

## Measuring Strategic Sourcing and Procurement Maturity within Indirect Spend

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**Abstract.** Balanced scorecard is a tool used for managing and tracking performance of corporate functions. Objective, holistic Key performance Indicator (KPI) measurement and reporting helps Procurement monitor progress against strategy execution, expected deliverables, organizational maturity and demonstrate credibility to stakeholders. Measurable goals and reporting engages teams to improve performance and enables sharing successes within companies. The purpose of this paper is to present a set of KPI's to track goals and progress in Indirect Spend categories. The KPI's address procurement value, stakeholder satisfaction, supplier performance management, employees and process efficiencies. The paper also presents external benchmarks for these metrics and suggests ways for measuring these key areas. As a conclusion, practical advice will be shared for building a balanced scorecard and reporting both inside Procurement and within corporations.

**Why Measure.** Leaders understand that you get what you measure. It's critical to track and follow right type of activities to drive organizational behaviour towards defined goals. KPI's need to align with future vision and strategy to ensure teams are on path to success in day to day execution. KPI's will help Leadership understand areas of success and challenge and adjust plans based on the outcomes. KPI's are a concise way of reporting status of activities and to share success stories within the team, executives and stakeholders. Internal goal setting also becomes easier and clearer to communicate with standardized KPI's. Effective external benchmarking requires KPI's for proper engagement. Different companies use different measures, but a balanced scorecard is a convenient way to get started and will provide at least directional input on companies position within best in class practices.

**What To Measure.** Well defined KPI's should address all areas of Procurement activity holistically and globally. Typically the different areas should include: Procurement Value, Stakeholders, Operational Excellence/Process Efficiency, Supplier Performance Management and Employees. The following KPI's have been selected as examples to measure these five core areas.

**Procurement Value.** The purpose of these KPI's is to define the value added of Procurement to the corporation. These metrics can also be used to assess organizational and process maturity of Procurement function within a company.

- Savings
- Sourcing Return on Investment (ROI)
- Spend per employee
- Savings per employee
- Procurement leverage applied/managed spend
- Sourcing rigor applied/proactive engagement
- Commodity strategy maturity

Savings are typically the most critical metric to track in Procurement organizations. This KPI can be divided to three areas to increase transparency to savings: cost savings, cost avoidance and cash generation. All significant savings should be verified by Finance Department for credibility and organizations should set up processes to track projects and related savings on a monthly or quarterly basis. Savings definitions should be globally agreed and applied with concrete examples to facilitate implementation and build consistency. Different organizations measure savings in a different manner, but some general guidelines apply in defining the actual savings.

- Last year's price vs. current year price
- First bid compared to last bid (with possible multiplier)
- Average of bids vs. the lowest
- Inflation and currency fluctuation adjustments
- Previous year's market basket cost vs. current year cost
- Improvement in spend through contracts (compliance savings)

Cost avoidance could be measured through documented cost increase mitigation or payment term improvements. Cash generation could be measured through incoming cash after fee or book value deductions. Managed spend is typically spend that Procurement actively manages from addressable spend. Proactive engagement can be measured based on which % of this spend is proactively, competitively sourced. Commodity strategy maturity can be determined through a five-step model that assesses company's category strategies against best in class category strategy elements. These KPI's address procurement engagement and maturity.

**Stakeholders.** It is critical for Procurement, especially in the Indirect Spend categories, to track customer satisfaction and engagement. One of the mechanisms to do this is customer satisfaction survey process. Surveys can be done either electronically or in focus groups quarterly or bi-annually. Experience shows that most insight is gained through focus groups or free-text input. It is important to keep the questions short, simple and consistent to allow continuous measurement and tracking.

**Operational Excellence.** Most Procurement organizations are focusing on improving process efficiencies both in strategic sourcing and in Procure-to-Pay process. The following KPI's address both processes.

- Use of eSourcing
- Cost per PO/line item
- % of hands free transactions
- Compliance to contracts/catalogs/preferred suppliers

Use of eSourcing can be measured per project. Which % of all sourcing initiatives use eSourcing (eRFI, eRFP, eAuctions) compared to all projects. Cost per PO can be determined based on volume and organizational cost. Similarly to eSourcing, % of hands-free transactions can be determined from overall volume of transactions. Compliance measures are becoming more critical as some Procurement value gets lost in non-compliance. Procure to pay tools provide mechanisms for capturing non-compliance and measurement can also be done manually.

**Supplier Performance Management.** One of the key elements of strategic sourcing is supplier management. These KPI's are some examples of critical things to measure in a supplier relationship.

- Quality

- On-time delivery; requested and confirmed
- Supplier rating score including stakeholder feedback
- Supplier innovation, % of revenue from existing and new products/services
- Contract compliance

This paper will not go in depth on these classic measures. Most organizations have ways of tracking supplier performance; however these practices are not typically applied consistently with indirect suppliers. Post transactional audits are an effective mechanism for tracking compliance to agreed contracts and service level agreements especially when buying services.

**Employees.** People are critical to any success, so it is important to track employee skills and competencies together with employee engagement/satisfaction. Skills assessments and personal development plan creation can be facilitated with a use of a skills matrix that typically has two dimensions: competencies and skill levels. As an example, a skills matrix for Procurement professionals could have the following dimensions:

- Skill levels: foundation, practitioner, expert, thought leader
- Key competencies: focusing on business needs, building propositions, developing and establishing strategic relationships, integrated working, technical skills, leadership skills

The assessments can be done either as self-assessments, with managers or with third party facilitation. The matrix clearly demonstrates areas for development and facilitates discussions around skill gaps and future development needs. The assessments can also be used as a KPI for current and future organizational competency and proficiency. Typically HR organizations facilitate employee surveys company-wide, so these results should be part of Procurement balanced scorecard as well.

**Concrete Examples.** A fast-moving consumer goods company have decided to measure five KPI's as a part of Indirect Procurement transformation. The initial KPI's are:

- Savings
- Cash
- Customer satisfaction
- Strategic sourcing rigor applied as % of all projects
- Non-compliant spend through procure to pay process

Key enablers for these measures are Finance validation of savings, small number of KPI's, global goals setting around these measures and a tacking mechanism for all projects and savings globally. Compliance reporting will take place through Ariba Buyer. Results will be presented to executives and stakeholders on a monthly basis for their specific area of responsibility.

**Benchmarks.** As it was stated in the beginning of this paper, KPI's enable effective external benchmarking with best in class companies and/or industry peers. The following chart provides some benchmarks for the KPI's presented in this paper.

KPI	Benchmark	Comments
Procurement leverage applied/managed spend	80%	% of addressable spend
Strategic sourcing applied	50%	% of addressable spend
Spend per employee	\$20-30M	Sourcing Professionals
Procurement ROI	>10	
Savings%	5%	From annual addressable spend
Savings per employee/year	\$1-2M	Annualized savings
Spend concentration	70%	Spend with top 20% suppliers
eSourcing/all projects	5%	Direct materials typically higher
Hands-free transactions	20%	Catalogs etc.
Cost per PO line item	\$9.5-\$15	India/Romania
Commodity maturity	2	Estimate
Competencies	2	Estimate

**Conclusions.** Key performance Indicators are an effective way to drive and measure organizational performance and execution towards agreed strategy and goals. Procurement organizations need to focus on essential KPI's, present data on a proactive manner and also take stakeholders needs into account when designing a balanced scorecard. Then used right, scorecard can be an effective communications tool for Procurement value, engagement and maturity. When used incorrectly, it can generate a lot of redundant reporting work and drive wrong types of behaviours. At the end of the day, you get what you measure.

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