companies, but the picture is very similar for small companies. In fact, it is even more depressing for small companies because they are unable to negotiate such keen prices and their administration is often more costly, simply because they do not have the economies of scale.

The secret of optimising sourcing is to begin by analysing the items being purchased and segmenting them into the following blocks:



The purpose of the exercise is to identify where the money is going in order to develop appropriate purchasing strategies. Obviously, for any one company, some boxes may be empty or contain very little, in which case there is no point wasting time in addressing something that is not an issue.

The next chart illustrates appropriate strategies for optimisation

Direct	High Volume	High Value	Key Supplier Relationships – develop long term. Review contracts. Manage performance
		Low Value	Depends on criticality of component develop relationship or reverse auction
	Low Volume	High Value	Individual Negotiation – sourcing costs high. Solution depends on technical complexity / individuality
		Low Value	Consider catalogue buying from designated suppliers
Indirect	High Volume	High Value	Depends on technical complexity / individuality Consider strategies like eAuctions or catalogue buying
		Low Value	Consider strategies like eAuctions
	Low Volume	High Value	Sourcing costs high - look at strategic commodity management to reduce costs
		Low Value	Ad Hoc sourcing or bundle with other items of same commodity e.g. catalogues

Concentrate on process cost improvement	Concentrate on item cost reduction
Concentrate on supplier relationship	Ignore



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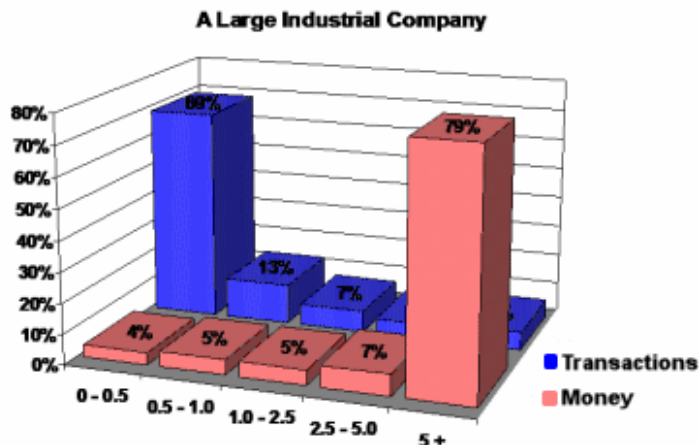
Peter Green, founder and director of eVision Services, is a Certified Management Consultant, a Chartered Engineer and a Member of the Institute of Business Consulting.

He has nearly 20 years of consulting experience, including board-level assignments with some of the world's largest companies, government departments, local authorities and SMEs.

As Head of eBusiness Consulting at AMEY, Peter introduced electronic procurement to the DTI and as a Practice Manager with IBM Consulting he led teams to rationalise procurement at HSBC and AIB and worked to build one of the largest e-marketplaces in Europe.

It is important not to lose sight of the opportunity for savings to come from both sourcing and process improvement

Analysis can be very revealing. The chart below represents analysis from a well known organisation. Don't worry about the detail - it's the shape of the chart that is revealing:



82% of invoices under £1,000 but only 9% of pounds spent

It is the old 80/20 rule, but more so, with more than 80% of invoices representing less than 10% of spend. That means lots of bits of paper - a disproportionate amount - chasing around the company for a small portion of the overall spend.

The message is clear. For low cost, high transaction volume items:

- **Consolidate suppliers, so there is less paper through the system and/or**
- **Adopt 'paperless' electronic processes (even small companies can achieve this)**

Process Savings are realised by taking an holistic view of the entire requisition-to-pay lifecycle. At the top end, concentrate on being smart, at the bottom end concentrate on being efficient.

Conversely, where a small number of invoices involve very large amounts of money:

- **Concentrate effort on getting the price down.**

Rogue Buying is another factor - where individuals make a direct purchase rather than sticking to the procedures, such as using a preferred supplier. In medium sized companies, particularly if there is more than one geographic location, 'rogue buying' can account for 15% of spend, typically at an increased cost of 25%. **For a company making a 10% margin, that's over a third of their profit!** (The maths is correct).

You may never eliminate rogue buying, but it is perfectly feasible to halve it.