

A close-up photograph of a pair of silver scissors cutting through a US one-dollar bill. The bill is held taut, and the scissors are positioned diagonally across it. The background is a solid, dark green color. The text "White Paper" is overlaid on the left side of the image.

# White Paper

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Lessons from Recession: Back to Sourcing Basics



## Background

The economic recession has had a profound impact on virtually every industry, with companies across all sectors being forced to take a harsh re-look at their cash flow patterns, revise forecasts, cut budgets, and change existing business practices. This white paper aims to share some of the best practices that GEP has seen (and helped) leading Fortune 1000 client organizations implement so as to convert the economic crisis into an opportunity and generate significant business value.

The economic downfall has provided a new opportunity for the purchasing function, pushing it to the top of CEOs' priority list, where it is seen as both a key function and a significant cost-reduction opportunity. This is accompanied by a shift in purchasing strategy, with several firms renewing their focus on the basics of good purchasing – improved spend visibility, greater spend under management, enhanced compliance tracking, better supplier relationships and a focus on overall value.

## The Basics of High Performance Purchasing

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GEP has been closely involved in facilitating the procurement transformation journey at several client organizations and our approach has been finely honed over the last decade. Every best practice listed below has been implemented by most of our clients and has yielded them considerable business value.

### Practice 1: Have the right organizational framework

Today's typical purchasing function is highly complex and plays many roles – ensuring an uninterrupted flow of materials and services, generating year-on-year cost savings, developing integrated purchasing strategies and supporting overall organizational objectives. Adding to this layer of complexity is the fact that purchasing has extensive interfaces with other functions, such as manufacturing, marketing, research & development.

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*“While the economic downfall shows no immediate signs of brightening, now is the time to start paving the way for change.”*

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Efficiency and effectiveness in driving high performance across purchasing and related functions requires the right foundational organization framework to strategize, execute, and manage this complexity. While the structure may vary from company to company, key building blocks remain the same:

- Enterprise-wide consistent purchasing strategies, processes & practices
- Common technology platform enabling collaboration and visibility
- Purchasing reporting to finance function
- Central category manager-based structure
- Well-defined roles and responsibilities, with best practice Key Performance Indicators (KPIs)
- Ownership of strategic sourcing and day-to-day procurement
- Global collaboration for key categories (IT, Ocean Freight, some direct materials)

Many organizations have used the economic recession as a catalyst to push through long overdue structural changes in the purchasing organization, and have found it easier to obtain internal stakeholder approval – given the economic climate and internal pressures. Streamlining resources, roles, responsibilities and reporting structures will establish a strong foundation for purchasing to thrive and to be better aligned with overall organizational objectives.

### Practice 2: On-demand is in demand

The market conditions have put a lid on most investment plans and have also generated greater management interest in the ROI of existing investments. This has encouraged the adoption and growth of on-demand services that enable organizations to optimize the investments made in technology and resources. Three key on-demand services that are seeing greater adoption by purchasing organizations that are performing well are:

1. On-demand technology
2. On-demand sourcing expertise
3. On-demand transactional services

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*“Stop concentrating on cutting costs and start focusing on increasing the value you bring to the market. Even in recession, companies and people still want/have to spend. The only difference is that they are more reserved and willing to hold out for products and services that provide great value at a great price.”*

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On-demand technology includes web-based SaaS applications like Spend Analysis, GEP RFX, GEP Auction, and GEP procurement systems. The key reasons for increased adoption are:

- No installation or capital investment
- Faster return on investment
- Short learning curve
- Pay-as-you-go pricing models
- Smooth integration with existing technology platforms

Instead of adding to existing staff, many organizations are turning to flexible staff augmentation models, enabling access to subject matter experts on an as-needed basis. This is accomplished with the help of on-demand sourcing expertise. This extends some of the benefits mentioned above for on-demand technology, to the “people” aspect (no capital investment, faster ROI, flexible pricing models and access to expertise, as needed.)

On-demand transactional services have not seen the same rate of adoption as technology and sourcing expertise, given the level of upfront planning needed and the longer time to value. However, our experience shows that companies that invest time and effort in identifying the right partner to manage their transactional services and prepare the detailed workflows necessary for success, see significant business value by outsourcing administrative tasks like requisition creation, PO processing, and invoice management.

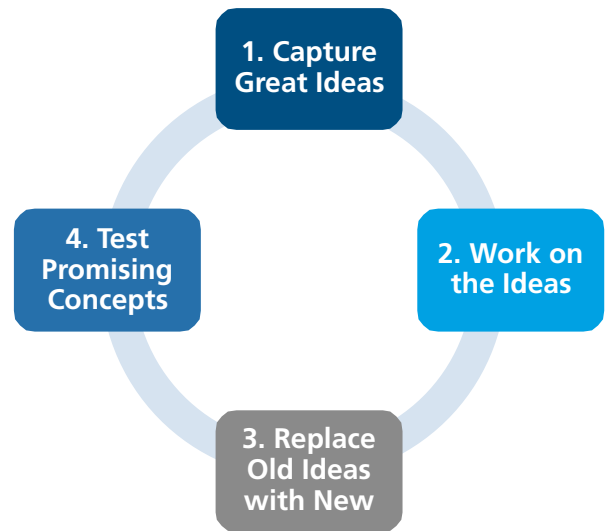
**Practice 3: Spur Innovation**

Traditionally, sourcing teams have focused primarily on price negotiations as the key business driver to identify cost savings. However, many sourcing professionals have now started expanding their role to include several more ways to add value.

After most categories have been through a few rounds of strategic sourcing, the law of diminishing returns can set in, which involves revisiting specifications. However, sourcing professionals can identify considerable savings through innovative strategies, such as specification improvement, brand substitution, and service level redesign. This requires a lot of collaboration with R&D, manufacturing and other functions, but the results typically justify the costs and

efforts involved.

Demand management is another way to unlock value by – if the purchasing department collaborates with manufacturing and sales, considerable benefits follow. Any enhancement at this stage (inventory level change, product shipping time and method change, reduced consumption) can yield considerable levels of cost reduction, much greater than the savings identified by cost negotiations only.



**Practice 4: Plug the Leakage Now**

Savings leakage due to limited compliance levels is a key concern for most companies. The most common reasons for lost savings opportunities are:

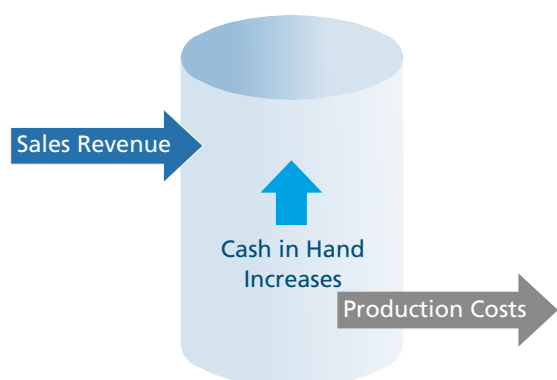
- Too much “savings” focus and not enough “service” focus during supplier selection
- Underestimating the challenges of change management
- Gaps in communication and implementation follow through
- No visibility into vendor performance, post sourcing
- No mechanism to track realized savings vs projected savings

Best-in-class organizations have shifted a lot of their efforts from simply “identifying” savings to “realizing” savings. Key strategies used by leaders to plug the savings leakage are:

- Involving multiple stakeholders at each stage of the sourcing process
- Linking performance metric to the identification and realization of planned savings
- Striking the right balance between cost savings and service levels
- Including upfront planning on change management and Implementation during a supplier switch
- Keeping purchasing engaged beyond contract signing, to ensure savings and value capture
- Establishing clear KPIs with respect to vendor performance, and savings tracking and validation
- Without a strong governance mechanism in place, an organization can easily traverse back to its past levels of inefficiency, and a lot of the good work can go in vain. A robust technology base can help enable reporting, and monitoring internal compliance at several levels.

**Practice 5: Manage Cash Flow Through Purchasing Levers**

Most Fortune 1000 companies deal with hundreds of suppliers and thousands of invoices every day. However, many of these companies are unable to fully leverage the untapped value in their ordering and payable functions. Paper invoices, manual verification and approval processes, delayed payments, and absence of technology enablers are some of the challenges inhibiting procurement transformation. In our experience, many companies can unlock tremendous value from their accounts payable functions by implementing the following best practices:



- Ensure strict adherence to contractual payment terms; avoid penalties due to delays, or lost opportunities due to pre-payments.
- Evaluate the benefits of renegotiating prepayment terms -- contrary to conventional thinking, many companies can realize significant benefits through early supplier payments, as long as suitable discounting terms have been negotiated; this can help preserve the suppliers' health, while generating good short-term returns for the company.
- Evaluate the viability of introducing third-party financing -- this facility shall allow a third party to finance accelerated payment to suppliers at low rates and enable an extension in metrics like Days Payable Outstanding (DPO); such a strategy can reduce supply chain risk and lower net working capital needs.

Multiple groups, including treasury, finance, AP and procurement, have an impact on an organization's ability to manage working capital effectively, but these groups often work in silos. While each group has its own goals, the entire organization must be aligned to gain maximum working capital efficiencies.

**Practice 6: Mitigate supply side risk**

While companies struggle with the economic decline, many suppliers feel a greater pinch. Organizations require a proactive and predictive strategy towards supplier risk management. It is critical to identify such suppliers who may be impacted severely by the crisis and put risk-mitigation plans in place. These plans could include continued monitoring of the financial status of suppliers, identifying alternate suppliers, re-evaluating inventory levels, providing short-term assistance through payment terms adjustments, etc. Similarly, if business volumes are forecast to be low for the short-to-medium term, companies should review volume commitments to suppliers under longer-term agreements, and be proactive in discussing and changing requirements with suppliers. Senior level discussions should be arranged with critical suppliers to share risks and rewards.



- Having the right organizational structure
- Planning and collaborating with other functions, using technology and external resources based on the organizational needs
- Striking the right balance between service and price
- Effective supplier relation management, managing cash flow, etc.

As leading purchasing organizations have shown, the sum of these parts is usually much more than the whole.

“During economic crisis, we should guarantee the supplier's survival to ensure supply chain smoothness and constant working progress, even during this recovery period. Procurement organizations and professionals actively understand, foresee, and calculate the market condition and help companies manage their supply chain.”

In conclusion, previous economic downturns have shown that procurement plays a key role in any cost reduction initiative. Best-in-class purchasing organizations are using this opportunity to not only generate short-term savings, but also build long-term sustainable competitive advantage. And transforming purchasing into a competitive advantage depends not on one radical new technology or a re-structuring exercise, but on getting the basics right across all purchasing aspects:



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With 14 offices and operations centers in Europe, Asia and the Americas, Clark, New Jersey-based GEP helps enterprises worldwide realize their strategic, operational and financial objectives.

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