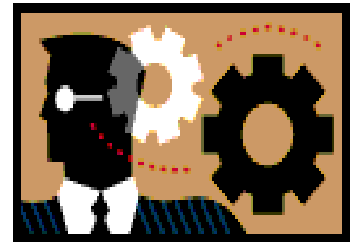




## Tips & advice for purchasing professionals

**Welcome to Transform**, the source for comment, news and information for organizations and procurement professionals whose goal is increased added value and improved corporate performance through effective management of procurement and the supply chain.



## Indirect Services Spend Management (ISSM) presents its own unique challenges but can deliver big rewards

A guide for CEO's, CFO's and CPO's on how procurement leaders are realizing significant benefits from their services spend

**What's in it for you?** Discover how a strategic approach to sourcing services can deliver cost savings, increased value from suppliers and your own resources.

Reading time: 10 minutes

### Introduction:



The services supply chain is in the spotlight at leading companies around the globe as these companies look to transform indirect spend management. By viewing services from a more strategic view point and applying more rigorous sourcing processes, companies can drive significant cost savings and improved performance.

Indirect Spend on Services is a significant, growing spend area with large, untapped opportunities in many organizations. This is because in today's ultra competitive environment companies are increasingly adopting strategies that, increases their dependence on external service providers. I.e.:

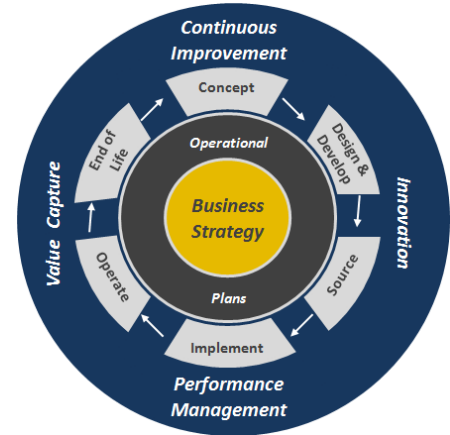
- Focus on core competencies and outsource or eliminate the rest
- Buy, don't build; Source, don't own etc



Outsourcing creates an 'extended enterprise' and in doing so sourcing success can create access to vast talent networks. In such an environment organizations must make sourcing a core competency to compete and even survive at the highest level!

Sourcing and purchasing services however, present unique challenges because they're often intangible, complex, fragmented throughout the organization and can often be typified by certain characteristics:

- Based on relationships rather than hard analysis.
- Lack of detailed specifications from informed stakeholders.
- Complex contracts and rate structures.
- Different perceptions of quality.
- Difficulty monitoring service delivery.
- Services are not returnable.



**Fig 1 – Services Lifecycle**

To generating value through all the stages of the 'services lifecycle' (See fig 1) to drive continuous improvement, procurement leaders have distinguished themselves in five key areas; organizational structure, processes, knowledge and data management, technology integration and performance management.

### **Indirect Services Spend Management (ISSM) – The Opportunity**

CAPS reported, annual corporate spend on third party services averaged 30%, and was as high as 98% in some industries. Aberdeen Group reports that companies that have implemented some form of services spend management are seeing noteworthy cost reductions in outsourced service areas such as travel (3 – 15% reduction), contract labour (3 – 27% reduction) and telecom (19 – 26% reduction). These figures fit with Purchasing Practices own experience of savings between 5 – 35%.

Leveraging the specialized skill sets of services suppliers therefore has become a key priority for procurement leaders to create sustainable competitive advantage.

### **Service Delivery and 'Passive Helplessness'**

Many companies still have no effective processes in place to track supplier performance. Suppliers that perform poorly on one project often continue to sell their services elsewhere in the company. Some managers continue to go back to the same suppliers again and again, simply because they see nowhere



else to go and preferring “the devil they know”. Such ‘passive helplessness’ only serves to close off opportunities to improve efficiencies, cut cost and condones poor performance.

## **Risk Exposure**

Intellectual property, privacy, contract labour, compliance laws, etc all has the potential to create significant risks for businesses and executives. Physical security is also important; contractors’ access to company facilities must be controlled and managed within the contract and service level agreement.

Procurement leaders therefore are addressing ISSM which is already driving the next wave of procurement transformation in many organizations.

## **The second wave**

The complexity of services compared to goods and their historically lower spend has meant they have not generally been part of most companies first wave of procurement transformation, but with competition and pressures to reduce cost intensifying, companies are increasingly bundling their offerings as services in an attempt to avoid ‘commoditization’ of their marketplace:

- Print management not print
- Document management not photocopiers
- Outsourced IT not PC’s, servers and networks

This trend toward outsourcing is further evidence that companies are relying more and more on external service providers, resulting in more and more companies focusing their spend management activities on service categories such as:

- Meetings, Travel & Events management
- IT & Telecommunications
- Knowledge based services such as Legal, Consulting, Publishing & Market Research
- Marketing & Advertising
- Printing
- Facilities management – janitorial, waste management etc
- HR services – relocation services, benefits etc
- Engineering – plant maintenance and construction, MRO parts etc

For such companies ISSM can be a strategic differentiator in which leaders will significantly outperform laggards in the services driven wave of transformation.



## In search of value

Whilst savings are certainly a primary goal for the indirect services spend, they're not necessarily the key driver. Increasingly, CEOs and CFOs are questioning the "value" they're getting in areas such as marketing, advertising, legal, and the human resources benefits spend, and they're looking to procurement for answers. For example, when sourcing employee benefits, simply cutting costs could affect the value of the benefits to employees. Similarly, mishandling marketing and advertising, can inflict damage to the brand. However, even with the emphasis on value, procurement leaders are notching up big savings by applying proven procurement skills to the services sector.

## Sourcing Management for Complex Services

A strong desire for local or functional control of services creates significant resistance to standardization and automation among managers who fear their unique needs will be overlooked. This has prompted many companies to push the services spend decision making down to the functional level. This desire for 'local control' is the primary driver of maverick services spending. However, functional decision makers tend to be risk averse, which often derails sourcing initiatives as they place a high premium on trusted established relationships. They consider a 'company-wide' solution to be a risk; it

### ISSM Best Practice:

#### Develop an organization-wide ISSM strategy:

##### Spend analysis and base lining:

- Analyse spend and market data for key services
- Group into market meaningful categories
- Assess strategic and tactical service needs.
- Perform gap analysis of internal resources, core competencies and service capabilities.

##### Organization and governance model:

- Define organizational structure, executive sponsorship and process governance
- Develop criteria to determine when to source or not outsource services.
- Define processes to engage external service providers.
- Engage internal customers so they understand and buy in to the opportunity
- Clearly assign ownership for service chain and ISSM components.

##### Category Management & Strategic Sourcing:

- Define company goals & objectives.
- Develop category strategy
- Review existing service relationships.
- Launch strategic sourcing program
- Build and enhance preferred supplier programs.
- Develop multi-level supplier relationships
- Introduce demand management

##### Technology:

- Evaluate options and identify system requirements for short-term and long-term implementation.

##### Performance Management:

- Via detailed statement of work, a master service agreement, and a service level agreement.
- Develop performance criteria based upon continuous improvement and innovation
- Criteria should cover service availability and performance level and be linked to payment
- Incorporate risk/reward incentives
- Track compliance



may help the company but would adversely affect supplier relationships or cause disruptions at the local level. So why not just maintain the status quo? Well unfortunately, this behaviour results in a lack of sourcing depth (skills shortages), lack of company knowledge of the marketplace and over-reliance on one or a few suppliers. In the long run this outcome *'actually increase risk'* associated with sourcing those services.

Increasingly, with economic forces impacting the supply and demand balance for skills, organisations must work to become the 'customer of choice'. To achieve this status, companies need to refocus their efforts on defining requirements, measuring performance, and regularly 'market-testing' to ensure that suppliers continue to provide the best value available.

When procurement takes place at the local level, sourcing efforts cannot capture the benefits of volume concentration or make the most efficient use of internal resources, and there is little integrated planning with suppliers. This fragmentation and lack of standardized work practices results in a failure to capture companywide performance metrics, process efficiencies and economies of scale.

### **Project Approach**

A common tactic is developing project based standards and methodologies incorporating an RFP process. This typically goes some way to generating competition for services and can result in a fixed price for completion of the project. The problem with this approach is that fixed price contracts have embedded risk that often offset the price certainty, which favours the seller over time.

Because suppliers must bid on an already created project plan input at best by a favoured incumbent supplier, both buyer and competing suppliers often overlook mutually beneficial productivity and performance improvement or innovation opportunities. In other words, suppliers make assumptions about labour cost and productivity and then add a contingency to protect them from the unknown risk. Meanwhile, the buyer loses the opportunity to refine the project scope, gain project efficiencies and reduce cost. As the project goes ahead, the successful supplier (usually the favoured incumbent) captures the benefits that result from positive performance variations and charges the buyer for changes in scope or for undisclosed conditions that impede progress. As a result most of the performance improvement benefits accrue to the seller, with few rewards for the buyer.

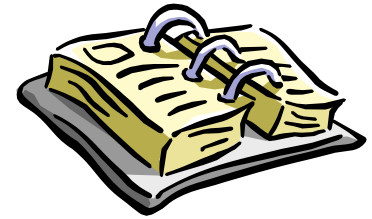
### **Time & Materials Approach**

Another common tactic is time and materials, which is often used when the project scope is undefined. In such a situation functional managers have often developed relationships with suppliers to provide services on an ongoing basis. Once decision makers find competent and trusted suppliers, little real



competitive activity takes place. Using these two approaches to source services has created significant obstacles for a more strategic approach to procurement to reduce cost.

Visit the Buying Magician blog: “10 Reasons why companies fail to control indirect services spend” <http://purchasingpractice.com/10-reasons-why-companies-fail-to-control-indirect-service-spending/>



### A More Enlightened Way

By applying a more rigorous process at a strategic level to complement their company’s wider goals, procurement leaders have achieved year on year savings of between 5 to 10% on average.

They develop a robust spend baseline and communicate this in the RFP process, this demonstrates the size of the opportunity and creates maximum leverage for competitive pricing. In none competitive environments where suppliers have been in place for years this can have a very powerful impact. When all proposals have been evaluated the buyer negotiates the optimum solution using a *total cost of ownership model*, during which they must balance the benefits from reduced mark-ups and improved productivity with the *risk* associated with the supplier selection. By negotiating key labour and material base cost buyers can gain greater visibility and control over cost whilst incorporating agreements on productivity improvements over time to drive both increased efficiency and effectiveness.

This process *evaluates risk and the supplier* against a set of criteria, and in some circumstances companies may forgo hard cost savings in favour of mitigating risk. Simply moving as much business to a firm price as possible is not always the optimum solution. Contracts with suppliers must create an environment of continuous improvement and innovation. To achieve this it must include incentives that create goal alignment between buyer and the seller and define clear expectations of year over year improvements. Finally, ongoing performance measures are critical and the buyer must ensure performance is routinely measured against these.

### Improving Indirect Services Spend Management

The [strategic sourcing process](#) establishes a solid foundation for success through clearly defining; requirements, understanding supply markets, negotiating SLAs with explicit targets, pricing model with at-risk fees, transfer process and clear management roles and responsibilities. Leading companies have learned that strategic sourcing requires strong governance, corporate sponsorship and stakeholders, and the time and effort to accurately define requirements and evaluate alternatives. It is no longer enough to reduce cost through tactical initiatives; rather a more strategic approach is needed not only to reduce cost and improve service but to sustain these gains over the long term.



**purchasingpractice**  
Corporate procurement made simple

## For More Information

Purchasing Practice Inc can work with your organization to develop a strategic procurement capability that will add value and positively affect your top and bottom line. To learn more, call 1-778-988-1052 to arrange a free consultation, or visit us at [www.purchasingpractice.com](http://www.purchasingpractice.com)

## Purchasing Practice –*Corporate Procurement made simple*

Purchasing Practice works with clients on the complexity and barriers associated with implementing world class procurement practices; enabling our clients to gain more control over their third party spend management, processes and supply chains, resulting in enhanced capability to deliver innovative cost effective solutions to their own customers.



We drive superior and sustainable financial performance through top line growth, free cash flow and margin improvement (in private sector companies), and best value and service excellence (in public sector organizations).

**We can help your organization “make change happen” in procurement. Our services include:**

**Transformation Management:** We will act as a change agent by working with you to articulate and communicate the need for change, develop an enterprise wide procurement blue print and support you through the implementation process.

**Opportunity Assessment:** By working directly with those staff responsible for committing expenditure, or managing suppliers, we will carry out a rigorous review and present our recommendations

**Sourcing Management:** Using our strategic sourcing service enables clients to realize full value from their supply base through leveraging our proven processes

**Category Management:** We work with clients to analyze spend data, define suitable categories then working on a category by category basis to deliver significant benefits

**Supplier Relationship Management:** We will carry out a rigorous review using proven tools and methodologies to present our recommendations.

**Mergers & Acquisitions:** We will work with your M&A team to carry out a rigorous review using proven tools and methodologies

**Private Equity:** Working across your portfolio of companies we will drive value from procurement across business units

Call us on 778 988 1052 or email us at [info@purchasingpractice.com](mailto:info@purchasingpractice.com) to schedule a consultation.

[www.purchasingpractice.com](http://www.purchasingpractice.com)