

# **Spend Matters™ UK/Europe**

## *White Paper*

### **Managing Indirect Services – Procurement’s Greatest Opportunity?**

**But having the Right Equipment is Critical!**

*Improving procurement across indirect services categories offers significant opportunities for savings. However, data, tools and capability must be carefully chosen to meet the specific needs of these spend categories.*

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## ***Executive Summary***

Every craftsman knows that ‘right tools for the job’ are essential in order to create a professional result and achieve full potential from his work. The same can be said for most functional areas in a business, including the increasingly specialised software applications that support those areas. Yet it appears this doesn’t always apply in the field of procurement, with many procurement executives taking the approach that they can manage every category, including the more complex indirect services categories, using and adapting tools that were not really designed for the purpose.

**Improving procurement across indirect services categories offers significant opportunities for savings. However, executives need to recognise the challenges, understand the value drivers for each category and identify the right strategies. Data, tools and capability must be carefully chosen to be appropriate, and in particular, specifically designed to meet the needs of these spend categories.**

Large organisations spend considerable sums of money with suppliers of ‘indirect services’, such as IT services, marketing and media, consulting, other professional services and contingent (temporary) labour. This represents a large but mostly untapped opportunity for better procurement, leading to better value and performance from the vendors who provide these services. However, extracting value from these categories is not easy.

While every indirect services category is different, there are common themes among them. Taking the right approach with knowledgeable staff and managing with the right data supported by the right technology can deliver significant value and demonstrate to the business that procurement has an important role across both direct and complex, indirect services categories.

**This white paper is aimed at helping organisations improve the way they manage direct and indirect services procurement spend.** It will be of interest to senior procurement executives and also to CFOs and CEOs, as well as other C-Suite members who often control significant services budgets.

We identify how organisations *can* move up the ‘maturity ladder’ in terms of procurement performance and using professional consulting services as an example, discuss the sources of value that lie within each category. These categories are not easy to manage, but the benefits make the effort well worthwhile. We describe the key steps procurement and the business can take to increase the likelihood of delivery of those benefits.

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## ***PART 1 – The significance of the “indirect services mountain”***

While procurement’s involvement in indirect services categories has grown, it has been a painfully slow process. When the author saw procurement involved with marketing spend in a global FMCG firm for the first time in 1985, it would have seemed unduly pessimistic to think that 25 years later, almost half of major organisations would still have little or no professional procurement involvement in that area. Yet that is the situation today according to recent surveys<sup>\*1</sup>.

Why has it proved so difficult for procurement functions to manage these categories effectively? Based on our experience and interviews and assignments with dozens of procurement organisations over the last ten years, we have identified seven key reasons:

1. Budgets for these spend areas are usually spread across the organisation such that it is difficult to understand just what is being spent with which suppliers, by whom and at what cost.
2. Requirements are often more complex and difficult to standardize compared to physical goods. The specification can be unique and subject to the particular skill set of an individual providing the service.
3. Supplying markets can be less well-defined than in the case of physical goods. For example, defining where the ‘consultancy’ market starts and finishes and its interaction with temporary or contingent labour can be challenging for a category manager.
4. Services are often ‘personal’ to the budget holder, even in a corporate environment. Personal relationships can add a markedly different dynamic to procurement decisions compared to those made on purely objective business grounds.
5. Budget holders for many high cost indirect services are generally senior executives and they will often be dealing with similarly senior contacts in supplying firms. A junior category manager trying to ‘tell’ the MD that they can no longer use their favourite adviser faces a tough task.
6. Tools and techniques (such as ‘traditional’ ERP technology) that are effective for procuring discrete goods have proved less useful for indirect services, perhaps because they do not fit neatly into the world of repetitive volume purchasing.
7. The intangible nature of indirect services means it is often difficult to measure their effectiveness or the performance of suppliers. This can make managing the supplier relationship (and supplying contract) challenging.

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<sup>1</sup> Cap Gemini CPO report <http://www.capgemini.com/insights-and-resources/by-publication/global-chief-procurement-officer-survey-2010/>

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## ***Why take a special focus on indirect services?***

Given that these factors undoubtedly make indirect services a tough target for procurement, it is understandable why some avoid them and focus on ‘easier’ direct categories. However, our experience has showed that there *are* compelling reasons why procurement should put a significant emphasis on driving procurement performance and achieving greater value from these categories.

Third-party spend can represent 30% to over 90% of revenue depending on the industry and particular type of organisation, while for the vast majority of businesses (excluding retail and trading), this percentage is in the 40-70% range. And “the average indirect spend for a Fortune 500-size company is approximately 50% of its total spend”<sup>2</sup>.

If you have not done the calculation for your own organisation to understand the scale of indirect spend, it is worth going through this exercise: the results may surprise you.

Given the overall scale of the expenditure, there is a clear and powerful business case for addressing indirect services categories in a deliberate, structured manner:

- ***Value for money*** – Even beyond aggregation, the intangible nature of many services creates much greater ability to optimise requirements, service level and delivery methods than can be accomplished in materials procurement.
- ***Control and risk management*** – Control and risk is becoming more relevant in how organisations manage their vendors and supply chains. For instance, the risks around contingent labour or project-based contractors working on sensitive projects or in risky locations are obvious. Better management of these categories can lead to understanding and control of that spend and a reduction in the likelihood of fraud, corruption or bribery.
- ***Competitive advantage*** – Markets are increasingly dynamic and rapidly changing, which gives organisations the opportunity to develop competitive advantage by choosing the right suppliers and establishing strong relationships with them. Many services have a ‘multiplier’ effect where the benefit (or conversely, the damage) from the work delivered can be many times its cost.

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<sup>2</sup> KPIs: Measuring Indirect Material Suppliers and Service Providers, Fedele and Dolan, ASM Conference 2004

<http://www.ism.ws/files/Pubs/Proceedings/BBFedeleDolan.pdf>

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## ***PART 2: Achieving success with indirect services categories***

So, how can organisations ensure that they achieve these significant benefits? How should procurement functions approach and manage these categories? What are the critical success factors?

We suggest focus on the following areas:

- ***Market and supplier understanding*** – Procurement must develop a deep understanding of the markets in which they are trying to operate. These markets are often complex and rapidly changing and offer a plethora of supplier options. Being aware of what they are and how to best use them is a core skill; successful organisations most often import subject matter experts into their procurement teams.
- ***Stakeholder credibility*** – Gaining the ‘permission to operate’ in these areas is vital. An executive mandate is valuable, but more relevant is gaining credibility from internal stakeholders and procurement must recognise that it has to constantly demonstrate that it can add value to the organisation.
- ***Appropriate sourcing strategies*** – The concept of ‘appropriateness’ is important in managing indirect services. Applying procurement methods that have worked for buying discrete goods poses two problems. Firstly, normal goods sourcing methods are unlikely to deliver optimum results. Secondly, the use of documentation and transactional processes designed for procuring discrete parts (that cannot cope, for instance, with project billing and change order processes) will rapidly cause a loss of credibility with supplying organisations.
- ***Data and technology*** – Access to the right tools and technology is critical in delivering data that provides a deep understanding and competence to drive value and performance from external providers. From spend analytics through to performance monitoring and reporting tools, it is hard to achieve strong performance or results in these categories without the appropriate technology support. We will elaborate on this theme later.

### ***Climbing the maturity ladder***

It has proved difficult for many procurement organisations to gain influence in indirect services spend areas and improvement is often slow and gradual although there can be step changes along the way.

Figure 4 illustrates the stages we observe as organisations become more sophisticated in their services procurement practices and ascend the ladder of maturity and improved performance.

Procurement functions often start by being *excluded* from these categories altogether. They progress to *assisting* the budget holders, but very much on their terms. At a certain point, if they can prove their value, they become truly *involved* in the procurement process and decisions. Eventually, procurement

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can actually take the lead and *drive* better value in these categories: collaborating and playing the lead role in the management of the spend category.

While technology is by no means the only critical factor in this picture, the depth of its support for indirect services categories is often indicative of the organisation’s state of maturity. Less mature organisations struggle with producing even basic spend data, whereas organisations that have developed to the next stage may rely on their ERP as the main source of information, supported by spreadsheets. However, these approaches cannot produce the granular data required for the management of complex services categories and they are only able to yield limited results with respect to the ability to monitor and measure real supplier performance. As they mature, some organisations begin to supplement ERP with more specialised home-grown applications and standalone databases.

Organisations at the most successful end of the scale will retain ERP for the backbone of their *transactional* records whilst almost certainly use ***specifically*** designed technology to support the management of their indirect services spend categories.

The information, control and operational efficiency that can be obtained from choosing and using the most appropriate tools and technology can help organisations in becoming more successful at managing indirect services.

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## **Maturity ladder – Procurement status and use of technology**

	Excluded	Assisting	Involved	Driving
<b>Overall Position</b>	Procurement has little or no involvement with complex service, organisations exploited by market	Some simple commercial controls and arrangements in place that give basic protection and deliver average levels of value and performance from market.	Organisation now manages categories well and uses technology to drive value. Consideration of risk and performance as well as up front value	Continuous focus on competitive advantage supported by technology, understanding of tactical/collaborative options, significant value obtained from carefully chosen strategic suppliers
<b>Procurement Role</b>	Not structured, occasionally invited to help negotiate a large or complex contract, usually involved too late to add value	A limited role in the major service spend categories, generally by setting up ‘preferred supplier’ or framework deals. Involved with budget holders on some major contracts	Involved in most categories, moving beyond simple frameworks using different contracting options. Some basic work on risk likely, and some involvement in performance management with users	Procurement well integrated with business, structured supplier selection, understanding of when collaborative approach with suppliers and when tactical approach is more appropriate
<b>Use of Tools / Technology</b>	Procurement has little or no data and little use of technology, there may be some basic total category spend numbers and basic spreadsheets	Some data primarily via ERP, so basic overall budget control and category supplier data. But little at a level of projects, or specific category tools, or ongoing tracking of spend/performance	Good data with use of home-grown or specialist systems integrated with ERP. Some category specific tools and ability to use technology to get more granular spend and performance data	Real-time data on spend, risk monitoring (e.g. visibility of contingent labour population on site), performance management with reporting on KPIs and feedback loop to suppliers
<b>Benefits / Outcomes</b>	Minimal – and no attempt to measure	Some harmonisation of rates and leveraged cost reductions, and some compliance gains	Genuine cost reduction and value improvement through leverage, demand and performance management – basic benefits tracking	Significant benefits tracked and measured with year on year targets in terms of value, innovation and risk reduction

**Fig 4: The Procurement Maturity Ladder**

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## ***PART 3: Practical steps for driving improvement – Identifying the right tools***

We have established the need for data, tools and capability to drive improvements in procuring indirect services and so provide mechanisms and data to support actions across all services categories.

Key capabilities for technology solutions include the following:

- Robust spend analytics in order to support understanding of current spend (essential when spend is devolved and dispersed widely around the organisation)
- Insight into specific markets with expert support at a category level
- Automated sourcing platforms and processes that are appropriate for services categories
- Reporting tools that can provide data in a usable format for these categories
- Contract and supplier management tools designed for services categories

Procurement executives should carefully consider whether their current solutions offer the capabilities that are required for indirect services categories. For example, (beyond how much money is spent with consultancy ‘X’), can your current systems tell you which consultancies are winning the most projects? How services are priced (fixed, day rate, etc.)? Which competitors did they face (if any)? Do they bring projects in at the bid price or do they frequently end up charging more? How do the buyers rate their performance?

The right tools will provide this level of insight and in turn allow organisations to take specific actions to drive improvement and shape the cost and performance of their indirect services supply base.

We recommend adhering to three fundamental principles when considering technology options:

1. Develop a clear strategy for priority categories and what you need to deliver from tools and technology.
2. Ensure that the tools you select have been designed for managing the spend areas on which you are focusing. The complexity of these categories means that a quickly customised solution originally designed for production raw materials, for example, will rarely meet the real needs around managing services procurement.
3. Because of the nature of spend in these areas, engagement of stakeholders and developing credibility with them is critical for procurement. Make certain that any tools or technology you select adds value and is demonstrably appropriate in the stakeholders’ eyes.

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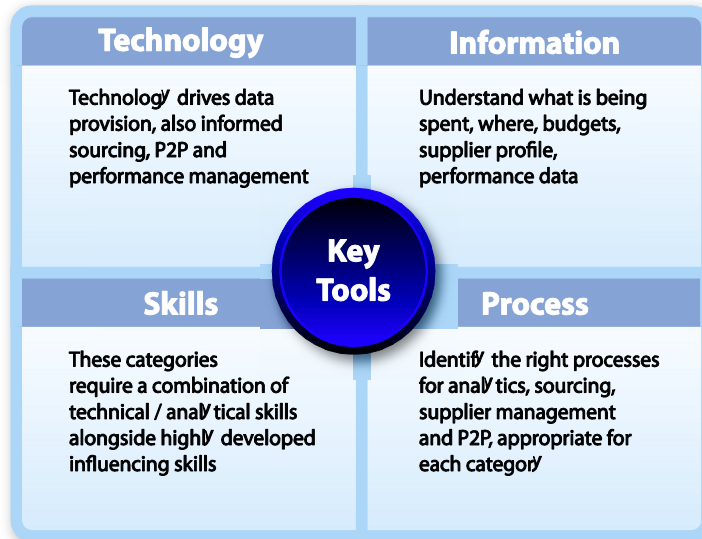


Fig. 5: Key enablers for successful management of indirect services categories

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## ***PART 4: A specific category example: The complexity of professional services procurement***

As procurement develops in maturity, new approaches and solutions will be employed to identify the benefits that can be delivered from indirect services categories and ensure that procurement has a positive impact on the organisation. For example, tactical negotiations – e-auctions at the extreme – are rarely appropriate in legal professional services, whereas that approach may be very suitable for major telecom spend or direct-mail marketing campaigns. In other categories, a deep market understanding will help to release value. ‘Success’ for procurement (and the organisation) may look quite different in different categories. Hence it is essential to understand the **‘sources of value’** in each category.

*“Since procurement got involved in Management Consulting, we have reduced the average day-rate we pay from £1400 a day to £1200”*

At face value, this may seem like an impressive story to take to the Board. However, if the response from the business is that it now takes twice as long to engage consultants who then produce worse results and have been found to have breached confidentiality, then procurement’s credibility will disintegrate.

*“We have made sure we are paying market rates for all our consulting work, which has already saved us several millions. We have selected and pre-qualified a list of preferred suppliers with whom we have broadly agreed on T’s and C’s, but we have left the door open for using other suppliers for specialist requirements. Most importantly, procurement is working with budget holders to make sure that consulting assignments are set up on a risk/reward basis wherever possible, providers are properly managed and their performance is carefully assessed. We now have a quality rating for consulting firms, which we will use to drive up performance of our preferred providers...”*

Now *that* is a pitch that is likely to have the Board nodding in agreement and admiration.

Every category has different **sources of value**. The key for procurement leaders is to identify what those sources are and make sure that their actions are focused on tapping into them to deliver beneficial outcomes for the organisation.

### ***Sources of Value – Example: Professional Consulting Services***

Key sources of value in professional consulting services include:

- Understanding the supplier marketplace and the different offerings that firms can provide, including their strengths and weaknesses

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- Ensuring that rates are market competitive, especially when ‘time and materials’ or day rates are used as the commercial model
- Understanding how and when to use different commercial models, such as target price, fixed price for delivery of defined outputs and risk/reward mechanisms
- Being able to run selection exercises (tenders, etc.) when necessary to meet urgent requirements and support budget holders
- Managing the risk and regulatory aspects specific to consulting (e.g. knowing who is on site, managing confidentiality and data protection issues)
- Measuring and managing supplier performance to drive continuous improvement and identifying the right suppliers for future work

Understanding the real value drivers enables procurement to put in place processes, tools and capabilities necessary to drive this value. It is clear that for professional consulting services, information and data are absolutely vital.

So what might the capabilities of a technology solution for consulting services look like?

- Ability to handle complex contractual arrangements, including provision for part-payments, payments based on results, and “statement of works” type assignments
- Automated ‘call-offs’ or competitions between preferred suppliers, communicating requirements to multiple providers and supporting the assessment of responses
- Ability to monitor and measure performance, enabling tracking of Key Performance Indicators (KPIs), including achievement of deliverables, performance ratings, etc.
- Tracking of consultants at an individual level where appropriate; monitoring hours worked, security or other accreditations
- Management of the billing process, including handling of complex commercial and payment models
- Tracking and reporting of performance by provider, budget holder and assignment

Naturally, there are many other services categories with their own unique features and qualities. Each needs handling differently to ensure that the sources of value are identified and that appropriate tools that add real value are used.

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## ***Conclusion***

Improving the procurement of indirect services spend categories offers significant potential for many organisations, and while excellence in these areas is not easy to reach, it is achievable with the right approach. Furthermore, the rewards can include significant value improvement, cost reduction, an improved risk profile for the organisation and competitive advantage in a dynamic marketplace.

However, there are no short cuts. A deep understanding of markets and suppliers is a pre-requisite; data and management information is essential; and smart performance management of suppliers is key to gaining on-going improvements.

The tools and technology needed to support the procurement process are very important. The key is making sure that they are *appropriate* for the categories that are being addressed. You cannot manage services categories in the same way you manage direct spend, and technology designed for general business use (or for other specific purposes) does not always translate successfully into spend areas as diverse and specific as consulting services, contingent labour or facilities management. You are also unlikely to succeed with manual processes or Excel-based tools once you get into large-scale category initiatives.

The right tools and technology, on the other hand, can provide data, management control and supplier performance information that can assist procurement in coming to grips with the considerable opportunities in these areas.

Indirect services categories represent perhaps the greatest procurement opportunity remaining for a majority of enterprises. And ensuring the selection and usage of appropriate and effective tools and technology to support procurement activities is one of the most critical success factors.

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## ***About the Author***

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Peter has 25 years experience in procurement and supply chain as a manager, procurement director, consultant, analyst and writer. He edits Spend Matters UK / Europe, and with Jason Busch, the founder of Spend Matters in the US, has developed it into a leading web-based resource for procurement and industry professionals. Peter worked as Procurement Director for the NatWest Group, the Department of Social Security (the DSS), and the Dun & Bradstreet Corporation, and held senior positions in the Mars Group during his management career. He has an MA in Mathematics from Cambridge University, is a Fellow and was 2003 President of the Chartered Institute of Purchasing and Supply, and his first (co-authored) book, “Buying Professional Services”, was published by the Economist Books in June 2010.

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