WHITE PAPER

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

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Abstract

Procurement outsourcing, a relatively new area compared to the more established practices like Finance & Accounting and HR has been garnering significant attention due to its ability to have a much larger impact on the organization. This white paper elucidates trends in procurement outsourcing, areas within the procurement space that lend themselves to a global delivery model and the key benefits. Further we share a view point on how organizations can approach this area from an implementation standpoint and share a client's experience as one of the early adopters of procurement outsourcing.

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Trends in Procurement outsourcing

Procurement is one of the least understood areas of outsourcing, but awareness is increasing through growth in the sector and an increasing body of research and articles. Much of the misunderstanding is due to two primary factors:

- The fact that the benefits of procurement outsourcing are distinguished from the benefits of better known forms of outsourcing, and, are less the result of improved operational efficiency and more due to an increase in effectiveness

- The concern that procurement is core and that by outsourcing this function, companies may be compromising the integrity of their contracting processes and vendor relationships, and reducing the role of procurement to a less strategic one in the organization

While these misunderstandings are gradually being dispelled, they remain a factor in some of the emerging trends in procurement outsourcing. In this context, there are three perspectives that are useful for describing current trends in the market:

1. Customer

Procurement Organizations are increasingly constrained in their delivery capability due to a lack of resources. In a time of declining budgets, Chief Procurement Officers (CPOs) are often forced to accomplish more with less, forcing prioritization of their efforts. Budgetary restrictions are thus moving more CPOs to look for lower cost deliver solutions such as outsourcing.

Also, many CPOs have underestimated the degree of change management required to transform the orientation of their teams from a transactional/negotiation focus to one of knowledge driven operational and service delivery excellence. There is an increasing awareness of how an outsourced service provider can provide a faster path toward the latter.

Lastly, especially in mid-sized companies, CPOs have struggled to obtain funding to refresh their procurement technology. Many of them perceive the advantages of improved technology bundled within an outsourced offering as a potential path over this hurdle.

2. Service Provider Innovation

Service Providers have invested significantly in their procurement offerings, enhancing their capabilities in a number of areas including an increased sophistication in spend analytics; new procurement knowledge process outsourcing offerings around such areas as contract drafting, risk analytics and value engineering, and the extension of their procurement outsourcing offering into supply chain management areas such as logistics support and inventory analysis. The Service Providers have additionally continued to recruit senior talent with category expertise to enhance and broaden their strategic sourcing offerings. Lastly, a number of providers have refined their technology approach to offer procurement "platform-based" outsourcing solutions that combine the benefits of service delivery excellence with improved automation.

3. Market

Capacity in the market has expanded, with continued new entrants and increased competition. The entry of Indian heritage providers several years ago put pressure on earlier outsourcing models, and has resulted in an increased degree of service provider flexibility and willingness to design a procurement outsourcing solution that will fit the unique requirements of the customer. While large Source-to-Pay contracts drive the fastest and most comprehensive benefits to clients, many clients are seeking ways to augment the capabilities of their internal organizations, or to move slowly because of organizational change or perceived risk issues. The market has adapted to the objectives of these clients by providing a wide variety of outsourcing solutions by spend category, process or sub-process, or geography. In many cases, initial smaller contracts are designed by both the customer and the outsourcing provider to expand organically, contingent upon the successful execution of the initial scope. To this point, TPI's research has shown a decrease in the initial contract value of procurement outsourcing contracts, but very high rates of contract expansions, extensions and renewals.

In all, we continue to see a healthy year over year growth in the market. The trends identified above are strong indications of increasing maturity which we believe will continue to bear fruit for both customers and service providers.

Areas in procurement that lend themselves to outsourcing

Service provider capabilities are continuing to mature, and providers now engage with their clients to add value across the spectrum of procurement activities, combining transactional, analytical, project and consultative services:

Transactional buying and settlement

Transactional activities were the starting point for procurement outsourcing. These include processing purchase requisitions and purchase orders, managing simple RFQs, and invoice matching and payment. Service providers incorporate lean approaches to drive the efficiency and accuracy of these activities.

Measurement & Development

Service providers also bring strong analytical methods to measure quality, and to analyze spending patterns and compliance.

Selection and Contracting

Provider offerings here tend to be highly collaborative with internal procurement organizations, offering both consultative and project services such as managing RFPs and many elements of contract negotiations. In the vast majority of instances, the client retains all decision and final execution responsibilities in the process.

Develop Sourcing Strategy

Service providers bring their insights, analysis and recommendations to procurement to assist in development of corporate supply and sourcing strategies, development of savings targets, savings analysis, and other special programs.

Results achieved through procurement outsourcing

Experience indicates that on average, procurement outsourcing can deliver improvements in Spend under Management (18%), Contract Compliance (31%) and Savings from Sourcing (28%) that are above and beyond the levels typically achieved by internal procurement organizations. There are a number of reasons why this occurs.

Economic Improvement

- Savings from sourcing can be improved and accelerated through category insights and improved visibility and compliance. Many of procurement outsourcers participate in common category markets on an ongoing basis rather than episodically as is the case with many internal organizations. This provides real time insight into market price points and the opportunity for continuous refinements of sourcing tools and processes specific to each market

- Outsourcing often provides a reduction in operational costs of 15-20% or more through process standardization and improvement, staff right-sizing, and realization of economies of scale. Outsourcers live or die by their ability to generate ongoing improvements to

processes and workflows, can leverage their resources across multiple clients, and also can bring the benefits of labor arbitrage to many procurement activities

Service Improvement

- Internal procurement organizations are often hampered by lingering perceptions of a bureaucratic mindset and a compliance focus. While many are anecdotally recognized for providing "good" service, internal clients still believe that many procurement activities take longer than they ought to. A good outsourcing contract will include an aligned set of Service Levels and an effective structure for measuring and reporting these SLAs consistently. These SLAs can measure cycle times, satisfaction and realization of benefits more consistently than is usually achieved internally. Because year-over-year improvements are contractually specified and aligned to service provider compensation, the SLAs receive the attention that they need, and consequently provide a more reliable source of data for the procurement organization to demonstrate its value and performance to the broader company

Capability Improvement

- As mentioned above, procurement outsourcers are often able to provide an expanded supply market knowledge in many categories above and beyond what companies can afford to maintain internally, thus resulting in more effective sourcing

- Some providers will bundle eProcurement tools such as spend analysis, eRFX, reverse auctions, supplier enablement, eProcurement and eInvoicing, or alternately can support client technology more cost effectively than internal options

- Budget constrained procurement organizations often cannot afford to maintain valuable but expensive

capabilities in areas such as market research, and risk measurement and analytics or even to effect the timely adoption of contract templates to different flavors of procurement requirements. Service providers can deliver these skills at a lower price point with the additional benefit of measurable service levels. This enables the procurement organization to deliver more value added services for the same cost, and enables the retained organization to focus more of its talent on earlier and more effective engagement with key internal customers on defining and executing sourcing and supplier management strategies

Adaptability

- Procurement is often one of the last organizations to obtain funding for capabilities improvement and growth, and often faces significant staff reduction pressures, being asked to "do more with less." Service providers can leverage their resources across multiple clients and can be more adaptable in staffing for peaks and valleys in business activity with a client company

Business Risk Reduction

- Because service providers are compensated on their ability to measure and report, they have greatly refined capabilities and typically provide improved transactional / spend visibility and compliance, thus enabling earlier detection and intervention of compliance and risk issues

- Service Providers must meet Sarbanes-Oxley standards and tend to be proficient in process documentation. It is standard for regular internal and customer audits to be provided for, under the terms of the outsourcing agreement

- Additionally, service providers often offer mature technology hosting, support and disaster recovery solutions

Regulatory and Corporate Social Responsibility

- Outsourcing can provide lower cost solutions for regulatory and Corporate Social Responsibility (CSR) requirements

Implementation: Options and the roadmap

Implementation of a procurement outsourcing program consists of the elements common to any other program like, Evaluation of approach options, Vendor selection, Contracting and Program roll-out.

While vendor selection / contracting may follow the much practiced process for any other outsourcing project and can run either in parallel to initial consulting phase or immediately after, what really differentiates a successful program implementation are the approach options and program roll-out. In this section we evaluate how Infosys has arrived at approach options in complex procurement outsourcing programs and helped companies choose the one which best fits their challenges and change management needs for the immediate term while also considering the long term, business needs.

There are two broad options to approaching implementing procurement outsourcing:

1. Consult, Fix and Outsource OR
2. Consult, Outsource and Fix

Apart from the sequence in which we approach these options, choosing an option depends on several factors which we will examine below. But first let's define the key phases involved:

Consult: The Consult phase is a constant across both options and an important precursor to the outsourcing journey. During this phase you create a detailed inventory of your "as-is" procurement ecosystem - including people, processes, systems, and special projects. This helps develop the blue-print of 'To-Be' ecosystem consisting of integrated retained and outsourced processes, people and governance for outsourcing service delivery and a business case which could be reviewed for the returns being generated through the procurement outsourcing program implementation.

Factors to be considered in choosing the right approach	Factor Description	Consult, Fix and Shift	Consult, Shift and Fix
As-Is Situation	As-Is state of procurement systems, people and processes in the capability maturity lifecycle.	A wide gap between current and best-in-class state requires significant upfront change management and policy intervention. In such instances, it is preferable to implement outsourcing after transformation initiation or after the roadmap is finalized.	In the absence of large scale systems and process change, it is optimal to shift (read outsource) the processes as-is and continue the process transformation using the service provider.
Speed to Benefit	Time taken for business benefits to start accruing and realize value.	Driving transformation internally is often more complex, time consuming and costlier. This reduces the ROI realized over project time frame.	Outsourcing followed by transformation has the advantage of realizing significant cost advantages early in the process. Leveraging the service provider's proven capabilities and experience acts as a catalyst to the change process resulting in higher ROI over the project duration.
Implementation Risk	Risk associated with project implementation often requiring specialized skill sets and domain expertise.	Change management involving procurement is more complex than other functions due to requirement of specialized skill sets, market knowledge and domain expertise. Doing it all in-house presents higher risk of implementation.	Choosing a service provider to bring in expert resources equipped with specialized skill sets and domain expertise enables faster and accurate implementation of best-in-class tools and processes and thus significantly lowering the implementation risk.

Fix: This is essentially akin to a mini-transformation phase where process optimization is accomplished, productivity adjustments are made, tools for enhancing effectiveness and efficiency are brought in as may be identified and blue-printed in the consult phase.

Shift / Outsource: During this phase, the outsourcer assumes responsibility for performing outsourced activities and is governed by service SLAs to work towards identified KPIs.

With both approaches, there are a few key considerations to be made for the program roll-out per the agreed approach and blue-print: Irrespective of the option chosen, like any other outsourcing initiative, top management support is a critical factor. Also, identifying internal champions within process areas is critical to success. Additionally, some of the following are key prerequisites to maximize success of your procurement outsourcing program.

Managing risks due to perceived reduced control over the process: One of the key challenges in procurement outsourcing is handing over control of the company's spend and crucial supplier relationships. To minimize implementation risk it is important to have the service delivery controls in the form of demonstrated ability and commitment to building measurable, enforceable service level agreements with penalties for non-performance.

Managing continuity of service delivery: Service delivery needs to be managed by a joint (client and service provider) process team to manage compliance to the outsourcing contract. Make this a strong governance team by empowering them to take the necessary actions.

Managing personnel and process transition issues: Before a procurement outsourcing contract is agreed and signed, it is important to arrive at a detailed transition plan which outlines the key milestones of the transition as well as how it addresses the issues surrounding people and service delivery.

Managing technology integration issues: Ensuring the service provider brings the technical competence to implement the technology solution as well as maintain the technology environment enables faster time to value. The one-size-fits all platform and solution is an unrealistic expectation. The key to success is a modular approach to procurement technologies and functionalities linked to the key processes.

Managing expectations and consensus: Putting together a cross-functional review team that includes representation from the following functions, helps build the necessary consensus for implementation of the procurement outsourcing program:

a. Human Resources: HR department should be brought on-board early in the game to help walk through the sensitive issues surrounding employee transfer to the service provider (if any), freeing up existing resources, defining new roles and responsibilities for the retained personnel and to help supervise change management.

b. Information Technology: An early on-boarding of the IT department helps assist with internal assessments of the technology / applications extendibility, information technology risk management and subsequent reviews of the service provider's proposal for technology connectivity and communications solution options.

c. Legal: Legal counsel need to understand the implications both from the perspective of your own legal liability as well as from the viewpoint of your supply base.

d. Finance: Finance departments help in the pre-implementation phase with guidance on pricing models suggested by the service providers, and post implementation on tracking and measuring the return on investment of the procurement outsourcing initiative.
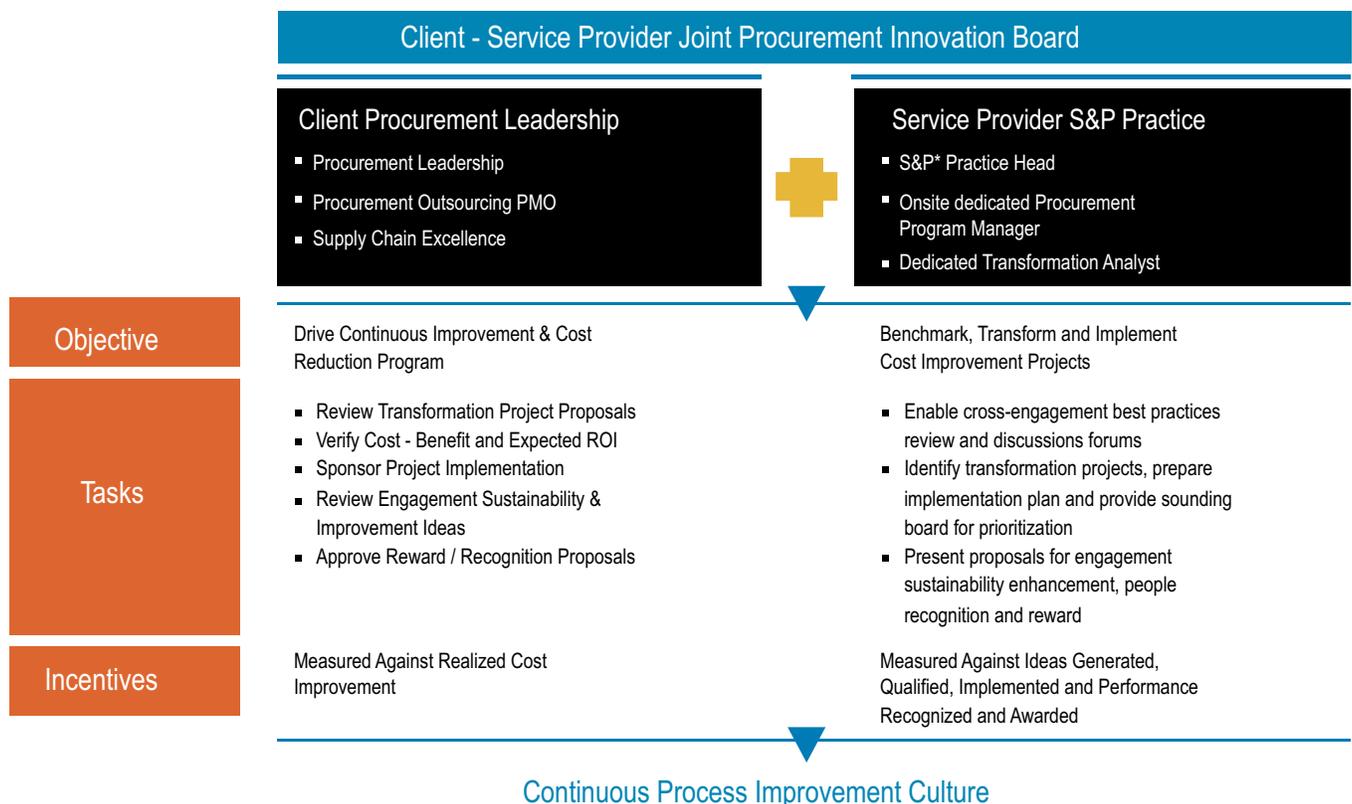
Figure: Joint governance and service innovation board

Joint governance and service innovation board: A Joint Governance and procurement innovation board should be established and comprised of executives from your organization and the service provider in order to provide the top-level attention necessary to ensure a successful working relationship and sustained value creation. Participating client executives may vary depending on the industry involved, but typically include the CFO, CPO (Chief Procurement Officer), and COO. The governance board should provide the right escalation path to escalate issues service delivery and compliance issues to the Joint Governance Board for resolution pursuant to previously agreed protocol. Escalation procedures are critical in ensuring issues are resolved quickly and to the satisfaction of both parties. It is

a good idea to include timeframes in the escalation so that issues do not languish and cause harm to the relationship. The joint governance and service innovation board should also provide for driving sustained value creation initiatives through the procurement outsourcing program.

Measuring Success: Metrics are a part of Service Level Agreements (SLAs) that will detail expectations and roles of both parties. While some companies may be interested in spend management effectiveness related KPI's, others may be concerned with cost of procurement. While traditionally the focus in any outsourcing engagement has been on SLA's linked to transactional metrics around turn-around-time, accuracy and quality, the value in procurement outsourcing engagements

is derived out of metrics related to spend reduction, category management, compliance and suppliers / spend under management. There are increasing instances of gain-share models being adopted for SLAs achieved beyond the threshold metrics.

While procurement outsourcing has its share of complexities, the promise of value realization and multifold ROI is too hard to ignore. With a well planned strategy, selection of the right service provider and de-risked implementation plan, procurement outsourcing can be a source of significant competitive advantage as experienced by some of the leading global companies.

Case Study

Fortune 50 Global Heavy Equipment Manufacturer

"Our partnership with Infosys is a key component of Global Purchasing's journey to best-in-class purchasing benchmarks. It is helping us make the shift to standard processes, optimize our cost structure and focus our energies on our core competencies"
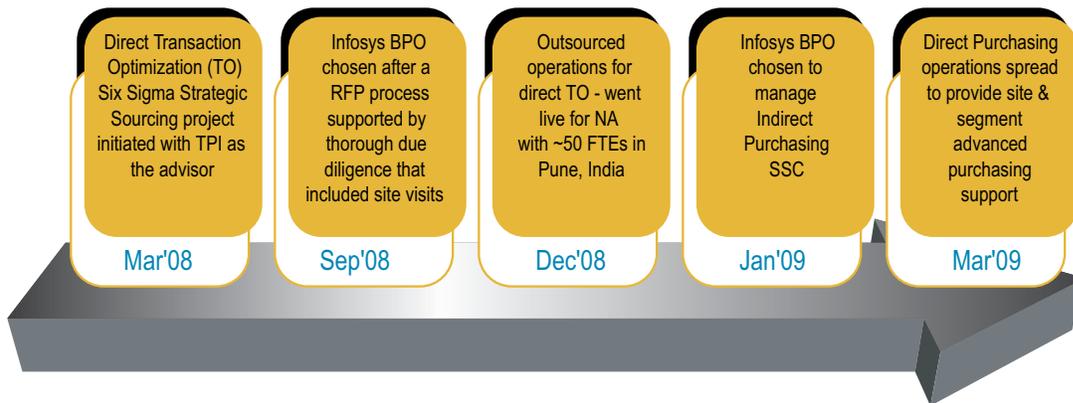
Carlton B. Adams
Director, Service Parts Purchasing

The Client, one of the world's largest maker of construction and mining equipment, diesel and natural gas engines, and industrial gas turbines, identified an objective of increasing the focus of its procurement organization on strategic initiatives, new product development and enhanced levels of collaboration with procurement's internal customers. To this end, the client identified the need for a partner that could support many of its transactional procurement functions

that utilized it's legacy ERP platform. In March of 2008, the client engaged TPI to assist it in understanding the procurement outsourcing market in conducting an outsourcing source selection process. The initiative was conducted under the clients Six Sigma protocols with a strong voice of the customer component throughout. The client assessed the overall market capabilities and then selected five service providers to participate in the RFP process. The sourcing process was designed to be

highly collaborative, and to enable candid executive interaction with the service providers early in the process to optimize alignment of the client's requirements with market capabilities. At the end of the process, the client elected Infosys BPO and several additional processes have been subsequently added to the contract as depicted below.

Mar'08	Sep'08	Dec'08	Jan'09	Mar'09
Direct Transaction Optimization (TO) Six Sigma Strategic Sourcing project initiated with TPI as the advisor	Infosys BPO chosen after a RFP process supported by thorough due diligence that included site visits	Outsourced operations for direct TO - went live for NA with ~50 FTEs in Pune, India	Infosys BPO chosen to manage Indirect Purchasing SSC	Direct Purchasing operations spread to provide site & segment advanced purchasing support

The client approached the project with dedicated resources and a Six Sigma black belt was deployed early in the project. Senior management within the purchasing organization ensured that internal stakeholders were made aware of the strategic intent of the project to meet best-in-class procurement benchmarks through open, proactive and frequent communication. Both organizations understood the need for a measured approach with initial success in the identified scope in direct purchasing being a key requirement for expanding the outsourcing footprint. A collaborative and flexible mindset on both sides helped manage any issues that cropped up in the implementation process. The company's key challenges were around the lack of standardized processes, multiple purchasing systems in use and dependency on legacy systems and Infosys leveraged its tools and process expertise to overcome these challenges. The strong leadership support and cultural alignment helped build mutual confidence and a transparent business relationship that has helped manage change smoothly and provided the benefits of standardized work, cost savings and enabled the client to focus on its core business.

About the Authors

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Madhusudan (Maddee) Hegde leads client services for customers in the discrete manufacturing portfolio in Infosys BPO. He works with global corporations to maximize value by helping them build their outsourcing roadmap, choose processes to outsource, implement governance models and manage and drive the performance of their outsourcing relationships. Maddee has over 13 years of work experience and prior to Infosys, was head of automotive sales for North America for a leading IT solutions provider. Maddee holds a bachelor's degree in engineering and a master's degree in management.

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