The Dollars and Sense of Procurement’s Real Value
Executive Summary

Leading procurement functions generate genuine value throughout the enterprise. They do so through activities such as strategic sourcing and category management — practices that many procurement departments already perform quite well. That said, what distinguishes top procurement functions from others is how well they quantify the value that they generate.

By calculating, documenting and communicating the actual and measurable value that their sourcing activities produce, procurement functions can build a stronger internal “brand” for themselves. This white paper focuses on the savings and value calculations, documentation and communications — along with six related, value-driving practices — that procurement departments should consider deploying to build a credible reputation and internal brand for driving value.
Introduction: How Procurement Earns a Reputation for Generating Value

“They make money the old-fashioned way. They earn it.”

This statement, which comes from a classic television advertisement for wealth management firm Smith Barney that ran in the late 1970s, crystallizes the modus operandi of best-in-class procurement functions.

While procurement functions often report that their work has saved the company millions of dollars, stakeholders frequently roll their eyes in response to these claims: Really? Well, then, where’s my $1 million check?

Too many business stakeholders remain unclear — and skeptical — of the value that the function generates for the company: Procurement is only concerned about price. Procurement takes too long to source agreements for goods and services we needed yesterday. Procurement prevents us from using the suppliers we want. The savings that procurement claimed were taken out of my budget — but those savings never materialized!

Valid or not, these criticisms reflect an underlying issue that requires attention: the procurement function’s inability to quantify value in a way its stakeholders will understand and appreciate. By improving how they quantify their value, procurement functions can earn their reputation and build the value of their brand among stakeholders. They also will be more likely to earn a seat at the strategic decision-making table. This effort is well worth it: Based on recent studies, companies with leading procurement functions are known to achieve about 1.7 times the savings and operating growth compared to all other companies.

Transformational Snapshot: New Sourcing Categories Net $25 Million in Savings

**Procurement Objective:** A U.S.-based global shipping and logistics company wanted to reduce $150 million in spend across a global supply base with a focus on Asia.

**Challenges:** The company had no local presence in Asia, which posed language and cultural barriers. It also possessed minimal local market and supply base knowledge. Additionally, the data quality of sourcing activities was poor with limited line-item visibility (non-U.S. purchases were relatively limited and primarily at the single SKU level).

**Improvements:** An in-depth spend and opportunity analysis to target attractive sourcing categories in the Asian market was conducted. The effort identified domestic and international suppliers through a rigorous qualification process to ensure quality, capacity and long-term feasibility. An experienced multinational team of procurement specialists in Asia and the United States managed RFx (i.e., request for information, request for proposal, request for quote and request for bid), negotiation and contracting processes. A new total landed cost model supported by a global distribution strategy was designed and implemented to address the international logistics complexities.

**Results:** These improvements ultimately achieved more than $25 million in annual, auditable total landed cost savings, which were quantified in a detailed benefits realization model that was reviewed and approved by all relevant business stakeholders, including supply chain, finance, procurement and regional leaders. With this, new internal relationships were initiated, and the cross-functional team established long-term suppliers in both the United States and Asia, complementing the existing U.S. supply base.

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1 “Smith Barney Commercial 1979”: www.youtube.com/watch?v=yAMRXqQXemU.
Generating and Promoting True Value

High-performing procurement departments (for an example, see the “Transformational Snapshot: New Sourcing Categories Net $25 Million in Savings” sidebar) are eagerly sought out by stakeholders who want to tap procurement for its:

- Customer focus
- Expansive category expertise
- Strategic-sourcing capabilities
- Cross-enterprise view of purchasing costs
- Knowledge of marketplaces
- Risk management savvy
- Understanding of compliance requirements
- Rigorous approach to managing costs
- Ability to drive innovation with suppliers
- Ability to generate real value

These benefits typically are generated via strategic sourcing (see chart below) and sustained through ongoing category management activities.

Six Steps to Strategic Sourcing

<table>
<thead>
<tr>
<th>Sourcing Assessment</th>
<th>Strategy Development</th>
<th>Sourcing Strategy Execution</th>
<th>Supplier Negotiations</th>
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<td>Key Activities</td>
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<td>Define the issue and scope</td>
<td>Agree on sourcing categories and scope</td>
<td>Analyze value levers</td>
<td>Select supplier finalist(s)</td>
<td>Award contract to selected supplier(s)</td>
<td>Finalize plan for implementation</td>
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<td>Gather high-level spend data</td>
<td>Develop internal profile</td>
<td>Determine selection criteria</td>
<td>Develop negotiation strategy</td>
<td>Support supplier contracting process</td>
<td>Develop communication strategy</td>
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<td>Develop category segmentation approach</td>
<td>Develop industry and supplier profile</td>
<td>Develop RFPs or contracts for select categories</td>
<td>Prepare fact-based negotiation case</td>
<td>Finalize fulfillment/implementation strategy</td>
<td>Establish supplier management structure</td>
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<tr>
<td>Identify and prioritize opportunities</td>
<td>Determine sourcing strategy</td>
<td>Launch sourcing event</td>
<td>Negotiate business agreement</td>
<td>Implement program</td>
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<td>Estimate opportunities</td>
<td>Define category baseline</td>
<td>Manage communications</td>
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<td>Draft execution plan, and define success criteria</td>
<td>Define internal change tactics</td>
<td>Collect, aggregate and evaluate responses</td>
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Output

- High-level spend analysis
- Prioritized list of initiatives
- Project charter and ROI analysis
- Project execution plan
- Sourcing strategy
- List of prequalified suppliers
- Approved project charter and ROI
- Savings methodology
- Response weight and scoring model
- Published RFx
- Supplier qualification summary
- Supplier short list
- Negotiation packet
- Award scenario models by supplier
- Final savings analysis and results achieved document
- Award notification
- Draft supplier contract
- Implementation strategy
- Implementation plan
- Project charter
- Vendor scorecard
- Knowledge transfer documentation
When it comes to quantifying the value of sourcing, business case charters help procurement document the value its activities generate. The charter functions as the business case for strategic-sourcing activities and also helps ensure buy-in among the function’s “customer base” (i.e., stakeholders).

Procurement should work with finance, accounting and/or budgeting colleagues to implement a benefits-tracking process and maintain visibility to the actual savings that have been generated in comparison to the estimated savings.

Valuable Facets to Business Case Charters

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A business case charter, which can apply to any category of spend (e.g., IT, travel, equipment, office supplies, professional services), documents current baseline spending, the requirements put forth by the requesting organization, a snapshot of the market, and the stakeholders in the organization who are affected by purchasing activity in the category (major stakeholders are often asked to approve the charter). The charter also features an analysis of the key sourcing levers, an estimate of the savings potential (i.e., the identified benefits), and an explanation of procurement’s sourcing strategy within this category.

Strategic sourcing is an information-based methodology for understanding and engineering the most cost-effective procurement solution while meeting or exceeding the operational requirements of the organization. It is a highly valuable process. Consider that a company with annual revenues of $1 billion would add $28 million to its bottom line by decreasing external spending by 5 percent, compared to adding only $3 million to its bottom line by increasing revenues by 5 percent.

In addition to potentially enhancing the bottom line, strategic sourcing can produce numerous benefits to all functional areas of the organization. These benefits include:

- Lower total cost of ownership
- Improved supplier performance and quality
- Enhanced decision support through spend transparency
- Reduced process costs and order cycle time
- Increased volume of “managed” spend and minimized noncompliance
- Stronger supplier relationships to minimize supply risk, increase supply chain flexibility and drive innovation
- Higher customer satisfaction levels among stakeholders
- Greater control of working capital to support the organization’s growth and financial obligations
- Improved purchasing process performance and effectiveness
- Development of more sustainable strategies

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After the sought-after benefits have been achieved, the next step is to document them: *The benefits associated with the implementation of a new contract, pricing and supplier relationship are estimated to be $10 million.* This process begins with updating the business case by inputting the estimated results — the real benefits or value expected to be achieved from procurement activities. Next, procurement should devise an implementation plan with all relevant stakeholders. For example, if a contract with a new supplier has been signed — one that will save the company $10 million over the course of two years — departments that interact with this new supplier need to be made aware of the changes and, when necessary, trained on ordering processes, service-level agreements, other relevant processes and governance matters. Finally, procurement should work with finance, accounting and/or budgeting colleagues to implement a benefits-tracking process and maintain visibility to the actual savings that have been generated in comparison to the estimated savings.

Savings can be measured and tracked in a variety of ways. A few of the more common approaches include comparison, indexation and estimation.

**Comparison** relates to time: comparing previous costs to new/updated costs resulting from procurement’s work. (For example, while an RFP may have identified $10 million in estimated savings compared to a previous contract, the actual savings over time may be higher.)

**Indexation** often applies to commodities. If a commodity previously cost $10 per unit and procurement finds and negotiates with a supplier that offers the same commodity at $11 per unit (while maintaining the same quality requirements), this appears to be a cost increase. However, if external indices show that the commodity’s price has soared 40 percent in the past 12 months to an average of $14 per unit, procurement has actually saved the company $3 per unit. This is often referred to as “cost avoidance.”

**Estimation** involves comparing actual costs to projections.

Clearly, there are other nuances and complexities involved in tracking savings and applying them to budgetary reductions, which is why it is important for procurement to partner closely with the finance function.

Ultimately, the key is to track actual savings actively. This tracking will enable procurement to report actual, quantifiable savings, as opposed to reporting so-called projected savings early on in the procurement process that tend to be viewed with skepticism as hypothetical, unreliable figures.

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Beyond calculating and communicating the quantifiable benefits associated with any one sourcing project or event, procurement should communicate its performance strategy and progress in achieving its plan. This includes devising a reporting capability and establishing a reporting cadence (e.g., quarterly performance reports) so that the enterprise is kept informed of how the function’s activities are producing bottom-line benefits. This reporting should focus on all the ways that the function drives value — cost reductions, cost avoidance, quality improvements, service responsiveness and so forth — by managing spend in a holistic manner.
Six Value-Driven Practices

As detailed above, clarifying cost reduction measurements and clearly communicating benefits throughout the business represent a pivotal enabler to improve procurement’s value and internal brand. Accurate tracking, measuring and reporting of cost savings can help procurement shift from a cost-centric mindset to a value-centric mindset. This type of “rebranding” requires other enabling steps, practices and relationships, as well.

The following activities are routinely present within top-performing procurement functions, and procurement executives interested in improving their own functions should consider introducing these practices:

1. **Identify and convey procurement’s role:** Just as leading consumer brands identify the core value that their offerings deliver to customers, procurement should clearly lay out the value that it provides to its enterprise customers – and to the company, as a whole. This exercise identifies, specifically, how the procurement function supports the achievement of enterprise goals. These procurement objectives should then be communicated throughout the organization. If procurement does this, common misperceptions (e.g., “They just want to hammer suppliers on cost.” or “They don’t like it when I use local suppliers.”) are replaced with consistent messages centered on the value that procurement helps its stakeholders achieve.

2. **Foster cross-functional collaboration:** Procurement should be knowledgeable about and formally aligned with different parts of the business. By working collaboratively with business partners, procurement can establish a consistent, enterprisewide view of spending and value among stakeholders. Such a holistic view helps enable sustainable savings. This approach also should include procurement’s involvement early in and throughout the buying processes (which stakeholders will begin to embrace once procurement’s value is demonstrated quantitatively). At that point, procurement’s insights can lead to better supplier selection decisions, compared to a situation in which procurement is tasked to execute a contract after the fact. With the benefit of its enterprise and global supply chain perspective, procurement can help its business partners understand the most valuable sourcing strategies.

3. **Stay in sync with the finance function:** While procurement should work effectively with all business partners, staying in sync with the finance function is especially important. These two groups should remain aligned regarding the savings that procurement is generating on an ongoing basis (savings tracking), how it ties back to the profit and loss statement (P&L), and the effect it may have on budgets. This type of traceability is crucial, and finance’s confirmation of the link between procurement’s performance and the bottom line also fortifies procurement’s credibility. Some large companies maintain a “supply chain finance” function that works closely with procurement counterparts. Companies that operate with supply chain finance functions realize that maintaining a current financial view of their supply chain is

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imperative and therefore should be performed on an ongoing basis. These functions also tend to focus on relevant aspects of treasury and working capital optimization, as well as cost savings and driving value. While a supply chain finance model is not viable for all companies, it illustrates the close procurement–finance relationships that all organizations should seek to foster and sustain.

4. **Know your numbers**: As emphasized above, accurate measurements of cost reduction and the value that procurement programs deliver are crucial to the function's effectiveness. These numbers should be auditable and aligned with budget decision-making. The accuracy of procurement’s savings and value reporting directly influences the function’s credibility. It is also vital to understand and present the numbers with clarity about what are “identified” or “projected” savings versus realized and quantified savings.

5. **Choose the right metrics**: The best procurement organizations select, monitor and manage key performance indicators (KPIs) that align with the enterprise’s strategic objectives. Selecting these KPIs requires both nuance and precision. In some cases, functional and operational metrics can be compared against comparable external market measures to help gauge performance.

6. **Treat suppliers as partners**: Few leading procurement functions view their primary role as hammering suppliers on cost. While costs must be managed to generate the greatest value to the organization, top procurement functions partner with suppliers in ways that cultivate understanding and innovation. These collaborative relationships frequently yield opportunities for innovative improvements that translate to greater value. Internal business partners recognize and appreciate that value and, in turn, tend to view procurement as the orchestrator of supplier relationships.
When procurement implements and improves the practices identified throughout this white paper, the function will have a stronger internal brand for delivering value and be viewed as a strategic business partner.

On this count, procurement might learn from UPS’s “What Can Brown Do for You?” corporate rebranding effort. The purpose of this well-known 2002 marketing campaign was to broaden consumer awareness of UPS’s services from a ground delivery shipping provider to a global provider of supply chain management, logistics, financial and retail service solutions. In essence, UPS positioned itself in the market as a business partner rather than as a shipping company. Of note, the rebranding contributed to some eye-opening benefits, including the company seeing a $2 billion increase in revenue in 2003.²

Ultimately, business partnerships flourish when procurement helps make the organization more profitable, drives competitive advantage and exerts a positive impact on the bottom line. Such benefits should be documented and conveyed to the rest of the organization.

The bottom-line success of such a rebranding effort is the result of deep analysis, hard work and communications that place just as much emphasis on process redesign as they do on logo design. In the case of procurement functions, rebranding themselves as strategic business partners should involve identifying and quantifying the essential value they provide to their stakeholders; determining the extent to which their stakeholders understand this value; and then creating the transparency, tools and track record necessary for stakeholders to understand the value, as well as how to leverage the procurement function going forward.

Organizations conduct rebranding efforts periodically. Building on the success of its 2002 and other rebranding efforts, UPS recently changed its branding message to further strengthen its relevance in the evolving marketplace.³ Procurement should embrace a similar approach in its ongoing effort to build, sustain and further its reputation with corporate stakeholders. The need to revisit its organizational brand and messaging efforts may arise, for example, even after procurement is viewed as a business partner that delivers quantifiable benefits and supports strategic activities throughout the enterprise.

Ultimately, business partnerships flourish when procurement helps make the organization more profitable, drives competitive advantage and exerts a positive impact on the bottom line. Such benefits should be documented and conveyed to the rest of the organization. An ongoing communications effort can help build, sustain and, when necessary, strengthen procurement’s organizational brand. It also helps for procurement to promote its brand in a way that clearly conveys the value it generates for the company. As the old Smith Barney ad begins, “Good investments don’t walk up, bite you on the bottom and say, ‘We’re here.’ Finding them takes good old-fashioned hard work.”

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Our consultants take a holistic approach to managing the supply chain by assessing, designing and implementing capabilities that enhance performance, reduce risks and manage costs.

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