

Corporate Procurement:

The Next Big Trend To Reduce And Contain Costs For The Long Term

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As companies continue to look for ways to improve performance, bolster bottom line revenues and lower operating costs, the concept of Business Process Outsourcing (BPO) continues to grow. Traditionally-outsourced functions like payroll processing, legal services, local delivery and fleet maintenance continue to be expanded. Outsourced call centers are increasingly the norm. Many companies are outsourcing large blocks of their recruiting, hiring and human resource management functions. Even historically “core” services are on the move to specialized providers (such as the recent decision by the Herald-Leader to outsource the creation of customer’s print advertising) as companies continue to refine their missions and business models. The quest for “better, faster, cheaper” seems to know no bounds.

According to a November 2010 report by the Aberdeen Group, one of America’s premier business management research groups, one of the biggest growth areas in BPO is procurement outsourcing. This study of over 260 companies in a variety of industries found that internal purchasing departments are increasingly seeking the involvement of third-party experts to leverage their abilities to drive down corporate operating costs. In fact, 40% of the organizations surveyed indicated that they would be outsourcing all or part of their procurement functions in the next two years.

What are the key drivers for this move to outsource procurement?

The top four reasons cited include:

- 45% Pressures to lower procurement transaction costs
- 41% Increased global competition
- 36% Need to gain access to improved pricing
- 34% Pressures to re-focus personnel on more strategic activities

In other words, cost savings and the best use of strategic assets drive the principal reasons behind procurement outsourcing for the companies participating in this survey. Outsourcing allows companies to limit the amount of staff expenses consumed by procurement while focusing the organization’s energy on its most important strategic purchases.

These key drivers are certainly reflected in our experiences with clients within the USA. We have encountered many circumstances where purchasing staffs are stretched well beyond capacity. In every case, those involved are keenly focused on strategic purchases – typically raw materials and key components. Tactical purchases, such as office supplies, freight, packaging, telecom services, overnight shipping and maintenance supplies, are rarely examined unless major price increases or service lapses force them to the forefront of attention.

Companies engaged in procurement outsourcing lower costs through lower transaction costs as well as from lower absolute costs on the items purchased. As part of this study, Aberdeen

measured the costs of the requisition-to-order cycle in participating companies. For companies with the lowest amounts of outsourced procurement, the average cost of each requisition-to-order cycle was \$33.00. For those with the highest levels of outsourced procurement, the average requisition-to-order cycle cost was \$14.15 – a savings of over 57% in staff resource costs.

Intuitively, this is easy to understand. In our typical engagement, we find that we are able to consolidate suppliers for our clients while simultaneously driving more ordering on-line, reducing the “shopping” time as well as the order creation time. In a recent project for a client using a substantial amount of less-than-load freight services, for example, we were able to introduce them to a freight broker whose computerized ordering system greatly simplified the solicitation of inbound freight bids. The service shops for multiple bids simultaneously on-line, rather than having the client call multiple carriers to seek bids. The result is a significantly shorter requisition-to-order cycle for each shipment.

Lowering absolute item cost is just as important to the process. Third-party procurement specialists frequently offer clients volume purchasing agreements with blue-chip suppliers in key purchase areas that the client would not have access to as an individual company. Aberdeen’s research found that for each dollar of spend brought under outside procurement management, companies were able to realize cost savings of between 5% and 20%. This is consistent with our experience in work for area companies. With the previously-mentioned freight broker, for example, we were able to offer our client savings of nearly 40% based on their previously-negotiated inbound freight rates with carriers. In another recent case, we were able to place a client on one of our national contract rates with one of their largest incumbent suppliers. This resulted in an immediate discount to the client of 12.6% based on their historic purchases.

According to the Aberdeen study, companies enjoying the greatest success from procurement outsourcing seem to share several common characteristics. They have evaluated their core purchasing competencies and have differentiated strategic purchases from tactical purchases. They have established monitoring procedures internally and with their procurement outsourcing partners to measure savings and track results. They have established procurement procedures and a defined group of pre-approved suppliers. And finally, they are evolving procurement to mine category experts (either internal staff or third-party procurement resources) for market intelligence that provides strategic insights to senior management.

As with most forms of outsourcing, procurement outsourcing will continue to be driven by the need of companies to focus on the true nature of their businesses. Are you in the business of designing and manufacturing world-class products, or are you in the business of buying pens and paper? Are you in the business of selling high-value products and providing great customer service in your stores, or are you in the trucking business? Investing more heavily in improving core competencies and outsourcing non-core functions to others who make those functions a core competency will allow companies to gain the maximum leverage from their capital and human resources.