

EXPERT COMMENTARY

Laying strong foundations for procurement transformation can help organisations create long-term value, write Efficio's Patrick Traynor and Fabian Bodoky



Sustaining procurement's impact on EBITDA

Private equity recognises the impact that transforming procurement can have on portfolio company performance and value. However, the focus is typically on short-term transformation, while sustaining the performance in procurement and delivering higher year-over-year value can boost EBITDA and valuation.

Many initial procurement transformation efforts have yielded strong results. Transformation programmes have proven to be an effective way to reset external costs and reposition the procurement function within the organisation. Despite this initial success, most companies struggle to sustain measurable impact beyond the initial surge. They fail to build on the momentum from the transformation programme and embed the discipline and practices needed to sustain performance.

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The stakes for sustaining performance in procurement are real. High-performing organisations are realising a 3-5 percent productivity impact year after year from effective procurement, compared with 0-2 percent for average performers. Maximising this long-term impact should therefore be a priority right from the beginning of the transformation to have the value flow through to EBITDA and valuation when exiting.

Organisations that sustain high year-over-year impact from procurement have four common characteristics, which are detailed below.

1. Clear spend accountability

Most organisations understand revenue

and profit accountability, but a surprising number do not practice spend accountability. An effective strategic category manager, one who is accountable for a key category spend area, can be as impactful for organisations as a strong sales or account manager.

Effective category managers understand how to work with business spend owners to balance short-term needs with longer-term category strategies. Strategic category managers develop multi-year category plans, setting year-over-year targets and working with the business to deliver against the targets. Top performing organisations integrate the review of these category plans into their c-level business review cycle, providing the category managers with the increased exposure and accountability befitting this important role.

2. Organisational alignment and commitment

Company leadership must commit to procurement – with actions not just their words. Procurement needs to be positioned as a strategic function that works cross-functionally to support the business to achieve its goals. Price compression through volume leverage cannot by itself lead to sustained, year-over-year impact. Realising maximum sustained impact from procurement can only be achieved through a holistic total cost focus, leveraging both demand and supply-side strategies.

Effective leaders include procurement when setting business targets and position the procurement team as support to the business managers. This enables the category manager to work hand-in-hand with their business and functional customers to understand their needs and help to choose and manage those suppliers to meet those needs. Procurement's involvement early in the process is an important factor to maximise the category manager's impact. Early engagement, shared objectives and aligned incentives across procurement and the business/functions will also help to promote collaboration and alignment.

3. Alignment with key partners

Once procurement has cross-functional alignment internally and has achieved success in helping the business source the right supply partners, it can look to key partners for next-level improvement across the supply chain. Suppliers often have innovative ideas that can help take cost out of the supply chain – ideas stemming from their product development efforts or from their other customer relationships.

Effective teams leverage ideas from both incumbents and challengers to this goal. With incumbents, they set up a structured supplier performance improvement process to achieve a collaborative, evolutionary change. Challengers can bring disruptive ideas to the table, which can lead to stronger

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results but more change. Mature procurement teams articulate advantages of both approaches, but incentivising suppliers to bring new ideas to the table is key.

4. Measurement discipline

A frequent complaint about procurement functions is the inability to clearly see their impact on the bottom line. “We have two sets of numbers” and “I’m not sure what I’m getting from procurement” are common refrains. Poor measurement discipline coupled with changing demand and business growth lead to uncertainty surrounding procurement's impact.

Effective organisations employ strong measurement discipline to assess this impact. Beginning with a solid savings tracking approach, one which ensures that negotiated price points are applied and new suppliers or services are leveraged. Effective measurement also requires tight co-ordination with finance to ensure that impact definitions are clear and to map category spend areas to budgets. Clear budget linkage enables organisations to understand where savings hit and to make explicit decisions on whether to re-invest savings into the business or to have them flow through to the bottom line. A disciplined, transparent approach to savings measurement helps organisations effectively assess procurement's impact while also enabling the organisation to row in the same direction.

Catalysing change

Embedding these four characteristics

in an organisation can be a catch-22. Procurement needs to build credibility with the business and management to get its seat at the table. However, without the support and alignment of the wider organisation, procurement cannot grow into its role as an enabler. Transitioning to an accountability-based category management organisation – for example, one in which procurement is a key player early in demand processes – requires initial success stories for credibility.

The transformation programme can be an effective catalyst for this change. To sustain the value and transform the company long term, organisations need to lay the foundation for the improvement of these four key characteristics. Effective transformation programmes build accountable category leads, promote cross-functional working and implement solid savings measurement standards. Success in a transformation event can prove to the organisation that early engagement of procurement pays dividends.

While transformation programmes can provide a catalyst, sustaining procurement impact requires more than a one-time programme. Successful companies work purposefully to imprint these characteristics of accountability, alignment and discipline in procurement into their organisational DNA. ■

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