

Procurement

SUCCESSING WITH NEW PROCUREMENT STRATEGIES

AN SAP® SURVEY CONDUCTED WITH THE
PROCUREMENT LEADERS NETWORK



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HOW PROCUREMENT HELPS ORGANIZATIONS STAY ON COURSE

IN A TOUGH ECONOMIC CLIMATE

Overview

Recent economic conditions require immediate, measurable, and sustainable cost reductions, and it's essential that procurement lead the way in delivering savings. The research presented here, conducted by SAP in conjunction with the Procurement Leaders Network, examines this issue. In a survey taken in April-May 2009, we asked over 200 procurement executives about what strategies are working today, in a period of economic free fall.

In these uncertain times, leading companies are not only getting back to procurement basics via online auctions and RFX events, they are also engineering innovative strategies to achieve corporate goals. But how?

First and foremost, organizations are enacting stricter guidelines regarding cost management. Beyond its outward face when interacting with suppliers, procurement must also sell within the organization to expand its influence. Gaining oversight of an increasing number of spend categories leads to more

control over maverick spending. The end result is the realization of savings already negotiated.

In addition, mitigating supplier risk is a topmost concern, with many organizations renegotiating contracts, enacting supplier performance management programs, consolidating their supplier base, and even aiding at-risk suppliers to minimize supply chain disruptions. Successful companies are partnering with key suppliers to enact joint planning programs that find a common ground without squeezing the supplier.

Interestingly, although organizations are focused on cost-cutting measures, the topic of sustainability continues to be a priority. Companies are not reducing their existing sustainability measures – they continue to source ethical suppliers, develop environmentally friendly products and packaging, and strive to lessen

the carbon footprint from transportation emissions. Green is here to stay.

Where does technology fit into this new world order? Organizations are continuing to invest in technologies to better drive cost savings and value. Spend analysis, benchmarking analysis, and e-sourcing applications are considered to be most valuable in this economic climate. In addition, organizations are increasingly utilizing on-demand solutions, which are deemed to deliver quick time to value.

More and more, companies are relying on procurement to help them stay on course. In response, procurement is rising to the challenge and fulfilling corporate goals. How the economic downturn will affect procurement in the long term remains to be seen. What we know is that the organizations are succeeding with new procurement strategies today.

Procurement departments are going back to basics, working out how to reduce costs and better manage their spend.

About the Survey

This analysis is based on over 200 survey responses from global procurement leaders and professionals, collected in April–May 2009. Of respondents, 90% named procurement as one of their core responsibilities, 26.5% included supply chain management as a core responsibility, and 11% included logistics. The responses cover all industry sectors, with 63% coming from companies with annual sales in excess of €1 billion. Top industries participating in the survey included industrial manufacturing (19.4%), banking and financial services (9.26%), oil and chemicals (8.8%), and pharmaceuticals (8.8%).

Cost Savings and Spend Management Is a Primary Focus in a Recession

Cost reduction is the number one objective for procurement professionals during this time of economic recession. The results of this survey reveal that procurement departments are going back to basics, working out how to reduce costs and better manage their supply chain spend. For example, in response to the question of how certain procurement development processes have been affected by the economy, 80% of respondents noted an increased focus on spend management initiatives and a reduction in maverick spend.

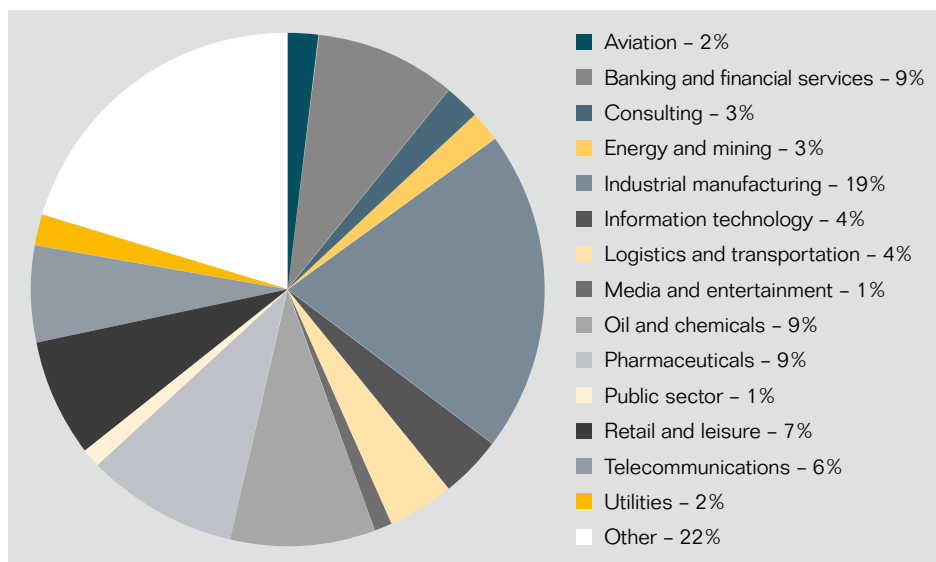


Figure 1: Survey Respondents by Sector

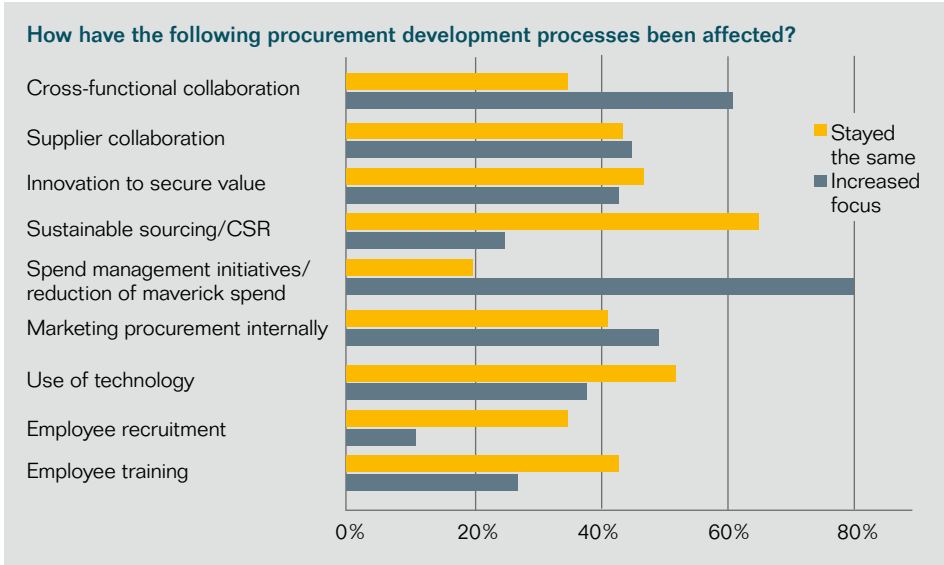


Figure 2: Economic Effect on Procurement Development Processes

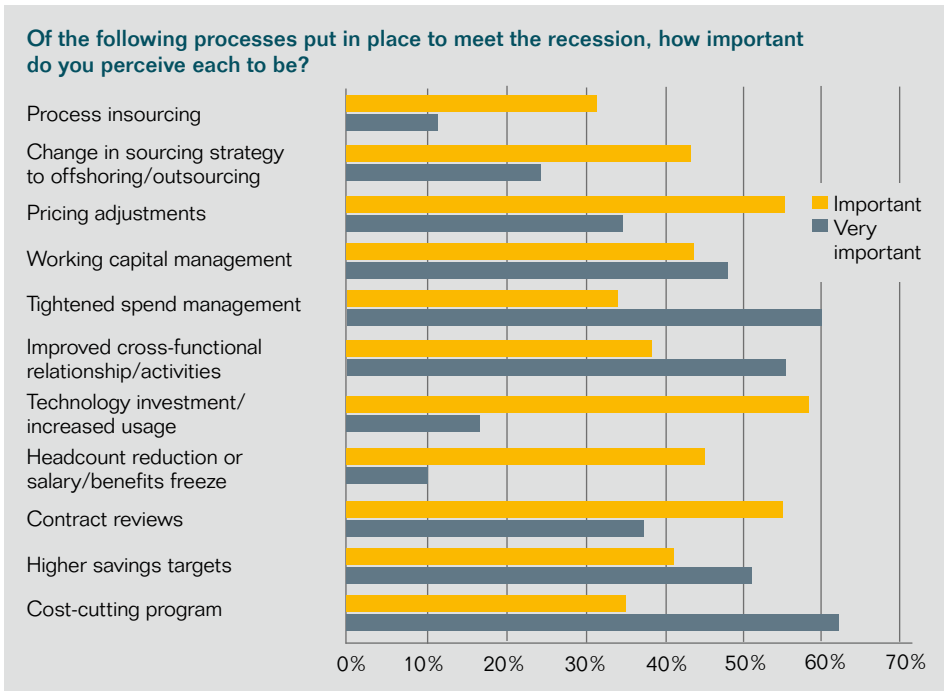


Figure 3: Importance of Processes Undertaken to Deal with the Recession

Correspondingly, the vast majority of respondents (97.3%) perceived cost-cutting programs to be either very important or important in terms of processes put in place to meet the recession. Likewise, the introduction of higher savings targets was rated extremely highly, as were pricing adjustments.

Twenty-six percent of respondents said that they have already enacted tighter controls to limit local spend and inefficiencies, and another 54% reported being in the process of doing so. Similarly, almost 30% responded they had already increased their focus on indirect spend, while 53.7% of respondents said they are currently doing so.

Cost Cutting Is a Long-Term Trend

Contrary to some expectations, however, our survey shows that most procurement professionals have been prioritizing cost-cutting and savings targets for several years now. For example, 64.7% of respondents from the banking and financial services industries named cost-cutting programs as their top procurement priority. Higher savings targets and contract reviews were named as the second-highest priorities, by 47% and 29.4% of the respondents respectively.

These responses do not differ substantially from those given to the question "What were your procurement priorities before the economic downturn?" In response to this, 41.2% of respondents in banking and financial services named cost-cutting programs as their number one priority, followed by contract reviews and higher savings targets.

In comparison, greater than 70.6% of respondents from the pharmaceuticals industry identified cost-cutting programs as their highest procurement priority right now. Of pharmaceutical respondents, 47% named higher savings targets as their second-highest priority at the moment. Before the economic downturn, the overriding procurement priority of the pharmaceutical respondents was still cost-cutting targets (64.7%), followed by higher savings targets (23.5%). This is a substantial increase for both metrics: cost cutting went up approximately 10% and higher savings targets doubled.

Companies Identify the Best Ways of Saving Money

Over the past 12 months, 57.7% of respondents named the low-hanging fruit of reductions in travel budgets as being the most effective way to drive cost savings. This was followed by working capital optimization (48.1%), demand management (44.9%), and low-cost country sourcing (41.7%). The most ineffective cost-saving initiative that was implemented in the last 12 months was the restriction of individual technology. Answering a survey question on areas in which they were being more innovative due to the recession, over 58% of respondents mentioned the area

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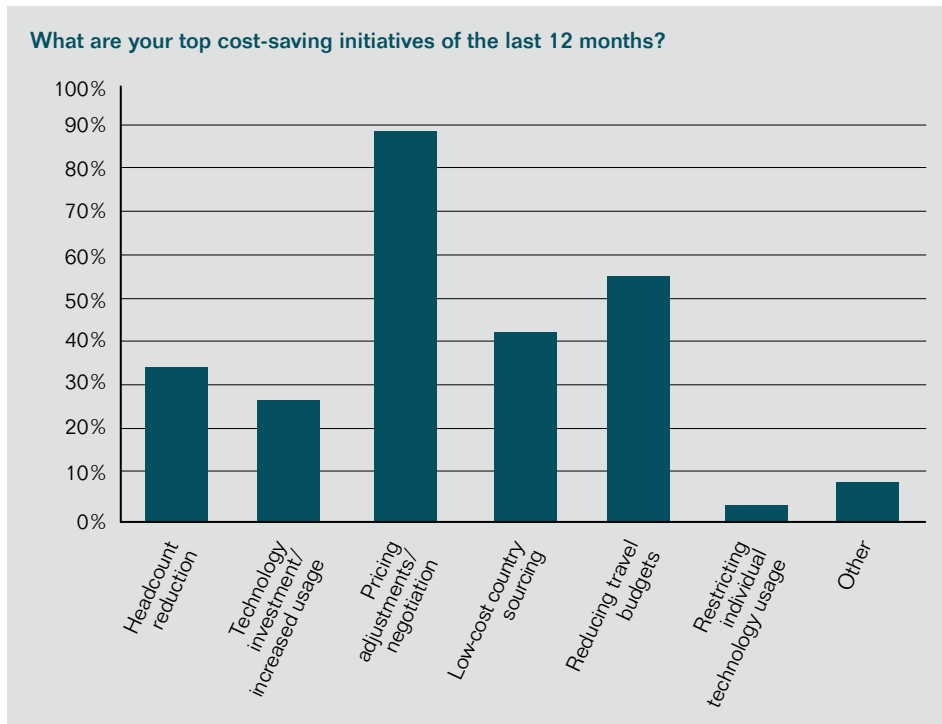


Figure 4: Top Cost-Saving Initiatives in Terms of Usage

of cost savings. Examples of strategies used include a greater focus on demand and specification management, improved visibility and control over transportation and logistics costs, more make-versus-buy analyses, and increased use of alliances with key suppliers.

Interestingly, the jury is out on whether headcount reductions or freezes in salary and benefits are worthwhile. Further cross-analysis of the results shows that the higher up the ranks you go, the more importance is placed on headcount reduction and salary/benefit freezes. This can be attributed to the fact that the higher-ranking executives who are making these types of decisions enjoy a greater sense of job security.

The area to have suffered the most as a result of the recession is clearly employee recruitment: 54% of respondents admitted that there is currently a decreased focus on this.

Cash Must Be Effectively Managed as well as Saved

Companies are not just focusing on saving cash right now, they are also paying more attention to how they manage it. Working capital optimization – processes such as collaborating with suppliers to improve payment terms with the ultimate aim of improving cash flow – was named by almost 50% of respondents as the most effective cost-saving initiative that has already been

put into place over the last 12 months. Over 90% of respondents also rated working capital management as being either very important or important as a process put in place to meet the recession.

In the industrial manufacturing industry, 64% rated working capital optimization particularly high as an effective cost-saving initiative.

Teamwork Is Important

The economy has shifted the importance of certain procurement development processes. For example, cross-functional collaboration was highlighted by over 60% of respondents as an area of increased focus. Typically, the most successful organizations rate interdepartmental communication and collaboration as an area of best practice, so it is unsurprising that more companies are focusing on this as they seek to become more efficient. Improved cross-functional relationships and activities were also named by 93.6% of respondents as being very important or important as processes that have been put in place to meet the recession. However, respondents believed there is much more scope for expanding cross-functional collaboration in the future, with 68.4% seeing potential for it to grow even beyond the current economic crisis.

External collaboration is also growing in importance: 46.5% of respondents noted an increased focus on collaboration with suppliers because of the recession.

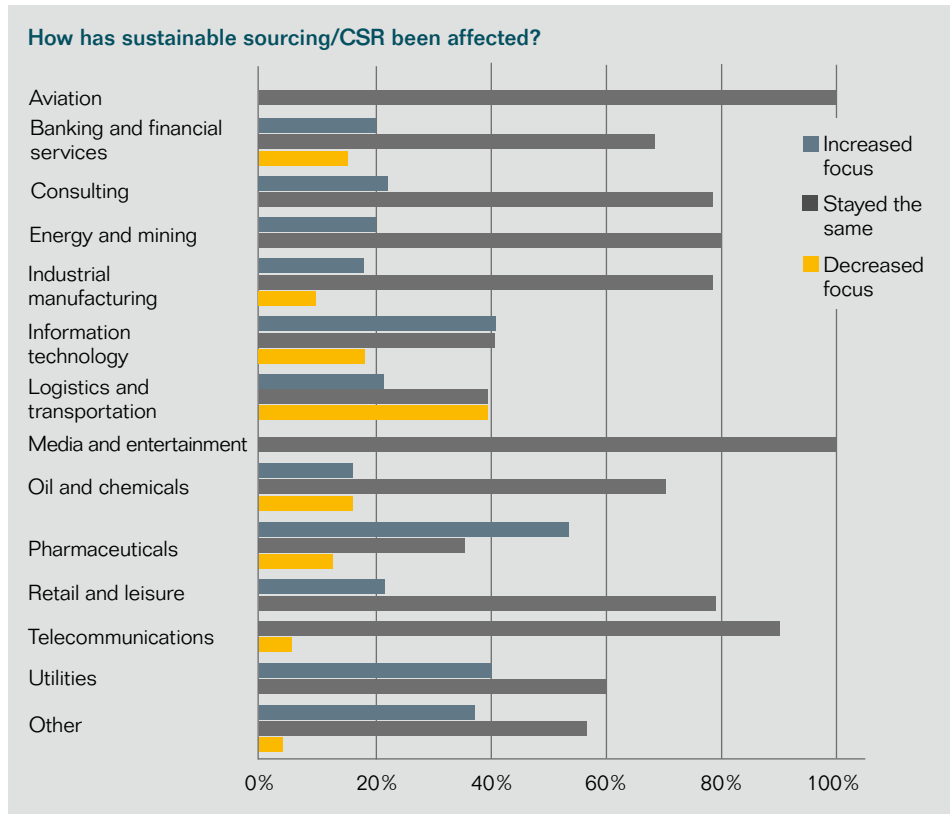


Figure 5: The Recession's Effect on Sustainability and Corporate Social Responsibility

Corporate Social Responsibility Still Holds Value

Companies are staying green. Almost one-quarter of respondents said there has been an increased focus on sustainable sourcing and corporate social responsibility (CSR) as a result of the recession. This is surprising because many would regard sustainability issues and CSR practices, such as ethical sourcing and increased governance, as luxuries to be focused on when business

is booming. The continued focus on sustainability is most likely because many companies that have invested heavily in this area are reluctant to undo their good work. Furthermore, the fact that the recession appears to have actually increased the focus on sustainability in nearly 25% of the responding companies could be due to the longer-term cost savings that many sustainable plans promise. More than 65% of respondents said that sustainable sourcing and CSR within procurement had stayed the same,

despite the uncertain economy, and only 9.7% said there was a decreased focus on it now.

A handful of industries, notably pharmaceuticals (at 47%) and IT (at 43%), have increased their focus on sustainable sourcing/CSR as a result of the recession. However, one industry in particular – logistics and transportation – has backed away from this area of procurement (38%). Ironically, it is exactly in the area of logistics and transportation that the most impressive sustainability savings can often be found, especially with regard to environmental and carbon emissions savings.

Suppliers Have No Place to Hide

Our findings highlight that there is no place for complacency among suppliers in a recession. Over 95% of respondents rated contract review as being either very important or important as a process put in place to respond to the recession and the increased focus on cost savings. Over one-fifth of respondents said that they had already renegotiated their contracts as a way of mitigating risk in their sourcing strategies, with another 69% saying that they are in the process of doing so. A very small percentage (2.6%) of respondents reported they had no plans to renegotiate any contracts.

Our findings also show that those suppliers that manage to keep their contracts must prove their worth to clients. Seventeen percent of respondents have already implemented supplier

performance programs, and another 62% are in the process of doing so. Sixty-nine percent of respondents report that they see opportunities for procurement to expand in the area of supplier performance management in the future.

Correspondingly, the focus on technology in this area – such as with supplier scorecards and performance management tools – has grown considerably. Less than 20% of respondents said, looking back, that they were focused on this area of technology in 2007, but the response grew to almost 50% in 2009. Similarly, less than 15% of respondents rated supplier scorecard and performance management tools as providing the most value in 2007, but by 2009 the number rating them as top-value solutions had risen to 46.3%.

Over 95% of respondents rated contract review as being either very important or important as a process put in place to respond to the recession and the increased focus on cost savings.

In a further example of more vigilant supplier management, procurement departments are conducting more in-person visits to their suppliers as a way of mitigating risk in their sourcing strategies. Over 75% of respondents said they have already started visiting suppliers or are in the process of organizing such visits.

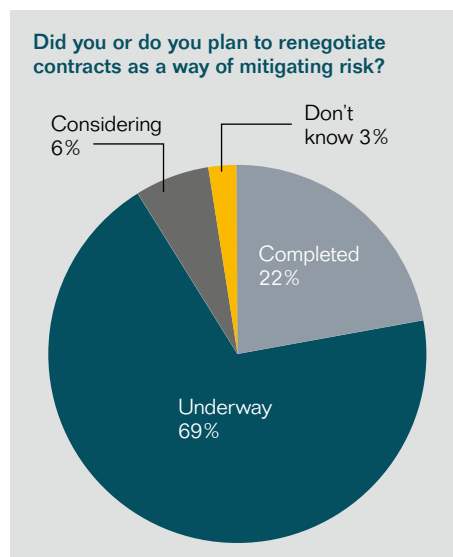


Figure 6: Renegotiating Contracts to Mitigate Risk

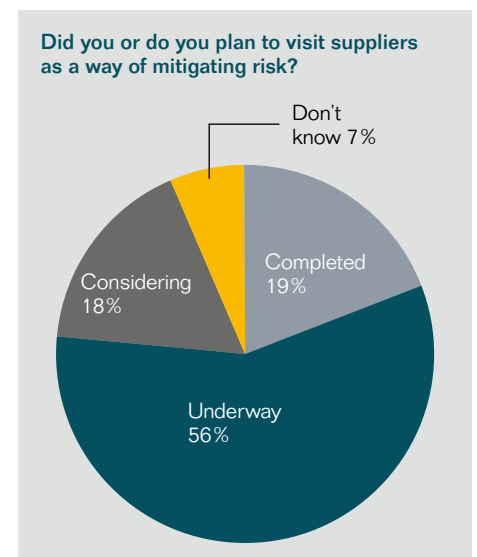


Figure 7: Visiting Suppliers to Mitigate Risk

Going forward, do you expect your supplier base to increase, stay the same, or decrease, and by how much?

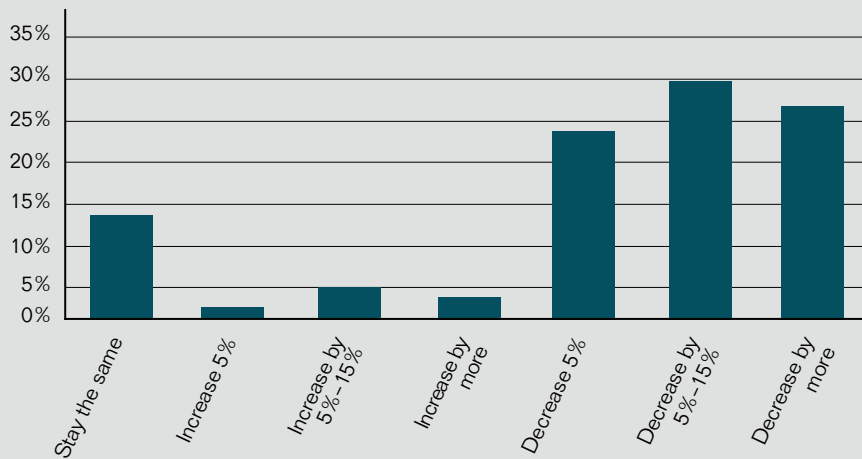


Figure 8: Overall Expectations for Future Size of Supplier Base

Looking forward, do you expect your supplier base to increase, stay the same, or decrease?

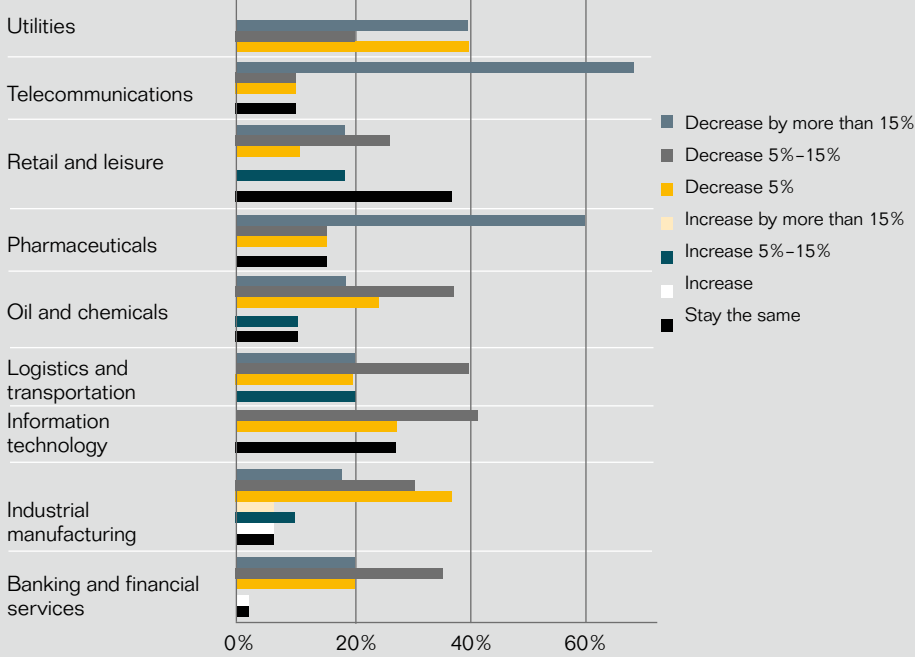


Figure 9: Industry Expectations for Future Size of Supplier Base

Supplier Bases Are Shrinking

The news for suppliers gets worse: looking forward, over three-quarters of respondents foresaw a decrease in their supplier base, with over one-quarter predicting a decrease of more than 15% in their future supplier bases. Less than 7.5% believed that their supplier bases will increase in the future.

The telecommunication, utility, and pharmaceutical industries are clearly anticipating a greater reduction in the number of suppliers they use in the future. Between 40% and 67% of respondents in those industries predicted that their future supplier bases will shrink by more than 15%.

Although the majority of procurement professionals predicted a decrease in their supply base in coming years, most also saw an increase in global supplier contracts. Of the respondents, 15.8% have already changed their strategy to include an increase in global supplier contracts to meet the structural shift in the global economy, and over 50% have such a strategy underway.

Regarding low-cost country sourcing (LCCS), 17.5% of respondents said that they have already used this strategy to mitigate risk related to sourcing, and a further 35% are in the process of implementing such a strategy. Over 40% of respondents named LCCS as one of their top cost-saving initiatives over the last 12 months, ranking it higher than headcount reduction, outsourcing/offshoring, or introducing spend limits.

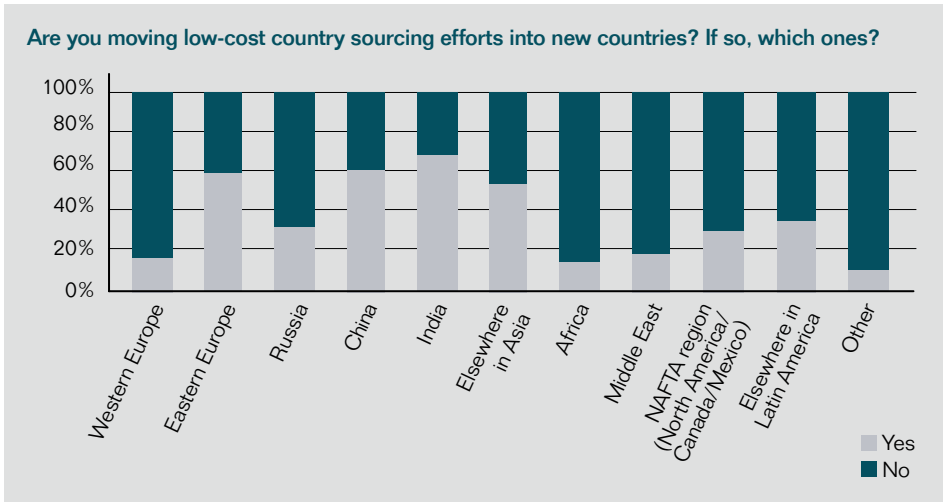


Figure 10: Where Companies Moving into Low-Cost Country Sourcing Are Headed

Over 40% of respondents named low-cost country sourcing as one of their top cost-saving initiatives over the last 12 months, ranking it higher than headcount reduction, outsourcing/offshoring, or introducing spend limits.

India is the most popular target for LCCS; it was included as a location for 69% of those who reported moving their sourcing efforts into new countries. The second most popular location is Eastern Europe (60.7%), then China (60%), followed by other Asian countries (54.7%). Russia is surprisingly low on this list, with a whopping 72% reporting they are not moving sourcing to this location.

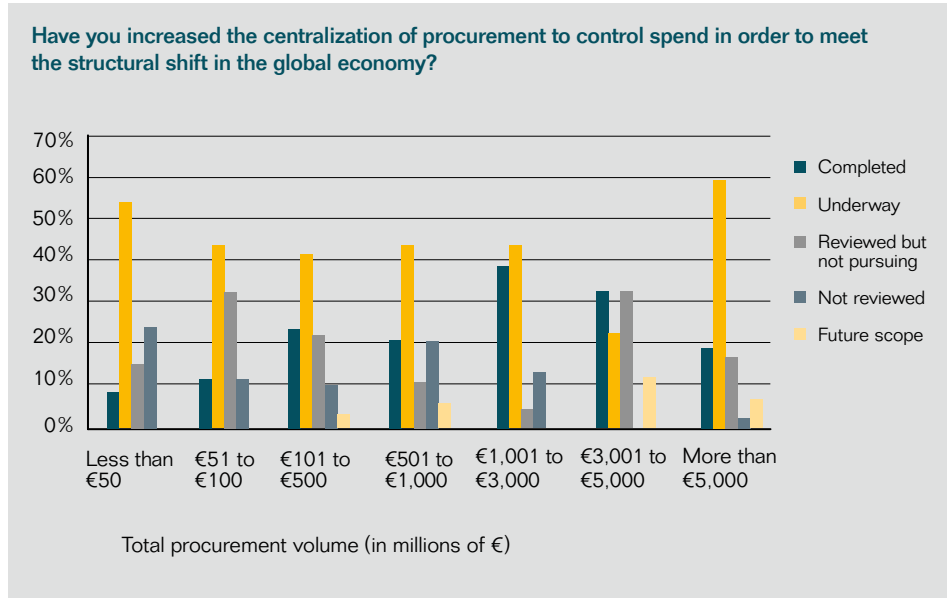


Figure 11: Increased Procurement Centralization (by Company Procurement Volume)

Centralization Allows More Control

Procurement is becoming increasingly centralized as companies seek out ways in which they can better control their costs. Almost half of the respondents are in the process of increasing centralization of procurement to control spend, and almost one-quarter has already completed this step.

As the global economy shifts, large companies (those with a total procurement volume of €1,000 million to €5,000 million) have moved quickly to centralize procurement as a way of controlling spend. In comparison, only 7.7% of companies with volume less than €50 million and 11.1% of those with volume of €51 million to €100 million have already completed this increased centralization.

Outsourcing and Offshoring Have Also Grown in Popularity

It is worth noting that although the strategy of centralization is becoming more popular as companies seek to gain more control of their costs, so are the processes of outsourcing and offshoring, as companies are willing to forgo a certain level of control in return for guaranteed reduced costs. To meet the challenges of the recession, 40% of respondents said that they outsource more business processes now than they did two years ago, and 65.6% rated a change in sourcing strategy to offshoring or outsourcing as either very important or important. Interestingly, higher-ranking executives (CEOs and COOs) appeared to place more importance on offshoring and outsourcing as strategies than their colleagues in lower management positions.

It is no surprise that the greatest amount of activity in this area is in offshoring to low-cost countries. Of the respondents, 15.5% said they had already changed their strategy to include this as a way of meeting the structural shift in the global economy, and another 41% reported

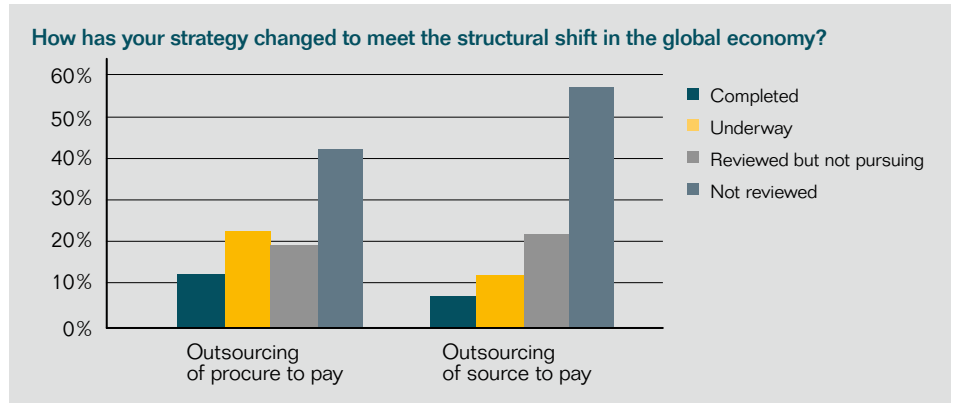


Figure 12: Changes in Outsourcing Strategies

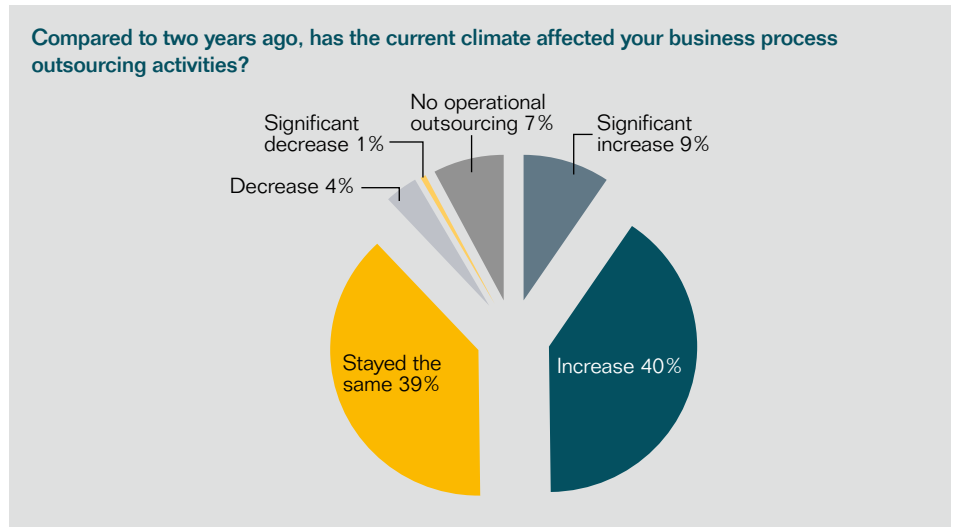


Figure 13: Changes in BPO Activities Due to the Economy

being in the process of changing it. The procurement outsourcing of procure to pay is more popular than the procurement outsourcing of source to pay.

With regard specifically to business process outsourcing (BPO), the situation is mixed. Almost 10% of respondents reported a significant increase in their

BPO activities compared to two years ago because of the current climate, and 40.1% of respondents noted an increase. Nearly the same proportion – 38.9% – said their BPO activities had remained the same in the current climate, leaving only 4% who said that their BPO activities had actually decreased as a result of the economy.

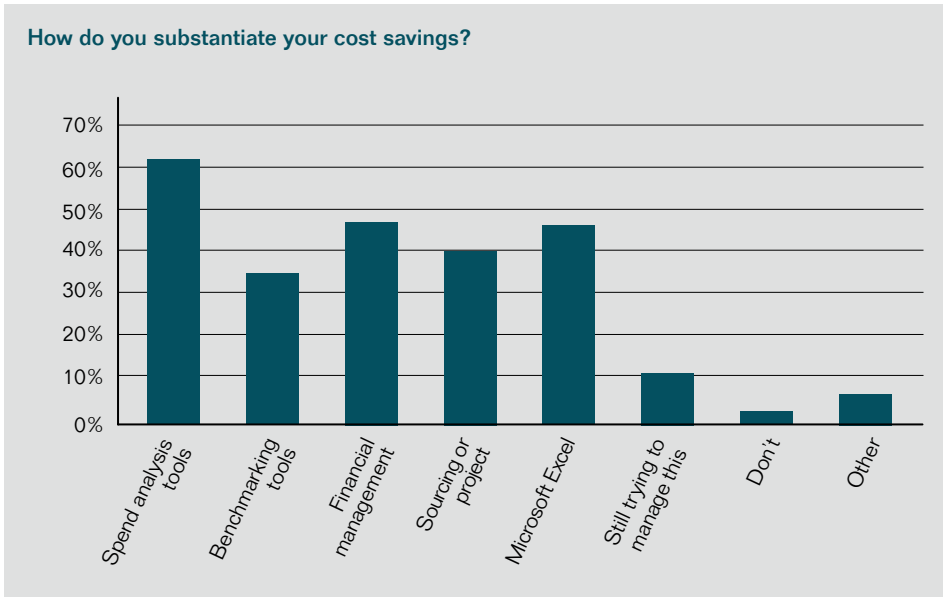


Figure 14: What Companies Use to Substantiate Cost Savings

Technology Is King

The benefits of the use of technology within procurement processes are increasingly appreciated. Almost 40% of respondents reported an increased focus on the use of technology within procurement development processes because of the recession, and 42.6% noted an increased focus on the use of innovation to secure value.

Breaking this down further, of those companies with annual sales of less than €100 million, 63.6% said there was an increased focus on technology. This compares to 29.7% for companies with sales of more than €10,000 million and 37% for companies with annual sales of between €5,000 million and €10,000 million.

Likewise, 76% rated investment in technology or increased use of technology as important or very important in terms of processes put in place to meet the recession. Not only is functionality being assessed, but also deployment models. For example, 40% of respondents reported that they have already increased or are in the process of increasing the use of on-demand technologies to meet the current structural shifts in the global economy. Over one-quarter (27.6%) named investment in

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or increased use of technology as a top cost-saving initiative of the past 12 months, and only 2.6% named the restriction of individual technology usage as a top cost-saving initiative.

Those respondents who agreed that the downturn has spurred an uptake in software as a service and on-demand solutions rate the time-to-savings factor – the speed of deployment and implementation – as their most appealing feature, followed by the improved flexibility.

The use of e-tools is also increasing as procurement departments seek to mitigate risk in their sourcing strategies. Over one-quarter of respondents reported they have already started using e-tools, 40% are in the process of setting them up, and 20% are considering doing so. The majority of respondents also rely on a single or a combination of specific tools to substantiate cost savings: 60.1% use spend analysis tools, 46.8% use financial management tools, 34.2% use benchmarking tools, and 39.9% use sourcing or project management tools.

Procurement departments' technology focus has changed over time. Looking back, respondents reported that in 2007, the most focus, 33%, was on

On which technology were/are you most focused?

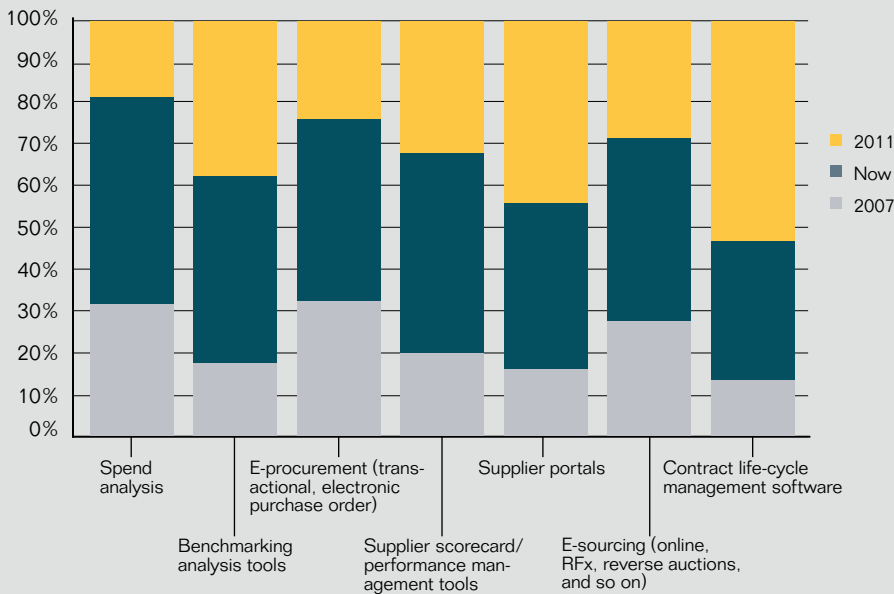


Figure 15: Technologies on Which Companies Are Most Focused

Which technology solution provides the most value?

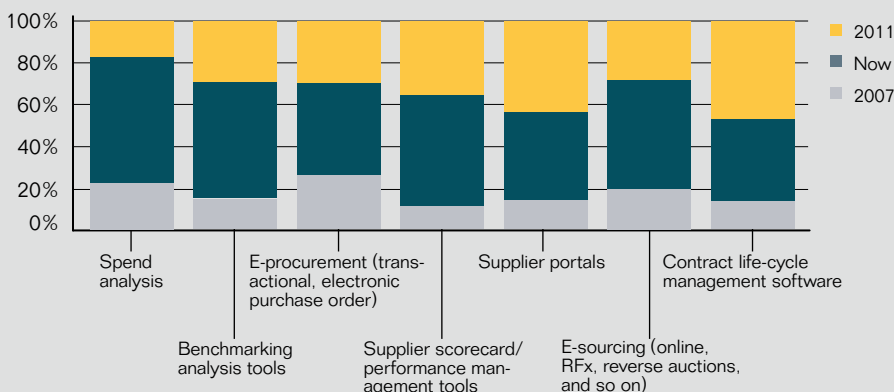


Figure 16: Technology Solutions That Provide Most Value

e-procurement (transactional and electronic purchase orders), followed by e-sourcing (online, RFX, reverse auctions, and so on) at 28.3%. By 2009, the technology focus has shifted, with almost half of respondents (49.1%) saying that they concentrate most on spend analysis, closely followed by supplier scorecard and performance management tools (48.6%). By 2011, the focus is seen shifting again, with over half of respondents (51.22%) foreseeing the spotlight on contract life-cycle management software and supplier portals.

Since the economic downturn, there has been a shift in which technology solutions provide the most value. Looking back, respondents reported that in 2007, this was almost evenly split between spend analysis (24%), e-procurement (23.7%), and e-sourcing (21%). However, things changed in 2009. Over half of respondents (56.2%) said that spend analysis technology solutions now provide among the best value, followed by benchmarking analysis tools (51.7%) and e-sourcing (49.6%). Looking ahead to 2011, approximately 45% of respondents believed that supplier portals and contract life-cycle management software will provide the most value and will be an area of increased focus.

CONCLUSION

CHALLENGES AND OPPORTUNITIES

Eighteen months into one of the worst global recessions in recent history, it's no surprise that procurement executives are getting back to basics to tackle the economic decline.

Spend Management

Many global executives see that success in today's changing economy requires applying renewed vigor to spend management and reducing maverick spend, as well as working more closely with other functions across the business.

However, one respondent, a chief purchasing officer (CPO), was clear about the risks associated with a myopic obsession with cost. "By focusing on the continuation of our procurement strategy, we are already ahead of our competition by having world-class procurement leaders driving and focusing on the right things," he said. "It is important in recessionary times, as you see the major benefit and expertise of a long-term strategy and not always focusing on cost. Value is the key."

The range of strategies adopted to tackle a challenging economy range from increased centralization to an increase in local sourcing – evidence that different companies and industries are being affected in different ways. But by far the biggest area where procurement professionals see potential is in indirect spend. Almost 30% of respondents said that they had completed a

strategy to put an increased emphasis on indirect categories; with a further 54% saying that such a strategy was underway.

Other popular strategies include taking another look at the balance of centralization compared to decentralization; the establishment of global centers of excellence, either by category or process; tighter control to limit spend inefficiencies; and a renewed focus on risk management.

Risk

According to this research, increasing spend visibility is the biggest single strategy to mitigate risk in procurement and the supply chain. As one CPO respondent said, "Meeting with suppliers [gives us] a better understanding of their elements of cost – cost-reduction philosophies must be implemented throughout the supply chain, not just at the top level."

Seventy-six percent of respondents rated investment in technology or increased use of technology as important or very important in terms of processes put in place to meet the recession. Not only is functionality being assessed, but also deployment models. For example, 40% of respondents reported that they have already increased or are in the process of increasing the use of on-demand solutions to meet the current structural shifts in the global economy.

Two strategies also proving popular are financial health auditing and revenue/risk sharing. These are both examples of more strategic approaches to addressing supply chain and procurement risk.

Supplier Consolidation

An indication of the risk of supplier failure can be seen in procurement executives' responses to whether they expect their supplier base to increase, decrease, or stay the same. Perhaps not surprisingly, more than three-quarters of respondents expect their supplier base to contract, with a further 12% expecting it to stay the same – evidence of both supplier failure and intentional supplier consolidation strategies.

Technology

The increased focus on spend analysis has resulted in investment in spend analysis systems. When asked which technology systems currently provide

the most value, respondents put spend analysis on top. Moving forward, however, respondents saw potential in both e-sourcing, supplier scorecard, and performance management tools.

One respondent said, "We have implemented an e-sourcing tool and started using reverse auctions to increase savings. We have also included finance as a team member on our projects, so they can extract our savings from the budget so there is no savings creep on our projects, and implemented a preferred supplier program to drive compliance through our enterprise resource planning system."

Measuring Success

You can enact change and save 10% – but if that 10% pales into insignificance against your competitors, in real terms your organization is going backward. To this end, respondents generally have well-advanced benchmarking processes in place, with cost savings, return on investment, and cost avoidance being three most-popular benchmarked measures of success.

Happily, the challenges that are clearly on the table for procurement professionals during these uncertain times also lead to opportunity. Talent attraction is one area that will certainly im-

prove following an increased focus on the benefits of procurement. Procurement executives will be able to expand their remit and improve their standing in the organization in terms of board-level exposure and cross-functional collaboration.

Find Out More

To learn more about how SAP can help optimize your organization's procurement strategies, please contact your SAP representative or visit us on the Web at www.sap.com/srm.

About the Procurement Leaders Network

The Procurement Leaders Network is an international membership-led community focused exclusively for executive-level procurement, sourcing, and supply chain management professionals. The network acts as a catalyst to spearhead innovation, leadership, and strategy and has been developed in support of its members' growing global remit. It delivers high-quality insight and perspective on today's most critical corporate issues, while providing members with new ideas, approaches, and strategies to meet their current and future business challenges. For more information or to become a member, please visit www.procurementleaders.com.

PROCUREMENT LEADERS
THE EXECUTIVE NETWORK

An SAP survey conducted in association with the Procurement Leaders Network

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