Best Practice Performance Measurement of the Procurement Function

How to Identify and Measure Key Performance Indicators and Reporting on the Procurement Function
Agenda

- Importance of measuring Procurement
- Key measures
- Examples of different measuring techniques:
  - Procurement Savings Scorecard
  - Industry Benchmarking
  - Integration Savings Scorecard
- Next steps
Importance of Measuring Procurement

- Procurement needs to demonstrate value delivery to the organisation.
- Appropriate measures ensure Procurement is motivated and activities are aligned with the corporate strategy.
- Other parts of the organisation may also need Procurement related KPIs, to ensure they comply with Procurement initiatives.
Key Measures for Procurement: Balanced Scorecard Approach

Financial
- Production costs
- COGS savings
- Payment Terms
- Leveraged agreements
- Supplier consolidation
- Low cost country sourcing
- Competitive bidding

Customers & Stakeholders
- Customer Satisfaction
- Procurement team utilisation
- Cross Functional Groups
- Communication

Organisational Capacity
- Team Satisfaction
- Turnover
- Development
- Procurement Training

Business Processes
- Spend under contract
- eProcurement usage
- Reverse auction use
- Purchasing card usage
- PO-invoice match rate

STRATEGY
1. Savings Tracking Scorecard
Why track savings?

Tactically……

- A scoreboard for procurement which -
  - Tracks progress toward financial goals
  - Quantifies procurement’s value contribution

- Which leads to -
  - Improved respect for procurement’s achievements
  - Attracting higher quality talent
  - Best-practice sharing within the procurement function
  - Improved internal morale & unity within procurement

Strategically……

- Leading companies will need to quantify value to its business customers and the financial market
Three phases of scoreboard development
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Three phases of scoreboard development

1. PLAN
   - What is the strategic landscape?
   - Why track savings?
   - What is the goal?
   - Who are the players?
   - Decision to proceed

2. Decision to proceed

3. PLAN
Three phases of scoreboard development

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   - Reporting format & process
   - Categories
   - Reporting Rules
   - Approval Process
   - Reporting mechanism

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3. IMPLEMENT
   - Communication
   - Training
   - Ensuring Compliance
   - Reporting
   - Review
Where is your business today?

<table>
<thead>
<tr>
<th>Number</th>
<th>Description</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Low</td>
<td>The Faculty Optimal Business Practice Scale</td>
</tr>
<tr>
<td>2</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>4</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>5</td>
<td>7</td>
<td>8</td>
</tr>
</tbody>
</table>

### Reporting must be:
- Endorsed by senior management
- In-line with financial reporting procedures
- Supported across the organisation
- Easy for “savings reporters” to understand

### The Faculty Optimal Business Practice Scale:

1. There is little or no procurement savings reporting and what is reported is discounted by the rest of the organisation.

2. Procurement savings reports are widely available and believed by the rest of the company. Bottom line benefits can be clearly traced to procurement savings.

3. Develop purchasing performance metrics
4. Establish regular savings reporting process
5. Develop a savings target work plan for each Division

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**Define Current State (As-Is)**

**Define Ideal State (To-Be)**

**Undertake Gap Analysis**

**Develop Plan to address gaps**

**Cost Benefit Analysis of options**

**Approve recommendations**

**Implement Plan**
Who are the players?
Who are the players?

**Senior management**

- Commitment to cost reduction
- Current cost reduction initiatives
- Support level for leveraged procurement
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**Finance**
- Challenges in cost reporting, including systems
- View of procurement organisation
- Challenging savings claims
- Where in the “bottom line”? 
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- Unquantified value contribution
- Concerned reporting is a non value-add process
- Cautious of corporate “scorekeepers”
- Double-dipping, who takes glory?
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- How is procurement contribution optimised and recognised?
- Further complicated with Division – Region – Corporate loyalties
How can savings be categorised to maximise value and have meaning within, and outside of, the organisation?

- **The spend**
  - Assets, goods, services
  - Strategic, Leveraged, Local
  - Corporate, Divisional

- **The savings type**
  - Structural
  - Cyclical
  - Punctual
  - Cost Avoidance

- **The “saver”** – location, division, region
- **Time period** – annual, quarterly
- **Actual vs projected savings**
Savings Type

**Structural**
Sustainable, medium-long term price change

**Cyclical**
A savings that was achieved based on market factors, rather than pure negotiation skills

**Punctual**
A one-off savings achieved through an identified market opportunity

**Cost Avoidance**
‘Holding the line’ on costs, when an increase was proposed
Finance & Procurement need to work closely to develop the procurement savings reporting rules, considering –

- Positive and adverse cost movements
- Cost issues outside the control of procurement
- Consolidated account rules – minority shares etc
- Inter-company/division price reductions
- Savings passed on to customers
- Currency or hedging gains/losses
- Total cost of ownership issues - defining “value-add” vs bottom line benefits such as improved vendor terms
- Timing differences – lagging & leading indicators
Scorecard Approval Process

Corporate Finance and Procurement report the same numbers to senior management.

Each Division’s Procurement Manager & CFO agree on the procurement savings achieved, based on the categories and “rules” developed for the system and report the agreed upon numbers to their respective corporate functions.
Example Procurement Dashboard

<table>
<thead>
<tr>
<th>Course Rating (sample: 76)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall Course</td>
</tr>
<tr>
<td>Course Presentation</td>
</tr>
<tr>
<td>Training Material</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Length of training</td>
</tr>
<tr>
<td>Course useful to my role</td>
</tr>
<tr>
<td>Feel confident</td>
</tr>
</tbody>
</table>

X% just right
X% agree
X% agree
Understanding the political & procurement culture landscape

- How are you going to gain commitment to reporting?
- What is procurement’s current attitude to being measured/accountable?
- What is the relationship between procurement & finance? And other groups?
- Is procurement a unified group? Is there a procurement community within the organisation?
- How is a reporting system going to be used/easy for reporters?
- Who “owns” cost reduction reporting within the organisation?
2. Procurement Benchmarking
Procurement Benchmarking Example

- Comprehensive Benchmarking Study to measure and compare performance of the Procurement function
- Gathers feedback from internal customers, team members, managers and peers to provide a 360 degree review of Procurement
- Involves qualitative and quantitative measures as well as comparison against other industry best practices
The Faculty Benchmarking Review Framework

Industry Context

Supply Base Dynamics
The Faculty Benchmarking Review Framework

Industry Context

Supply Base Dynamics

ENABLERS

PAY
ORDER
NEGOTIATE

EXECUTION

GOVERNANCE
STRATEGY
SYSTEMS

PEOPLE & COMMUNICATIONS
CORPORATE SPONSORSHIP & CULTURE

EXECUTION

ENABLERS
The Faculty Benchmarking Review Framework

Industry Context

Supply Base Dynamics

ENABLERS
- GOVERNANCE
- STRATEGY
- SYSTEMS
- PEOPLE & COMMUNICATIONS
- CORPORATE SPONSORSHIP & CULTURE

PAY ORDER NEGOTIATE

EXECUTION

RESULTS

IMPACT

EXECUTION

ENABLERS
Comprehensive Review of 40 practice areas

- RESULTS
- PAY
  - ORDER
  - NEGOTIATE
- GOVERNANCE
  - STRATEGY
  - SYSTEMS
- PEOPLE & COMMUNICATIONS
- CORPORATE SPONSORSHIP & CULTURE
The Faculty Definition:
Influence and scope describes the procurement department’s ability to penetrate and influence the way the company buys. A high level of influence and scope means procurement is deeply involved in all purchasing decisions and is very well integrated into the organisation.

Organisation’s Internal Perspective/Rating

The Faculty Optimal Business Practice Scale

<table>
<thead>
<tr>
<th>Level</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Procurement is a part time job for an operator or clerical employee.</td>
</tr>
<tr>
<td>2</td>
<td>Primary role is to keep the factory running. All major decisions made by</td>
</tr>
<tr>
<td></td>
<td>user of the category/commodity.</td>
</tr>
<tr>
<td>3</td>
<td>Procurement is assigned a large number of categories, but major areas are</td>
</tr>
<tr>
<td></td>
<td>still under control of operations or end-users.</td>
</tr>
<tr>
<td>4</td>
<td>Procurement manages the majority of corporate spend.</td>
</tr>
<tr>
<td>High</td>
<td>Procurement has a high level of respect and influence over the organisation’s</td>
</tr>
<tr>
<td></td>
<td>purchasing decisions.</td>
</tr>
</tbody>
</table>
Common Themes in Benchmarking Study

1. Structure and influence of Procurement within the organisation
2. The direct/indirect dichotomy
3. Developing people and procurement as a place to work
4. Communicating the value of procurement
5. Total Cost of Ownership
6. Supplier management
7. eProcurement and systems to drive Procurement initiatives
Procurement Integration Scoreboard

- Identify, quantify and establish plan to capture synergy opportunities
- Base all savings estimates on chosen Financial year budget
- Quantify unit cost savings by estimated volume
- Pro-rata volume across combined companies
- Factor in adjustments for timing and cashflow considerations
- Becomes key action plan for delivering synergy benefits
High Level Structure of Initiative List

- Category – eg Direct Materials, Services, etc
- Origin – eg Company 1, Company 2
- Project Description – eg detail proposal for cost saving
- Type of improvement – eg cost reduction, cost avoidance
- Person responsible – ensures accountability
- Level of confidence – likelihood of achieving savings
- Cashflow benefit and timing – model future benefit as savings flow through to bottom line
Classes of Savings Opportunities

- Different classifications of savings
- Black – Banked, already delivered
- Green – Confident of delivery, actively working on projects to deliver
- Amber – Medium level of confidence, dependent on resources and stakeholder approval
- Red – Low level of confidence, no allocated resources and no stakeholder approval yet
# Example of Scorecard

## Procurement Integration Scorecard

### Summary of Individual Initiatives

<table>
<thead>
<tr>
<th>Year</th>
<th>Black</th>
<th>Green</th>
<th>Red</th>
<th>Total Opportunity</th>
<th>Total Opportunity</th>
<th>Total Opportunity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>$1.2</td>
<td>$2.4</td>
<td>$5.2</td>
<td>$5.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year 2</td>
<td>$1.4</td>
<td>$2.8</td>
<td>$3.7</td>
<td>$6.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year 3</td>
<td>$1.6</td>
<td>$3.2</td>
<td>$4.6</td>
<td>$7.7</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Opportunity Key
- **Black** = Banked
- **Green** = High confidence
- **Amber** = Medium confidence
- **Red** = Low confidence
Measurement is Key

- Measurement is essential to delivering a best practice Procurement function
- There are multiple measurement techniques available
- Most importantly – choose one and get started, then refine over time to suit your organisation and needs
- There is help available in setting up and establishing these measurement systems