

PRIMER

Demystifying Procurement Outsourcing: A Primer for Business Leaders

Confused about procurement outsourcing?

Wondering if it is right for your organization? You're not alone. Many senior finance, shared services and procurement executives are in the exact same fix, undecided and unsure about its pros and cons.

However, as procurement teams seek to increase their scope and impact without spiking their cost of operations, procurement outsourcing is becoming an increasingly important strategic option.

That's why we've asked Wayne Clark, Vice President of Procurement Outsourcing at GEP, to help demystify procurement outsourcing. Wayne, who has more than 20 years of strategic procurement and supply chain experience, leads large-scale procurement transformation and outsourcing projects at GEP.

Here, he shares important tips on evaluating, planning and implementing procurement outsourcing initiatives, including:

- How to determine whether procurement outsourcing is right for your organization
- Which procurement activities can be outsourced successfully
- How to identify the right procurement outsourcing partner
- What results to expect and how to measure them

Q1 So, what exactly is procurement outsourcing?

A1 In the simplest sense, procurement outsourcing is transferring specific procurement activities, including sourcing, category management, and transaction management, to a third party. In turn, a company which does so expects to increase its focus on core spend and competencies, reduce overall costs and realize bottom line savings.

The services delivered by Procurement Service Providers (PSPs) typically fall into three broad categories:

- **Transactional services:** These services support day-to-day buying, including processing purchase orders, and driving compliance to preferred suppliers.
- **Tactical services:** These include performing spot buys, managing low-dollar 'tail-spend', or providing support to internal category managers.
- **Strategic services:** These include leading strategic sourcing projects, or providing end-to-end category management services for non-core spend areas.

Q2 Why would companies outsource the procurement of critical goods and services?

A2 Precisely because it enables them to ramp up their bottom line. There is a cause and effect here. Companies that outsource their procurement function can tap into a pool of experts, which can guide them in matters pertaining to process and policy compliance. They can avail themselves of this collective expertise to improve their efficiency and overall performance. Taken together, this leads to measurable cost-cutting and tangible savings. While cost-reduction is the largest substantiated reason, there are other benefits as well, such as being able to utilize in-house resources for core processes.

Companies have a choice of outsourcing only their non-core spend and non-core processes

as they are less critical to the manufacture and production of final goods. This encompasses the following areas: Marketing, IT, Telecom, Logistics, Transportation, General & Professional Services, MRO, Travel, Packaging, etc.

This indirect spend can equal 20%-40%, or more, of total revenues of a company. However, it is quite often unsupported or under-supported by the procurement department, as developing in-house expertise can be challenging and costly. It is no surprise then that more and more companies are exploring ways to tap into external category expertise.

Q3 Which activities should be considered for procurement outsourcing?

A3 While procurement outsourcing has mostly been limited to the transactional purchase-to-pay process, firms can also hand over the complete category management of non-core spend areas to a third party.

The following table lists most frequently outsourced procurement activities.

Typical Procurement Services Provided

Transactional, Tactical & Strategic		
Procurement Operations	Procurement Support	Services Sourcing & Category Management
Transaction Management (Req-to-PO Management)	Sourcing Support	Strategic Sourcing
Contract Administration	Market Intelligence	Category Management
Master Data Management	Spot Buying	Spend Data Management
eCatalog Management	Contracting	Strategic Vendor Performance Management
New Vendor Set-up	Tail-spend Management	KPI Tracking & Reporting
Compliance Tracking	Vendor Score Carding	Opportunity Assessments

Q4 How are these services delivered?

A4 Delivery models, typically, include a mix of on-site, near-shore and/or off-shore resources. On-site resources can collaborate more closely with their clients and stay better connected when leading big sourcing projects, or when managing a complete category. Off-shore

resources are effective for routine or transactional activities, sourcing analytics, market research, spot buys and even leading RFPs when client and vendor communications can be managed remotely.

Q5 What are the real benefits of procurement outsourcing?

A5 The benefits are immense. As the spend that can be influenced is huge, procurement outsourcing delivers a more attractive return on investment, compared to other BPOs. Annual returns totaling three to eight times the fees of the PSP are fairly typical. The main financial benefits are:

Cost reduction: PSPs bring sourcing and category expertise to areas that are not generally supported by procurement teams, leading to greater spend under management and increased savings. They provide spot buy and tail-spend purchasing support that can deliver additional savings on high-volume/low-dollar contracts.

PSPs also provide compliance tracking and reporting services that enable companies to translate 'identified savings' into 'realized

savings' by reducing rogue spend and increasing compliance with preferred vendors.

Lastly, by outsourcing low-dollar or low-value activities, internal procurement teams can focus far more time and effort on large, strategic deals that deliver greater savings.

Operational efficiencies: PSPs provide operational cost advantages by building dedicated, highly trained, SLA-driven processing teams. They are also best-placed to take advantage of lower-wage, highly skilled off-shore resource centers, such as Asia and Central Europe. These centralized transaction management teams often deliver higher levels of service at lower costs and also free up internal resources to perform higher-value tasks.

Q6 What are the other benefits of procurement outsourcing?

A6 Procurement outsourcing also provides other strategic advantages that are equally valuable and compelling. These include:

Flexibility: In today's volatile times, procurement outsourcing helps firms to quickly ramp up (or down) their procurement team to match rapidly changing market needs. Some PSPs provide an on-demand service model, where clients pay only for the resources they need, or the services they consume. PSPs can often move more quickly with respect to down-sizing teams if demand drops, replacing under-performing personnel, or shifting the mix of expertise to match ever-changing business requirements.

Focus: The proverbial '80/20' rule is particularly true within procurement, where 20% of the total vendor pool often accounts for 70%-80% of the total spend. The remaining 80% of vendors, though less strategic, often remain untapped and their potential unexploited. PSPs are best-placed to address this tail-spend and derive value from it, thus freeing up in-house teams of firms for providing highly strategic support to their clients. Otherwise, their

attention is often diluted across a vast range of vendors, big and small.

Expertise: PSPs bring a significant amount of expertise and knowledge gained from multiple clients, sectors and geographies that an in-house team can find hard to match. As a result, they can deliver highly specific domain expertise across a wide range of categories. Besides, they have a deep pool of best practices, market intelligence, price benchmarks, sourcing tools and contracting templates gained from managing billions of dollars of spend for their clients.

Customer satisfaction: With well-structured SLAs and clear performance targets, procurement outsourcing partnerships can lead to improved service levels and greater overall support for business units. Indeed, some firms adopt a partially outsourced procurement model precisely with the aim of transforming their overall service delivery model and increasing their 'value-add' to the organization, often with dramatic results.

Q7 Are many companies engaging in procurement outsourcing?

A7 The past five years have seen procurement outsourcing register considerable growth. In the past one year alone, over \$1.6 billion in annual contract values were signed; the market is forecast to continue to grow at 15%

annually. Over 80% of expiring procurement outsourcing contracts are extended, or renewed, indicating a high rate of satisfaction in the marketplace. When structured properly, PSP partnerships work very well and deliver significant benefits.

Q8 What are the keys to success with procurement outsourcing?

A8 A company intending to outsource the procurement function needs to be mindful about the following:

Clarity of scope and responsibilities: As procurement is highly cross-functional, it is important to accurately define the responsibilities of the PSP and the internal procurement teams so that roles and responsibilities are clear and unambiguous.

Communication and change management:

Firms must ensure that all stakeholders are aware of all changes before the actual outsourcing commences; a detailed communication and change management plan is critical.

Key performance metrics and reporting:

All metrics, performance expectations and reporting requirements should be well-defined, such that both parties are clear about the rules of engagement.

Q9 What are the steps in outsourcing procurement processes?

A9 The main steps in implementing a procurement outsourcing program are:

1. Developing the business case: A firm first needs to determine the range of activities that needs to be outsourced. A cost-benefit analysis can then be done to get clarity regarding the outcome.

2. Selecting the PSP: A formal RFP process is advised when entering into this level of partnership. Companies should check references, perform site visits and probe for real examples of the PSP's expertise.

3. Designing the detailed solution: Next, in collaboration with the selected PSP, a firm needs to design detailed process maps with clear roles and responsibilities, and determine location and skill sets of the team. Besides, SLAs and governance plans need to be developed and communication and change plans mapped out thoroughly. Another requirement at this stage is engaging key stakeholders to ensure that the proposed

solution is thoroughly vetted and fit for implementation. IT plans also need to be developed to update any automated workflows and provide system access to the PSP.

4. Entering transition phase: The PSP will then on-board and train its staff to understand the firm's business, policies and procedures. At the same time, the firm needs to engage more comprehensively with all impacted stakeholders so that they are fully informed of any changes to processes that affect them. This will ensure that there are no service disruptions.

5. Maintaining post-transition relationship: Once services are transferred to the PSP, performance needs to be tracked closely and adjustments made quickly so that SLAs and performance targets are consistently met, or exceeded. Thereon, it is an on-going process of reviewing performance and governing the partnership.

Q10 What should companies look for in a PSP?

A10 A PSP should have in-depth expertise in the area of spend, and in other processes that a firm is considering to outsource. Additionally, a matching geographic footprint is critical to ensure global/local coverage. Other essential elements are change management skills, the ability to help drive new behavior and best practices, and a strong cultural fit.

It is critical that the PSP be able to function as a seamless extension of a company's team. A company should select a partner with whom it can work closely and from whom it can learn. If the right partner is chosen, then a PSP can help transform the procurement function into a more strategic, more valuable and more efficient process.

Q11 How can companies determine if procurement outsourcing is the right course of action for them?

A11 A company should start by reviewing the strategic goals and objectives of its procurement team. If clear targets have not been set, companies should engage their CFO and Head of Supply Chain to identify these. Typical KPIs include annual savings targets, spend under management goals, process improvements, client satisfaction scores, etc.

The next step is to objectively assess the current team's performance vis-à-vis these goals and identify the critical gaps. A company needs to ask itself some tough questions: Does our team have the bandwidth to manage our top direct AND indirect suppliers efficiently

and optimally? Is procurement supporting all our business areas, including Marketing, IT, Legal, Finance, Supply Chain and HR departments? Do we have the full range of category expertise needed to support our clients?

If critical gaps emerge from this assessment, then that becomes the basis for action. This is when the services of a PSP should be evaluated. The PSP who meets the requirements best should then become the new business partner.

Summary

Procurement outsourcing is an increasingly important strategic option, and a growing number of global enterprises have leveraged its operational and financial benefits in the past ten years. It is not, as some believe, a blunt 'in or out' option with regard to a company's procurement department. Rather, it is a dynamic tool, a flexible set of services that can be used to help procurement leaders fill gaps, reduce supplier costs, manage vendor risks, improve customer service and provide more strategic support to clients.



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