



European CPO Club

Lisbon Proceedings, 23rd – 24th March 2006

Procurement Outsourcing

A Pathway to Value or a Road to Nowhere?

Outsourcing support functions is very much here to stay with evidence suggesting that more and more CEOs will be looking in particular to outsource their indirect procurement function in the future. If you couple this with the increasing awareness of the value locked up in the procurement process, and some of the difficulties associated with delivering procurement excellence, CPOs are keen to look at the latest trends. The March 2006 CPO Club retreat in Lisbon spent two days focussed on the emerging approach of Procurement Outsourcing, canvassing the opinions of a core group of representatives from the advisory and delivery community. This paper presents many of the insights and the conclusions that were reached.



The opening presentation from Tom Slaight of A.T. Kearney set the scene for the focus of the two day retreat of the CPO Club in Lisbon, namely to address the question of whether procurement outsourcing is a pathway to value or a road to nowhere. After laying down a clear definition of procurement outsourcing, and providing some historical context, it was then explained how procurement outsourcing differs from conventional outsourcing in the way that it generates value through sourcing and compliance savings, as opposed to run rate and efficiency reductions.

The distinction between the vertical and horizontal offerings that are available in the market was also drawn, where vertical offerings involve the outsourcing of an entire category, end-to-end, whereas horizontal offerings involve service providers assuming responsibility for multiple

categories, covering whole or part of the source-to-pay value chain.

An outline was provided of the pivotal deals of the last two years, namely Deutsche Bank and Unilever, describing the further opportunities for increasing the scope of these deals in terms of category and geographic coverage. A call was made for the need to establish more groundbreaking examples, thus leveraging the learnings from these innovative outsourcing arrangements. This was coupled with a petition for greater consensus in terms of the flexibility of service partners, improved collaboration between outsourcing providers and the need to perceive sourcing as being an incremental above and beyond the infrastructure value that is created from procurement outsourcing.

Building on the opening presentation, Patrice Gilles from Equaterra highlighted some of the challenges encountered by organisations in

A call was made for the need to establish more groundbreaking examples of outsourcing deals, thus leveraging the learnings from these innovative arrangements.

focussing on addressing the indirect categories, developing the theme that procurement outsourcing catalyses change by generating visibility, and locks client and service provider into a gain share arrangement, albeit complex, which provides a penalty and reward structure that will ultimately benefit both sides, provided it is executed in its entirety.

Again the distinction was drawn between conventional outsourcing and procurement outsourcing, of note being the premise that procurement outsourcing is a form of transformational outsourcing with a proportion of the savings generated being used to finance the transformation – this is again very different to conventional outsourcing. Questions were raised as to why organisations need to resort to engage third parties to support themselves in transforming their procurement functions, particularly when the effort required in obtaining sponsorship for the deal could equally be expended in generating sponsorship for an internal change programme.

This was countered by stressing that this form of outsourcing is not for all organisations, and is targeted at those entities where catalysing significant change in the way an organisation runs its procurement function has been incredibly limited. The argument was supported by an examination of the profiles of the types of organisation that may be looking to outsource their procurement function,

such as multi-nationals who have failed to consolidate their procurement functions, banks where spend is skewed towards the indirects, or those companies who have taken their eye off the ball when it comes to managing their indirect spend.

An insight into the legal ramifications of executing a procurement outsourcing arrangement was provided by John Halvey and Sean Keaton of Millbank, Tweed, Hadley and McCloy. On one side, the lawyers contended that outsourcing of non-core activities and procurement of indirects is ineluctable, arguing that this is happening even in their own area of legal advice and services. On the other side, procurement outsourcing represents a number of non-trivial challenges from a legal point of view. Asset ring-fencing, indemnity issues from the European Commercial Agency Directive, pass-through of warranty conditions, measurement of performance and contract termination, were some of the issues highlighted.

The particularity of procurement outsourcing is its leverage; services are being contracted where the value being purchased is manifold that of the services rendered. The new role of the CPO will be to manage external value networks. A discussion ensued on the inevitability of procurement outsourcing, where several CPOs expressed the view that the take-up of procurement outsourcing will be slow because of the complexity

and the amount of risk associated with such an undertaking. Finally, of specific note was the contention that service providers will develop a platform for offering multiple outsourcing arrangements using an underlying common infrastructure, leveraging the commonality of activities across the service offerings.

The value proposition from the perspective of the service provider was presented by Graeme Dougal of IBM. Of particular note were the concepts of extending procurement outsourcing into areas such as leveraging the opportunities offered by aggregating spend between clients and the service provider, and the inclusion of accounts payable to help with locking in benefits through controlling the way in which third party suppliers are paid. The importance of a strong stakeholder network to sponsor such arrangements was emphasised, as was the fact that procurement outsourcing programmes are not one shot exercises, but complex, investment intensive, multi-year contracts.

This was echoed in the importance of the service provider knowing when to walk away. These perspectives were challenged by the view that catalysing change within the procurement function is more of a stakeholder issue than anything, regardless of any of the outsourcing offerings that are available in the market place. Moreover, a strong preference was expressed for organic change as opposed to that

delivered by an external third party. These views were countered with the contention that a high degree of change can be driven by creating the right kind of conditions contractually to allow this to drive it, although this did not necessarily imply the need for gain share type arrangements.

At this juncture it was clear that a number of take-aways were emerging some of them for the basis of further discussion.

Arriving at a common definition of procurement outsourcing

- Strategic Sourcing *and* Transaction Processing i.e. P-to-P
- Vertical Segmentation
- Horizontal Segmentation
- Vertical and Horizontal combinations

Getting a joint view of category scope and applicability

- Mostly non-strategic indirect categories
- For non-core, complex, and limited scale procurement functions
- Can catalyse change, but execution can be undertaken by the organisation, or consultants can be deployed
- Primary target industries are therefore: Financial Institutions, FMCG, some Utilities...

Getting it right

- Execution cost is much lower than the value generated and

execution risk

- Contracting and legal issues present a high degree of complexity
- Change management issues are substantial
- The need for a strong retained organisation and governance framework are key

Forecasting how the market will develop

- Verticals already happening and will develop rapidly
- Horizontals need more “poster children” and will take time

In the form of breakout groups, the CPO Club members then focused on three questions, namely;

- When does procurement outsourcing make sense?
- Which categories/industry sectors/parts of the value chain is it applicable for?
- How to manage the realities of execution?

When does procurement outsourcing make sense can be captured in two words: capability and ability. Procurement outsourcing makes sense when the organisation is lacking capabilities in the sense of competence, for example in a given category, and when the ability to build up these capabilities would be limited in the sense of it being uneconomical or too risky. There was a generally shared

No amount of outsourcing will resolve the situation, where the CPO has no relationship with the CEO; in attracting investment and resources into the procurement function, what’s required is a concerted effort to engender sponsorship for change, and whilst outsourcing provides the toolkit, it does not create sponsorship.

opinion that a selective outsourcing by category (i.e. Vertical) makes a lot of sense.

When asked about horizontal outsourcing, most CPO participants felt that it does not make sense for large global organizations, who are already leaders in procurement, to opt in. Most of these organisations, after admittedly wasting too much money on eProcurement solutions, are finding that simple cherry picked solutions like spend management or the use of a market place providing P-to-P processing, provide enough support for managing their procurement organisation. They also have the critical mass and the geographical reach to cover most categories of interest. On the other hand, outsourcing providers and some of the early converts contend that a comprehensive solution from an outsourcing provider with an order capture front end (portal and cost center) as well as an end-to-end procure-to-pay system does add value. The jury is still out. Reflecting the current state of thinking though, only one CPO of almost twenty present, declared that he would be considering seriously in the next two years a horizontal outsourcing opportunity.

What was clearly evident from comments made by the advisory and delivery group was that a high degree

of care was required for execution, given the level of associated opportunity and risk. Here, several key success factors were formulated by the advisory and service provisioning group:

- Manage risk, but promote success
- Have one executive to take responsibility, coordinate the deal to the point of closure and oversee implementation
- Manage the legal side carefully
- Align stakeholders cautiously
- Establish relationship governance and look at the relationship under the partnership principles but keep control over what is being outsourced
- Do not abdicate strategic activities
- Do not outsource what you don't know

Of particular note was the strongly held view that no amount of outsourcing will resolve the situation, where the CPO has no relationship with the CEO; in attracting investment and resources into the procurement function, what's required is a concerted effort to engender sponsorship for change, and whilst outsourcing provides the toolkit, it does not create sponsorship. This need for stakeholder alignment and support in executing a procurement outsourcing arrangement was a recurring

theme presented by all the breakout groups. And this view was used as an argument against outsourcing in a number of instances; a CPO that generates sponsorship for an outsourcing arrangement may be better off working on generating sponsorship for his function, as opposed to subjecting his organisation to the challenge of outsourcing.

Overall, it was concluded that selective outsourcing does already and will increasingly make sense for category verticals, as evidenced by the maturity of its application to categories such as Travel and Facilities Management. The application of the horizontal solutions is more relevant for organisations with a 'burning platform' or with severe lack of capabilities, and in any event, the high degree of sponsorship required for 'pulling off' such deals begs the question as to why such sponsorship could not be focussed internally on transforming the procurement organisation as opposed to finding an external party to do it for you. In closing, what was clear was that the most important message of all is the need to stay on top of how the concept is developing, taking care to ensure that the impact of new approaches are well understood.

For more information please contact:

HAYDN JONES
Manager

A.T. Kearney Ltd.
Lansdowne House
Berkeley Square,
London W1J 6ER
haydn.jones@atkearney.com

JULES GOFFRE
Vice President

A.T. Kearney GmbH
Lenbachplatz 5
80333 München

jules.goffre@atkearney.com