THREE STEPS TO BETTER PROCUREMENT PRACTICES

Kenneth Loi
Save money, save time and bring measurable strategic value to your company through smarter, more automated and more transparent procurement practices.
CONTENTS

3 Introduction
4 The State of Procurement
4 Procurement: the Red-Haired Stepchild

7 Step 1: Establish Stronger Policies
7 For Newbies
8 For Juniors

11 Step 2: Enable ‘Smarter’ E-procurement
11 For Newbies
12 For Juniors
13 Pitfalls of ERP-based procurement systems

16 Step 3: Gain Better Visibility
16 For Newbies
17 For Juniors
17 Spend Analysis: The Ultimate Goal of Visibility

19 It’s Always About People
20 Conclusion
21 About Procurify
Introduction

When it comes to spend management at mature, growth-minded organizations, the state of the economy should have little bearing on strategic decisions. In both good times and bad, it always makes good business sense to reduce costs and control spending. These efforts translate into more relevant bottom-line savings in a bear market, but this doesn’t mean companies should ease up when times are rolling. Money in the table is money on the table.

Strategically speaking, the needs of small or medium sized business are very similar to those of larger entities. As organizations grow processes become more sophisticated, headcount increases and management becomes more complicated. Every department grows in complexity, and supporting functions like Human Resources and Accounting take on larger roles. This applies equally to Procurement. Keeping the wheels of enterprise greased is a perpetual challenge, be it for core material acquisition (direct spend) or supporting purchases (indirect spend such as office supplies, travel, printing, etc.)

The benefits of better spend management are immediately measurable. Devising strong policies and using transparent, systematic controls to enforce them – typically with e-procurement software at the core – can reap substantial benefits. In fact, research conducted by the Aberdeen Group indicates that e-procurement initiatives can:

• reduce requisition-to-order costs by nearly 50%
• shrink requisition-to-order cycle time from 9.6 days to 3.4 days
• increase spend under management by 43%
• eliminate nearly 40% of maverick spend

In this paper, we identify three practices you can start implementing – or improving on – today to advance procurement effectiveness at your company, squeezing more savings and earning greater efficiencies out of where and how you spend money. They are:

1. Establish Stronger Policies
2. Enable ‘Smarter’ E-procurement
3. Gain Better Visibility
The State of Procurement

For most small & medium businesses - if not businesses of every size - the top two business priorities are Sales and Production. It’s all hands on deck to keep the orders flowing in and the factory floor working at capacity. This isn’t to suggest that functions such as accounting and human resources aren’t important; it’s merely a generalization about what makes most businesses tick. Typically, if there’s an extra dollar to squeeze out of a budget, sales and production managers have a stronger chance of getting it than do the heads of other areas.

Corporate culture is often the single largest determinant of how a company organizes itself. If its roots are in engineering and production, then leaders from those areas will exert the strongest influence. If the company was founded by an accountant, then financial practices will rule the roost. Over time, as more professional managers are brought in across the organization, they will, by way of personality or expertise, alter the mix of influence.

Procurement: the Red-Haired Stepchild

The hallmark of most small and medium sized businesses is their agility. Whereas their Fortune 1000 counterparts move like ocean liners – slow to start and slow to change course but hard to disrupt once underway – small and medium businesses behave more like small power boats: quicker out of the gate and more nimble and responsive to internal or external forces. A flatter organizational chart and fewer processes are the great enablers of this agility, helping to reduce decision cycle times and convert ideas into action. From a procurement perspective, these traits often translate into more delegated responsibility for purchasing across departments and less centralized control or monitoring. There might very well be a procurement department (or person) on the payroll, but their role is often limited to more downstream functions such as issuing POs and tracking orders and shipments until they reach the dock.
While most small and medium businesses have devoted significant resources to developing professional sales systems and top-tier processes, Procurement often gets neglected. Many companies muddle through with non-existent or inconsistently-applied policies and wasteful paper-based systems that cost thousands of dollars and dozens of hours more than needed. Others attempt to make use of rigid and complex processes built in to their ERP system, but these rarely reflect the requirements and capabilities of smaller companies.

When the right procurement manager comes along, the opportunities for improving efficiencies and saving money will be there like low-hanging fruit. For companies with basic policies and practices in place, there will still be ample room to improve upon existing practices and earn a rock star reputation.

The rest of this paper will guide you on where to start. Each topic will contain two tracks: one for companies with little to no application of the principles, and another for companies that have some application in place but could benefit from taking things to the next level. We’ll call these tracks ‘Newbie’ and ‘Junior’ respectively.
1

ESTABLISH STRONGER POLICIES.
Step 1: Establish Stronger Policies

Bringing order to chaos can be a monumental task, but when applied in the context of modern corporate practice it isn’t as difficult as it seems. Start off small, in a contained space like procurement, and apply some tried-and-tested approaches to earn some quick wins and build momentum.

Rules of behavior are the simplest, most natural place to begin. Ask any child psychologist and they’ll tell you that kids need boundaries, not just to keep them out of trouble, but to help them learn what is expected and to provide a frame of reference for building their own judgement skills. By setting expectations and providing thoughtful parameters we empower people to take charge of matters. Same goes for procurement; provide people with a system they understand, and they’ll happily comply because it makes their lives easier. Start by establishing rules and policies for everyone in the organization.

For Newbies

The first place to start asserting some control over spending is to assign purchase authorization levels across your company. These pre-authorized spending thresholds create a more productive working environment, in which people are empowered to make purchasing decisions within assigned limits. People spend more time on the job and less time in the approvals loop, either with fewer requisitions or fewer required approvals. And you, the procurement manager, will create a more defined procurement process with clearer accountability at all levels.

Each level of your organizational chart should carry a spend level, below which no approvals are needed, and above which the next senior manager must authorize. For example, thresholds can look like the following:

<table>
<thead>
<tr>
<th>Employee Level</th>
<th>Can purchase up to</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entry/Level 1</td>
<td>$0</td>
</tr>
<tr>
<td>Mid-Manager/Level 2</td>
<td>$1,000</td>
</tr>
<tr>
<td>Senior Manager/Level 3</td>
<td>$5,000</td>
</tr>
<tr>
<td>Executive/Level 4</td>
<td>Executive/Level 4</td>
</tr>
</tbody>
</table>
Step 1: Establish Stronger Policies

NOTE: These spend brackets apply to indirect purchases, goods and material not used in production. The assumption here is that raw material is managed more closely by production managers in conjunction with the Procurement team. For the sake of this paper we will be focusing primarily on indirect spend.)

With these thresholds in place, every employee will know what to do when they need to buy something. Either they bring the request directly to Procurement or they filter it through their manager for approval. This basic approach puts some checks and balances in place and delegates some responsibility for spend management across the company. The main advantage for Procurement is they will not have to chase down approvals before placing orders.

For Juniors

With thresholds in place, the next logical step is to funnel purchases through approved vendors. When companies spend time and effort negotiating better pricing and/or delivery terms from certain suppliers, they should channel as much buying through them as possible. To properly implement this, companies should have a policy in place requiring all purchases (or at least those of a defined type or minimum value) to be made by the Procurement team. There will always be times when someone requests a specific brand or product with no real substitute, but for the vast majority of purchases, people will be happy not to have to source a supplier as it saves them valuable time and energy. With that work already done for them, they can simply raise the request and wait for the goods to arrive.

The average large enterprise typically has no more than 60.2% of total spend under management.

Once you develop a set of key vendors and suppliers, you then introduce concepts known as ‘Maverick Spend’ and ‘Spend under Management’. Maverick spend refers to purchases made within an organization that are either not budgeted or are not compliant with negotiated contract terms. For example, your marketing team goes to Kinko’s to print a thousand brochures for an upcoming trade show, rather than place the order with your printer of record. There are times when such decisions need to be made quickly and must necessarily fall outside of negotiated contracts (such as when the trade show in question is in Buenos Aires and the brochures got held up at Customs), so eliminating all maverick spend is simply not realistic. But reducing it is very realistic, which takes us to the next concept, Spend under Management.
Step 1: Establish Stronger Policies

Spend under management refers to spending that has come through a defined sourcing and procurement process. It refers to purchases that have been categorized for recurring use and allocated to specific vendors based on negotiated contracts. In other words, spend under management is spending over which the procurement team maintains visibility and direct control (before you go and assume you can effectively funnel all purchasing through Procurement, you should know that the average large enterprise typically has no more than 60.2% of total spend under management).

As we will see below, reducing maverick spend and increasing spend under management require systems to be put in place, as well as the ability to educate and train employees on how to comply. Naturally, the simpler and more accessible the system, the better compliance you will achieve. With the right policies in place and the right systems installed to both encourage and enforce those policies, your company will quickly begin to reap the benefits of more cost-effective and efficient procurement.
2

ENABLE ‘SMARTER’ E-PROCUREMENT.
Wikipedia defines E-procurement as the “purchase and sale of supplies, work, and services through the Internet as well as other information and networking systems, such as electronic data interchange and enterprise resource planning”. The E-procurement ecosystem is vast, including services such as e-Auctioning and e-Tendering, catalog management, invoicing, e-Payment and contract management. Most of these services are beyond the capabilities (and desires) of small and medium businesses, extending well beyond into enterprise business practices. Truth is many of these services are cost- or operationally-prohibitive. For the purpose of this paper, we will limit the definition of E-procurement to internal processes only, stopping at the point where data is shared with suppliers.

What we’re essentially talking about then is paperless purchasing: using computer-based or online systems to standardize and automate the process of gathering purchase requests, converting them into orders and distributing them to suppliers.

For Newbies
Many companies wishing to move away from paper start by using email. Email is good because it’s traceable, accessible and already a part of your company’s daily routine and culture. But email doesn’t integrate easily with centralized control systems so data sharing is limited. If someone wants to follow up on a request, they’ll have to send another email which may or may not be attached to the original thread. And data from emails cannot be manually or automatically embedded into a purchase order. The benefits of email to purchasing begin to unravel quite quickly.

**People submitting requisitions shouldn’t have to call or email you for an update; they should be able to access a system where they can look up information themselves.**

For some businesses the next step is to build and maintain a spreadsheet to gather purchase requests. Others may design an internal web-based form. Those are good starts at going paperless, and they even introduce a modicum of centralization, but because they’re not built for purchasing they have considerable limitations (we’ll discuss the notion of customization in more detail below).

What you should be looking for is a dedicated software platform that allows your colleagues to generate requests on their own.
Step 2: Enable ‘Smarter’ E-procurement

The same platform should be able to automatically enforce an approval workflow based on your authorization thresholds, while also allowing you to maintain oversight of the entire process. People submitting requisitions shouldn’t have to call or email you for an update; they should be able to access a system where they can look up information themselves. When it comes to form factor, you have two choices: a local, client/server based system installed on your company’s network, or a SaaS-based (Software as a Service) system that is accessed through a web browser. More and more software applications are deployed via the SaaS model for a number of reasons:

- You do not need to install anything on your computers (assuming they already have a web browser)
- SaaS solutions are typically priced per user/per month, and cash outlays are smaller, treated as an Operating Expense rather than a Capital Expense
- Licensing terms are more favorable, and it is easier for companies to scale up or down or switch platforms as their needs change
- The software can be accessed anywhere, anytime, by any device with a browser: PC, Mac, tablet or smartphone. This vastly improves accessibility and productivity

The key is to ensure that anyone who needs to make any kind of purchase has access to the system.

A specialized platform will have been designed with a wide range of customer needs in mind, and will likely offer features, performance and value far beyond what you could expect from something custom-built just for you.

Each person will have his/her own login to maintain security and enforce approvals. The simpler the system is, the easier it will be to train users and obtain their buy-in (we’ll cover more on the subject of change management below).

For Juniors
If you are currently using email to manage purchasing, then we probably don’t have to remind you of all the shortcomings that solution entails. You’re probably only slightly better off than when you were paper-based. Or maybe you are using a dedicated system built in-house by one of your database experts. If so, chances are high it carries a lot of customizations or unique code that can’t be easily maintained if the designer leaves your company. And there are questions as to whether or not it can scale as you grow, or evolve as your needs evolve (for example going to EDI integration with suppliers for automatic transfer of purchase orders).
Step 2: Enable ‘Smarter’ E-procurement

As in most other functions across your company – from manufacturing to accounting to marketing – you should be looking for a specialized procurement platform designed, built and maintained by a third party. The reasons are commensurate with the challenges outlined above. A specialized platform will have been designed with a wide range of customer needs in mind, and will likely offer features, performance and value far beyond what you could expect from something custom-built just for you. It will offer long-term support to help you as your own team comes and goes. And it will be forward-thinking, offering new features and capabilities that you could invest in when the time is right.

Pitfalls of ERP-based Procurement systems

If you are like many small and medium sized businesses, especially those in manufacturing or distribution, your ERP system is the most important operational asset in your company next to your equipment and labour. It’s the very backbone of your company, used to manage inventory and production, and very likely distribution as well. Accounting likely has its own system for keeping the books. This system might integrate with your ERP platform to gather data on inventory, pay invoices and handle payroll.

Over in your corner, you may be using a procurement module built into your ERP system. If that’s the case, chances are it’s not doing what you need, nor is it the easiest to work with. And it almost certainly doesn’t enable the transparency we’ll talk about below. There are many reasons why your ERP-based procurement system is unsuitable. It was likely built by the software vendor as an afterthought to the core ERP functionality, aimed at integrating purchases for raw material and consumables related to production. It was likely not designed to handle indirect purchases coming from elsewhere in your company. The licensing model your company is on could make it cost-prohibitive to allow people outside of Production to use it, meaning accessibility and transparency are all but gone. And finally, its feature set is likely a lot more bloated and over-engineered for small or medium sized business level procurement For example, SAP requires users to take a training course before using the system. This potentially places a limit on the number of users within an organization who are actually qualified to use the system.

TYPICAL ERP COSTS

For a typical mid-sized company, the total software and services cost will range between $150,000 and $750,000, not including hardware. Cost components can be broken down as follows:

- $4,000 per concurrent user
- $200-$400 for each additional ‘light’ user
- 10-35% extra for third-party add-ons
- Implementation costs of 1.5-2.5 times the cost of the software

Source: erpsoftwareblog.com
Step 2: Enable ‘Smarter’ E-procurement

The good news is dedicated E-procurement systems – laser-focused as they are on a single function – don’t carry the big-ticket price tag of an ERP system. With the right pitch and the right support from key colleagues whose lives will be positively impacted, you should be able to demonstrate the return on investment that a dedicated E-procurement system offers.

If you have a software-based procurement management system in place, it’s time to take a step back and make sure it’s doing all it can for you and the company. Workflow is fairly straightforward, but where you will notice differences is in the degree of visibility offered by competing platforms. And visibility is the key to knowledge and performance.

<table>
<thead>
<tr>
<th>Company Size</th>
<th>Avg. # of Users</th>
<th>Avg. Software $’s</th>
<th>Avg. Service $’s</th>
<th>Avg. SW &amp; Service $’s</th>
<th>Avg. Maint. %</th>
<th>Avg. 3 Year Maint. $’s</th>
<th>Avg. Total Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under $50 million</td>
<td>30</td>
<td>$176,597</td>
<td>$126,022</td>
<td>$278,642</td>
<td>15.3%</td>
<td>$81,676</td>
<td>$384,295</td>
</tr>
<tr>
<td>$50 million to $100 million</td>
<td>92</td>
<td>$482,941</td>
<td>$351,374</td>
<td>$833,337</td>
<td>16.1%</td>
<td>$247,554</td>
<td>$1,081,869</td>
</tr>
<tr>
<td>$100 million to $250 million</td>
<td>195</td>
<td>$695,395</td>
<td>$581,090</td>
<td>$1,347,887</td>
<td>16.6%</td>
<td>$443,066</td>
<td>$1,719,551</td>
</tr>
<tr>
<td>$250 million to $500 million</td>
<td>334</td>
<td>$985,714</td>
<td>$655,263</td>
<td>$1,677,143</td>
<td>14.7%</td>
<td>$346,639</td>
<td>$1,987,616</td>
</tr>
<tr>
<td>$500 million to $1 billion</td>
<td>475</td>
<td>$1,364,286</td>
<td>$1,110,000</td>
<td>$2,513,750</td>
<td>16.4%</td>
<td>$617,735</td>
<td>$3,092,021</td>
</tr>
<tr>
<td>$1 billion to $5 billion</td>
<td>2187</td>
<td>$2,360,577</td>
<td>$2,081,000</td>
<td>$4,472,575</td>
<td>17.9%</td>
<td>$1,479,208</td>
<td>$5,920,785</td>
</tr>
<tr>
<td>Over $5 billion</td>
<td>3365</td>
<td>$2,652,500</td>
<td>$2,102,778</td>
<td>$4,659,375</td>
<td>16.0%</td>
<td>$1,163,531</td>
<td>$5,918,809</td>
</tr>
</tbody>
</table>
GAIN BETTER VISIBILITY.
Step 3: Gain Better Visibility

Maintaining visibility into purchasing practices is vital on a number of levels. First, within the procurement function at your company, the more visibility you have into who is buying or approving what, the more you will be able to identify areas for savings and efficiencies. For example, you will be able to pinpoint approval bottlenecks and then devise tactics for easing them, perhaps through training or simply through communication. You will also be able to see who tends to skirt company policy, investigate why and devise plans to bring them on board.

Second, better visibility empowers you with the ability to add more strategic value to your company. Your procurement system should generate data that helps you rationalize vendors, negotiate better contracts and accelerate the buying cycle. It should automate processes wherever possible, and it should enable macro-level performance analysis for continuous improvement. Like any process or piece of software, your procurement system should be an enabler of better business, helping to cut costs and increase productivity.

Last but not least, better visibility means you will be better equipped to answer questions from the folks in Accounting, or even the CEO. When someone wants to know why spend is over budget for this quarter, you’ll be able to explain where and why. That makes you the keeper of valuable information, setting you up to have a voice at the table when it comes to discussing ways to make the company more profitable.

So you have inward visibility within the Procurement team, and you have outward visibility from senior management. But there is also outward visibility for those making purchase requisitions. Think of all the emails and phone calls you can eliminate if you could enable your colleagues to search for their own answers. In this age of instant information at our fingertips, it’s almost an obligation to delegate outward in this way, not a privilege. It’s more efficient for everyone, making the entire purchase process smoother and more credible.

For Newbies
Eliminating paper-based processes is a critical first step in improving visibility. That’s because paper isn’t easily searchable, and almost certainly can’t be accessible on demand. When you migrate to a paperless process, you opt for a data-driven – and hence highly accessible – system that immediately overtakes old paper-based processes in terms of visibility. Requisitions become data points, and data points are fluid and reportable.
Step 3: Gain Better Visibility

If you aren’t at the point where you can go paperless, then increasing visibility will require some duplication of effort. You will be limited in just how much you can consolidate your purchase information, and much of your effort around gaining visibility will be just that: effort. To get the ball rolling, you can consider the following steps:

- Scanning paper requests and keeping them on a central server
- Emailing updates to originators to keep them apprised of their order status
- Maintaining a hardcopy spreadsheet of all pending and open orders that people can come by and check out on their own, or putting it on a central server for remote access

As you can see, until you make the decision to go paperless, there is little in the way of visibility for you to enjoy. But you already know this, don’t you?

For Juniors

Here we will assume that you are using an e-procurement solution, and all you need now is help figuring out how to use the data it generates. Your software should already have some basic reports at your disposal, but if it doesn’t then you will need to export data and use a separate reporting tool to gain the perspective you seek. Sometimes this can be done within a spreadsheet application such as MS Excel®, but such platforms are limited in terms of ease of distribution.

Some of the basic reports you should be using are:
- Purchases by Item/Type/Category
- Purchases by Vendor
- Spend per Employee or Department
- Budget by Vendor

Spend Analysis: The Ultimate Goal of Visibility

Spend visibility is a critical determinant of Procurement’s success within an organization. Every Chief Purchasing Officer knows that achieving world-class performance requires controlling and leveraging an organization’s existing spend. This means optimizing purchases from trusted vendors (ones that balance price with availability and service), and it also means being able to drill into your purchasing data in both directions: where it’s coming from, and where it’s going.

Measuring Maverick Spend

According to the Hackett Group, an average of 14.4% of all indirect spending at U.S. corporations is non-compliant.
Step 3: Gain Better Visibility

Accurate, detailed reporting gives you the insight you need to make more informed decisions about spend management. After all, this is where you deliver strategic value to your organization. Unless you are using a platform built specifically for procurement, there is little chance you have the right tools to do your job more effectively.

Of course, visibility is relatively powerless without the ability to measure and respond. Many other parts of your business – production, distribution, sales and marketing – are assigned annual, quarterly and even monthly yardsticks often referred to as Key Performance Indicators (KPIs). These KPIs are put in place to measure performance against target, and to identify areas of the business where results are lagging. In production it could be ‘Defects per 1,000,000 units’; for Distribution it could be ‘On-time deliveries’; Sales have their sales quotas, and marketing has their ‘New leads per campaign’. Over in your corner, common procurement KPIs include Procurement cycle time, Cost per invoice, First time match rate (PO, invoice and packing slip), and obviously Spend under management. Continuous measurement against an agreed set of KPIs will encourage continuous improvement in these areas. You can even benchmark your company against others in your industry and tie KPI results to salary or bonus structures to motivate your people to constantly improve procurement practices and results.
Rosabeth Moss Kanter, tenured Harvard business professor and one of North America’s leading authorities on change and change management, says that “mindless habitual behavior is the enemy of innovation.” Yet we all know how hard it can be to push back when someone – especially someone senior to us – says ‘that’s not the way it’s done around here’. Does this mean that change is bad? Hardly. An astute manager would recognize the flaws inherent in this knee-jerk argument against change. All he needs to do is ask if his organization is the number-one organization in the industry, because surely it would be if it was doing everything right. And if it is number one, then what can it do to stay there in the face of challenge? What people are really saying is that change is scary and difficult. Taken one step further, they’re saying that people and habits are tough to overcome. But with the right approach, people and habits can change – or at least get out of the way.

As in any other part of your business, the degree of success you will have when implementing any of the suggestions discussed in this paper will depend largely on how well you address one fundamental truth: people matter more than process. Building a more systematic, paperless and visible procurement practice will require a tremendous amount of change throughout your company, not just in your corner. The better you are at anticipating or genuinely acknowledging resistance, complications and roadblocks, the more likely you will be to succeed. Dealing with the people side of the equation is often more important than choosing any specific technology or process. In fact, even the most advanced systems, promising thousands of dollars in savings as they raise your own stock in the company can be undermined and doomed to fail if you don’t factor in how to help your people deal with the coming change.

“One must change one’s tactics every ten years if one wishes to maintain one’s superiority.”
- Napoleon Bonaparte
Jack Welch, famed CEO of General Electric during the 1990s and world-renowned management guru once emphatically urged leaders to “change before you have to.” He advised people and companies to learn and change ahead of the curve, not behind it where the stakes are a lot higher. Welch also said “an organization’s ability to learn, and translate that learning into action rapidly, is the ultimate competitive advantage.” Procurement systems that embrace transparent processes, reduce administrative overhead and generate better visibility into how an organization spends its money are a powerful source of learning, and thus, according to Welch, a wellspring of competitive advantage. This is why procurement professionals with the right toolbox are increasingly finding themselves at the strategy table.

To achieve rock star status, you will have to help your company deal with the changes about to take place as you upgrade its procurement processes. But how to do so is beyond the scope of this paper. All we aim to accomplish here is to raise your awareness of the human angle, and to never underestimate its significance.

Conclusion

The road to better procurement practices is a challenging one, but the reward is easy to measure. By establishing and enforcing clear purchasing policies, moving away from paper-based systems and mining purchasing data for better insight, procurement teams can make a powerful contribution to the bottom line, freeing up cash for more productive use and earning a seat at the strategy table. There are many tools available to make this a reality, and they are easier to adopt than you might think.
About Procurify.

Procurify’s mission is to provide useful, well designed, simple business software that is accessible to everyone.

Procurify is an online spend management solution that gives you control and visibility into your company spending. Procurify helps streamline the entire purchasing process to drive higher compliance with contracts, maintain control, assign accountability, and increase visibility into your organization.

For more information, visit us at www.procurify.com.

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i The E-Procurement Benchmark Report, Aberdeen Group, August 2008.
iii http://en.wikipedia.org/wiki/E-procurement
iv http://blog.procurify.com/2013/03/13/key-performance-indicators-procure-to-pay/
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v http://www.brainyquote.com/quotes/j/jackwelch173305.html