Procurement Outsourcing

A Proven, Cost Reduction Solution

This White Paper provides a practical approach and insights into how an organisation can reduce costs, streamline procurement operations and increase bottom line profitability. The White Paper is by its nature generic, and therefore certain aspects of this article may not apply to each company's unique situation.

Accordingly, for personalised answers, customised solutions, more information on this topic, **or to receive a free, no-obligation, Cost Reduction Assessment**, please contact IronStar Consulting on info@ironstarconsullting.com.au

These papers defines and explains the ins and outs of procurement outsourcing, why it is growing rapidly as a practice among companies, its benefits, and why more and more companies are utilising procurement outsourcing to solve a range of challenges and to dramatically reduce their costs.

Net Margins and Costs are hurting Companies

Most companies have not been able to increase revenue and credit is harder to come by for expansion. Employees have been downsized to cut costs (less people are doing more work), global competition has increased, raw materials continue to increase annually, and the bottom line for many companies is not what it used to be.

Procurement Outsourcing Provides Solutions and Answers

Companies are looking for ways to innovate, with many struggling to stay in business or even grow the bottom line. Procurement outsourcing is a viable means to help companies, with cost reduction being the largest single benefit. A few of the many other benefits are Compliance; Enhanced Ability to Compete; Efficiency Improvement and Overall improvement in Performance.

Who are some of the larger Procurement Outsourcing Firms?

Leading companies such as IBM, Accenture, ICG Commerce, General Electric, and Xerox are a few companies in the procurement outsourcing business. Most of these concentrate on serving only extremely large clients and do not typically provide cost reduction services to reduce costs on individual products or services.

Choose Procurement Outsourcing

As this paper will show, procurement outsourcing is growing, companies are becoming more aware of its many benefits, the outcomes have been documented (substantiated), and results from procurement outsourcing are improving company bottom lines. With procurement outsourcing, companies are becoming more competitive, companies are focusing on what they do best (their core business) and most importantly, more companies are staying in business and in many cases, jobs are being saved as procurement outsourcing reduces costs and increases profits.

Procurement Outsourcing

Many companies do not know what procurement outsourcing is and why it can become a vital part of their operations. In the 1990's, a number of consulting firms such as AT *Kearney* consulting started procurement outsourcing and began offering procurement outsourcing consulting services. Since then, procurement outsourcing has gained both acceptance and momentum.

The main reason that the field of procurement outsourcing has begun to expand rapidly in recent years is due to its ability to generate hard dollar cost reduction savings.

As procurement outsourcing has continued to mature, cost reduction has increased and continues to be the main reason why companies continue to outsource all (or part) of their procurement.

What is Procurement Outsourcing?

Procurement outsourcing is the action of a company to outsource some or all of their procurement functions, and/or the acquisition of goods and services, through a third party. This does not mean that the company loses control of the procurement process, but merely that is utilises the services of third party service provider.

By taking this approach, the company, which elects to implement outsourced procurement, can realise cost reduction, improved efficiency, improved compliance, and enhanced performance. Procurement outsourcing can involve some or all of the company's staff, technology, systems, and vendor management. In most cases, the procurement outsourcing firm will report to the company that has engaged its services.

Procurement Outsourcing Equals Cost Reduction

With cost reduction being one of the main driving factors for companies, procurement outsourcing helps meet this need. Even with economic upturns in certain industries and geographical areas, profit margins are likely to remain low and global competition will continue to increase. In addition, raw material costs have increased and are expected to continue increasing and the world's economic conditions will continue to affect more and more nations, companies, and people. With companies spending more than half of every dollar earned on external goods and services there is the potential to reduce a great deal of costs.

Other Procurement Outsourcing Benefits

Due to cutbacks (or deficiency in investment) in the procurement area, many companies lack the internal staff or have no staff to conduct the necessary procurement processes (or even the staff available are not given sufficient resources to adequately perferom their work). Because of this, companies are leaving billions and billions of dollars on the table in terms of potential savings. In addition, many smaller companies cannot afford a purchasing department, or at best, they have one person who buys for the company. Accordingly, little or no cost reduction, vendor negotiation, updating of contracts, or price analysis takes place. Even larger companies are at not immune. For example, one $8 Billion Fortune 500 has six people in their procurement group, while another, which buys $100 Million a year, has a procurement staff of just three full time people.

Large Company Outcome Example

One large company with annual revenues of more than $5 billion in Australia had cost over runs, budget problems, compliance issues, very little communication and supply problems. With 252 purchasing personnel across its entire operations and more than $1 billion per year spent for goods and services, the company's situation offered a major potential for procurement outsourcing.

What was the outcome?

Through engaging a professional Procurement professional firm, the company realised the following:

1. Centralised procurement
2. Better communications
3. Increased production at each location
4. Cost reduction of more than $50 million per year within two years, increased staff competencies,

5. Expansion of certain areas, and closing of other areas that were a drain on the company's resources, and streamlined purchasing personnel across the Australia which provided greater outcomes in all areas of each region.

Below shows, the beginning and ending staff amount and labour costs after procurement outsourcing took place.

Summary:

- $5 Billion Revenue.
- $1 Billion Annual Spend.
- First Year Spend Savings $20 Million.
- Second Year Spend Savings $30 Million.
- Increased Productivity and Efficiency.

Large Company Cost Reduction / Productivity Outline Example

- 252 Purchasing Staff before Procurement Outsourcing.
- 149 Purchasing Staff after Procurement Outsourcing.
- **Centralised and Reduced Nationwide Staff by 103 = $8,940,000 Estimated Annual Savings**

National Personnel/Staff Centralisation Example
Small Company Outcome Example

A professional outsourcing procurement organisation adopted cost reduction methodology to conduct work for a smaller company where they had no procurement department and only one person was buying (purchasing/procurement function) for their company. This company was unable to effectively engage the procurement process for their goods and services. Procurement outsourcing was conducted in several areas for this business. From the work undertaken, the company was able to reduce costs by almost $1 million per year in three different areas. This not only helped their bottom line, but it provided needed working capital and they did not have to reduce staffing levels.

With all types of companies and organisations, a significant opportunity exists to increase the percentage of savings.

Many of these companies listed below already had some type of procurement department and procurement process already taking place. Despite this, a professional approach to procurement brought about many positive savings outcomes when goods and services were outsourced using appropriate procurement techniques. For example:

Percentage Savings	Saving	Good, Services, Company Type, and Size

32%	38,000.00	**Office Supplies, $38 Million Company)**
17%	298,000.00	**Travel (air, hotel, car rental), Aggregate/Construction**
15%	32,000.00	**Promotional Items, Cement ($ 2 Billion Revenue)**
24%	252,000.00	**Furniture, Quarry ($100 Million Company)**
34%	354,000.00	**Office Supplies, Toner, Paper, Federal ($140 Million Company)**
47%	602,000.00	**Telecom/Network, Construction ($1 Billion + Company)**
45%	104,000.00	**Copiers, Educational Youth Organisation ($50 Million Organisation)**
13%	321,000.00	**Fuel/Gas, Asphalt**
28%	266,000.00	**Filters (MRO), Fleet/Machinery**
31%	1,200,000.00	**Explosives, Quarry**
37%	359,640.00	**Fleet Finance, Fleet**
43%	905,000.00	**Mobile, Construction**
23%	52,000.00	**Uniforms, Federal**
7%	1,820,000	**Food, Tribe/Casino ($380 Million + Company)**
31%	299,000.00	**Chemical, Cleaning, Janitorial, Casino**
17%	36,040.00	**Personal Computers, Educational Facility ($28 Million Organisation)**
62%	2,100,000.00	**Credit Card/ATM, Casino**
11%	244,581.00	**IT, Computers, Banking ($2 Billion Banking Organisation)**
28%	22,064.00	**Landscaping, Facilities ($ 1 Million Company)**

The processes Adopted in Outsourcing:

While every company is different, there are common phases (or steps) that the outsourcing process goes through. The following provides an example of these phases.

Phase 1

- Gathered Data for a particular category or number of categories.
- For example office supplies (vendors, items purchased, spend, outlined needs, specifications, and goals).
- Total annual spend for office supplies was $122,000.

Phase 2

- Implement Request for Proposal/Bidding Process with all the data from Phase 1 with deadlines and expectations to vendors who wanted the business.
- In the example, proposals were submitted by some of the companies invited to participate.

Phase 3

- Proposals submitted are evaluated for all expectations (price, warranty, returns, service, contract, ordering, and delivery, online) and a vendor is selected as the winner.
- In the example, the winning vendor started the contract with a cost reduction of 38% annual $45,800 savings per year.

Procurement Outsourcing Process and Steps Example

(Almost All Goods and Services can be outsourced)

Procurement outsourcing can be utilised to reduce costs for just about all goods and services. It is a generally held misconception by orgnisations that they are unique and that outsourcing does not work for them. Some of the details surrounding the misconceptions are propegatited on the belief that some of the goods and services used are so specialised and exceptional that they cannot be touched or the internal processes are so integrated into operations that any changes will jepordise operational efficiencies. Of course this is not totally true and infact processes and in particular procurement processes which are not regularly challenged or benchmarked to market processes often lead to inefficiencies and missed costs savings. Some areas where outsourcing has been proven to work include:

Some Category examples are:

- Utilities and Energy;
- Office supplies;
- Telecommunication;
- IT equipment;
- Paper; Toners;
- Packaging;
- Chemicals;
- Cleaning Equipment;
- Freight and Couriers;
- Facility Management;
- Subcontracting; MRO;
- Plant Equipment Machinery and Materials;
- Software; Information Technologies;
- Payroll; Accounting;
- Insurance; Legal;
- Flooring; Asphalt;
- Credit; Credit Cards;
- Banking; Financing;
- Cement; Steel;
- Fleet Automobiles and Trucks;
- Human Resources;
- Signs; Printing;
- Shipping;
- Travel;
- Food and Beverage;
- Raw Materials, **and many other expense areas**

The bottom line of procurement outsourcing is that when the acquisition of goods and services can be outsourced through a third party (the procurement outsourcing company), this will result in **cost reduction, enhanced compliance, more efficiency in production, an**

opportunity for the company to focus on their core competencies, increased competitiveness and increased profits.

Procurement Outsourcing Market

Everest Research Institute, a well known global consulting and research firm, predicted that APAC procurement outsourcing would grow by 20% to a total managed spend of more than $170 billion in 2012. In 2013, we saw more than $190 billion under management, just in the ANZ region.

What is Causing Procurement Outsourcing to Grow?

The future is bright and profitable for procurement outsourcing, as companies continue to look for ways to improve performance, bolster bottom line revenues and lower operating costs. As the procurement outsourcing industry continues to grow, traditional outsourcing functions like fleet maintenance, payroll processing, legal services and local delivery continue to expand. Other areas that had never been outsourced are also experiencing record growth, such as recruiting, hiring, and human resource management. In all reality, business outsourcing will continue to grow because **companies are looking to refine their mission and business model in order to seek cheaper, better and faster options**.

Procurement outsourcing is being widely utilised and is growing across a number of sectors. The top reasons for this growth in procurement outsourcing is due to the results it is able to achieve (bring to the strategic management table of a company) and these include:

- Unit Price Reduction
- Demand Management; and
- Supplier/Price Compliance

Market

The events and happenings of 2014, such as the:

1. Global natural and other disasters;
2. Currency volatility of the Australian dollar and the Euro debt crisis;
3. Supply chain difficulties for vendors;
4. Technology changes to the cloud; and
5. Focus shift to direct expenditure.

Highlighted the need for companies to become leaner, healthier and retain core competencies without letting more key resources being distracted fromt eh real game in addition to global competition, has positioned Procurement Outsourcing to see substantial growth in the years to come.

Procurement Outsourcing Benefits

Many benefits can occur from procurement outsourcing. Depending on the needs of a specific company or organisation, these can include:

- Reduced costs and increased quality;
- Centralized procurement;
- Improved access to goods and/or services;
- New market development;
- Just-In-Time Inventory (JIT);
- Increased supply chain efficiency;
- Best value;
- Improved competiveness;
- Government compliance;
- Supplier performance improvement;
- Support of day-to-day buying activity;
- Policy/Procedure creation, implementation;
- Validation;
- Transaction automation and processing;
- Ability to focus on core competencies;
- Strong end-user to provider relationship developed;
- Lower procurement related labour costs;
- Overall procurement performance improved;
- Greater control, reporting, and vendor compliance;
- Organisation and internal cost performance;
- Data for benchmark analysis, goals, and results;
- Enhanced procurement personnel training;
- Hedges against future cost increase of raw materials; and
- Procurement department creation and implementation

In summary, many companies are now realising due to internal or external reasons the need to focus on their procurement activites, after all it is an area of their bigesst expense and an area under their control. This focu of procurement has given rise to procurement specialists to take the lead. The professional procurement orgnaisation can deliever value even to orgnaisations which already have a procurement department. In fact, companies are now coming around to realise that even procurement requires specialised skills and is an area which can yield more value if it is outsouced.

Iron Star Consulting

IronStar Consulting
Level 3,
389-391 Sussex St,
Sydney, NSW, 2000
(612) 9439 4942
info@ironstarconsulting.com.au