

White Paper

Procurement – The Bermuda Triangle of Business



The Bermuda Triangle is the area between Florida, Puerto Rico and Bermuda. According to popular culture, a number of aircraft and ships have disappeared under mysterious circumstances in this location.

Something similar happens to corporate profit as it passes through the Procurement Department.

To address this problem, there are conceptual issues of which executives need to be aware; there are organizational sociological factors that need to be addressed; and an appropriate process needs to be put in place to maximize procurement effectiveness.

The Conceptual Issues

Economic conditions in most countries have resulted in a shrinking markets, further complicated by over-supply. Executives in pursuit of more profit have conventionally analysed sales, marketing, research and development, and even operations, for opportunities.

In a manufacturing environment, more than 50% of revenue is spent on procuring goods and services. A 1.5% reduction in procurement costs could translate into a 3% increase in profit. The choice of 1.5% in this example is because it is widely believed that this is an easily achievable saving, even in the best-run procurement departments.

Lower procurement costs directly improve net income. Procurement optimization must be the simplest and most effective tool for short-term and long-lasting profit enhancement. It is therefore surprising that corporations have overlooked the Procurement Department for so long. Even management theorists have largely overlooked the subject of strategic procurement. Conventional wisdom also has executives believing that the monitoring provided by the recipients of Procurement's work is sufficient. It is not, in all but a small number of exceptional companies.

The Organizational Sociology Perspective

What follows is a caricature of a Procurement Department amalgamated from a number of examples across different industries. If your Procurement Department bears a resemblance to the caricature that follows, the profit it could yield could well reach double digits in months, rather than years.



The business regards the Procurement Department as a necessary department, but hardly one that is essential to the success of the enterprise. It is the neglected stepchild and is given scant attention.

In the large financial institutions of Europe, no more than 20% of the staff in procurement departments have a university education. In medium and small firms, the number is only 8.5%. Salaries for employees in procurement are almost half those paid to sales staff.

The Procurement Department spends approximately 80% of its time administrating the decisions of other departments.

The implicit departmental objective is a turnaround time as close to “immediate” as possible. Failure to achieve this objective is so common that other departments cite this as the primary reason for excluding Procurement from most of the procurement process. The department’s principal activity is securing prices and doing paperwork.

As little more than paperwork slaves, the Procurement Department is invariably understaffed. The department has an efficient administrator in charge that is “the numbers.” He or she has a loyal posse of suppliers capable of responding swiftly to urgent requests.

As a consequence of this lacklustre performance, senior executives demand little of this department, and the department, in turn, achieves little.

Understanding what has gone wrong requires looking at the problem through the lens of organizational sociology.

The IT manager rose from being an in-house technical support service to a board position only when the CEO recognized the importance of the IT function to profitability. The rise of the manager of the Personnel Department to the board as HR Director followed a similar path.

Until the financial value of the Procurement Department is recognized, it is unlikely to attract the calibre of staff, budget, and authority levels required to be much more than an administrative arm of various departments.



If Procurement were able to prove its worth despite the current limitations described in the caricature above, the staff, budget and authority level required would follow. However, instances of this achievement cited in the literature are so scant as to hold little hope. Procurement Department staff members are barely able to cope with the administrative demands made on them. They cannot think widely and creatively about new possibilities for strategic procurement.

Awareness by the most senior executive of the profit potential from strategic procurement is a prerequisite for change. The executive level commitments required to actualize the profit that is lost in this Bermuda Triangle will result from this awareness.

When this commitment is evident, talented people currently working in the accounting, sales and technical departments will seek transfers to Procurement.

The Business Model

There are many compelling reasons for setting profit-impact targets for the Procurement Department (as one does for sales, for example). As with a Sales Department, the target cannot be sales volumes only, but rather sustainable, profitable sales.

With a profit-impact target in which the cost of the Procurement Department is a factor, being under-skilled and under-staffed would be addressed appropriately, as would the departmental business model. Strategic procurement requires market knowledge, comprehensive supplier research, an understanding of competitor behavior, and more.

Given more respect, Procurement would evolve from its current role as “paperwork slaves” to that of an information broker. Procurement would be the location other departments turn to for details on the market and suppliers.

A properly staffed department would have the time to procure even better.

The conceptual tools necessary to do a professional job of procurement are available. Price hammering is no longer the only method in the repertoire.

TCO (Total Cost of Ownership,) for example, is a well-known but insufficiently used tool. TCO is a financial estimate that Procurement uses to determine the direct and indirect costs of a product or service. It takes both a broader and longer-term view of price, and so avoids using the purchase price alone as the measure of a successful deal. TCO includes all the additional costs in calculating the purchase of a product or service.



These include opportunity costs, tax credits, and expedited delivery. A supplier's price may be slightly higher, but if "just-in-time" delivery is offered, the total cost of ownership may easily justify the difference. Storage costs would be lower, a serious consideration for larger products, and less capital would be locked in stored goods.

The savings over time on a higher valued product are more obvious when repair, maintenance cycles, trading interruption, downtime, warranties and other factors are included. Less obvious costs, such as transaction costs, common language, customer-oriented supplier visits, outage and failure expenses as well as up-skilling could similarly justify a higher purchase price.

The current lack of technical skill could be overcome by the qualifications of the staff in the department, or access to relevant technical skills elsewhere in the organization. An engineering qualification could be a requirement for work in Procurement in a large engineering firm, as could HR experience in a firm that is constantly hiring.

With the higher status accorded Procurement by the executives, and the higher order work done by the department, Procurement can demand more of its internal clients. The department could require timely instruction, full briefs, and accurate specification.

This will overcome the common problem of informing Procurement too late, which leads to the quick call to a friendly, loyal supplier with the erroneous assumption of a fair price.

Retailers, who purchase for sale, have long held Procurement in higher regard than companies procuring ingredients for products they will produce. It is the immature retail buyers who are notorious for hammering price for volume. Their more sophisticated counterparts, with a clear commitment to offensive procurement, are more creative.

Aldi, the German-based global leader in grocery retailing with more than 5000 stores across the world, has achieved a reputation for high quality products combined with low prices. It achieves this by sourcing domestically and internationally, and by making ever-increasing but not unreasonable demands on its suppliers. While the negotiations may be tough, both sides know they have a reliable business partner which will honour agreements fully.

When Executives expect creativity, depth of knowledge and profit impact from the Procurement Department, the calibre of staff will increase. Additionally, staff's motivation will increase, as will the respect they can expect and will receive internally and externally.



Using ERP to improve Procurement performance

Insight and data are the backbone of a profit-impacting Procurement Department. As such, utilizing the company's ERP system effectively is a prerequisite. A standalone procurement program can only assist in managing purchasing with greater efficiency. However, being stand-alone it lacks the mission-critical quality of integration with the rest of the company's system. This is where the real advantage of a fully integrated system lies.

Procurement requires insight into current stock holding, stock-turns and sales order information so that a metric-like time-to-delivery can become a strategic procurement tool. Integration with SYSPRO's Inventory Management and Sales Order modules provides crucial support to the Procurement Department in its role in the supply chain and customer service. The insights into sales patterns, cash flow, product cycles and other information available through the ERP system further enhance the profit-impacting potential of Procurement.

With the heavy dependency of Procurement success resting on knowledge and information, SYSPRO Analytics has a valuable role to play. The ease of configuration of this program allows data to be customized to meet the needs of the department. Its ease of use makes the information it produces accessible at all levels.

Profit contribution-driven departments have utilized internal information in numerous, widely different, and locally relevant ways. The potential value that lies within the ERP system is limited only by the creativity of the Procurement Department.

In the quest for rapid profit improvement that is sustainable, your Procurement Department is a promising arena. There is money to be made immediately by giving careful consideration to this Bermuda Triangle.

About SYSPRO

SYSPRO software is an award-winning, best-of-breed Enterprise Resource Planning (ERP) software solution for cost-effective on-premise and cloud-based utilization. Industry analysts rank SYSPRO software among the finest, best-in-class enterprise resource planning solutions in the world. SYSPRO software's powerful features, simplicity of use, scalability, information visibility, analytic/reporting capabilities, business process and rapid deployment methodology are unmatched in its sector.

Formed in 1978, SYSPRO has earned the trust of thousands of companies globally. SYSPRO's ability to grow with its customers and its adherence to developing technology based on the needs of customers is why SYSPRO enjoys one of the highest customer retention rates in the industry.



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