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Procurement Value -
It's Not All About Savings

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Executive Summary

In this paper, the true meaning of “procurement value” is explored. If procurement functions and executives are to maximise their contribution to their organisations’ success, it is important that they understand the different ways in which value can be delivered. That goes far beyond just “cost savings”, into areas as diverse as the procurement contribution to internal efficiency improvement, risk management and even staff retention and motivation.

The paper looks at the fundamentals of organisational competitive advantage and the drivers that have been defined for that such as low-cost or innovation strategies. It then considers key metrics such as revenue growth and balance sheet strength that investors and analysts consider when evaluating a firm’s value. In every organisation, procurement needs to relate what it can do to support both the competitive advantage strategy that is being pursued and align itself with those key measures of corporate success and value.

That is not to ignore the basics of procurement, and it is argued that essentials such as spend visibility, control and good data are vital for procurement credibility. The core of this paper then looks at eight distinct areas, from cost savings to revenue growth and access to scarce resources, through which procurement can lever real value, and identifies in each case how they can contribute to that wider organisational value.

Introduction

It has become a regular occurrence at procurement conferences. The speaker, whether practitioner, industry expert, or even solution provider, says, “procurement is all about providing value to the organisation, not just cost savings”.

Every senior professional, Chief Procurement Officer (CPO) or similar, in the audience will nod their heads earnestly in agreement. Sometimes though the speaker will follow up with a key question.

“How many of you have savings as your primary KPI or performance measure?”

The vast majority of hands will go up at that point, and sometimes there’s a further question: “how many of you have cost savings as the only significant measure for procurement?” That will also elicit a worrying high proportion of positive responses. What does this tell us?

We can assume that most procurement and supply chain professionals today do understand at least conceptually that “savings” is not the only game in town, and that value has to be what matters. However, that is not translating well enough into performance measures. So, either procurement itself doesn’t understand exactly what value means, or perhaps procurement has a very clear view of “value” but is simply not good at communicating it to key senior stakeholders. A third possibility is that although everyone is clear about procurement value, it is just difficult to incorporate the concepts into meaningful and practical performance measures.

We suspect in many organisations there are elements of all three issues at play. While it is one thing to understand that “value” is key, it is another to know how various aspects of procurement activity contribute towards it. We also know that procurement has not always been noted for its skills in internal communication and stakeholder management, at either individual or functional level, and some aspects of value are hard to pin down with simple numbers and measures.

So in this short briefing paper, we will address that issue of defining “procurement value” in particular; if that is not in place, the rest is inconsequential. Procurement can add significant value in all the areas that most businesses care about, but that needs to be well understood in order to explain to others and position the function within our organisations.

What do organisations care about?

Competitive advantage sits at the heart of business success, and is recognised as a vital concept by academics, practitioners and advisers globally.

“A competitive advantage exists when the firm is able to deliver the same benefits as competitors but at a lower cost (cost advantage) or deliver benefits that exceed those of competing products (differentiation advantage). Thus, a competitive advantage enables the firm to create superior value for its customers and superior profits for itself”. *(Wikipedia)*

Organisations strive to achieve competitive advantage in different ways, through various business strategy options. Academic and business author Michael Porter talked about low cost, differentiation and segmentation strategies. Operational excellence, product leadership and customer intimacy have also been proposed as core approaches to achieve advantage.

Wherever the organisation’s focus lies, it is essential that procurement understands the key drivers for success and how the organisation positions itself to compete. Procurement value should as far as possible link to that. It is fairly obvious that if an organisation competes on cost, then procurement should be heavily driven by cost reduction and internal efficiency objectives. But if the organisational strategy relies on innovation or operational excellence, then a procurement function that is purely focused on cost will never be seen by the Board as strategically important.

While competitive advantage underpins success, businesses live or die by their financial results and performance. “The market never lies”, as the old adage has it, so looking at what is valued by investors, shareholders, and analysts can tell us a lot about what really matters. Reviewing commentaries on financial results therefore tells us which issues are seen as the most critical, and four stand out.

Profit is obviously vital, although it is actually made up of two distinct factors – profit margin and sales volume. In some ways, profit is less important than many people might realise in terms of valuation; so, a share price might drop even if profit is up if either results show an increase in sales but declining margins, or a high-growth firm sees sales slow suddenly.

Revenue and particularly revenue growth are certainly a key factor. That's because revenue growth is a good indicator of future prospects, which feeds back into the current share price and company valuation. Amazon and other modern tech giants made no profit for years yet saw their share price boom because of the rapid revenue growth. Investors assumed, correctly in the case of Amazon, that profit would follow.

Balance sheet management - asset and working capital issues - also have a high priority; for instance, even a profitable company can have big problems or go under if it doesn't manage its cash flow.

"Reputation" is another factor that plays strongly into shareholder value – including the power and value of a firm's brand, its competitive positioning and any negative issues that might hit its future prospects. This is a forward-looking indicator that investors use to assess future prospects for earnings.

Linking procurement activities to business value - and first things first

Understanding the organisation's positioning and competitive advantage, and being clear about the key metrics that affect valuation, enables procurement to start talking about its contribution in a way that will resonate with senior stakeholders.

However, it is important to emphasise that procurement will only be credible if the fundamentals of good procurement and spend management are already in place. This is not rocket science, but there are certainly necessary (if not sufficient) conditions for procurement success, as the mathematicians would say.

The 3 Basic Conditions for Procurement Success

1. **Spend controls** must be in place so there is the ability to manage spend and costs in an organised, structured and controlled fashion.
2. Procurement must have **visibility of third-party spend**, as close to 100% as possible, in order to understand and prioritise where it can add this value.
3. **Spend, market and supplier data** must be accurate, appropriate and timely in order that procurement and the business can make good decisions based on the data and information that is available.

Spend control, visibility and data are the vital fundamentals, and assuming that these are in reasonable shape, we can look at how procurement can support achievement and improvement of those four core valuation metrics. Some procurement activities will support more than one; even "basic" cost reduction is not necessarily just about profit or margin. It can drive margin improvement, but it might also enable product price reductions which boost revenues.

Procurement professionals and functions undertake a wide range of tasks with different objectives. Over several years of lecturing on the University of Birmingham MBA course, we have challenged the students to think about the roles and activities that procurement functions undertake and classify them into distinct areas of activity, with as little overlap as possible. From that, eight headings have emerged, capable of capturing "everything procurement does!"

The Eight Procurement Goals

These eight procurement headings can support in various ways the four organisational core metrics described above (profit, revenue, balance sheet, reputation). How each of the procurement headings can primarily contribute is shown in the table at the end of each section.

1. Reduce third-party costs

This is the activity that many consider the heart of procurement activity. There are many ways to achieve it, and it encompasses (in our classification) not just negotiating price reductions from existing suppliers, or finding cheaper suppliers, but also changes in specification that save money. Demand and budget management has a significant role here – simply not spending money where previously it was spent.

It can also in some firms include complex approaches such as the use of commodity markets, hedging and related financial instruments, or it could be as basic as amalgamating internal spend to achieve better economies of scale. Savings may go straight to the bottom line, be re-invested as price reductions to drive revenue or used to fund investment of some sort within the business. Reducing the cost of assets can also improve the balance sheet position.

This is in effect the foundation of procurement’s role in many organisations, as we said earlier, and our inclusion of seven other goals is not meant to downplay its importance in many organisations.

Profit margin	✓	Balance Sheet	✓
Revenue Growth	✓	Reputation	

2. Contribute to top-line revenue growth

There are many ways in which procurement can contribute to sales and revenues. Working to improve product quality can generate increased sales. Reciprocal trading (turning suppliers into customers) must be handled carefully to remain ethically sound but is an example of a very direct procurement contribution to sales. Other innovative ways in which procurement can help revenues emerge constantly; for example, the banking example given below.

In a slightly different example, “resources” might mean the rights to mine metals or minerals. In one mining firm, procurement has played a major role in securing rights by offering to build local supply in developing countries. That can be an important factor when governments decide which firms they should work with in this sector.

CASE STUDY – A leading Danish bank has turned its internal procurement capability into a resource that is winning new business for the Bank. Prospective mid-sized clients are offered a set of procurement tools, templates and guidance, developed by the bank’s procurement team, plus direct advice if it is needed, in order to help those organisations improve their own procurement performance. The bank has won new business where this was the clear differentiating factor – “there isn’t much else that is different in the proposals from various banks!”

Profit margin		Balance Sheet	
Revenue Growth	✓	Reputation	

3. Asset, cash and working capital optimisation

Procurement can influence the balance sheet in a number of ways. Firms seek to maximise return on assets; so, managing assets well in various ways can support this goal. For example, optimising output from existing equipment rather than buying more is a simple example which can apply to factory equipment or the corporate “stock” of laptops or printers. Payables form a major element of working capital, so procurement’s role in managing supplier terms, ensuring that payment is made to the terms agreed rather than early for instance, is key. Early payment schemes can boost profit margins (by effectively reducing purchase price); and supply chain finance schemes have become more prevalent, playing into working capital management, with some schemes now designed so they can even become revenue generators.

Profit margin	✓	Balance Sheet	✓
Revenue Growth	✓	Reputation	

4. Capture market / supplier innovation

In a sense, this point could be seen as a contributing element of others listed here, but we consider it so important that it is worth highlighting directly as a core procurement goal. Capturing supplier innovation does drive many of the other goals. It can influence profit directly, through new ideas that lower material or processing costs for the supplier, leading to reduced prices for the buyer. It can drive revenue, through supplier-driven product innovation or improvement. It can also lead to reduced risk and enhanced reputation - perhaps an initiative around sustainable use of key resources or materials, for instance.

In some sectors, this is rightly seen as very high on the procurement list of priorities, but in many organisations, procurement has not managed to deliver on this value generator. Too often, it has failed to communicate the potential or indeed actual benefits that can arise from these activities.

CASE STUDY – A major global consumer goods company has a corporate objective that 50 % of its revenues in any given year should come from products launched within the previous three years. Many of their products are susceptible to “own label” copying by other producers so constant innovation and new product launches are key strategies to drive the firm’s competitive advantage. A linked objective is that 70% of this revenue should arise from ideas provided by the market and suppliers rather than internal innovation.

Profit margin	✓	Balance Sheet	
Revenue Growth	✓	Reputation	✓

5. Efficiency and effectiveness

This classification covers a vital contribution that procurement can and often does make, yet one that is often not well prioritised enough by practitioners or understood by senior stakeholders. It relates to how third-party purchases and suppliers can improve the efficiency and effectiveness of the overall buying organisation. It is clearly independent of the price paid, yet can have a multiplier effect many times the value of the purchase. That efficiency may be taken directly as a profit margin benefit, or re-invested to drive revenue growth. There

are good examples in the professional services categories; procuring top-class legal advice or a brilliant consulting assignment might have a benefit measured in millions (or more) in profit or revenues for a relatively small outlay.

On a more operational note, improving the way raw materials or components are handled and incorporated into a manufacturing process might save large amounts in terms of labour costs or stockholding (and therefore play into balance sheet benefits). The unit purchase price may not go down, or may even increase, yet the benefit to the organisation can be considerable. And even closer to home, efficiency within the end-to-end procurement and supply chain process (easier ordering and approvals, automated invoicing, effective stock management) can have obvious benefits.

CASE STUDY – A food firm used large quantities of milk powder, delivered to the factory in 25 kilo sacks on pallets. Handling was hard work and carried safety risks too. The materials buyer worked with key suppliers and factory colleagues – as well as an innovative tanker firm – to develop a new process whereby the powder was transported in bulk in tankers and pumped directly into large silos in the factory. This brought benefits in labour cost, hygiene and safety and although the purchase price of the milk was virtually unchanged (the saved cost of sacks was offset by a more expensive vehicle for transportation), the overall benefits were considerable.

Profit margin	✓	Balance Sheet	✓
Revenue Growth	✓	Reputation	

6. Risk profile (internal and external)

Supplier and supply chain related risk is rightly recognised now as a major issue for pretty much every organisation. Whether it is risk arising from supply interruption, from political, natural or human-driven events, reputational risk or financial risk, it is on the agenda for most Boards now. But many procurement functions still do not even attempt to track, address or measure supply chain risk in a structured fashion.

Risk feeds into profit margin – for example, better supply chain risk management might reduce the cost of insurance premiums. Fewer risk events or better mitigating actions means fewer factory slow-downs / closures because of raw material shortages, which will increase efficiency and reduce costs, as well as potentially improving working capital (lower stock levels). Such actions may even drive revenue through better product availability. But risk also has a major effect on the “reputation” driver of business value, as we have seen in many cases, from horsemeat scandals to factory tragedies in the clothing supply chain.

Profit margin	✓	Balance Sheet	✓
Revenue Growth	✓	Reputation	✓

7. Promote monopoly positioning – access to scarce resources

Our two final procurement activity groups or goals are the least commonly discussed and cover issues that many people will never consider. However, both relate to valuable contributions procurement can make, and do not overlap with the other points in our list.

This type of activity is not significant in many organisations, but where it is, it can provide a major benefit. Securing supply of scarce materials, components or even services, and perhaps even tying up the supply market to deny competitors supply, has been key in state-of-the-art technology products. It is certainly something high on the priority list for Apple’s supply chain function, given the huge quantities of rare metals and high-tech components that the firm needs.

Effective sourcing like this can obviously help profit margin, but can also drive revenue, as in the case of many high-tech products, and as in the example below, it can have an impact on “reputation” too. Scarce resource issues are not just about rare metals, either. In many sectors of the labour market, from skilled IT security specialists to drivers of heavy vehicles, supply is tight, so spend areas such as contingent labour or recruitment are as much about finding and attracting the best people as they are about cost reduction.

CASE STUDY – CNBC reported this year that “Apple is looking to procure cobalt, an essential component in smartphone batteries, directly from mining companies” because of concerns about potential supply shortages of this vital metal. Not only will Apple’s supply chain executives look to secure supply, but the report suggests that visibility and risk management are also issues, as Apple is mindful of the reputational issues (see point 6 above) around human rights in countries such as the Democratic Republic of the Congo, the largest global producer of cobalt.

Profit margin	✓	Balance Sheet	
Revenue Growth	✓	Reputation	✓

8. Staff motivation

As the “war for talent” gets bloodier, in certain industries at least, developing and maintaining staff motivation is a real issue, and in some organisations at least, procurement can actually play a useful part in retention of key employees. What do we mean by this? Consider a travel policy or an expense claim process that is complicated, constrains travellers, and generally makes staff suffer - it can actually get to the point where that becomes a factor in decisions to stay with the firm or leave. Lack of decent IT equipment can frustrate people tremendously, and at the top end of the market, firms such as Google have made wonderful staff benefits part of how they attract the brightest and best.

These factors rarely are the only reason why employees leave a company, but they can certainly accumulate as negatives and make it a lot easier for an employee to choose to work elsewhere when the time comes. We’re not suggesting every CPO starts buying pool tables or luxury catering services for the office, but in some firms, this is something on the procurement agenda in certain spend categories.

Profit margin		Balance Sheet	
Revenue Growth		Reputation	✓

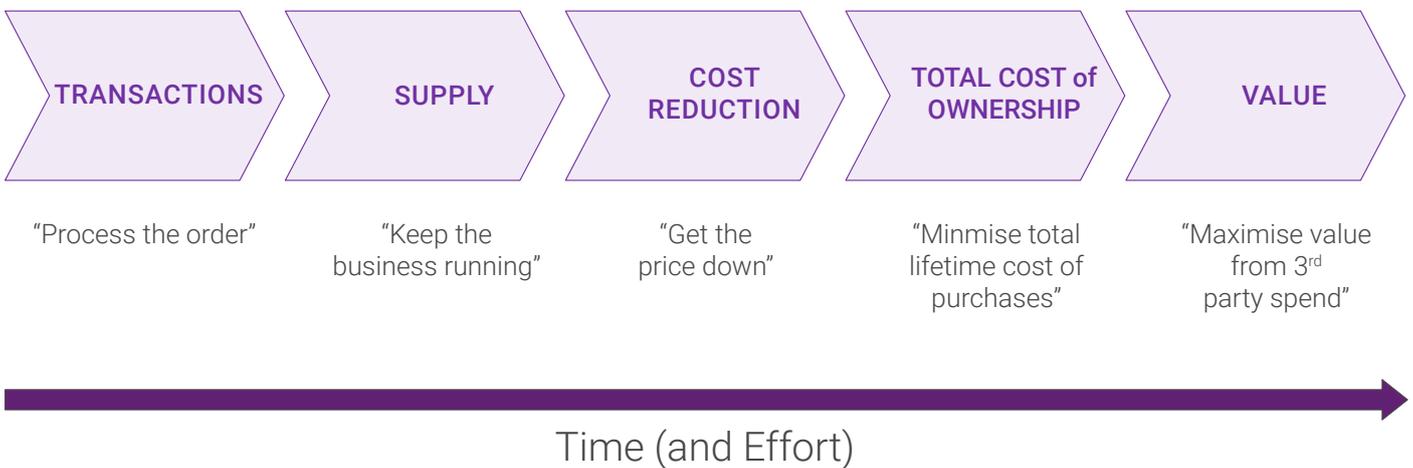
Final Thoughts and Conclusions

The purpose of this paper is not to suggest how all these aspects of value could and should be measured – that is for another day. But it is clear that different measures are appropriate for the different areas of focus and for different spend categories. There is nothing wrong with measuring real “cost savings” or “unit cost reduction” in certain areas, where it is a meaningful measure, but we would suggest it is an inappropriate measure for spend on complex services, for instance, or for one-off asset purchases.

What is important we believe is that procurement leaders start to have regular conversations with their senior stakeholders and the organisation generally around these different ways in which procurement supports the wider-value goals. That should be framed around those basic metrics which drive shareholder value (in the private sector), such as revenue growth and working capital as well as margins and costs. In the public sector, understanding the policy goals of the organisation is the starting point, and again procurement needs to position itself in terms of how it supports achievement of those.

We would also stress that procurement organisations need to work out where they are in terms of developing procurement maturity before developing their strategies. Moving from a position of immaturity to one where all these procurement value levers are fully understood is not an overnight job, and the fundamentals mentioned earlier – spend visibility, control and data – must be in place to drive sustainable procurement performance.

How Procurement Maturity Develops



Equally, in many organisations, procurement will need to prove itself in terms of supporting cost reduction and efficient operations before it is likely to get the support needed to focus and invest more in activities that improve strategic risk management or help to drive revenue.

But ultimately, procurement demonstrating that it delivers value that is relevant to the organisation in different ways through its activities will position the function and the people working within it in a positive manner. Good luck!

Acknowledgements

We are grateful to Coupa for their support in the publication of this paper, but the views expressed here are those of the author. Further information on this topic and others, and links to the other sites in the Spend Matters Group, can be found at <http://spendmatters.com/uk/> or Peter Smith can be contacted at psmith@spendmatters.com. Reproduction of this publication in any form without prior written permission is forbidden.

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Peter has over 25 years' experience in procurement and supply chain as a manager, procurement director, consultant, analyst and writer. He is Managing Editor of Spend Matters Europe, and with Jason Busch, the founder of Spend Matters in the US, has developed Europe's leading web-based resource for procurement and industry professionals. Peter worked as Procurement Director for the NatWest Group, the Department of Social Security (the DSS), and the Dun & Bradstreet Corporation, and held senior positions in the Mars Group during his management career. He has an MA in Mathematics from Cambridge University, is a Fellow and was 2003 President of the Chartered Institute of Purchasing and Supply, and his first (co-authored) book, "Buying Professional Services," was published by the Economist Books in 2010.



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Coupa Software (NASDAQ:COUP) is the cloud platform for business spend management. We deliver "Value as a Service" by helping our customers maximize their spend under management, achieve significant cost savings, and drive profitability. Coupa provides a unified, cloud-based spend management platform that connects hundreds of organizations representing the Americas, EMEA, and APAC with millions of suppliers globally. The Coupa platform provides greater visibility into and control over how companies spend money. Customers – small, medium, and large – have used the Coupa platform to bring billions of dollars in cumulative spend under management. Learn more at www.coupa.com.

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