Five things
Getting the basics right in procurement
“Many procurement functions put large savings numbers ‘up in lights’ when contracts are signed, then clock-off leaving the executive wondering where all the money has gone. When done well, contract management can deliver on the promises made and make sure you get what you signed up for.”

Scott Blackwood
Executive Director, Ernst & Young, New Zealand
Five things you should expect from your procurement function

A lot can be achieved by doing the simple stuff well

Has the desire to improve the efficiency and effectiveness of procurement created unnecessary complexity? Have we become technology led rather than technology enabled? Do procurement transformations rely too heavily on complex process re-designs rather than focus on getting the basics right?

In many government and commercial organisations procurement has now become recognised as a fundamental enabler of business strategy and a preferred method for achieving sustainable cost reduction. It is often a source of opportunity for process simplification with technology enablement and a window into understanding what is really going on in operations through data and information. Based on our experience in working with organisations to improve their procurement outcomes, we believe that there are, at a minimum, five things you should expect from your procurement function right now. If you are unable to ‘tick these boxes’ chances are that money is being left on the table, commercial decisions are being made in isolation from the business and antiquated processes and systems are a barrier to realising the full potential that procurement can deliver. Furthermore, compliance to strategy and process will be encumbered by the increasing cost to change.

It is our point of view that your procurement function should:

1. Have a detailed spend map across your entire organisation, updated quarterly.
2. Be a driver of sustainable savings (when, where, why and how) across the organisation.
3. Be engaged with the wider organisation to understand how procurement can reduce costs across the value chain.
4. Ensure that value is realised through contract management and supplier relationship management frameworks which are operationalised.
5. Be delivering procurement within an operating model that connects commercial and technical capability to drive optimal client outcomes.
One

Procurement spendmap

Do you understand your spend at an organisational level rather than just a divisional or geographic level?

Most organisations do not have a spendmap and rely on poor quality information including summaries of general ledger categories or spend by a supplier. A spendmap can provide you with the basis for identifying opportunities and risks, providing the foundation for cost reduction initiatives and improving the value you receive from your suppliers.

Mapping spend, and regularly updating that map, will give you invaluable insights which include:

- Knowing what your total spend is
- Who is spending and on what
- Which vendors supply multiple business units
- Which business units buy the same or similar goods and services
- What portion of your spend is with the core suppliers (e.g., top 10) and the total number of one-off and small value transactions suppliers
- How many transactions your organisation processes and the associated administrative cost

The challenges in analysing spend and preparing the spendmap should not be underestimated. The key is to ensure all data and information repositories are captured and that rules are in place to establish cost categories and ‘buckets’. We find that when organisations complete this for the first time the information is surprising for many and is quickly utilised to assist with decision making and informs financial reporting.
“The most frequently heard phrases when a spend map is first published – “I didn't know that” and “do we really spend that much on them?” A spend map is the first foundation step for a procurement function to better manage up, down, in and out.”

Alan Codd
Partner, Ernst & Young, Australia

### Category Analysis
- Am I buying the same/similar goods and services from different vendors or too many vendors?

We build a 3-tier category hierarchy that reflects your business/industry, this includes a Super Category, Category and Sub-Category. We then categorise all of the spend transactions into the most appropriate sub category. Our reporting then allows you to explore your spend in the defined spend category hierarchy. This allows you to identify spend leakage issues such as fragmented purchasing across vendors and across the organisation for specific categories, rogue/maverick spend.

### Item Analysis
- Am I buying the same item from different vendors, in different geographies or business units at different prices?

We can analyse your expenditure at an item level. Our analysis enables us to explore situations where the same item is being purchased from multiple vendors, at different unit prices, by different geographies or different branches of the business. Our item analysis allows us to focus on fragmented purchasing in the business and identify spend leakage issues such as purchasing from non-preferred vendors, fragmented purchasing across the organisation and rogue/maverick spend.

### Payment Analysis
- Am I leveraging all possible discounts or interest from my invoice payment process?

Payment analysis enables us to analyse payment practises and terms within your P2P process to identify issues such as unrealised discounts through late payments of invoices or unrealised interest from early payments of invoices.

### Vendor Analysis
- What goods and services am I purchasing from a single vendor?

Vendor analysis allows you to create detailed spend profiles for each vendor. We perform vendor normalisation to create a single view of vendor i.e., Ernst & Young, Ernst & Young LLP and EY LLP are all identified as the same vendor. Our vendor profile will show vendor spend by category, organisation structure, item, payment, contract (where available) and historic spend over time. This process is designed to provide a single view of total organisation engagement with a single vendor.

### Contract Analysis
- Am I complying with my existing negotiated contract terms?

Where contract data is available and used in your finance system we will analyse spend with vendors by contract to identify issues such as contract over spend and/or contract non-compliance.

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Five things Getting the basics right in procurement
There is a large body of evidence suggesting that the majority of cost reduction programs fail to meet expectations, often because of poor planning, management and execution. Our experience suggests that an effective cost reduction program considers the full range of procurement levers across demand, source, fulfil and manage using a hypothesis driven approach where ownership and accountability for achieving savings are aligned with the business.

This means that the procurement team should not be the ‘sole owners’ of savings. Instead the focus of the team should be on facilitating and driving initiatives. They should also be accountable for the governance function through recording, measuring and reporting savings. The importance of this distinction should not be underestimated. As the focus of the procurement team moves from unit cost reduction to ‘total cost of ownership’ improvement many of the initiatives will rely on process and business unit practice changes. This means that business units need to be accountable for changes and the consequential savings. Our observation is that the procurement team needs to be rigorous in making sure that the savings are actually realised. In some cases this may lead to the procurement team ensuring budgets and cost estimates are actually reduced in accordance with financial management practices.

Two

Savings – How much and when?
Have you got the right balance between short and long term savings?
Another important challenge for the procurement team is in getting the right balance between shorter term savings opportunities and longer-term transformational opportunities. The typical mandate for a procurement team is centred on a need to produce savings in the short-term to ‘get buy-in’. As a result, the short-term opportunities are often pursued at the expense of longer-term and more strategic core service delivery improvement initiatives. Our observation is that the most successful procurement transformations split and appropriately resource short-term (quick win) opportunities as well as longer-term more strategic change. Whilst shorter-term initiatives provide good traction, more substantial benefits usually accrue from the longer-term and more transformational initiatives.

Five things Getting the basics right in procurement
If your procurement cost reduction initiatives are focused solely on achieving a price reduction from contracts, then the full potential for benefits has been missed. The squeezing of profit margins for many suppliers means that the ability to extract further savings through adversarial price-based negotiations is more challenging.

Instead of looking at price as the number one target, the opportunity for significant savings often sits within an organisation and a new way of working. Looking across the entire value chain opens up greater opportunity, for example:

- **Demand**: is there a mismatch between your ‘wants’ and your ‘needs’?
- **Source**: are you getting the best value for your money or are their alternative contract models or service delivery approaches?
- **Fulfill**: have you balanced demand and supply and ensured your requisition-to-pay processes enables compliance and risk management?
- **Manage**: are you losing value, reducing the cost of doing business with you or asking your suppliers what could save them and you money?

One of the critical drivers of spend leakage is the mismatch between what your organisation and people want and what they need. The (often) incremental creep towards ‘wants’ rather than ‘needs’ comes from a natural desire to do better however at its worst it fails to recognise a fit-for-purpose solution. A deeper understanding of ‘demand drivers’ can be used to develop initiatives that improve quality and time whilst eliminating, reducing or shifting demand such that the overall cost to deliver is reduced. The levers that should be under consideration include:

- Eliminating demand
- Reviewing volume requirements
- Reducing demand frequency
- Considering alternatives to filling need
- Encouraging re-use
- Simplifying and/or standardising product/service specification
- Reducing portfolio range and complexity

Three Savings initiatives across the value chain

Do you consider more than unit costs when identifying procurement savings?
Historically, procurement has used sourcing methods to reduce unit costs on an initiative by initiative basis. This often comes at the expense of the wider portfolio of spend or neglects the life cycle cost of assets. Your procurement function should use a category planning process to drive a more holistic view of spend prior to undertaking discrete go-to-market activities. We have observed many instances where this approach has changed what an organisation goes to market for, for example examination of internal costs through category planning may lead to an outsourced (or an in-sourced) solution rather than a discrete sourcing exercise.

Another aspect of the procurement value chain where further analysis can yield potential rewards is the requisition-to-pay process. Does your organisation manage these processes efficiently and effectively? Has it got the balance between risk management and process efficiency right? Is there an opportunity to improve the effectiveness of the accounts payable team by reducing the number of transactions or reducing the number of incorrect invoices received? Detailed process mapping and data analytics can highlight these issues instantly and can save in terms of value leakage and shifting resourcing to more value adding tasks.

“Procurement professionals continue to push the line – ‘standardise the spec, reduce suppliers and cut unit costs’ without considering the full range of benefits across the demand, source, fulfil and manage value chain. Procurement can deliver a lot more that unit cost reduction including value generation, cost reduction and speed to revenue.”

Noah Costelloe
Partner, Ernst & Young, Australia

Procurement value chain levers

Five things Getting the basics right in procurement
Contract and supplier relationship management frameworks

Are you ensuring that value is not lost due to the lack of a comprehensive contract management process that covers performance and manages risk?

Too often we see organisations fail to manage their contracts and suppliers, typical symptoms include:

- Excessive effort managing ‘transactional suppliers’
- Informal or issue based management of strategic suppliers
- Putting the contract under the table until a legal issue arises and then calling the legal unit
- Lack of a balanced approach to performance management often focused on time rather than value and cost
- Failure to include continuous improvement as part of the contract management process
- Inability to have conversations with suppliers about strategic issues affecting the market

An effective supplier management framework that appropriately aligns risk, effort and reward is a key enabler of ongoing sustainable value creation. The framework needs to include segmentation (i.e., strategic, operational and tactical), performance management framework(s) and a clear articulation of organisational accountability and responsibility.

Vendors are not psychic. They require demand information to be effective. The integration of key suppliers into longer-term demand planning processes will yield value.

Another observation is that supplier risk assessment is generally poorly executed in many organisations. Supplier risk assessment is not only a parameter that should be assessed during the sourcing phase but also continuously monitored and managed. The position of many suppliers may vary considerably from the time at which you contracted with them, especially if you signed a long-term contract. As the economy changes, so too does the position of your suppliers. Understanding their position in the market can provide the basis for identifying opportunities to mitigate your risk and ensure that those areas in your supply chain that are exposed and might cause disruption can be effectively managed.

Where appropriate, you may be able to rebalance risk through negotiation with identified suppliers. Typical risks that should be assessed include:

- Financial stability
- Ethical performance
- Quality control
- Technical skill
- Depth of skills and supply chain
Another aspect of supplier risk assessment that is often missed is the understanding of who is best place to manage risk – your organisation or the supplier. For example, are you or your supplier best placed to manage inventory risk? In addition, some suppliers may be prepared to reduce cost in return for a longer-term commitment. For those suppliers that are significant to your operations, there may be opportunities to re-negotiate on more commercially beneficial terms in exchange for a longer commitment or changed terms of trade. Many suppliers will be looking for commitments from their clients and opportunities for improving relationships and shifting contracts from an adversarial model to a more collaborative gain sharing approach. Sourcing or re-negotiation should be done selectively, looking for the highest impact opportunities that do not increase longer term risk.

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<thead>
<tr>
<th>Plan</th>
<th>Execute</th>
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<tbody>
<tr>
<td>Contract management planning (continuous cycle)</td>
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<td>Contract management reporting</td>
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<td>Government and compliance</td>
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**Five things** Getting the basics right in procurement
Many procurement teams operate under an informal mandate that does not clearly articulate what they are accountable for. In the absence of a procurement capability and operating model, a team is fundamentally limited in their effectiveness.

The key to defining this is to consider the following:

- **Strategy**: establishing the vision, objectives, strategies and performance scorecard for the team.
- **Governance and control**: defining executive oversight and how procurement interacts with the wider business. Defining appropriate procurement delegations that reflect value, risk and capability. Defining how risk and compliance are going to be measured and monitored.
- **Organisation and skills**: defining the appropriate reporting relationships, organisation design and determining appropriate role and responsibilities. Determining the right mix between commercial and technical skills and identifying the key skills gaps.
- **Procurement value chain**: what are the key operating processes that support the procurement function?
- **Data, information management and reporting**: what information is required to improve the management of third party spend and what reporting is required?
Our observation is that many organisations do not recognise the importance of defining a procurement strategy or implement effective governance and control. Without these key enablers procurement leaders and staff are often unable to influence or drive sustainable performance improvement. Central to this is sponsorship at the C-suite.

Experienced procurement professionals are a scarce breed and are worth their weight in gold. We have observed that there is a mismatch in the supply and demand of high quality procurement professionals in the market. This has been the case for a number of years and we believe that the market fundamentals will not change in the short-term. Our point of view is that high calibre procurement professionals need to be grown rather than sourced. We believe this is best done through coaching, experiential learning and clarity of roles and responsibilities with a clear career path.

Underpinning the procurement operating model is the need for a strong process framework, enabled by technology. In addition, procurement needs to be supported by a robust performance management framework that includes:

- Voice of the internal customer and external supplier
- Financial and non-financial benefits
- Operational efficiency and effectiveness
- Data and information
- Risk and compliance

“We often see organisations attempting to improve one aspect of Procurement and being frustrated by poor results because the other elements necessary to sustain them are not addressed or are only superficially dealt with. Taking a holistic approach, building on the strengths of your team and doing what you say you will do is central to delivering sustainable procurement outcomes.”

Mark Nixon
Partner, Ernst & Young, Australia

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Mark Nixon
Partner, Ernst & Young, Australia
# Procurement health check

<table>
<thead>
<tr>
<th>Key questions</th>
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<tbody>
<tr>
<td><strong>Spendmap</strong> Understand what (and how) your organisation spends.</td>
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<td>How much does your organisation spend and who is it spending with?</td>
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<td>What is your unit cost for purchased items and how much does this vary?</td>
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<td>How much of your spend is associated with the top ten suppliers?</td>
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<td>How many suppliers do you have supplying the same or similar items?</td>
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<td><strong>Savings</strong> Get the right balance between short and long-term savings initiatives.</td>
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<td>Have you got the right balance between short and long-term savings?</td>
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<td>Do you link the forecasting, budgeting and procurement savings programs?</td>
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<td>How effective is procurement at achieving savings and improving service delivery effectiveness?</td>
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<td>Are you measuring, tracking and reporting realised benefits?</td>
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<td><strong>Procurement value chain</strong> Focus on demand, source, fulfil and manage levers, not just unit costs.</td>
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<td>Are your savings initiatives focused on unit cost or total cost of ownership?</td>
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<td>Do you understand the difference between ‘needs’ and ‘wants’?</td>
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<td>Are you a collaborative client for your suppliers – are you working together to take cost out?</td>
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<td><strong>Contract and supplier relationship management</strong> Realise the value of your contracts by managing them and your strategic suppliers.</td>
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<td>Are you getting what was promised when you signed your contracts?</td>
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<td>Have you integrated your strategic suppliers into your longer term planning and reporting processes?</td>
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<td>Are you addressing your transactional processing issues?</td>
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<td><strong>Operating model</strong> Create an operating model that builds on the strengths of your team, commercial and technical.</td>
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<td>Is there a documented procurement vision, objectives, strategies and performance scorecard that is signed by the CEO or Board?</td>
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<td>Do you have blended teams delivering procurement outcomes?</td>
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<td>Does your procurement function have credibility within your organisation?</td>
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