

Operations Practice

Revolutionizing indirect procurement for the 2020s

There's a new vision for indirect procurement, enabled not just by new technologies but also by a radical new understanding of the value indirect procurement can generate.

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Since 2011, indirect spend has been growing by an estimated 7 percent per year globally. Even so, many organizations fail to give indirect categories the attention they deserve.

Common challenges are apparent across industries. Spending is often fragmented among multiple locations, business units, and categories, making it hard to identify and capture enterprise-wide savings opportunities. Leaders of indirect-procurement functions typically lack sufficient clout within the organization to obtain the technology and talent they need. And most companies do not have mechanisms to monitor indirect categories and reflect their performance on financial statements.

To overcome the challenges, companies need a new vision for indirect procurement that combines cutting-edge tools and practices, as well as traditional approaches to category management, to address fundamental issues relating to processes, capabilities, and data. Using this coordinated, technology-enabled approach, global companies are already achieving marked improvements that allow them to capture the untapped value of indirect procurement.

Simply put, evolution is not enough. To succeed in the 2020s, companies need a revolution in indirect procurement.

The distinctive elements of the new vision

What makes the new vision for indirect procurement so powerful? Certainly, digital technologies and best-in-class practices provide the foundation. But these are just the starting point. To unlock the full potential, these elements must be applied comprehensively (exhibit). In the Appendix, we set out the differentiating features of each element of the approach. Here, we describe the most advanced solutions relating to each element.

Intelligent spend engines. These digital tools, blended with machine-learning technologies, use automated engines to classify and categorize

spending. Full transparency into analytical opportunities and validation status is enabled by automated data extraction from enterprise resource-planning (ERP) systems and databases, along with automated harmonization and classification. By integrating data pools and analytics functions, the tools can recognize cross-category synergies. Machine-learning features improve the tools and perform data cleansing, categorization, and enrichment activities. Visualization software translates the results into reports and drillable dashboards. Taxonomy booklets provide up to five levels of granularity on the basis of global best practices.

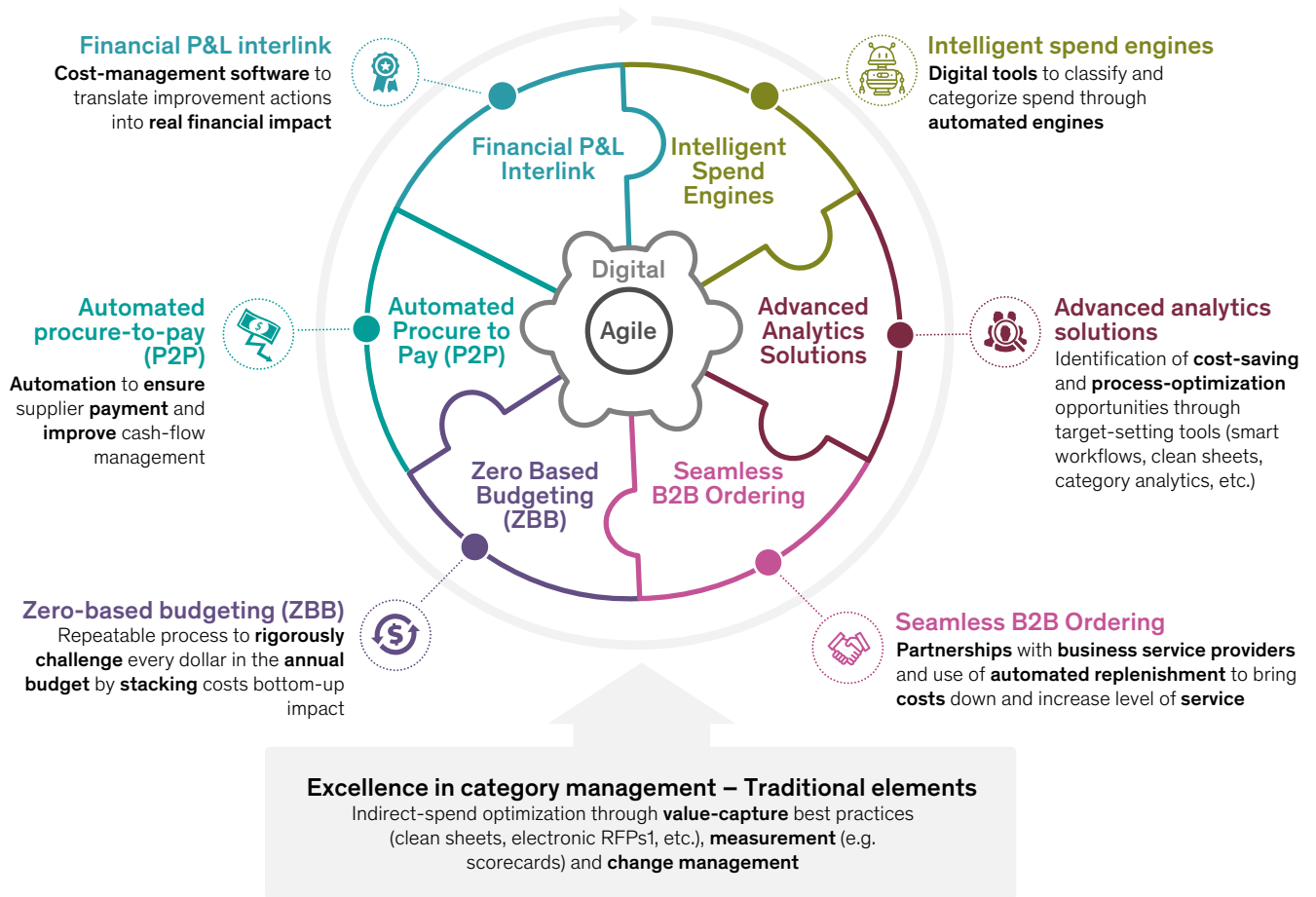
The enhanced transparency and standardization can drive significant bottom-line savings. For instance, merged companies face the challenge of integrating multiple ERP systems, fragmented taxonomies, and limited visibility on actual spend across the organizations. Intelligent spend engines can, for example, identify similar maintenance parts used by both companies and consolidate vendors. In our work supporting post-merger integration programs, we have seen these tools enable savings of 10 to 12 percent.

Advanced analytics solutions. Companies can use advanced analytics enhanced with target-setting tools to identify cost-saving and process-optimization opportunities. Several types of target-setting tools are available:

- **Category-specific.** Automated solutions—hard-coded into analytics—identify, apply, and monitor standard and advanced levers unique to a category.
- **Smart workflows.** These platforms review the forecast spending per category and activity and provide a guide to integrated best-practice actions for selected categories. Buyers use the insights to develop negotiation strategies for each category.
- **Functional advanced analytics tools.** To improve category functionality, buyers can apply a

Exhibit

The indirect procurement function revolves around six new elements.



¹Requests for proposals

variety of tools, including: network optimization tools; automated, real-time KPI dashboards and executive scorecards; parametric clean-sheets, and eSourcing tools powered by artificial intelligence and advanced analytics.

Product and service costs can be reduced by 10 to 25 percent, while the manual effort for supplier governance can decrease by 30 to 50 percent.

Seamless B2B ordering. Partnerships with business service providers, along with automated replenishment, can be leveraged to reduce costs and increase service levels. Various tools and platforms have been developed. Leading companies have created a B2B offering catalog that lists all online marketplaces, additional services, and supplier offerings. Online B2B platforms—such as Alibaba, Amazon Business, and ThomasNet—are

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e-marketplaces that are used for supplier evaluation and selection, cross-category orders, and financial traceability. Internet-of-things replenishment tools are intelligent storage equipment that can automatically reorder based on stock levels. E-commerce integrator software powers an internal order-coordination platform that manages replenishment data and automatically places orders to B2B platforms.

Price reductions enable savings of 6 to 15 percent, while access to an expanded assortment eliminates a company's dependency on single suppliers.

Zero-based budgeting. To rigorously challenge every dollar in the annual budget, many companies use a repeatable process that stacks costs starting from zero. The foundation of the process is a budget-creation tool powered by software that applies zero-basing policies. The tool has capabilities for spend visualization, forecasting, and systems integration. It includes zero-basing "bluebooks" that cover the analyses and processes, efficiency levers, and organizational structure required to fully unlock the potential. The zero-basing process is supported by standard procedures to build and negotiate budgets, including knowledge, guidance, and practices that equip the organization to negotiate at scale.

Industries ranging from energy and transportation to banking and telecommunications are seeing early successes with zero-basing, following examples

from consumer industries. SG&A savings of 10 to 20 percent can be identified in less than six months, and unproductive costs can be redirected to the most productive areas. Joint responsibility for the process by category owners and budget owners improves accountability.

Automated procure to pay (P2P). Companies can use automation to ensure supplier payment and improve cash-flow management. Robotic process automation (RPA) solutions automate routine tasks through existing user interfaces and motorized machinery. Machine-learning software uses supervised and unsupervised learning (for example, decision algorithms) to identify patterns in data, thereby automating the assessment of improvement potential. Cognitive agents and natural-language processing tools comprise a virtual workforce that can support employees and customers through the parsing and analysis of task descriptions. (For more, see "A next-generation operating model for source-to-pay.")

Companies deploying automated P2P have achieved 15 to 25 percent savings in most transactions and reduced processing times from days to minutes. These tools also promote the transition from spot checking to total quality control. Over a 12-month period, one company succeeded in reducing value leakage by approximately 3 percent and captured savings by gaining better control over spending.

Financial P&L interlink. A procurement-finance interlink tool is powered by cost-management software that translates improvement actions into real financial impact. The solution tracks the status of initiative implementation and projected revenue. Forecasting is automated through algorithms that disaggregate volume, mix, and market effects from indirect performance. The software is paired with financial department systems, so that initiatives' financial impact can be automatically uploaded to the department's database. Auditing features check data accuracy and compare data with supplier reports and cross-functional data. The tool is supported by a basic finance boot camp. This online financial-knowledge academy teaches buyers how to improve their negotiation skills, initiatives definition, and impact tracking.

The company gains the benefits of improved forecasting and budget planning and clear visibility into how procurement influences the P&L. These benefits, in turn, allow the company to more accurately identify the level of funds available to reinvest in growth and strategic projects. Moreover, the interlink increases the engagement of top management in indirect-procurement initiatives.

Agile organization. In an agile organization, category-specific managers are replaced by a working group of managers that perform negotiations for different categories, depending on variables such as the timing of the negotiation and the required expertise. The working group is a pool of multidisciplinary professionals drawn from all categories. The agile operating model includes defined processes with clear ownership, involvement of internal and external stakeholders, and standard but flexible activities. Cross-functional collaboration is powered by visualization and communication tools that allow managers to share information and monitor and make inter-departmental decisions instantaneously.

Benefits include a 20 to 30 percent reduction of time-to-market, improved services to internal business partners, and enhanced cross-functional collaboration.

Staying focused on the basics

While adopting the new approaches, companies should also stay focused on traditional approaches to achieving excellence in category management:

Value capture. Best practices for capturing value include requiring frequent and more detailed RFPs. Clean sheets—bottom-up estimates of a supplier's costs for specific parts and services— are especially valuable analyses. Periodically searching for new vendors is important to avoid the high costs that result from being “locked in” with a particular vendor. A company can enlist support from industry experts to negotiate lower prices from vendors. Additionally, using off-the-shelf e-procurement technology is a low-cost way to support value capture.

Measurement. Procurement's performance can be measured using scorecards linked to annual run-rate cost savings. Scorecards, as well as a tracking system, can also be used to measure suppliers' performance.

Change management. The procurement function can lead efforts to change procurement practices throughout the organization. Members of business units and other functions can learn how to improve procurement approaches by “shadowing” experienced procurement analysts. It is important to link processes to contract expiration and develop a calendar that sets timetables and deadlines for actions. The company should use historical performance as a benchmark for setting aspirations. By establishing joint targets with functional peers, procurement experts can ensure that these peers have skin in the game when it comes to achieving excellence in category management.

Establishing enablers beyond the tools

A program to transform indirect procurement begins with setting clear goals and focusing on categories and subcategories. A company can then analyze the potential value of categories and subcategories by using benchmarks and spend visibility tools, such as spend cubes. To unlock the opportunities and execute rapidly, it must apply category levers,

validate the baseline, and identify the global and local champions who will lead the program and drive change. To monitor and sustain performance, the company must plan resources, track revenues, and refine the process for continuous improvement. A cloud-based platform enables all functional departments to share information in real time, while a “control tower” can monitor impact.

To successfully deploy the new approach, a company must create the right culture and bring new digital and analytics skills to the procurement team. This requires taking tactical actions that instill the necessary mindsets and behaviors, as well as building the hard and soft capabilities required for the organization to reach and sustain the full potential. Support from top management is essential to maximize the impact—as examples, CEO sponsorship is needed for zero-basing and

the CFO must support efforts to establish the P&L interlink.

The comprehensive suite of digital solutions that we have discussed has enabled cost savings of 15 to 20 percent. A company can gain competitive advantage by applying the bottom-line savings to fuel growth and innovation. These new techniques have matured beyond the experimental phase and are now fully tested and ready to be deployed at scale. Even so, they have not yet been widely adopted, making them a source of competitive differentiation for companies that adopt them today. Leading companies have already positioned themselves for success in the 2020s by implementing the new vision for indirect procurement. The time has come for all companies to join the revolution.

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