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Procurement Outsourcing, Part 2: Trends, Challenges, Benefits and a Roadmap for Implementation

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INTRODUCTION

Last year, the authors published “Procurement Outsourcing: Trends, Challenges, Benefits and a Roadmap for Implementation.” This white paper examines how the landscape has evolved since then and the road that lies ahead. Service provider capabilities and maturity have continued to increase over time and, even with some of the contradictory signs in the economy, so has interest in procurement outsourcing. Key drivers of this increase include the realities of growth in emerging economies, low availability of trained supply management professionals and the need to drive efficiencies and effectiveness in the supply chain.

Procurement outsourcing is no longer synonymous with transactional procurement but has expanded to include strategic aspects of procurement including category management, strategic sourcing, supplier management, analytics and knowledge management. Market trends and information from transactions point to procurement outsourcing growing at the highest rate relative to all other areas of outsourcing in business processes.

TPI market data showed a 43 percent increase in procurement outsourcing new contract volume in 2009 and sustained high volume in 2010. In fact, the number of new agreements for 2009 – 2010 exceeded the volume of the three prior years.

EVOLUTION OF THE PROCUREMENT FUNCTION

One of the strongest drivers fueling the unprecedented interest is the realignment of procurement organizations and their focus on areas that either help create or strengthen competitive advantage for the overall supply chain.





However, the focus on year-over-year procurement cost savings for traditional categories will produce diminishing returns after these categories are optimized. In addition, over the long term, similar rates of savings for these categories are not sustainable. This does not mean that the value being provided to the corporation by the procurement function is diminishing. In fact, the opposite is true. But traditional ways of accounting for the impact of procurement must be reexamined to reflect the long-term sources of value. To this end, there is a clear shift in the way procurement teams are being reorganized to:

- Leverage increased integration with internal business stakeholders in co-sourcing.
- Create sourcing centers of excellence (CoEs) and scalable knowledge management framework.
- Redefine activities and focus areas within the realm of supplier management.

Co-sourcing

After the initial rounds of supplier consolidation and spend aggregation, sourcing leverage diminishes if efforts are solely focused on these levers for traditional categories. Co-sourcing can provide continued value when the procurement function and internal business stakeholders align to form a procurement council and jointly drive spend optimization strategy focused on lowering the overall cost of acquisition by approaching the end-to-end supply value chain. Implementing co-sourcing requires expert help to run advanced market analytics and benchmarking, which are difficult to sustain internally due to lack of tools and skilled, dedicated resources. By virtue of providing category sourcing services, outsourcing providers have access to a wide range of databases, analytics tools and expert resources. Categories

that are common across industries tend to be the ones where service providers have better market information and benchmarking data, and they can therefore bring in a higher level of expertise. The value creation occurs through the coupling of the category insights from the service provider with the business insights from the internal stakeholders to drive innovative strategies specific to the client's situation. If governed well, this combination can be a powerful differentiator in business effectiveness.

Sourcing CoEs and Knowledge Management

A realignment of work domains as shown in the preceding diagram leads to opportunities where several activities in the source-to-contract cycle such as RFx desk, spend analytics, spend reporting, contract management and compliance reporting can be centralized. This centralization of transactional activities often directly calls for systems and tools to manage the increased volume, automated workflows, flexibility to change approval hierarchies, deployment of layered delegation of authority and superior reporting capabilities for key performance indicators (KPIs). Off-the-shelf enterprise resource planning (ERP) solutions often lack features to foster the increased collaboration, compliance and control, and this gap can be addressed by comprehensive managed platforms that bring together best-of-breed applications enabling information visibility, reporting and knowledge management with core information systems. The business need to drive faster value can benefit service providers who can bring technology expertise across a host of platforms, enabling workflow tools and knowledge management tools to complement their client's CoEs — whether these CoEs are retained internally, outsourced or operating in a hybrid model.

Companies need to invest in identifying and training personnel who can perform in this new paradigm



with a focus on driving expertise in critical categories that will be retained within the organization. External providers can supplement an organization's efforts with a bench of expert resources either on a project basis or on longer-term dedicated assignments. As an example, a sourcing and analytics CoE could be established either remotely or nearshore with trained resources to fill the gaps in benchmarking and predictive analytics (which assume increased importance in areas including supplier risk assessment, cross-border trade, supply chain management of direct goods and specifications management).

Knowledge management is critical to ensuring sustained value from the CoEs. Best practices captured across and within processes, categories and geographies can be leveraged to drive continuous improvements and standard work practices across the enterprise. In addition, the CoE needs to stay up to date on trends relevant to the industry from new technologies, materials and sources that can provide a competitive edge to the organization.

Supplier Management Redefined and Revisited

Supplier management is assuming a new definition of "strategic supplier value management." Progressive companies are looking to strategic supplier value management as a new source of competitive strength. Strategic supplier value management takes an end-to-end view of supplier relationships. Key supplier relationships are nurtured to assume strategic status, and suppliers that do not jointly drive consistent value realization find themselves relegated to secondary status. Strategic supplier management requires operational support and specialized tools for supplier risk modeling, predictive analytics, access to sustainability databases, efficient external and internal surveying tools and sophisticated data

mining — all of which complement an efficient relationship and governance framework between a buyer and supplier. A clear trend is emerging where companies are finding more value in dedicating their internal procurement staff to focus on establishing a robust governance framework while looking to external help or outsourcing for operational aspects of supplier value management as highlighted above. By doing so, smarter firms are able to respond to swift market changes a lot faster without a significant impact on the supply value chain; ensure regulatory compliance; innovate in sustainability areas; and, most importantly, create joint intellectual property and market-leading products.

BPO EVOLUTION AND THE IMPACT ON PROCUREMENT OUTSOURCING

The business process outsourcing (BPO) industry itself has matured and, while cost is always a key driver, the value delivered to business stakeholders is equally if not more important as a reason to consider engaging with service providers. This can be seen in the way service providers are measured today with the movement from FTE- to transaction-based pricing models, from measuring processing efficiency metrics to business metrics and from a vendor relationship to a partnership. Procurement BPO, though a late entrant, has made the transition from infancy to adulthood rapidly. It has, for example, moved from spend analysis and reporting to global spend and category management; from enabling supplier management back-end analytics to actually managing tail-end suppliers. The table below depicts the broad evolutionary trend and some of the trends specific to procurement BPO that are likely to occur in the next few years.



	BPO 1.0 (2000 – 2005)	BPO 2.0 (2005 – 2010)	BPO 3.0 (2011+)
BPO a tool to ...	Run the Business	Optimize the Business	Transform the Business
By delivering ...	<ul style="list-style-type: none"> ▪ Labor arbitrage ▪ Unit cost reduction ▪ Business unit focus 	<ul style="list-style-type: none"> ▪ Spend aggregation ▪ Supplier consolidation ▪ Profit maximization through shared services centers and offshoring ▪ Offshore procurement hubs 	<ul style="list-style-type: none"> ▪ Global spend and category management ▪ Effectiveness and efficiency ▪ Managed services ▪ Faster time-to-market ▪ Reduced risk
Price model	FTEs	Transactions	Business Outcomes
Toolset	<ul style="list-style-type: none"> ▪ Six Sigma ▪ Lean 	<ul style="list-style-type: none"> ▪ Reengineering ▪ Technology tools for master data management, eSourcing and Supplier Mgmt. 	<ul style="list-style-type: none"> ▪ Integrated source to pay platform ▪ Global CoEs ▪ Category expertise
Delivery	<ul style="list-style-type: none"> ▪ Hub 	<ul style="list-style-type: none"> ▪ Hub and spoke 	<ul style="list-style-type: none"> ▪ Global delivery model
IT integration	<ul style="list-style-type: none"> ▪ Siloed 	<ul style="list-style-type: none"> ▪ Connected 	<ul style="list-style-type: none"> ▪ Integrated

Our view on the likely evolution of business as shown above is predicated on service provider maturity, the increasing global footprint and the realization of more integrated technology and BPO services. It is equally predicated on mature and effective governance within the client organization.

Service Provider Capabilities

Service providers have invested heavily in growing category expertise and expanding their geographic footprint. Not surprisingly, investments in category expertise have primarily been in areas that are common across industries to drive higher value across clients. Also, an increasing number of providers now have dedicated procurement outsourcing CoEs in nearshore locations in Latin America, South America, China and Europe to address skill shortages in these regions arising out of increased economic activity. In many cases, this geographic footprint expansion has incorporated a strategy combining the use of co-locating service provider personnel with customers, nearshore centers and expansion of backend low-cost centers. This approach can address the need for customer proximity to manage more complex services, enable better project management and provide language coverage. At the same time, it retains the global model to provide backend analytical, service desk and processing capabilities that continue to provide efficiency, scalability and flexibility.

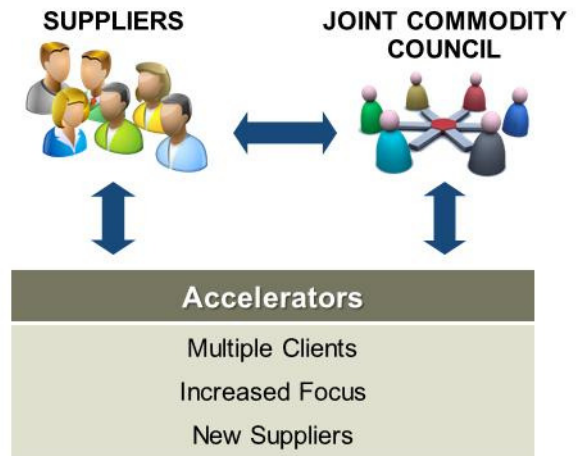
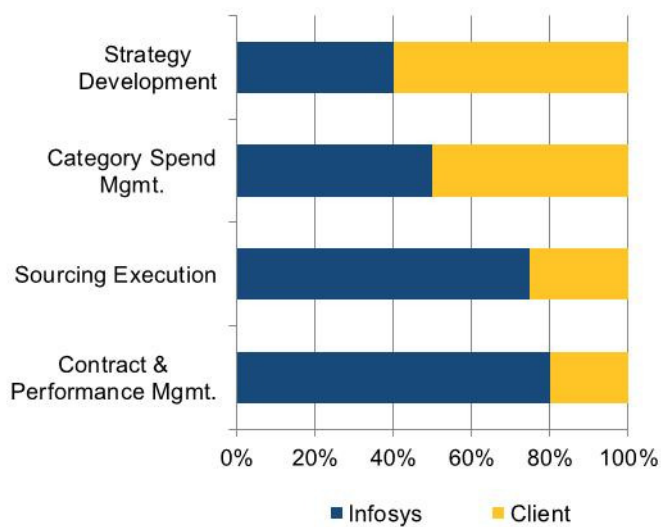
A regional presence is also critical to help drive adoption of standardized elements of global processes and overall adoption of best practices in the regions.



Indirect Procurement

Let's consider an example of this concept in the area of indirect spend. Most global organizations have substantial spend in areas like marketing and advertising, professional services and travel. A lot of such spending is embedded in businesses, so there is no clear ownership and, consequently, companies lack the category expertise needed to manage this indirect spend. Quite a few procurement outsourcing providers are large global corporations themselves and have substantial spend in similar areas, but because they provide their services to many clients, they instead often combine their own global spend to proactively invest in building superior category expertise.

Shown below are a representative operating model and key business benefits that result from procurement outsourcing with a higher emphasis on sourcing and category management.



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Direct Procurement

Although the promise of procurement outsourcing in indirect procurement is well understood and acknowledged, select industry segments have also shown an interest in direct procurement. The maturity and scale in direct procurement certainly lag indirect procurement, but service providers are investing in skills in these areas to provide a more holistic set of industry-focused procurement and supply chain offerings.

For example, in discrete manufacturing, there is a significant degree of activity in procurement engineering, procurement quality and logistical procurement support that need to be delivered globally. Areas like target costing — where service providers can assess the cost breakdown of manufactured parts using engineering knowledge, especially when sourcing in emerging markets — lend themselves to a more augmentative model of engaging with companies looking to drive both increased sourcing and local market sales. In the Oil and Gas industry, for example, direct procurement industry experience and knowledge of supply value chain are critical with the upstream and downstream businesses having their own very different challenges and supply market dynamics. Also certain processes that enable activities in direct procurement — such as low-cost country sourcing, supplier assessments, supplier quality and supplier risk management — provide a good source of competitive advantage and companies will look to partner with providers where a unique proposition can be created.

Technology Advances Drive Higher Value Across Procurement

A majority of ERP products lack the sophistication and alignment to serve the twenty-first-century procurement function. The initial functionality and architecture of ERP products were designed with

transactions in mind, mostly to support the day-to-day direct materials buying against a bill of materials. These products never anticipated collaboration needs that the procurement function will require for dealing with suppliers, businesses and payables. Key processes such as strategic sourcing, supplier management, category management, spend analysis — and even purchase order and invoice processing — were treated as stand-alone and fragmented processes. A variety of enabling systems are also needed to tie all these capabilities together and address all types of indirect spend categories and, to a large extent, direct spend too. These include performance dashboards, advanced analytics (e.g., supply risk analytics, predictive analytics), sustainability, compliance reporting and other reporting tools, knowledge management environments (document management, workflow and collaboration) and domain-specific systems for various individual categories and industries. Thanks to the increased spotlight on the supply management function and its elevation in organizations seeking more effective and profitable ways of working, there is a great deal of activity in this space. This includes start-up businesses, technology development by service providers, and select acquisitions by established ERP vendors building on acquired product platforms.

The emergence of Cloud Computing has enabled further business transformation, and mature procurement outsourcing providers now offer fully integrated and turnkey Cloud-based platform solutions. This is not just about making the technology available in a software as a service (SaaS) format. Rather, it means offering an integrated solution with technology and the processes as managed services, including the nontransactional areas highlighted above. Making this ecosystem of tools, core information backbone, surrounding workflow and services available requires a number of supporting work activities,



including ongoing master data management, reporting, help desk and standard templates. This combination is what makes the promise of cloud-based platforms all the more interesting. As an example, Infosys has made significant investments in building a set of proprietary workflow, analytics and procurement channel optimization tools that, combined with Cloud-based platforms, offer a one-stop solution for an overall transformation program, combining people, process and technology elements.

Case Examples

- A leading financial institution was faced with all the pressures from the recent meltdown: declining revenues, pressure to cut costs and budgets eliminated for any process, technology, or expert help in leveraging a deflationary market. This situation created the need to explore avenues that would have been unacceptable before: realigning the procurement function and setting up of outsourcing CoEs for sourcing and procurement.

Infosys worked with this organization in designing an optimal sourcing and procurement outsourcing solution with a clear definition of the retained scope of strategic supplier management and outsourcing of CoEs. Together, they transitioned select processes into a new niche platform suitable for handling complex spend categories (such as telecommunications and software) and for rebuilding its core sourcing and supplier management processes. With refocused client procurement leadership, Infosys' complementary processes and tools, a dedicated sourcing CoE and outsourcing of all transactional activities of procure to pay, the organization is able to focus on its core competencies. It is also able to influence a

larger portion of sourceable spend through sound sourcing and category management strategies and to institute a higher degree of procure-to-pay compliance. It can now make sure that sourced savings are realized through the downstream processes and better control its overall procurement expenses.

- A leading and fast-growing U.S.-based technology company was faced with limited visibility into indirect spend across its global footprint. As the company experienced higher growth in emerging markets, it struggled to meet demand for procurement services in North America, where it had a mature sourcing organization. It also lacked the ability to support spend management in most locations in the rest of the world. The company sought a strategy to expand and leverage its North American sourcing expertise into a global service delivery model, and used TPI to assist it in defining its strategy and going to market to identify the right solution. As a result, the company has begun to implement a hybrid model that comprises global strategic sourcing, contracting, spot buying and transactional capabilities combining internal and service provider resources. It can leverage on-site, nearshore and offshore delivery centers as well as Cloud-based technology to facilitate deployment and support.
- A leading mining company was faced with an acute shortage of skilled resources when they undertook a large spend transformation program. The problems of disparate systems and processes were compounded multifold by a recent acquisition. At the same time, this global mining firm had undertaken a multi-year transformation exercise focused on its core supply management systems. This transformation exercise placed significant demand on an already strained procurement team to standardize processes, support



systems transition and deliver year-over-year spend savings.

Infosys worked with the mining company in two phases of procurement outsourcing in which operational sourcing and supplier management activities were outsourced in the first phase followed by category management and transactional procurement outsourcing. With the complementary skill sets in these processes available through an augmented Infosys team dedicated to sourcing and procurement, the retained supply management team could focus on a number of strategic initiatives: Cloud-based sourcing, increased eProcurement adoption, increased end-to-end downstream contract and purchasing compliance. Most importantly, the company could bring more spend under the direct influence of supply management function resulting in overachievement of spend reduction targets by a few basis points. With a few basis points applied on billions of dollars in spend, this mining major had truly struck gold!

CONCLUSION

Procurement has often played a role in advocacy for and facilitation of large outsourcing transactions where other functions were the key stakeholders, but procurement professionals have generally been late to embrace the integration of outsourcing strategies for the procurement function itself. This is

now changing. As a result of successful examples of procurement transformation through outsourcing, most strategic procurement leaders are recognizing the need to make up for lost ground and have begun to embrace innovative procurement outsourcing strategies. This trend of increasing adoption of otherwise nontraditional categories is being fueled by new engagement models of platform-based delivery (procurement has historically been one of the lowest investors in technology), superior category expertise (in noncore spending areas) and expert help (process transformation and organization change management).

Highly qualified advisory firms like TPI will provide you with the insight to develop the right strategy for your organization, and to effectively manage the sourcing process with clarity, speed and transparency. Leading procurement service providers like Infosys offer innovative solutions that leverage their global capability and investment in key skills and technology to provide value to your company that would be more difficult to realize internally.

LOOKING FOR A STRATEGIC PARTNER?

Looking for a strategic partner? Contact **Bill Huber**, Partner, Procurement Advisory Services, TPI, at **+1 540 318 0124** or bill.huber@tpi.net.

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Bill Huber is Partner, Procurement Advisory Services for TPI. Bill joined the firm in 2006 following a successful career as a sourcing leader spanning four Global 500 companies with responsibility for all areas of outsourcing and procured services. Since joining TPI, Bill has led strategy and implementation initiatives in the Manufacturing, Financial Services, Energy, Construction, Consumer Products and Life Sciences industries, resulting in both internal and outsourced solutions.

Bill worked in several senior management positions in the Financial Services industry before joining TPI. He was Senior Vice President of Outsourcing Strategy and Governance, Chief Procurement Officer and Head of Strategic Sourcing, and VP/Head of IT Sourcing at Wachovia. As Senior Vice President Outsourcing Strategy and Governance, Bill completed the enterprise service delivery transformation strategy for Wachovia. The transformation included an enterprise offshore strategy, multiprocess human resources outsourcing and the establishment of a large virtual captive offshore solution for business and knowledge processes.

As Chief Procurement Officer and Head of Strategic Sourcing, he was responsible for procurement transformation and attained more than US\$300 million in annualized savings, led merger integration and rationalization activities, implemented a leading sourcing management system and outsourced facilities management for office towers.

Bill holds a Bachelor of Arts degree in Government from Dartmouth College and a Master of Business Administration degree in International Business from the University of Bridgeport. He completed additional postgraduate work in Accounting at Western Connecticut State University and is also a graduate of the Executive Leadership Program at the Kenan-Flagler Business School at the University of North Carolina. Bill was two-term Chairman of the Board for the International Association for Contract and Commercial Management and currently serves on the Advisory Board for the Sourcing Interests Group.

Rajiv Kumar Gupta is a Sourcing and Procurement Practice Engagement Manager at Infosys BPO. He is responsible for the Procurement Leaders Partnership and Geo Business Development across the Americas.

Rajiv has 16 years of functional, consulting and sales experience in procurement consulting, BPO and strategic management. He is a trusted advisor to many global clients who have embarked on global sourcing and procurement transformation through outsourcing. Rajiv helps clients elevate the competitive advantage of their sourcing and procurement by apply his hands-on experience in spend management, sourcing and procurement effectiveness, improvement through application of the right technology and automation tools, category management expertise and global delivery. He is also an experienced global transition and program manager, having successfully designed and led complex transition and outsourcing programs involving change management, technology enablement and process reengineering across source to pay.

Madhusudan (Maddee) Hegde is head of business development and leads client services for customers for the United States manufacturing portfolio in Infosys BPO. He works with global corporations to maximize business value to drive effectiveness and efficiencies in their business processes. Maddee has collaborated with companies to help them structure their business plans to reduce SG&A and drive better cost of revenue by leveraging business process management. He has helped them build their outsourcing roadmap, identify the processes to outsource, implement governance models and manage and drive the performance of their outsourcing relationships. Prior to Infosys BPO, Maddee was head of automotive client services for North America for a leading IT solutions provider.

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ABOUT TPI:

TPI, an Information Services Group company (NASDAQ:III), is the founder and innovator of the sourcing advisory industry, and the largest sourcing data and advisory firm in the world. We are expert at a broad range of business support functions and related research methodologies. Utilizing deep functional domain expertise and extensive practical experience, our accomplished industry experts collaborate with organizations to help them advance their business operations through the best combination of business process improvement, shared services, outsourcing and offshoring. For additional information, visit www.tpi.net.

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