



Paul Blais

BETTER BUYING

Guy Strafford has seen it all in his decade working with companies' procurement processes. So he's been moved to tell us the key mistakes – and the biggest wins – when it comes to purchasing.

Illustrations **Paul Blow**

LET ME ASK YOU A QUESTION. You have decided to tender your audit. Are you going to let your procurement team run the tender? They would involve you – you know your needs – but would you involve them?

If the answer is 'no', perhaps you don't trust your procurement team. And if you don't trust them, there's a good chance your colleagues may feel the same.

After all, in many areas – such as audit – detailed knowledge of what's required is held by people outside procurement. Your procurement team is there to challenge and add commercial discipline and process. It means they have failed 'The Audit Test' and this is usually a good indicator that there is more value that could be extracted from your purchasing.

According to Ron Jarman, global director of procurement at Reuters, "The difference between good and bad buying is 15 per cent." While this is a rule of thumb, how much is 15 per cent off your costs with all of your suppliers worth to you? £1m? £10m? £100m a year?

Now I have your attention.

You might be like many FDs who worry about whether they are getting best value from their procurement functions. Anecdotally,

you see evidence that all is not well. Maybe you can't get to the bottom of the value you are getting from marketing? Maybe you are uncertain why there are quite so many suppliers and how come that laptop you signed off is so expensive compared with the Dell leaflets you see in the *Sunday Times*?

If you're asking yourself these questions, you're certainly not alone. A quick survey I made of 50 FDs at a recent conference showed that just over two-thirds felt material further value could be taken out of their businesses' purchasing.

Don't think that you're not exposed to these problems. Our research suggests that businesses generally put around 50 times more resource into selling than buying. This means that your business faces spending 50 times as much resource thinking about how to get money from you – to "spring leaks" – as you have to stop it. There is a salesman exclusively thinking about how he or she can sell more at higher margins and who is trained to exploit your weaknesses and your failure to monitor, track or manage.

Finance can have a big impact on redressing this balance and, ultimately, achieving 15 per cent. But you need to know how.

The box on page 55 shows the key mistakes FDs make. So let's deal with your buying in terms of the five groups of mistakes. >>

TOP TEN MISTAKES IN PROCUREMENT DATA

OBJECTIVES

- 1 Providing data not fit for purpose and purchasing accepting it.

SCOPE

- 2 Not accepting there is a role in commercially managing suppliers.
- 3 Tolerating colleagues trying to buy unsupported without the requisite skills.

OBJECTIVES

- 4 Not consistently defining savings that all are happy with.
- 5 Focusing on savings to the exclusion of all else.

RECRUITMENT

- 6 Paying peanuts – you get monkeys!
- 7 Recruiting/enumerate purchasing staff without the necessary people skills.

STRUCTURE

- 8 Procurement not reporting to the FD or COO – procurement is toast without FD support.
- 9 Failing to resource procurement functions on the scale needed to defend against sales departments.
- 10 Finance cutting budgets from procurement.

DATA AND VISIBILITY

Accounts payable data is your business' record of what it buys. It is not usually set up in a way that best suits the needs of purchasing. Below are the top five mistakes made and suggestions on how to solve them.

- Poor categorisation – the categories are cost codes that do not correspond to the products and services purchased and how you buy something. For example, you buy gas, electricity and water, not just a cost code of "utilities".
- Multiple entries for the same supplier – 37 variations on IBM is our record.
- Internal transfers confuse the amount being spent and expense claims often increase the number of suppliers.
- The reports produced do not reflect procurement's needs – compliance and savings reports are needed.
- No detail is held on what is bought

The solution? You do not need to make cost codes more complex. Instead run a separate database, which you can update regularly and drop the accounts payable into. Problems one to four can be solved this way with the suppliers set up to be rationalised and recategorised. Problem five requires either a p2p platform where requisition detail is recorded and/or suppliers can be asked to provide a detailed breakdown of goods or services purchased.

Most businesses do not have visibility of what they buy, or adequate reporting

to buy well. Given finance's affection for numbers, it often tolerates an unacceptable lack of visibility when it comes to purchasing. However, data is the keystone to the whole purchasing edifice. What gets measured gets done.

SCOPE

There are many businesses where purchasing's impact is limited because its scope is restricted. In part, this is down to purchasing departments failing to make the case for involvement. However, when considering purchasing's scope, finance should be clear on two points.

One, your colleagues do not always recognise that buying well is a skill that they do not necessarily possess. For instance, they may be poor negotiators and lack the time to manage suppliers effectively.

Two, your colleagues do not always have an interest in saving money. Furthermore, your marketing director's credibility at conferences they attend is determined by the scale of his or her budget, not the savings made on suppliers.

FD'S VIEW

DAVID BRYANT, CFO, UNIVERSAL MUSIC

As the CFO of an award-winning procurement function, what do I expect from procurement?

A continuous drive to take costs out of the business is a prerequisite – it makes for an easier conversation with the chairman when you can say that the firm spends X on procurement but delivers savings of Y.

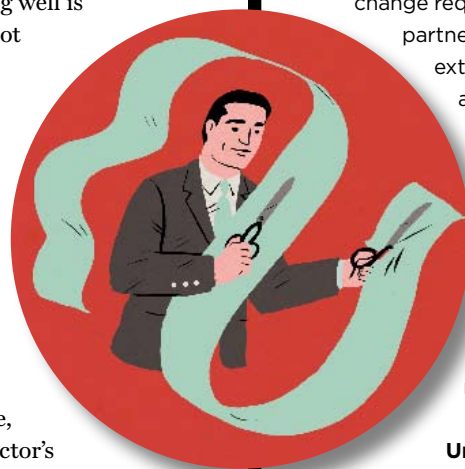
However, the ability to quantify and capture the savings is equally important. Having the savings on paper – that is, contractually – is one thing but making sure the right behaviour takes place is another. For example, check that people use managed suppliers and that systems are in place to measure the savings.

In my experience, a good purchasing department works across all areas of the business. Achieving cost savings is not just about buying well, it's about changing the processes you use. I believe that the procurement department has an important role to play in innovation, partly because its cross-functional role puts it in a position to "join up the dots".

People in your procurement department must understand the business and work well with people. Producing cost savings and initiating

change requires long-term partnerships between external suppliers and internal customers. And, most important, people in procurement must be able to balance short-term and long-term requirements.

Universal Music
was winner of the
**Chartered Institute of Purchasing
and Supply Overall Best Purchasing
Award 2005.**



Finance can help by pushing for the involvement of purchasing in all areas of major expenditure. As we shall see, this means agreeing procurement's scope and the role that you want them to play.

OBJECTIVES

As an FD, you almost certainly want procurement to find savings. However, a surprisingly large number of organisations are not clear about what constitutes a saving. It is important to make this clear and to ensure that you have a sign-off procedure with stakeholders, finance and purchasing to agree what has been saved. You should also consider how to assess procurement when it buys something for the first time, or when it prevents a cost increase.

You need to have more targets – purely savings-based objectives can be counterproductive. Mark Selawry, vice-president of management services at Hilton Hotels, says: "Don't just have one priority. Most successful functions have more than one goal to build a more comprehensive set of drivers. This will ensure that not only are the savings actually being delivered, but that this is achieved without compromising the business' and colleagues' real needs."

It is worth remembering that many of

WHAT TO ASK IF YOU ARE A NEW FD?

FIVE QUESTIONS A NEW FD SHOULD ASK THE PROCUREMENT FUNCTION

- 1 How many suppliers do we have and how much do we spend with them all?
- 2 How much expenditure do you influence, how much do you contract and how much do you manage?
- 3 What do my fellow directors think about you?
- 4 What is the purpose of the procurement function?
- 5 What do our suppliers think about us?

The first two questions are about data – inadequate understanding of data means inadequate purchasing. The third is about the scope and impact of the function and in particular whether they believe that suppliers need to be commercially managed – it is an insight into mindset and willingness to plug leaks. The fourth question is the most crucial – it is an indicator of who purchasing speaks to and whether they believe that the function is a service function.

your colleagues have less focus on profits, so helping frame procurement's objectives in broader terms is useful.

RECRUITING THE RIGHT TEAM

When recruiting a head of procurement, most companies tend to focus on deals done and categories sourced. This is too narrow and, for the most part, a mistake.

It is far more important to understand if they have the people skills to win the support of your colleagues. Your head of procurement needs to be good at engaging with you and your colleagues, yet this area is consistently under assessed and under regarded.

Additionally, they must have the numeracy skills to do their job. Profiling on more than 1,000 procurement professionals earning more than £50,000 per year who we have interviewed suggests that around two-thirds of procurement professionals have significantly below-average maths skills.

And you get what you pay for. Businesses frequently under-invest in purchasing, even by their own criteria. Purchasing is usually asked to provide a return on investment which far exceeds the ROI expected of normal business investments – 15 times the cost is often known yet, a return of 15 per cent a year on many capital expenditure projects is sought. This leads to far fewer projects and reduces the overall amount saved.

STRUCTURE - HOW YOU SHOULD THINK ABOUT THE DEPARTMENT

Unreasonably high ROIs not only mean that functions are small and fail to cover

much of the expenditure of the business, they also encourage businesses to pay procurement professionals badly. This in turn sets off a vicious cycle of not attracting good people into the profession and so there is poor delivery.

So if you have got good data, recruited good people and you are clear about the scope of the department there are still two things finance must do.

First, ensure that procurement reports to the FD or COO. In many organisations, procurement is a low - ranking function and the procurement manager/director reports to facilities or some other cost



FIVE THINGS TO MEASURE PROCUREMENT ON

- 1 Savings.
- 2 Per cent compliance to centrally negotiated deals.
- 3 Cost of non-compliance.
- 4 Spend under contract and management by procurement.
- 5 User satisfaction survey covering as much of the organisation as appropriate.

There's nothing like tracking how much money is being lost to focus your team on the costs of not using arrangements that are already in place. Many firms are also increasingly worried about risks and corporate social responsibility. These are important but you aren't going to credibly address them unless you have a rationalised supply base that's under control.

FD'S VIEW



DAVID CLEARY,
DIRECTOR OF
FINANCE,
RICOH UK

- 1 Recognise your business' weaknesses. Think about whether you are looking at these.
- 2 You have to keep at it. Just because you did it three years ago does not mean you can file it away.
- 3 Look at each component and do not just go for the big things – think about what you have not looked at recently.
- 4 There is always an opportunity for improvement.
- 5 Encourage your organisation to challenge what it does and why it does it.

TOP TIPS FOR ASSESSING PROCUREMENT PROFESSIONALS

- **Maths skills – test them formally at interview. Test all of your existing team.**
- **Purchasing skills – ask them about their greatest triumph and what the organisation felt about it. If they don't know, reject them.**
- **People skills – make them give a presentation. If they can't present to you, they can't present to your board and their prospects are limited.**

centre. It is a mistake for procurement to report to a major spending department because it makes it hard to challenge such departments and thus get maximum value.

Lowly status makes it difficult for procurement to engage with and be respected by more senior stakeholders. In practice, the procurement director should report to an individual who has responsibilities that cut across the whole business. If you do not feel that this person is right to report to a board director, then you have the wrong person as head of procurement.

Second, finance should cut budgets behind procurement. One consistent complaint that FDs have made to me is that they hear endless stories about the savings being made but never see these savings come through to the bottom line.

Some of the reason for this is covered by areas we have already discussed, namely suppliers recovering revenue when procurement's back is turned. But it would be good if finance cut budgets after procurement. This needs careful thought – thought that is facilitated by having a method to measure savings.

The advantage is that this is a powerful tool to enforce take-up. Cutting 20 per

cent off a budget for a particular item when a saving is identified places an onus on the budget-holder to save the money in that category. But it also means – if they like the supplier or simply enjoy spending money – that they may be much less co-operative. Ultimately this is solved by delaying the budget cut to the year after.

Finance is well positioned to ask about the structure of the procurement department. In light of the importance of stakeholders, a frequent error of many procurement functions is to structure themselves according to categories of product. However, it might be better to align themselves with the departments in the business.

Finally, finance can ask the 'make or buy' question. Your business has already outsourced some of its purchasing; you just didn't call it that. Instead you called it brokerage (insurance) or agency (media buying, print and the like). Increasingly, businesses are seeking to focus the procurement functions they retain on servicing the stakeholders. Thus they are seeking external support in the form of specialist expertise.

Given the shortage of good resource, this frequently means bringing in the experts on a flexible/on-demand basis as they are needed for the time required. This allows the business to build a very different structure within the procurement function.

If you believe that your business could buy better or wonder whether you are doing as well as you need to then this article shows you how to assess more clearly whether the opportunity is there and what to do about it.

If you have absorbed only three things, they should be, first, that savings do not just come from suppliers. They come from your business behaving differently and the knowledge that a purchasing function orientated exclusively towards its suppliers is achieving only a small proportion of what it could. Just think of all the value leaking out. Second, if you



FD'S VIEW




SIMON HORNE,
DIRECTOR
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Never underestimate the power of upsetting the equilibrium, a strategy adopted by many insurgents to displace powerful incumbents. Change creates opportunity, particularly for an early adopter. When managing a supply chain, the same philosophy can be applied.

There are always alternatives and it is all too easy to say no, that won't work in our company. But by challenging the market convention unexpected benefits often accrue.

A simple but illustrative example is our decision to build an in-house photographic facility. We knew that we could provide photography services cheaper to our business by cutting out the third-party margin. We never imagined that by making this change we would see downward pressure on third-party photographic studio prices – our suppliers wanted to remain competitive.

do not manage suppliers, they will claw back the value while you are not looking or keeping the pressure on. Third, buying is a skill and not everyone is good at it. You need to ensure that you have the right purchasing support in place.

Now take on your business' purchasing. 

GUY STRAFFORD is a director of BuyingTeam. He is ACA with 15 years' experience helping larger businesses improve procurement. He rates the practical over the theoretical.

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http://snipurl.com/govt_buying

www.ogc.gov.uk/procurement.asp

For the public sector viewpoint