CIPS KNOWLEDGE

The keys to developing an effective procurement strategy

Patrick Marter FCIPS highlights six key focus areas for development when developing your procurement strategy.

This knowledge paper is supportive of procurement professionals operating at Advanced Professional level of the CIPS Global Standard

01 CPD HOURS

CIPS members can record one CPD hour

Introduction and Summary

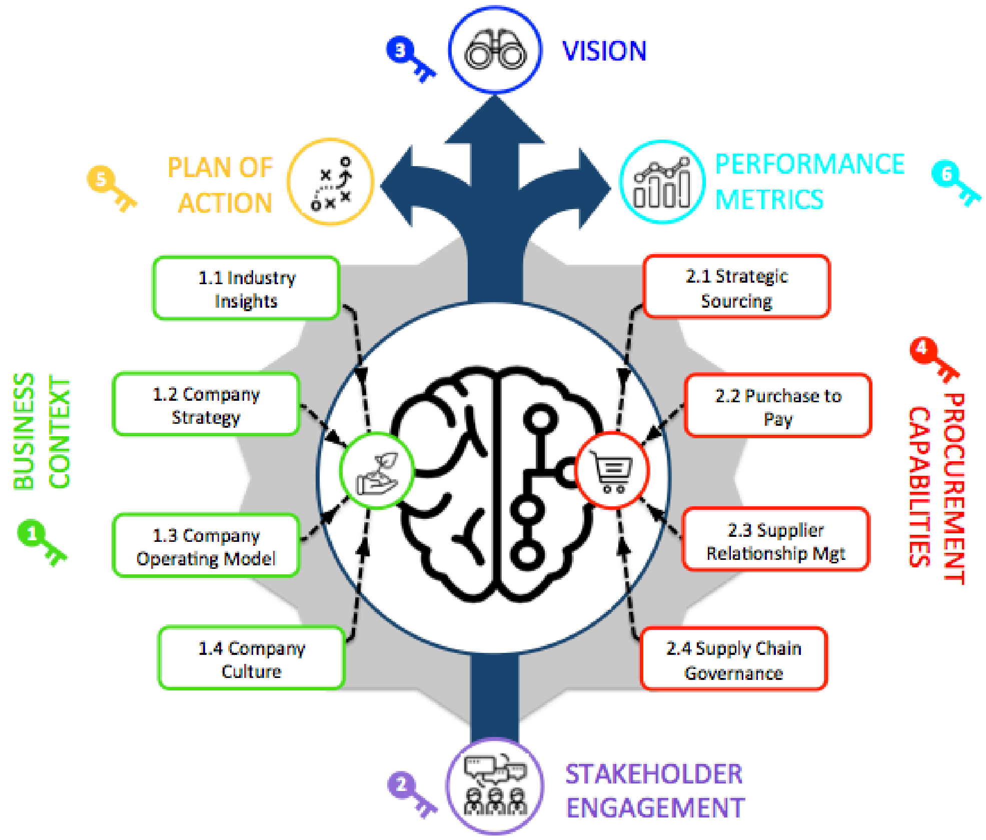
There is a significant amount of information readily available on how to develop an effective strategy, and on what makes a good procurement function. This paper doesn't aim to replicate either body of knowledge, just to synthesise the two subjects into a concise and practical framework from which to build.

A strategy is traditionally defined as: 'A **plan of action** designed to achieve a long-term overall aim or **vision**'.

However, to ensure the strategy is successful there are four additional factors to consider:

- Ensuring that **stakeholders** are properly **engaged** in developing the strategy.
- Understanding the **industry** and **business context** that the function will operate in.
- Confirming the **metrics** that will be used to measure progress/success.
- Confirming the **scope of services/capabilities** required to deliver these outcomes

THE SIX KEYS TO THINKING ABOUT AN EFFECTIVE PROCUREMENT STRATEGY



These six elements will be explored in more detail throughout the paper and a case study from Financial Services to try and put the content into context.

1 BUSINESS CONTEXT

"Cynics know the price of everything, and the value of nothing"

Oscar Wilde

One of the biggest factors in building or transforming a procurement function is changing how it is viewed by the broader organisation. Improving perception requires moving the function away from a pure price play to supporting the business in creating value for its customers. Here are four things to consider:

Industry Insights

The current environment in which your organisation operates impacts the priorities for the function e.g. whether to support growth, reduce cost or risk or drive product innovation. Understanding these factors and their relative importance is crucial in planning how you do things.

Business Strategy

The procurement strategy must be aligned to how the company derives value and tempered by an understanding of where it fits in the hierarchy of business priorities. For example, every organisation deals with competing pressures for resource whether it's investment in new systems, headcount for new initiatives or airtime in the organisation's agenda.

Business Org Structure

There are many different ways to organise and run a business. Procurement needs to fit into the broader operating model of the firm. Factors to consider include whether it's global or regional, led by product brand or distribution channel and the degree of outsourcing that is the norm.

Business Culture and Values

Understanding how the organisation makes decisions effects how you implement the strategy. Some organisations will allow a chief procurement officer (CPO) a high degree of autonomy around organisation design, systems implementation etc, others will want a more active engagement with the HR and tech functions.

Tools: STEEPLE analysis.
Case Study: Background and context.

Company X is a Financial Services firm. As a historically high margin business, costs had not been in focus. In fact a bull market (a year over year rise in equity indices e.g. FTSE 100) had allowed revenue to grow strongly, which had masked a similar increase in the cost of running the business.

However, an increase in competition from new entrants and a stagnation of financial markets began to impact performance. At the same time, global social and political unrest and a wave of legal and regulatory reforms were systemically increasing the risk, complexity and cost of doing business.

Company X was also changing its business model. It was investing in new markets e.g. Asia Pacific and adapting its decentralised operating model to leverage the new, more global footprint and upgrading its technology infrastructure and customer management systems to embrace a more digital/cloud architecture.

2 STAKEHOLDER ENGAGEMENT

"Culture eats strategy for breakfast"

Peter Drucker

When you are running a change program, it can sometimes feel like an invisible hand is conspiring to steer you onto the rocks. When this happens, it's likely you've missed a cultural/stakeholder engagement issue. Discussing the procurement strategy in the right way with the wider organization and its' key stakeholders can protect against this phenomenon. It requires an understanding of who these stakeholders are and what they are concerned about.

Executive Team

Developing and delivering a successful strategy requires collective agreement and support. Most organisations struggle with competing pressures for scarce resource, and implementing a new strategy requires change which can require compromise. The executive team needs to be behind it if its going to succeed when things get tough.

Functional Heads and SMEs

Key stakeholders may have to give up some level of control or even provide support to a central procurement function e.g. use a group supplier or a local one, agree to product specification changes to standardise goods or services being bought or even outsource a team or function within their remit. These compromises need to be discussed and understood at the outset.

Whole Organisation

A procurement function owns only a small part of the firms total budget and cannot manage all day to day dealings between the business and suppliers. Therefore, the whole organisation needs to have an awareness of procurement best practices and their role in deploying them.

External Stakeholders

The changes in procurement will mainly impact internal stakeholders. However understanding the legal and regulatory regime the firm works within, and talking to existing suppliers can provide meaningful insights on potential gaps in the existing framework. Further discussions with peer group companies and trade bodies can help identify best practices.

Tools: Stakeholder mapping.
Case Study: Understanding the challenge

Initial conversations with the executive team made it clear that whilst the organisation needed to reduce cost and complexity, they didn't know how. At the outset, they weren't even sure of the total third party spend or the number of suppliers the firm used globally. Furthermore, simultaneous risk management, growth and technology transformation programs were also higher priorities for the organisation.

There was also perception that costs could be reduced by simply negotiating better deals. However, in reality the organisation's decentralised model and tendency to build (versus buy) led to a structurally higher cost base. For instance, a further discussion with the chief financial officer (CFO) confirmed that only 25% of third party spend managed by accounts payable was covered by a purchase order (PO)/catalogue leading to an inability to accurately forecast cost or manage demand. Elsewhere, the chief risk officer (CRO) confirmed that supply chain risk events were one of the major concerns of the firm's regulator "The Financial Conduct Authority" (The FCA) and that they accounted for a large percentage of risk events within the organisation.

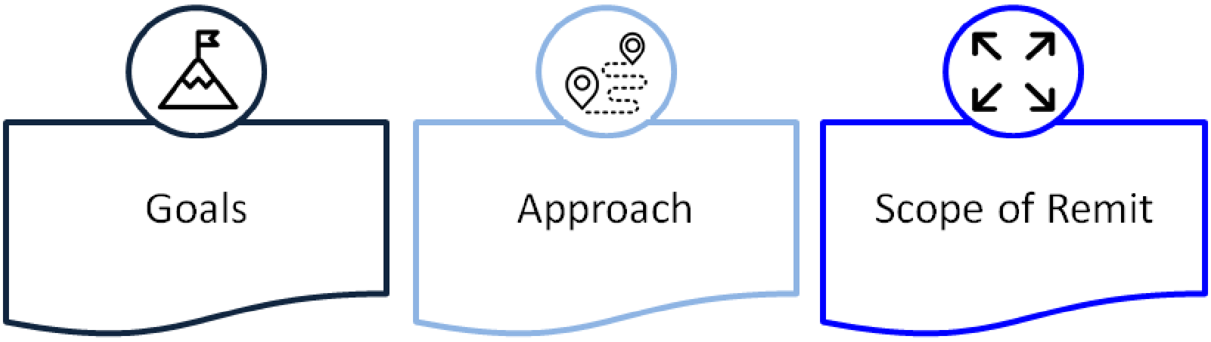
As these discussions progressed, it became clear that strong historic profits meant that very few people in the organisation understood the need to actively manage the supply chain. This resulted in a lack of discipline in managing both cost and supplier relationships which were largely established and maintained based on personal contacts.

3 VISION

“Leaders must invoke the alchemy of great vision”

Henry Kissinger

The vision for an organisation is normally a clear, aspirational statement of that which it would like to achieve over the long term. It serves as the North Star for current and future decisions. Here are three suggested areas that should be covered when developing the vision for a procurement function:



Goals

As early as possible, clarify and agree what success looks like. It helps define the capabilities to be developed.

Normally the desired outcomes include, as a minimum, reducing cost, complexity and risk within the supply chain.

Approach

Generally, procurement’s adds value by leveraging spend from across the organisation and then applying procurement best practices to create value. There are many ways to achieve this but generally they fall into one of three models

(i) centralised
(ii) centre led
(iii) federated.

The preferred option depends on the organisation's broader approach (see section 1).

Scope of Remit

Procurement is responsible for third party spend. However, the extent of the remit needs to be clearer e.g.:

(i) Is it direct & indirect spend ?
(ii) will it cover sourcing & P2P? (iii) Is Supplier management in scope ?

Understanding these factors is crucial to planning the strategy and stakeholder engagement plans.

The key elements from each of these areas must be synthesised into a single, clear and succinct statement of intent.

Case Study: Defining the future

Degrading financial performance, compounded by the need to invest in new technology and growth into new markets led company X to embark on a firm wide cost management program. This included creating a strategic sourcing capability. However, discussions with the CFO and CRO had also identified the need to fill gaps in spend controls and supply chain risk management. As a consequence, purchase to pay and supplier risk management capabilities were included in the scope of the new function.

It was also understood that company X's current decentralised decision making approach, and lack of cost management culture, would present challenges to implementing a global procurement capability. Therefore, it was agreed a strong, fully centralised operating model was required. It would become the single point of contact for all supply chain matters and ensure procurement best practice and discipline was instilled across the organisation. In summary, the vision was to:

"Actively manage all third party spend to support growth and reduce complexity, cost and risk in the supply chain."

Note: 'Actively manage' is an investment management term that implies the use of market research and investment expertise to reduce risk and improve performance. It is shorter than 'aggregate and leverage spend and use procurement best practice' and has greater resonance with stakeholders.

4 PROCUREMENT CAPABILITIES

"When ambition exceeds ability, the likelihood of success is limited"

Ralph Half

Having established a clear vision for the function, we need to make sure it is supported by the capabilities to deliver it. This normally includes a combination of one or more of the following:

Strategic Sourcing

The methodology for creating a sourcing strategy hasn't changed since ATKearney first created it. However, the tools and delivery models have with eRFX and eAuctions, advanced data analytics and external research firms like like Gartner being common place. As are delivery models such as captive service centers, outsourcing, or collaborative procurement hubs.

Purchase to Pay

The P2P process manages the day to day process for the approval, ordering, receipt and payments for goods and services. Significant changes in the technology landscape means a move away from ERP systems to point P2P solutions and Supplier Networks. In addition the scope of P2P operations now often includes managing accounts payable, corporate cards, travel and expense management operations.

Supplier Relationship Mgt

Supplier management includes pre contract due diligence on the suppliers operational capabilities, day to day management of performance and billing and managing supplier risk events as and when they occur. It should also cover development activity i.e product innovation or outsourcing of additional services to the supplier. SRM roles are often performed by the business who are advised by procurement.

Supply Chain Governance

As global socio-economic conditions become more complex, third party risks have to be managed. These risks include service delivery risk, continuity of business, data privacy and IT security as well as the emerging theme of environmental, social and governance (ESG) risk. Procurement, as SME, can help support the organisation's risk teams oversee these risks and key outsourcing decisions.

Talent, Data, Systems, Operations, KPI, Policies and Procedures, Communications

Case Study: Understanding the existing capabilities and changes required

A small team of existing staff already managed the technology procurement transactions. However, if the organization was going to meet their overall cost reduction targets this would need to be transformed to support delivery of category strategies, and extended into managing non technology spend.

The P2P capability was split between two separate teams: a PO processing team for technology spend, and an accounts payable (AP) team in finance who managed all invoices. These teams also used different and poorly integrated systems, which in turn resulted in poor control and erratic payment performance.

The organisation also had a ratio of 1 procurement professional to every 300 supplier relationships. There were no preferred supplier lists, many lacked contracts and few had nominated relationship managers. A program of consolidation would be required to improve leverage and performance. Limited sourcing and

Purchase to Pay (P2P) controls also meant over 150 new suppliers being created each month. Further, an existing internal audit report had highlighted that few suppliers had the appropriate due diligence prior to on-boarding.

Finally, across the whole organisation, there was poor management information, data, policies and procedures with regards to procurement and no talent program to develop the relevant skills.

Each of these elements would need to addressed if the new function was going to be effective in delivering the agreed vision.

5 THE PLAN OF ACTION

"No plan survives contact with the enemy"

Colin Powell

To turn the vision and capabilities into reality, a plan of action is required. The plan should take a long term view and break the strategy down into a sequence of logical steps to deliver each capability. This would normally include the technology, process, people and data changes required for success. It should also recognise any limitations imposed by the business, its culture and appetite to invest and be flexible enough to adapt to changing market conditions.

Overall Timeline

A procurement strategy will typically take 2-5 years. The lower limit ensures changes in Procurement are included in at least one full cycle of the strategic and financial planning process. The upper limit is more open ended. However, generally speaking the volatile, uncertain, complex and ambiguous (VUCA) world we currently operate in means requirements greater than five years out are hard to predict.

Developing Workstreams

All corporate services capabilities tend to follow a similar evolutionary path. Hackett's Global Business Services maturity model describes this as well as any other (see appendix X). It shows the journey from de-centralised transaction processing capability to value-add strategic partner. It identifies the key building blocks and the sequence in which they are deployed.

Creating the Plan

'Agile' is becoming increasingly popular and is especially effective for developing and delivering a new strategy. It allows you to plan changes in each capability in small increments and compensate for external factors along the way. An effective way to document the high level plan, which supports an agile approach, is to create a one page 'Sun Diagram' for the overall strategy (see appendix X).

Case Study: Building for the future

A plan was developed and approved by senior management. However, competing priorities for resource meant procurement had to fund the new capabilities by creating efficiencies from the existing teams. This meant introducing procurement cards to reduce the number of low value transactions and suppliers the team was managing. It also required improving invoice automation to reduce manual transaction handling. The resource this freed up, would then be used to create a service centre for low value sourcing transactions. This would in turn allow the existing technology procurement team to focus on developing category plans, and managing higher value transactions across both technology and non technology spend.

In parallel, a systems review confirmed the cost of running and maintaining the legacy AP and purchasing systems could be reduced by introducing an end-to-end software as a service (SaaS) solution. This would also enable the use of catalogues and other self service tools which would free up further resource for redeployment.

The capacity all these changes created also allowed the creation of a new supplier risk management team, who would work alongside the CRO to develop a risk management framework. They would also ensure the appropriate due diligence was performed for new suppliers and the root cause of supply chain risk events were properly investigated.

6 PERFORMANCE METRICS

"What gets measured, gets managed"

Peter Drucker

'What gets measured gets managed' is certainly true for the delivery of a procurement strategy. And there are many performance metrics available to choose from. However, the key is to differentiate between metrics that measure operational efficiency, and those that measure the strategic outcomes you are trying to achieve. The most widely accepted framework for developing metrics is the use of a balanced scorecard which assesses performance in four key areas:

Commercial	Risk	Spend Control	Supplier Management
A procurement team is an overhead for a business. However an efficient and effective one should be able to demonstrate a material return on investment. This is normally calculated as : Cost reduction / cost of the Function.	It is impossible to eliminate all risk from any business. However, procurement should ensure the supply chain doesn't breach the Firm's risk appetite (a threshold set by the organisations risk department).	Procurement's ability to add value depends on spend being (i) covered by an agreed category strategy (ii) managed via an approved buying channel ie PO, procurement card or catalogue. Without these controls, spend will leak to non preferred suppliers on poor T&C's.	Suppliers are an extension of the businesses value chains. However, if the supply chain is too complex, it's impossible for these suppliers and the products and services they supply to be managed properly. Aim is to reduce the number of suppliers.
ROI > 5x	0 Events > £XX	>95%	-50% of Suppliers

Case Study: Measuring progress and ultimately success

From the outset the transformation program began to improve stakeholder awareness which, combined with the pressure to reduce cost, significantly increased demand for the team. This presented a challenge because it would take up to 12 months to build some of the capabilities and infrastructure required to significantly enhance performance, and to redistribute resource to value add activity.

As a result, it was only in the second financial year that changes began to impact key metrics. Having prioritised developing the strategic sourcing capability, the function's return on investment (ROI) quickly increased from 1:1 to 5:1. In parallel, the impact of procurement cards and invoice automation had reduced the number of staff required to process Invoices and, as a result, resource was made available to set up the supplier risk management and sourcing centre of excellence (CoE) teams.

By the end of the second year, improvement opportunities were harder to identify and an additional suite of operational metrics were required to uncover further inefficiencies in the operating model. In addition, the changes in AP had also plateaued. A new, more user friendly and better integrated P2P tool was also required in order to further improve purchasing controls. Finally, the introduction of a procurement academy helped to develop the capabilities of both the strategic sourcing teams and the sourcing CoE, improving efficiency and contribution to the savings targets.

In Conclusion

"The simplest solution tends to be the best"

Occam's Razor

I've tried to provide a simple and concise framework that you can use to develop your own strategy. However, if it's still too much to digest here's the one page summary…. the 10 commandments of creating a procurement strategy:

1. **Keep it so simple (KISS)** – The political/technical/economic business environment is already complex. Make it easy for stakeholders to engage you, and don't use procurement jargon.

2. **Procurement is important** – On average more than 50% of most firm's expenses are with suppliers. This is increasing with the rise of asset light business models/cloud/SaaS etc.

3. **Procurement is a discretionary function** – To gain influence, identify how you can help the business create value, or solve problems for its clients.

4. **Recognise that suppliers are an extension of the business** – Therefore the procurement strategy needs to align with the business strategy.

5. **It's all about stakeholder engagement** – Procurement will become more automated, and big data will drive greater insights. However, it doesn't matter if no one is listening…. to achieve that, you have to get the stakeholders attention.

6. **Create a clear vision** - Not just to create an identity for the procurement function, but also to help all employees understand the importance of managing suppliers and third party costs.

7. **Look after the pennies** - Managing the day-to-day transactions is as important as creating innovative strategies. Make sure you know how P2P fits into your strategy.

8. **Planning** – It's good to have a plan. But it's more important to get stuff done. Keep the plan high level, break it down into manageable projects, and focus on delivery.

9. **Managing performance** – Focus on strategic outcomes. When thinking strategy try not to become fixated on important but secondary operational metrics e.g. payment performance, cycle times etc.

If this is still too much, one final simple piece of advice …(and why CIPS is so important):

"Talent is the last competitive differentiator"

Peter Drucker

10. **So if nothing else recruit, develop and retain the best people you can….** and everything else will fall into place.

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Supporting templates available

- Five year strategic plan template

Chartered Institute of Procurement & Supply