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Procurement Outsourcing: Trends, Challenges, Benefits and a Roadmap for Implementation

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INTRODUCTION

Compared to the more established practices in finance, accounting and HR, procurement outsourcing is a relatively new area that has been garnering significant attention because of its ability to have a much larger impact on an organization.

This white paper explains trends in procurement outsourcing, areas within the procurement space that lend themselves to a global delivery model and the key respective benefits. In addition, we discuss how organizations can approach this area from an implementation standpoint and share a company's experience as one of the early adopters of procurement outsourcing.

TRENDS IN PROCUREMENT OUTSOURCING

Procurement is one of the least-understood areas of outsourcing, but awareness is increasing through both growth in the sector and an increasing body of research and articles. Much of the mis-understanding is due to these two primary factors:

1. Understanding the benefits of outsourcing
2. Appreciating the role of outsourcing within the organization

In contrast to the better-known forms of outsourcing, the benefits of procurement outsourcing are less the result of improved operational efficiency and more because of an increase in effectiveness. The other primary concern is that procurement is a core business function, and by outsourcing it, companies may be compromising the integrity of their contracting processes and vendor relationships, thereby reducing procurement to a less strategic role in the organization.

While these misunderstandings are gradually being dispelled, they remain a factor in some of the emerging trends in procurement outsourcing. As a result, buyers often take a strategy of “dipping their

toe in the water” rather than committing holistically and also often focus on technology enablement rather than full business process outsourcing (BPO). In this context, to best examine these current market trends, we look at them from three key perspectives: the customer, the service provider and the market.

Resource Constraints Force Customers to Examine Procurement Outsourcing

Procurement organizations are increasingly constrained by insufficient resources and outdated skill sets. In a time of declining budgets, Chief Procurement Officers (CPOs) are often forced to accomplish more with less, forcing prioritization of their efforts. Budgetary restrictions are thus moving more CPOs to look for lower-cost service delivery solutions such as outsourcing.

Also, many CPOs have underestimated the degree of change management required to transform the orientation of their teams from a transactional/negotiation focus to a mindset of providing knowledge-driven operational and service-delivery excellence. Today there is an increasing awareness of how an outsourced service provider can provide a faster path toward the latter.

Lastly, especially in mid-sized companies, CPOs have struggled to obtain funding to refresh their procurement technology. Many of them perceive the advantages of improved technology bundled within an outsourced offering as a potential path over this hurdle.

Service Providers Innovate and Invest to Seize Opportunities

Service providers have invested significantly in their procurement offerings by enhancing their capabilities in a number of areas. These areas include an increased sophistication in spend analytics, new procurement knowledge process outsourcing (PKPO)



offerings in areas such as contract drafting, risk analytics and value engineering, and the extension of their procurement outsourcing offerings into supply chain management areas such as logistics support and inventory analysis. Service providers have additionally continued to recruit senior talent with category expertise to enhance and broaden their strategic sourcing offerings. Last, a number of providers have refined their technology approach to offer “platform-based” procurement outsourcing solutions that combine the benefits of service delivery excellence with improved automation.

Markets Grow and Adapt to Client Objectives

In terms of the number of service providers in the market as well as the number of procurement subject matter experts at each provider, capacity in the market has expanded, with continued new entrants and increased competition. The entry of India-heritage providers several years ago put pressure on earlier outsourcing models, resulting in an increased degree of North American and European-based service provider flexibility and willingness to design a procurement outsourcing solution that will fit the unique requirements of the customer. While large source-to-pay contracts drive the fastest and most comprehensive benefits to clients, many clients are seeking ways to augment the capabilities of their internal organizations or to move slowly because of organizational change or perceived risk issues.

The market has adapted to client objectives by providing a wide variety of outsourcing solutions by spend category, process or subprocess or geography. In many cases, initial smaller contracts are designed by both the customer and the outsourcing provider to expand organically, contingent upon the successful execution of the initial scope. To this point, TPI’s research has shown a decrease in the initial contract value of procurement outsourcing contracts, but very high rates of contract expansions, extensions and renewals.

In all, we continue to anticipate healthy year-over-year growth in the procurement outsourcing market. The aforementioned trends are strong indications of increasing maturity that we believe will continue to bear fruit for both customers and service providers.

PROCUREMENT AREAS THAT LEND THEMSELVES TO OUTSOURCING

Service provider capabilities are continuing to mature as providers today engage with their clients to add value across the spectrum of procurement activities, combining transactional, analytical, project and consultative services:

Transactional Buying and Settlement

Transactional activities were the starting point for procurement outsourcing. These include processing purchase requisitions and purchase orders, managing simple RFQs and invoice matching and payment. Service providers incorporate lean approaches to drive the efficiency and accuracy of these activities.

Measurement and Development

Service providers bring strong analytical methods to measure quality and analyze spending patterns and compliance.

Selection and Contracting

Provider offerings here tend to be highly collaborative with internal procurement organizations, offering both consultative and project services, such as managing RFPs and many elements of contract negotiations. In the vast majority of instances, the client retains all decision and final contract execution responsibilities in the process.

Sourcing Strategy Development

Service providers bring their insights, analysis and recommendations to procurement to assist in



developing corporate supply and sourcing strategies, savings targets, savings analysis and other special programs.

RESULTS ACHIEVED THROUGH PROCUREMENT OUTSOURCING

TPI and Aberdeen research indicates that on average, procurement outsourcing can deliver improvements in spend under management (18 percent), contract compliance (31 percent) and savings from sourcing (28 percent) that are above and beyond the levels typically achieved by internal procurement organizations.

The balance of this section describes the benefits of procurement outsourcing.

Economic Improvement

Savings from sourcing can be improved and accelerated through category insights and improved visibility and compliance. Many procurement outsourcers participate in common category markets on an ongoing basis rather than the episodic involvement of many internal organizations. This provides real-time insight into market price points and the opportunity for continuous refinements of sourcing tools and processes specific to each market.

Outsourcing often provides a reduction in operational costs of 15-20 percent or more through process standardization and improvement, staff right-sizing and realization of economies of scale. Outsourcers live or die by their ability to generate ongoing improvements to processes and workflows, are able to leverage their resources across multiple clients and can bring the benefits of labor arbitrage to many procurement activities.

Service Improvement

Internal procurement organizations are often hampered by lingering perceptions of a bureaucratic mindset and a compliance focus. While many

procurement departments are anecdotally recognized for providing “good” service, internal clients still believe that many procurement activities take longer than needed and often focus on “staying in the process” over achieving business outcomes. In contrast, a good outsourcing contract will include an aligned set of service levels and an effective structure for measuring and reporting these service level agreements (SLAs) consistently. SLAs can measure cycle times, satisfaction and realization of benefits more consistently than is usually achieved internally. Because year-over-year improvements are contractually specified and aligned to service provider compensation, the SLAs receive the attention that they need and consequently provide a more reliable source of data for the procurement organization to demonstrate its value and performance to the broader company.

Capability Improvement

As discussed previously, procurement outsourcers are often able to provide expanded supply market knowledge in many categories already mentioned and beyond what companies can afford to maintain internally, thus resulting in more effective sourcing. Some providers will bundle eProcurement tools, such as spend analysis, eRFx, reverse auctions, supplier enablement, eProcurement and eInvoicing.

Budget-constrained procurement organizations often cannot afford to maintain valuable but expensive capabilities in certain areas (market research, risk measurement, analytics, etc.) or even effect the timely adoption of contract templates to different flavors of procurement requirements. Service providers can deliver these skills at a lower price point with the additional benefit of offering measurable service levels. This enables the procurement organization to deliver more value-added services for the same cost, while the retained organization can focus more of its talent on earlier and more effective engagement with key internal



customers to define and execute sourcing and supplier management strategies.

Adaptability

Procurement is often one of the last organizations to obtain funding for improvement and growth and often faces significant staff reduction pressures, including being asked to “do more with less.” Service providers can leverage their resources across multiple clients and can be more adaptable in staffing for peaks and valleys in business activity with a client company.

Business Risk Reduction

Because service providers are compensated on their ability to measure and report, they have greatly refined capabilities and typically provide improved transactional/spend visibility and compliance, which enables earlier detection and intervention of compliance and risk issues.

Service providers must meet Sarbanes-Oxley standards and tend to be proficient in process documentation. It is standard for regular internal and customer audits to be provided for under the terms of the outsourcing agreement. Additionally, service providers often offer mature technology hosting, support and disaster recovery solutions.

Regulatory and Corporate Social Responsibility

Outsourcing can provide lower cost solutions for regulatory and corporate social responsibility requirements.

IMPLEMENTATION: OPTIONS AND THE ROADMAP

Implementing a procurement outsourcing program consists of evaluating approach options and vendor selection and contracting before the actual rollout. While each step has its own value to the overall

process, successful program implementations are differentiated by their approach and the program rollout itself.

Here we evaluate how Infosys has arrived at approach options in complex procurement outsourcing programs, has helped companies choose the one that best fits their current challenges and change management, and puts them in the best position to meet their business needs several years into the future.

There are two broad options to approaching implementing procurement outsourcing:

1. Consult, fix and outsource
or
2. Consult, outsource and fix

Apart from the sequence in which we approach these options, choosing an option depends on several factors that we will examine. But first let’s define the key phases involved:

Consult: The consult phase is a constant across both options and is an important precursor to the outsourcing journey. During this phase, you create a detailed inventory of your “as-is” procurement ecosystem, including people, processes, systems and special in-flight projects. Creating this inventory will help develop the blueprint of a future ecosystem, consisting of integrated retained and outsourced processes, people and governance for outsourcing service delivery, and a business case that could be reviewed for the returns being generated through the procurement outsourcing program implementation.

Fix: This is essentially akin to a mini-transformation phase where process optimization is accomplished, productivity adjustments are made, and tools for enhancing effectiveness and efficiency are brought in as may be needed and blueprinted in the consult phase.



Shift/Outsource: During this phase, the outsourcer assumes responsibility for performing outsourced activities and is governed by service SLAs to work toward identified key performance indicators (KPIs).

Factors To Be Considered In Choosing the Right Approach	Factor Description	Consult, Fix and Shift	Consult, Shift and Fix
As-Is Situation	As-is state of procurement systems; people and processes in the capability maturity life cycle.	A wide gap between current and best-in-class state requires significant up-front change management and policy intervention. In such instances, it is preferable for outsourcing to follow transformation initiation or at the minimum finalization of roadmap.	In case no large-scale systems and process change is involved, it is optimal to shift (outsource) and continue process transformation using service provider also as a change agent and implementation vehicle.
Speed to Benefit	Time taken for business benefits to start accruing and realize value	Driving transformation internally is often more complex, time consuming and costly. This reduces the ROI realized over project timeframe.	Outsourcing followed by transformation has the advantage of realizing significant cost advantages much earlier in the process. Leveraging service providers' proven capabilities and experience gives the change process a better chance of resulting in a much more attractive ROI over the project timeframe.
Implementation Risk	Risk associated with project implementation often requires specialized skill set and domain expertise	Change management involving procurement is more complex than other functions due to requirement of specialized skill sets, market knowledge and domain expertise. Doing it all in-house presents higher risk to project implementation.	Choosing a service provider to bring in expert resources equipped with specialized skill set and domain expertise enables faster and accurate implementation of best-in-class tools and processes and thus significantly lowers the implementation risk.



While the chart above may help identify the best approach to a particular implementation, a few key factors should be considered for the program rollout per the agreed approach and blueprint. At the top of the list — irrespective of the option chosen, and like any other outsourcing initiative — top management support is a critical factor. Also, identifying internal champions within process areas is critical to success.

Additionally, here are some key prerequisites for maximizing success of your procurement outsourcing program:

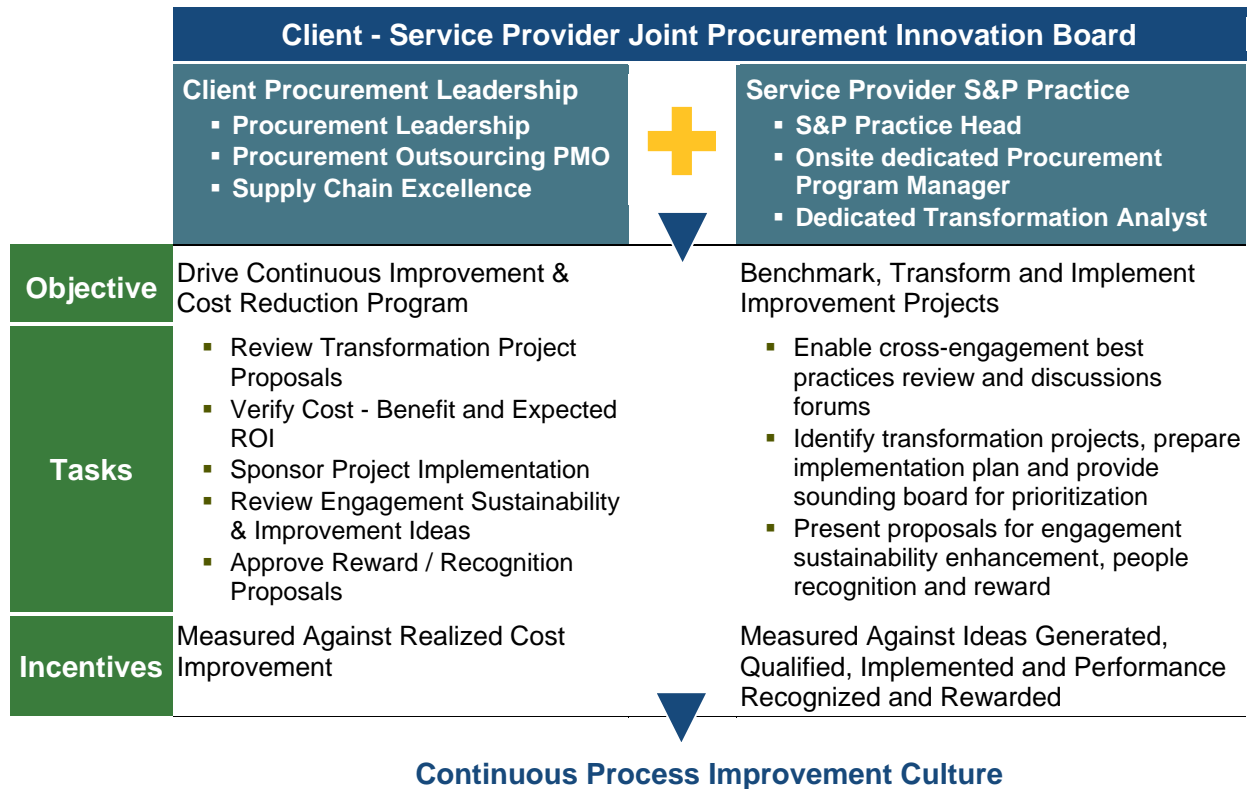
1. **Managing risks due to reduced control over the process:** One of the key challenges in procurement outsourcing is handing over control of the company's spend and crucial supplier relationships. To minimize implementation risk, it is important to implement service delivery controls that demonstrate ability and commitment to building measurable, enforceable SLAs with penalties for nonperformance.
2. **Managing continuity of service delivery:** Service delivery should be managed by a joint (client and service provider) process team to manage compliance to the outsourcing contract. Make this a strong governance team by empowering them to take the necessary actions. It is important to secure the service provider's commitment to being governed.
3. **Managing personnel and process transition issues:** Before a procurement outsourcing contract is agreed to and signed, a detailed transition plan should be created that outlines the key milestones of the transition as well as how it addresses the issues surrounding people and service delivery.
4. **Managing technology integration issues:** Ensuring the service provider brings the technical competence to implement the technology solution as well as maintain the

technology environment enables faster time to value. The one-size-fits-all platform and solution is an unrealistic expectation. The key to success is a modular approach that links procurement technologies and functionalities to key processes.

5. **Managing expectations and consensus:** Assembling a cross-functional review team that includes representation from the following functions helps build the necessary consensus for the procurement outsourcing program implementation:
 - a) **Human Resources (HR):** HR should be brought on board early in the game to help walk through the sensitive issues surrounding employee transfer to the service provider (if any), freeing up existing resources and helping supervise change management.
 - b) **Information Technology (IT):** An early onboarding of the IT department helps assist with internal assessments of the technology/applications extendibility, IT risk management and subsequent reviews of the service provider's proposal for technology connectivity and communications solution options.
 - c) **Legal:** A transaction of this magnitude requires review in detail by legal counsel from both the perspective of the client's own legal liability as well as from the viewpoint of the client's supply base.
 - d) **Finance:** Assistance from finance departments will be needed not just pre-implementation to provide guidance as to the pricing model suggested by the service provider, but also to ensure that the client appropriately accounts for and measures the return on investment of the procurement outsourcing initiative.



6. **Joint governance and service innovation board:** A joint governance and procurement innovation board should be established and comprised of executives from both the client and the service provider in order to provide the top-level attention necessary to ensure a successful working relationship and sustained value creation. Participating client executives may vary depending on the industry involved but typically include the CFO, CPO and COO. The governance board should provide the right escalation path to bring service delivery and compliance issues to the joint governance board for resolution pursuant to previously agreed protocol. Escalation procedures are critical for ensuring that issues are resolved quickly and to the satisfaction of both parties. It is a good idea to include timeframes in the escalation so that issues do not languish and cause harm to the relationship. The joint governance and service innovation board should also provide for driving sustained value creation initiatives through the procurement outsourcing program.



7. **Measuring success:** Metrics are a part of SLAs that will detail expectations and roles of both parties. While some companies may be interested in spend management effectiveness-related KPIs, others may be concerned with the cost of procurement. While traditionally the focus in any outsourcing engagement has been on SLAs linked to transactional metrics concerning turnaround time, accuracy and quality, the value in procurement outsourcing engagements is derived out of metrics related to spend reduction, category management, compliance and suppliers and/or spend under management. The fast-maturing



industry is also increasingly adopting gainshare arrangements for SLAs achieved beyond established thresholds that relate to metrics as described above.

While procurement outsourcing has its share of complexity, the promise of value realization and multifold return on investment is too hard to ignore. With a well-planned strategy, selecting the right service provider with a risk-averse implementation plan, procurement outsourcing can be a source of significant competitive advantage as experienced by some of the leading global companies.

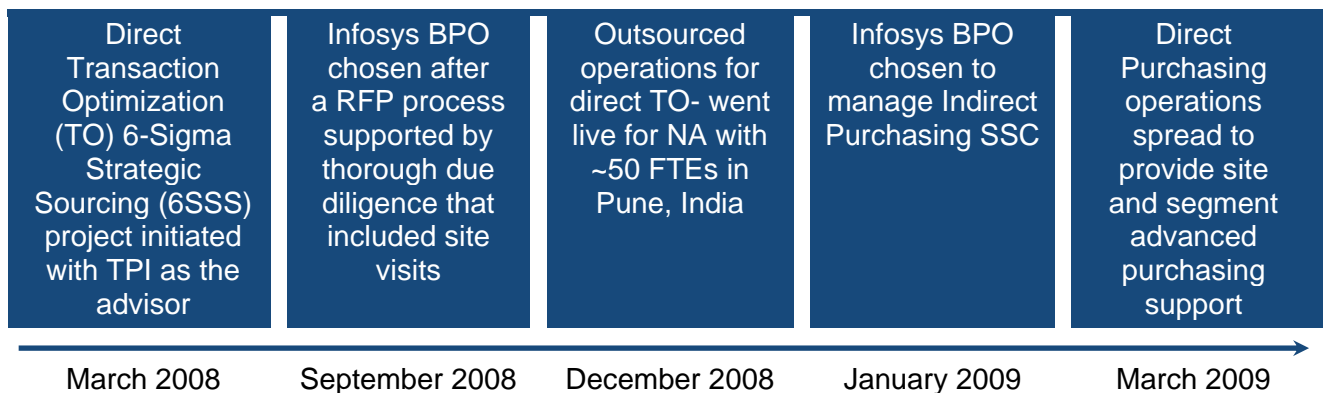
CASE STUDY: GLOBAL MANUFACTURER

One of the world's largest manufacturers, located in the Midwestern United States, wanted to increase the focus of its procurement organization on strategic initiatives, new product development and enhanced levels of collaboration with procurement's internal customers.

To support this initiative, the company's procurement group wanted a partner that could support many of its transactional procurement functions that utilized the company's legacy ERP platform. In March 2008, the company engaged TPI to assist it in understanding the procurement outsourcing market by conducting an outsourcing source selection process. The initiative was conducted under the company's Six Sigma protocols with a strong "voice of the customer" component throughout. The company assessed the overall market capabilities and then selected five service providers to participate in the RFP process. The sourcing process was designed to be highly collaborative and enable candid executive interaction with the service providers early in the process to better align company requirements with market capabilities.

At the end of the process, the company selected Infosys BPO, and several additional processes have been subsequently added to the contract as depicted below.

The Company's Procurement Outsourcing Journey





The company approached the project with dedicated resources and deployed a Six Sigma black belt early in the project. Senior management within the purchasing organization ensured that internal stakeholders were made aware of the strategic intent of the project to meet best-in-class procurement benchmarks through open, proactive and frequent communication. Both organizations understood the need for a measured approach, with initial success in the identified scope in direct purchasing being a key requirement for expanding the outsourcing footprint. A collaborative and flexible mindset on both sides helped manage any issues that cropped up in the implementation process. The company was challenged by the lack of standardized processes, multiple purchasing systems in use and a dependence on legacy systems.

Infosys leveraged its tools and process expertise to help the company overcome these challenges and focus on its core business by leveraging the strong leadership support, a cultural alignment that helped build mutual confidence, and a transparent business relationship that has helped manage change smoothly and provided the benefits of standardized work and cost savings.

CONCLUSION

Service providers continue to develop their capabilities in procurement outsourcing. As more buyers gain familiarity with this unique form of outsourcing, we expect to see continued robust growth in this sector.

LOOKING FOR A STRATEGIC PARTNER?

TPI's CPO Services experts can help you achieve your organizational goals through objective advice, knowledge of your industry, and experience with arrangements from simple to complex.

Looking for a strategic partner? Contact **Bill Huber**, Director, CPO Services, TPI, at **+1 540 318 0124** or **bill.huber@tpi.net**. For more information, visit www.tpi.net.



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Bill worked in several senior management positions in the financial services industry before joining TPI. He was Senior Vice President of Outsourcing Strategy and Governance, SVP/Chief Procurement Officer and Head of Strategic Sourcing, and VP/Head of IT Sourcing at Wachovia. As Senior Vice President Outsourcing Strategy and Governance, Bill completed the enterprise service delivery transformation strategy for Wachovia Corporation. The transformation included an enterprise offshore strategy, multiprocess human resources outsourcing, and the establishment of a large virtual captive offshore solution for business and knowledge processes.

As Chief Procurement Officer & Head of Strategic Sourcing, he was responsible for procurement transformation and attained more than US\$300 million in annualized savings, led merger integration and rationalization activities, implemented a leading sourcing management system and outsourced facilities management for office towers.

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ABOUT TPI: TPI, a unit of Information Services Group, Inc. (ISG) (NASDAQ:III, IIIIU, IIIIW), is the founder and innovator of the sourcing advisory industry, and the largest sourcing data and advisory firm in the world. We are expert at a broad range of business support functions and related research methodologies. Utilizing deep functional domain expertise and extensive practical experience, our accomplished industry experts collaborate with organizations to help them advance their business operations through the best combination of business process improvement, shared services, outsourcing and offshoring. For additional information, visit www.tpi.net.

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