Why should you consider procurement outsourcing?
A holistic approach towards vertically integrated to virtually integrated business process services

WHITE PAPER
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Introduction

Leading organizations have already outsourced a major chunk of IT services and have tested and proved that outsourcing and off-shoring works. Now organizations are clearly focusing on outsourcing their business processes to a specialist as they feel that most transactional activities done today are non core in nature. With current technology advancements in internet and security it has become easier to manage and execute business processes from any part of the world where good infrastructure is available. So this has become an increasing focus area for CXO’s to carve out core and non core activities within a process and outsource through a managed services model using captive or third party providers.

In this current economic situation companies seeking to improve their financial performance have already started looking Business Process Outsourcing as a key enabler in streamlining business processes and also improving operational performance. While F&A and HR outsourcing have been around for quite sometime, procurement outsourcing is becoming increasingly accepted as a more viable strategy for both cost and performance improvements. The current trend clearly shows that companies are pursuing procurement outsourcing using as an incremental approach to test and prove the concept works.

This is similar to what happened in 1940’s when manufacturing companies started focusing on core manufacturing of key components and also on designing, development and marketing and outsourced all other component manufacturing to specialists. A concept of moving from “Vertically Integrated Supply Chain to Virtually Integrated Supply Chain”

Exhibit 1

Manufacturing moving from Vertical Integration to Virtual Integration
WHY SHOULD YOU CONSIDER PROCUREMENT OUTSOURCING?

The diagram below depicts a holistic view of applying yesterday’s manufacturing story to today’s Business Process Services – A logical shift from “vertically integrated approach to virtually integrated approach”

**Exhibit 2**

Business Process Services moving from “vertically integrated to virtually integrated” leveraging global efficiencies

Procurement has always been looked at as a cost center until the 2000s. From early 2001, leading organizations changed their approach towards procurement organization from a cost center perspective to profit center. This approach has given a new dimension to procurement and organizations started focusing on value levers in strategic and tactical areas. This resulted in new enterprise focus areas like:

- IT enablement for sourcing and procurement
- Dedicated focus on procurement – Strategic center led initiatives
- CPO as a key executive role created for executive level commitment
- Standardization of processes and systems and focus spend analysis
- Improved focus on negotiations - Price centric to TCO approach
- Improved on processes using lean initiatives and six-sigma
- Reduce process redundancy across global operations
- Revisiting supply base – Focus on supply base reduction
- Globalization as an approach – For cost reduction
With the advent of technologies and availability of global skills, access has improved for:

- Supply base
- eSourcing has given a totally new approach for strategic sourcing
- eProcurement has given a totally new approach for ease / speed / compliance, monitoring and control for procurement process
- eInvoicing has given a totally new approach for invoice processing and payments

The advent of technologies, global skill sets both in terms of technology and process has made organizations look at procurement differently. Some leading organizations were quick enough to capitalize on the opportunity of technology and standardized the procurement processes by implementing best practices in people, process and technology.

This has also created an opportunity for CFO’s / CPO’s / Sr. VP’s of Procurement to re-think the strategy for procurement process handling. Leading organizations identified each area within the procurement process as individual opportunity areas and started focusing on core and non-core areas. This has resulted in a new opportunity called “PROCUREMENT OUTSOURCING” for cost reduction, productivity improvement, standardization, globalization, consolidation of procurement services, transformation and IT enablement etc.

**Procurement Outsourcing Defined:**

Procurement Outsourcing is defined as a process wherein organizations take a calculated approach of moving some of their processes around source to pay to a specialist. This involves organizations identifying the core and non-core activities with source to pay and start outsourcing non-core activities to a specialist. This process involves different approaches:

- Full outsourcing – Survey shows only 17% take this approach - Only leaders adopt this route
- Incremental nutsourcing – Survey shoes 83% take this approach
- Hybrid approach towards strategic and transactional activities

Today leading organizations are adopting PO as a key approach to improve corporate performance, standardize processes, and consolidate operations. Procurement outsourcing unlike other areas has an added advantage of achieving strategic value over and above cost cutting.

The potential of procurement outsourcing is that it can deliver 5X potential savings compared to others.
Why Procurement Outsourcing?

Increasing interest in procurement BPO can be credited to its ability to provide two key benefits:

- Cost reduction
- Value creation

The two factors that are of high importance to companies in today’s changing economic climate.

Procurement outsourcing is well suited for companies faced with mounting competitive pressures and rising demands to cut costs and bolster shareholder value. Also organizations with procurement operations that are overburdened by recent strategic moves such as mergers & acquisitions may find a viable solution in procurement outsourcing.

“$” saved is “$” earned, and companies can use these dollars in several ways: The strategic initiatives within the procurement organization can be made self funding based on the savings realized through procurement BPO or the same can be used for funding other strategic initiatives. An example is an outsourced category management process for logistics services with an annualized spend of $ 100 mn dollars with a savings potential of 10% ($ 10 mn) will fund an organizations initiative of eSourcing tool implementation with in a company.

This strategy works well for companies that continue to grapple with “maverick buying” and ineffective processes despite huge investments of time and money.

Drivers for procurement outsourcing

The following are the important factors that drive organizations toward procurement outsourcing:

Exhibit - 3
Procurement Outsourcing—A holistic approach using Spend vs. Complexity

In the exhibit below, the procurement processes from commodity management and process & technology enablement perspective is analyzed to arrive at a spend vs. complexity model. Each of the areas (routine, bottleneck, leverage, and strategic) is analyzed from an outsourcing perspective of core and non-core.

Exhibit – 4

The above analysis provides an opportunity to outsource an average of 50% activities as they form pure non-core, non-value added activities.

This gives an opportunity to apply the concept of moving from a “vertically integrated supply chain” to a “virtually integrated supply chain” i.e. looking at each process within an organization as part of a supply chain and then deciding which one to make and which to buy.
Is Procurement Outsourcing right for you?

Organizations under constant pressure to cut costs, improve revenue, remove waste, standardize processes, implement best practices and adopt best in class tools and technologies should consider the points below as a ruler to decide whether to outsource procurement or not:

<table>
<thead>
<tr>
<th>SL No.</th>
<th>Key questions to identify a PO opportunity</th>
<th>Yes / No</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Are you under constant pressure to reduce costs and improve shareholder value?</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Are you facing increasing competitive forces making it difficult to fight against competition?</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Are global companies able to deliver products and services considerably cheaper than you?</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Are your competitors selecting procurement BPO as a strategy to reduce cost?</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Have you made any recent strategic activities in terms of mergers, acquisitions etc. that has put significant pressures on your procurement operations to standardize, rationalize, streamline and automate?</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Do you need a change agent to transform your procurement operations and systems?</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Is your procurement practices best-in-class, ready to be commercialized?</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Is your procurement process well standardized, well documented, well automated giving an opportunity to execute using global delivery model?</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Even after best efforts, does your firm still struggle with “maverick buying” and inefficient processes?</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Does your corporate culture lend itself to an outsourcing environment?</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Do you have a successful track record in managing outsourcing relationships?</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Would you be able to obtain an executive buy-in for PO?</td>
<td></td>
</tr>
</tbody>
</table>

If you answer yes to over 60% of these questions, then perhaps your procurement operation is an opportunity gold mine for outsourcing dazzle.

Leading organizations have already capitalized on this opportunity to identify and outsource non-core activities to a specialist and leverage both best in class services and also improved performance with considerable reduction in cost.

The leaders (CPO’s / Sr. VP – Procurement) of leading procurement organizations have identified procurement outsourcing as one of the key strategies for both value creation and cost reduction opportunities:

The key focus areas of CPO with respect to procurement includes

- Establishing a standard enterprise wide policy, processes and system
- Category management and grouping
- Center led strategic initiatives with localized execution
- Business Process Outsourcing as a value lever
Though procurement outsourcing is on the radar of both CPOs and CFOs for value creation, organizations are taking a very calculated approach for outsourcing their procurement function. The more prevalent one is an “Incremental Outsourcing” approach where organizations are outsourcing part of their procurement operations to start with to test the service providers strengths and capabilities before doing a full blown outsourcing.

### Challenges or barriers for effective procurement outsourcing

- Perceived loss of control
- Internal resistance - Procurement is complex and cannot be outsourced
- Difficult to measure and report value realized
- Handful of PO vendors and difficult to decide
- Unclear benefits of outsourcing

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**Performance improvement through Procurement Outsourcing:**

<table>
<thead>
<tr>
<th>Key KPI</th>
<th>KPI - Indicator</th>
<th>Leaders</th>
<th>Others (above average)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sourcing savings</td>
<td>Strategic</td>
<td>8.3%</td>
<td>7.6%</td>
</tr>
<tr>
<td>Compliance</td>
<td>Strategic</td>
<td>55%</td>
<td>41%</td>
</tr>
<tr>
<td>Cycle time for sourcing</td>
<td>Strategic</td>
<td>8.2 days</td>
<td>9.9 days</td>
</tr>
<tr>
<td>% supplier enablement for e-transactions</td>
<td>Transactional</td>
<td>30%</td>
<td>25%</td>
</tr>
</tbody>
</table>
How important is PO in today’s competitive economy?

Procurement department’s strategic importance is rising within an organization and has become a board level topic to improve cost, productivity and shareholder value. This is because a typical organization spends between 40% to 50% of its revenue on procured goods and services.

This means any reduction in that 40% to 50% of spend is a direct impact on companies' bottom-line. With an increased top management focus, comes a highly elevated performance expectation. Procurement leaders are therefore looking for external help and also applying virtually integrated concept to buy non-core services from an expert who is an expert in doing that. The exhibit below shows how manufacturing transformed to a virtually integrated approach from a vertically integrated approach

With this approach and to meet the increased expectations, enterprises are developing a focused approach to outsourcing their procurement operations. The key steps taken by leading organizations are:

- Defining core and non-core in sourcing & procurement
- Key areas that can be outsourced in non-core
- Defining internal organizational benefits of procurement outsourcing
- Creating cross functional teams to identify saving opportunities through PO
- Define – establish target – measure – enforce savings
- Manage operational costs – system investments, resource ramp-up etc
- Executive commitment
- Evaluate systems, processes and tools
- Engaging leading analysts and advisors in developing a business case

Key opportunities in procurement outsourcing

The table below shows key areas that organizations should consider outsourcing, which will enable the organizations to focus more on strategic areas and key supplier negotiations. Organization should approach the procurement outsourcing exercise from an incremental approach starting from transaction processes that are early movers where the companies can adopt a “lift & model”.

Once, the transactional processes are outsourced and stabilized, the organization should consider moving more value added activities to the service provider to gain leveraged productivity and efficiency. This has to be done through a joint effort through “transformation & shift” model. Exhibit 5 below shows the process areas as “early movers”, “late movers” and “retained internally”

Exhibit 6 – Provides an indicative procurement outsourcing opportunity across the spectrum of “source to pay” with clearly identified low hanging opportunities which has minimal impact and high value. These opportunities are indicative as outsourcing each of these processes is a function of degree of automation and standardization. Organizations should map their internal process across the quadrants and identify low hanging opportunities and start with an “incremental approach”
Proposed outsourcing landscape

Based on the above areas as early movers, late movers and retained the core activities can be broadly classified into 7 sections as below – Exhibit 7

Exhibit – 7

Conclusion

With the above analyzed facts and figures procurement outsourcing is going to become an inevitable strategy for companies in gaining a competitive advantage by lower cost of operations and value creation.

Procurement outsourcing adoption is growing at a rapid pace of 22%, which is a clear sign of organizations moving towards PO as a strategic value creator. With increased adoption of technology and standardized processes, leading organizations have already adopted procurement outsourcing as a strategic initiative towards achieving process excellence and gaining supply management leadership.

With procurement outsourcing becoming a game changer, the procurement organizations within a company are looked at as a profit center as compared to the earlier notion of cost center. The following are some of the key factors that organizations should consider before venturing into PO. These points are based on the maturity of the procurement organization:

Key process steps for success:

- Evaluate internal procurement competency – do a through assessment
- Ensure key stakeholder are involved in the assessment and also have an advisor / Key Procurement Service Provider (PSP) to support the assessment
- Selecting a PSP should be strategic forward thinking initiative
- Make sure the PSP fully understands the objectives
- Ensure processes are standardized and stabilized with clearly defined SLA’s
- Ensure that the PSP has key competencies and has a good past record
- Establish a center led procurement organization
- Clearly define the service level expectation and objective for PSP
- If you have already developed best practices around procurement process then make sure that the PSP is capable of moving up the value chain to provide more value creation benefits other than labor arbitrage
- Cross implement the best practices across the company and other SBU’s
Key benefits of procurement outsourcing:

- Lower transactional procurement cost
- Opportunity for head-count rationalization and refocusing on strategic areas
- Improved opportunity for market intelligence and supplier intelligence
- Improved spend visibility
- Improved pricing
- Increased opportunity for transformational initiatives across people, process and technology
- Increased opportunity for process standardization and application rationalization

Key notes from leading analysts

- BIC companies have already outsourced around 50% of their spend
- BIC companies are outsourcing contract management functions more frequently and have achieved 35% higher contract compliance rates
- BIC are more likely to outsource request to check process, spot buying and operational sourcing
- BIC companies utilize PSP for supplier enablement and supplier training
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