

Procurement Value: Moving Beyond Price Savings Toward Strategic Value Recognition

By Constantine Limberakis and Amy Fong

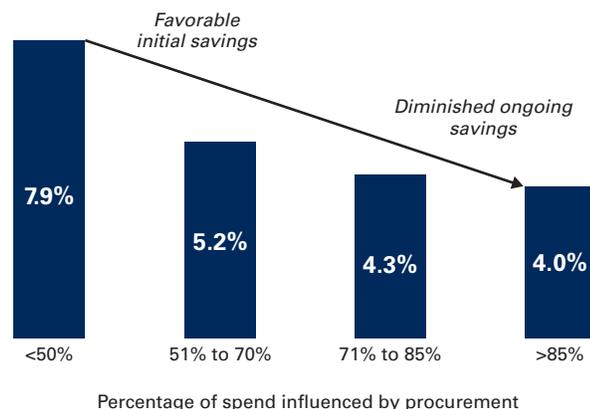
Executive Summary

According to Hackett Group research, measuring and managing procurement’s business value is the top priority for procurement executives. However, most have difficulty calculating the function’s value contribution to the achievement of the company’s strategic goals. While procurement is most commonly recognized for its successes in reducing and avoiding purchase costs, top-performing organizations invest more in value-channel activities that track more ways value is created from savings beyond purchase-price reductions alone.

Adjusting Procurement’s Value Scorecard in an Era of Diminishing Returns

Thanks to years of process improvement and technology investment, procurement organizations are starting to be viewed more strategically by their internal stakeholders. Much of this can be attributed to procurement’s success in increasing the amount of spend influenced or managed through the use of strategic sourcing and purchase-to-pay technology. But procurement organizations face challenges increasing savings year over year due to diminishing opportunities over time. Hackett Group research shows that savings benefits tend to diminish once major spend categories become properly sourced and suppliers are rationalized (Fig. 1).

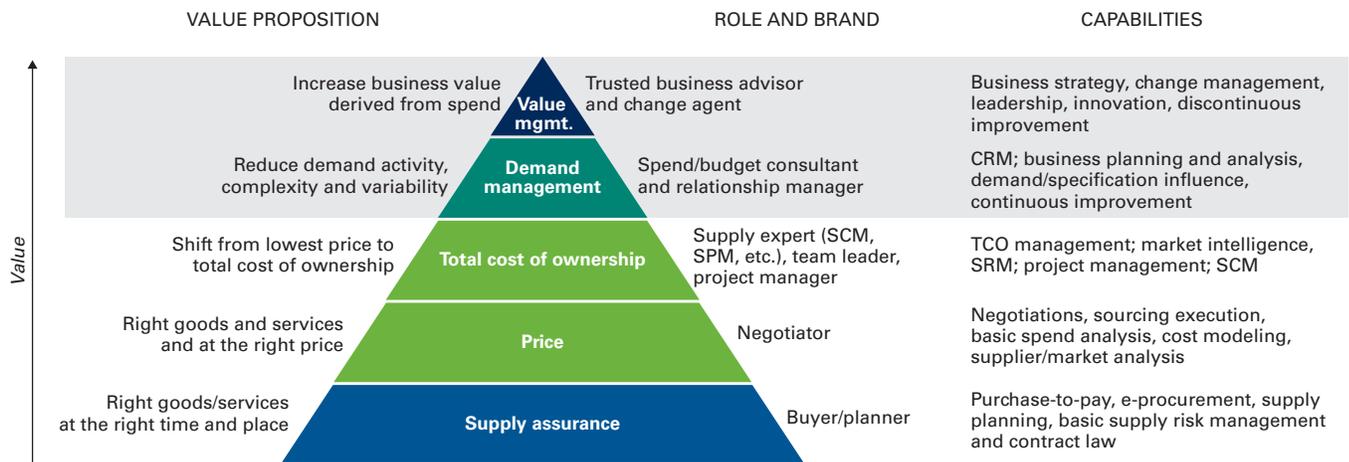
FIG. 1 Savings as a percentage of influenced spend



Source: The Hackett Group, 2017

When procurement organizations experience this challenge, they need to look at alternative sourcing and purchasing approaches. These require more coordination with internal stakeholders and suppliers beyond negotiated cost alone. At this point, procurement needs to become less of a buyer/negotiator and more of an expert, consultant and change agent for its customers in the finance organization, supply chain and business overall. Gaining the trust of stakeholders requires procurement groups to upgrade their internal brand, demonstrate a more strategic value proposition, and contribute value in areas beyond purchase-price reduction, such as total cost of ownership (TCO), demand management and value management (Fig. 2).

FIG. 2 Procurement value pyramid

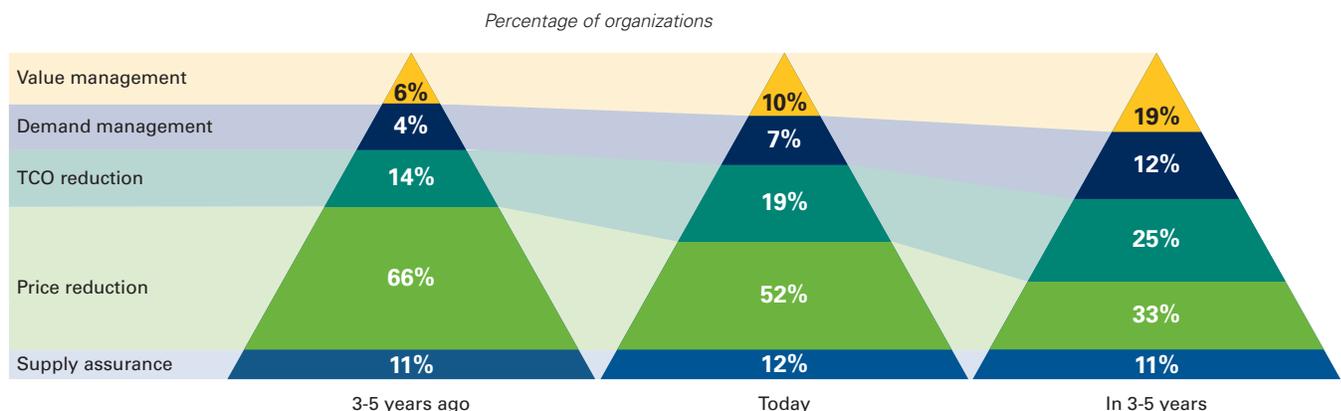


Source: The Hackett Group

Our 2017 Procurement Value Measurement Study found that, as procurement organizations mature, 49% of organizations move away from savings toward other areas like strategic value and non-price-related cost reductions. However, the desire to move beyond purchase-price reduction is not universal: over a third of respondents' primary focus is still reducing costs and delivering savings.

Moreover, 16% of organizations note they can continue to provide value from purchase-cost reductions, since there is no shortage of opportunities remaining. This group is probably made up of organizations whose capabilities are less mature, or that have not been able to attain the stakeholder buy-in needed to move toward more strategic objectives. But the desire to go beyond savings as a primary goal is an ongoing trend, as shown by changes to typical procurement scorecards over time (Fig. 3).

FIG. 3 Relative importance of primary recognition metrics on the procurement organization scorecard



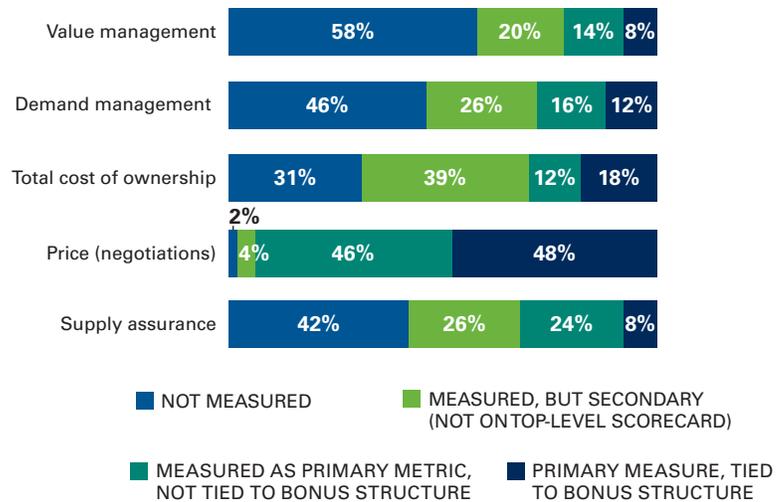
Source: Procurement Value Measurement Study, The Hackett Group, 2017

Achieving Price Reductions Is Still Essential, But Top Performers Demonstrate Broader Value

Despite the reported desire to move away from emphasizing only price reductions, this remains the primary measure for the procurement scorecard (Fig. 4). Areas that are not recognized, often referred to in Hackett Group research as the “zone of uncredited value,” demonstrate that much of procurement’s efforts go largely unacknowledged by the finance department. This misalignment of desire and recognition can have a dramatic impact on where time is spent by procurement staff. Examples of how this hampers procurement’s delivered value include:

- A disproportionate focus on areas that consume procurement resources but do not receive recognition.
- Turf battles between procurement and the business over how to measure value being contributed.
- Misalignment in performance metrics and incentives between procurement and finance.

FIG. 4 Primary recognition metrics on procurement scorecards

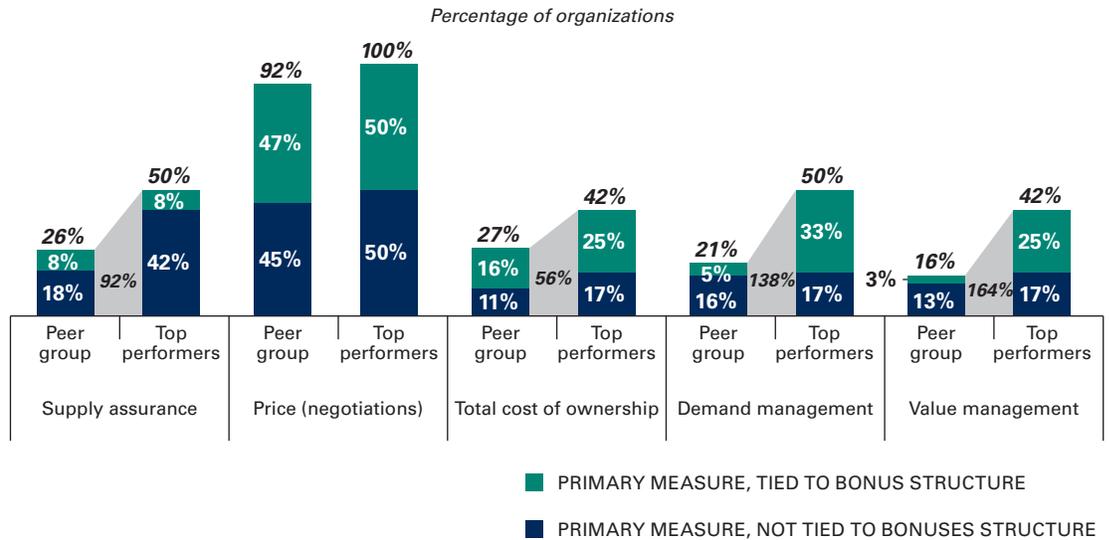


Source: Procurement Value Measurement Study, The Hackett Group, 2017

For maturing procurement organizations and those where savings opportunities may have become exhausted, the dilemma is how to properly allocate or reallocate resources, and get the right mix of tools and talent for meeting wider stakeholder objectives. Procurement organizations – even top performers – need to work more with executive management to gain recognition for non-cost-related value drivers. But the fact that more top performers receive recognition for non-cost-related value drivers (67% compared to 34% of the peer group) demonstrates that there are factors that allow them to increase their value-contribution recognition.¹ For instance, while the percentages of the peer group and top performers that use price as a primary scorecard metric are similar, far more top performers include supply assurance, TCO, demand management and value management as primary metrics as well (Fig. 5).

¹ Value Measurement Study, The Hackett Group, 2017.

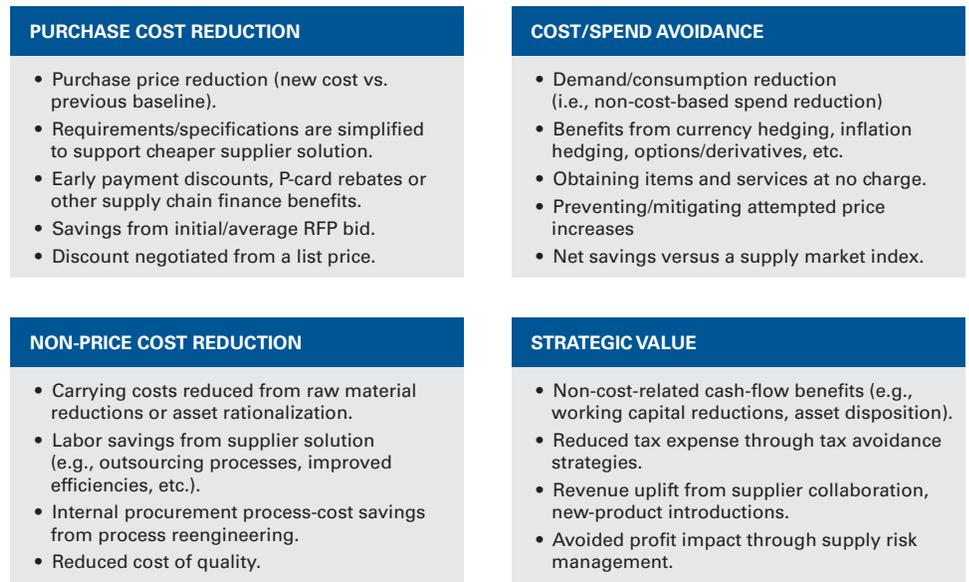
FIG. 5 Primary metrics tied to bonus recognition on procurement scorecard



Source: Key Issues Study, The Hackett Group, 2018

To better understand how procurement value streams are recognized (i.e., as hard-dollar or soft-dollar benefits), we organized the function’s value-generating activities into 18 distinct value streams within four categories: purchase-cost reduction, non-price cost reduction, cost avoidance and strategic value (Fig. 6).

FIG. 6 Example value streams led or supported by procurement organizations

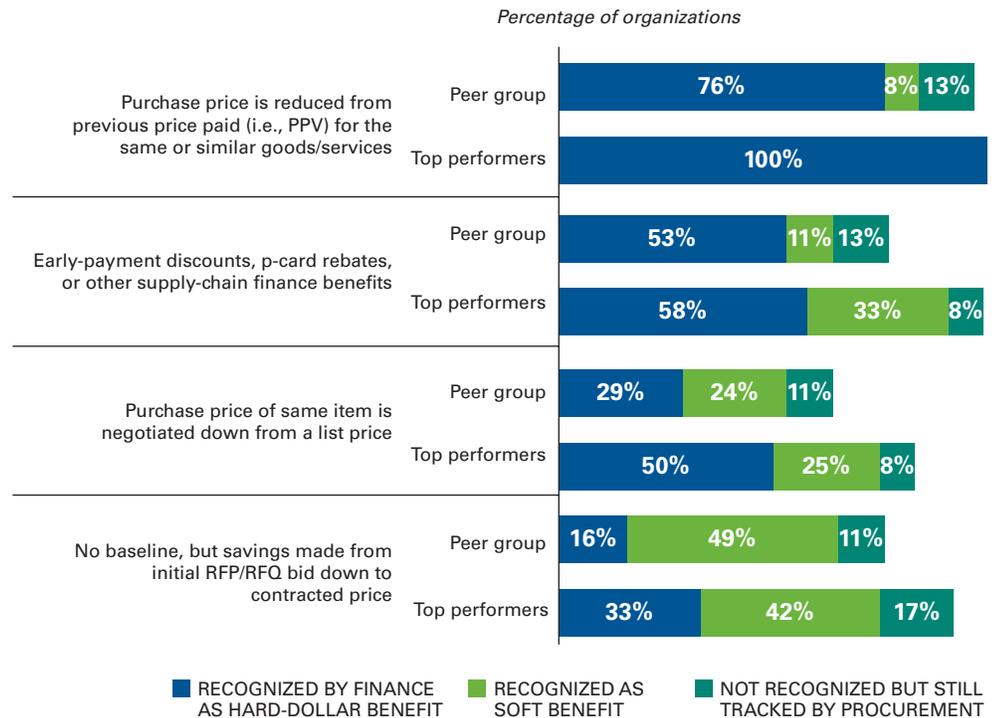


Source: The Hackett Group

Purchase cost reduction

Not all purchase cost reductions are treated alike. Reduced purchase price (i.e., purchase price variance, or PPV) for the same or similar goods is still the major criterion finance uses to recognize procurement for hard-dollar financial benefits (Fig. 7). Price reduction from negotiation is king when it comes to a hard-dollar financial benefit: 100% of top performers get hard-dollar recognition, as do 76% of peers. Purchase-cost reductions stemming from other strategies also get hard-dollar recognition, but not nearly to the same extent.

FIG. 7 How purchase cost reduction value streams are credited to procurement



Source: Procurement Value Measurement Study, The Hackett Group, 2017

Similar levels of recognition for early-payment discounts, procurement-card rebates and other financial supply-chain benefits shows the importance to the finance organization of tracking and managing payment transactions. This is an area that also requires collaboration with accounts payable and treasury to maximize recognition of supply-focused program efforts.

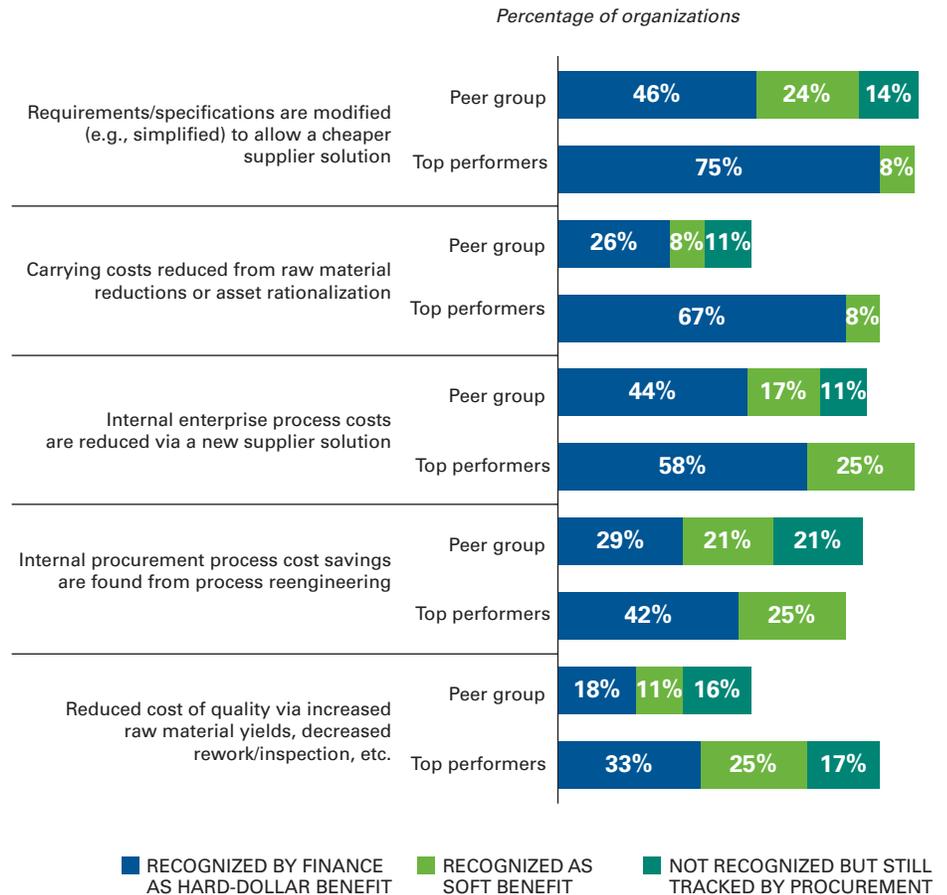
Better success at negotiating price reductions separates top performers from peers in hard-dollar recognition. It is possible that the establishment of a negotiation process may be part of the reason: our 2017 Key Issues Study found that 31% of respondents have a well-established negotiation process that is informally leveraged, but only 19% have one that is leveraged consistently.

Further still, savings occurring between the initial bid and final contract are recognized as hard-dollar benefits by 33% of top performers, but only 16% of the peer group. The importance of obtaining greater value recognition from competitive bidding efforts as a part of negotiations cannot be overstated, since contract creation, combined with negotiation and approval tasks, can make up more than a third of sourcing/procurement resources' time.

Non-price cost reduction

Process efficiency is the biggest factor leading to recognition for non-price cost reductions. Most recognition as a hard-dollar benefit is based on procurement’s ability to find cheaper alternative products (Fig. 8). Differences in recognition of non-price cost reduction suggest that top performers have better access to supplier information (e.g., finding new suppliers through a supplier portal or network) and the ability to monitor supplier specifications and quality – advantages that translate into improved abilities to find alternative solutions at lower cost.

FIG. 8 How non-price cost reduction value streams are credited to procurement



Source: Procurement Value Measurement Study, The Hackett Group, 2017

Process cost savings achieved from reengineering also suggest that top performers have a higher focus on technology deployments throughout the procurement organization. Digitizing routine, rule-based manual processes contributes to better efficiency in supplier onboarding, supplier information capture, catalog availability, purchase-order workflow, invoice capture and reconciliation. These improvements lead in turn to better non-price-based value through efficiency. Risk is reduced as well, since removing manual labor from the process strengthens controls and compliance.

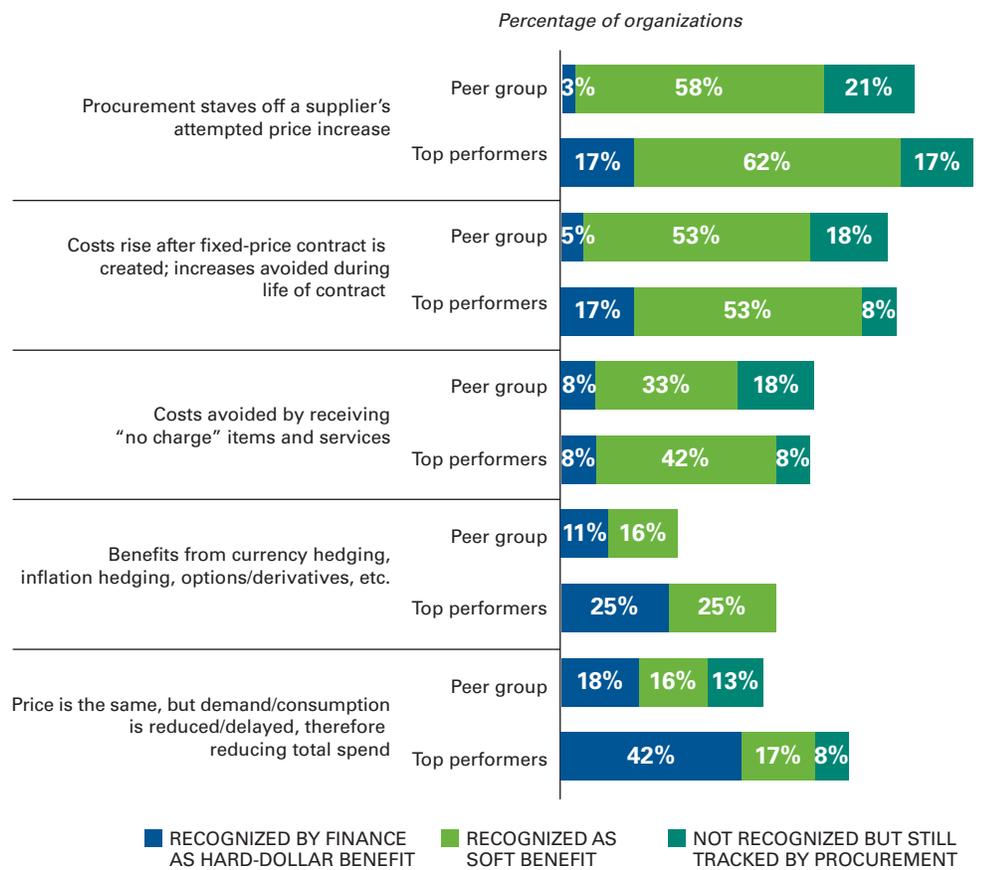
Another major contributor to greater recognition of hard-dollar benefits is the ability to cut carrying costs by reducing the amount of raw materials needed or rationalizing assets. Hard-dollar recognition by top performers hints at their greater skill at tracking TCO in categories like direct materials.

World-class organizations are effective at measuring their raw materials/packaging and purchased finished goods for asset rationalization efforts. Their cost-measurement capability supports efforts to reduce cost beyond unit price, and improves visibility and accuracy of cost/savings tracking. The application of TCO models is foundational to recognizing non-price cost-reduction value because it gives procurement professionals more complete internal and external cost information for use in decision-making, holding suppliers accountable and tracking savings.

Cost/spend avoidance

With cost/spend avoidance, we begin to cross the divide between hard-dollar and soft-dollar recognition. In general, more companies recognize cost avoidance as a soft-dollar metric. This is in large part because stakeholders tend to take exception to claims that cost avoidance should be measured as part of actual cost. While many procurement organizations measure cost-avoidance factors, they tend to use it internally because finance and other stakeholders don't value them as a hard-dollar financial benefit (Fig. 9).

FIG. 9 How cost/spend avoidance value streams are credited to procurement



Source: Procurement Value Measurement Study, The Hackett Group, 2017

Procurement efforts related to staving off price increases (as part of negotiation efforts) and creating fixed-price contracts have similar levels of recognition by top performers and peers as a soft benefit. This suggests a shared struggle for recognition of success in cost avoidance. Avoidance of cost by obtaining items and services at no charge may also reflect negotiation tactics or benefits derived from improved supplier relationships. But even when suppliers are willing to provide benefits in recognition of procurement's success at closing a deal or increasing contract value with renewals, procurement may still not receive hard-dollar recognition.

Demand/consumption and financial hedging reveal the biggest differences between top performers and the peer group. Collaboration with finance and supply-chain resources is required for the best understanding of the benefits derived when supply-chain influence is balanced with managing supply continuity. Finance and treasury organizations that hedge are often concerned about the impact of fluctuating commodity prices on cash flow. As a result, minimizing or eliminating the risk associated with cash-flow volatility is considered part of a wider cost-avoidance strategy by more top performers than peers.

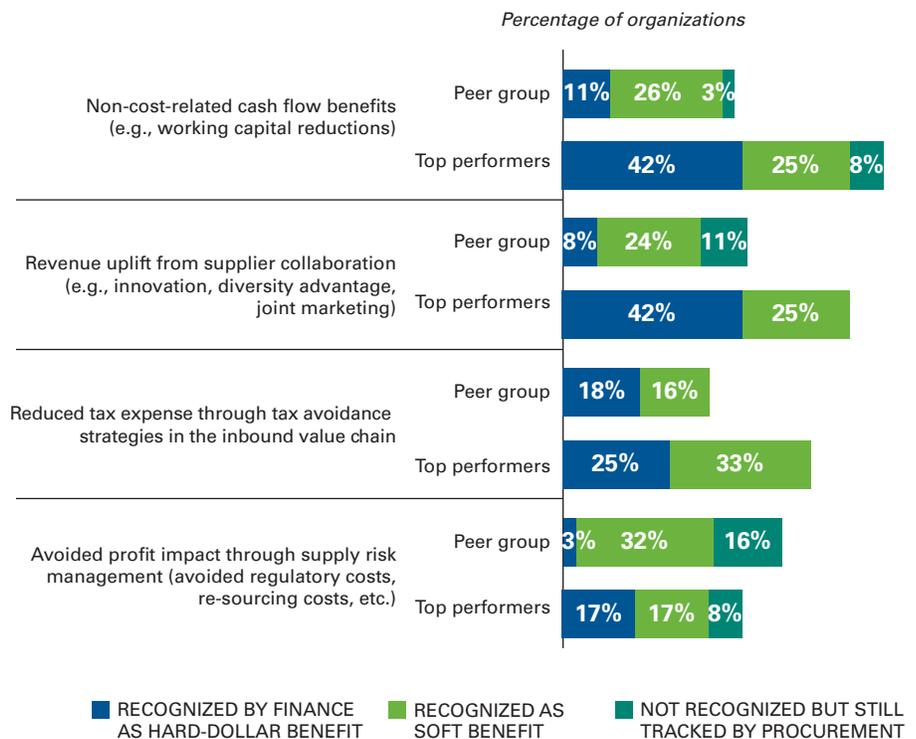
Ironically, while procurement may not be able to influence the macroeconomic conditions causing changes in demand or consumption, this is the area most recognized for hard-dollar savings at top performers and peer-group organizations alike. Especially in the case of top performers, this reflects recognition gained for working better internally to improve specifications or upgrade items/services purchased.

Strategic value

The value streams in the strategic value category with the greatest recognition as hard-dollar benefits relate to non-cost cash-flow benefits and revenue uplift from supplier collaboration (Fig. 10). For instance, improvements to working capital come from supply-base-related initiatives (primarily DPO and DIO) that are relatively easy to measure quantitatively, but require end-to-end purchase-to-pay capabilities. The data suggests that more top performers have designed them this way.

Procurement organizations can also increase their contribution to the bottom line (in the form of more working capital) by improving accounts payable, accounts receivable and inventory management. Top performers work more closely with treasury, finance and accounts payable in efforts that lead to improved net working capital outcomes.

FIG. 10 How strategic value streams are credited to procurement



Source: Procurement Value Measurement Study, The Hackett Group, 2017

Top performers also excel in collaborating with suppliers to drive innovation, by harnessing the benefits of diversity and conducting joint research and marketing efforts. The incremental benefit of innovation achieved from collaboration can represent as much as 7.4% of companies' annual revenue, compared to an average of 3.5% for the peer group. Here again, among top performers, 42% are recognized for hard-dollar benefits and 25% for soft-dollar benefits. The peer group fares much worse: only 8% gain credit for hard-dollar achievements.

In general, hard-dollar and soft-dollar impacts from tax-avoidance strategies are recognized to a lesser degree. Taxes affect contracts and invoicing, requiring collaboration with suppliers during negotiation and cost identification. This is especially true for multinational organizations working in several global tax regimes. Fewer peer-group organizations operate in companies where contributions to reductions in tax expense are recognized.

Procurement organizations' capabilities in supply risk management are also generally less mature than other value streams among both comparison groups. Supply risk management systematically and proactively identifies events with the potential to adversely affect the supply chain. Risk management efforts remain largely manual: 84% of respondents rely on Microsoft Office, making it difficult to comprehensively manage regulatory compliance efforts.² However, once again top performers are more able than peers to gain hard-dollar recognition in this area.

Conclusion and Recommendations

Our study found that even top performers have not yet reached the top of the procurement value pyramid. However, their behaviors and practices allow them to achieve more recognition for their cost-savings efforts. Procurement organizations must align their goals to support those of the overall business by standardizing metric definitions (such as the definition of cost savings) and collection/calculation methodologies with the finance department and other internal stakeholders such as treasury and supply chain. It should also be understood that metrics change over time, as the business environment and enterprise objectives evolve. Procurement's performance scorecard must therefore become more dynamic. The discussion can then be broadened to encompass definitions and calculations of a wider range of metrics (e.g., non-price cost reduction, cost avoidance, strategic value), where deemed appropriate.

Related Hackett Group Research

[Are Strategic Sourcing Resources Providing the Best Return?](#), October 2017

[Craig McKenney, Citi's Head of Enterprise Supply Chain: "Procurement Must Transform Itself Into a Competitive Enabler to the Business,"](#) July 2016

[Pfizer CPO Mike Hoffman: Creating a Procurement Brand to Drive Stakeholder Engagement,](#) May 2016

² Integrated Risk Management: A Playbook for Procurement. The Hackett Group, 2016.

About the Advisors

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Mr. Limberakis leads the development of intellectual property and research relating to procurement and supply chain. He has over 15 years of experience in supply management, having worked in a variety of consulting, product development and market research jobs. He was recognized by *Supply & Demand Chain Executive* magazine as one of its "Pros to Know" in 2013 and 2015. Areas of procurement-related expertise include strategic sourcing, contract management and supplier management.

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Ms. Fong has 20 years of experience in industry and consulting with a focus on procurement, supply chain and organizational effectiveness. She helps business leaders improve source-to-pay processes, manage complex supply chain partnerships and mature their organization's service delivery model. She also performs primary research in source-to-pay and operations and is the author of a number of publications on these and other topics.

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