

Unlocking Value in Procurement

A Guide for
Category Managers and
Chief Operation Officers

Volatility in commodity prices and supply chain complexities have helped analytics emerge as a vital tool for category managers, chief procurement officers (CPOs) and chief operation officers (COOs). They are increasingly turning to analytics to drive decision-making, optimize operations, and secure competitive advantages.

This whitepaper explores how analytics can transform procurement into a strategic business function, offering category managers, CPOs and COOs insights into actionable strategies for navigating the complexities of today's business environment.

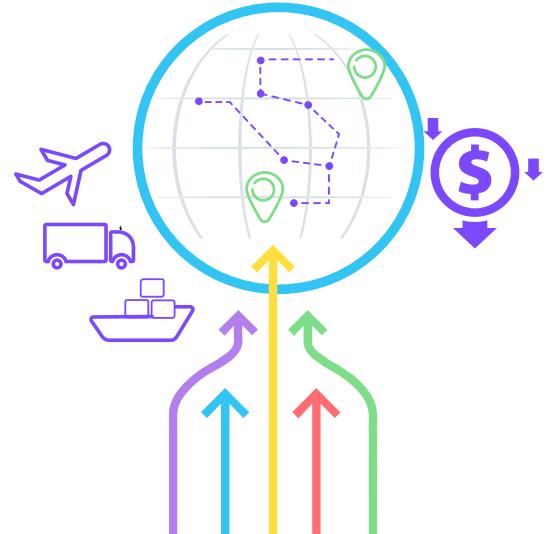


The Changing Dynamics of Commodity Prices and Supply Chain Management

The Impact of Volatility on Procurement

Traditional approaches to product cost optimization are less effective in the face of volatile input costs. Between March 2020 and May 2021, the procurement landscape witnessed unprecedented volatility, with the price of steel rising over **200** percent and copper **doubling**. This trend of instability across various commodity categories highlights the complex interplay of demand fluctuations, supply disruptions, and market dynamics, presenting a significant challenge for manufacturers. In the context of increasingly outsourced supply chains, understanding and managing material costs become even more critical, particularly for industries like automotive and consumer packaged goods, where a substantial portion of the value chain lies with upstream suppliers.

Companies will need to adopt more sophisticated strategies, such as cost modeling, to mitigate the impact of price fluctuations on materials and components.



Challenges in Cost Transparency and Supplier Management

With most product costs hidden upstream in the supply chain, especially in industries like automotive and consumer packaged goods, achieving cost transparency and efficient supplier management has become increasingly challenging.

The Role of Analytics in Procurement

In an era marked by constant change, the procurement and supply-chain functions emerge as pivotal players in bolstering corporate resilience. With significant price erosion across various industries, the urgency for cost and cash management has intensified. Their strategic role encompasses ensuring supply and price stability in the immediate term, deploying advanced tools to mitigate costs in the medium term, and institutionalizing a cross-functional approach to procurement to prepare for future challenges.

That's why we're seeing a big shift towards data-driven decision-making that enables procurement professionals to address critical business questions. From identifying high-spend categories and assessing ROI, to understanding supplier performance metrics, analytics will serve as the foundation for procurement leaders.

Critical Business Questions Answered by Analytics

Understanding Spend Dynamics

Identifying which categories represent the largest spend areas.

ROI Assessment

Calculating the return on investment for each category.

Delivery Performance

Evaluating the punctuality of goods and services delivery.

Payment Trends

Analyzing the trends in payment terms with suppliers.

Supplier Diversification

Assessing the number of suppliers providing identical goods or services.

Pricing Analysis

Identifying which vendors have frequently raised their prices.

RFP Process Efficiency

Measuring the duration of the average Request for Proposal (RFP) process.

This segment emphasizes the untapped potential of procurement analytics in driving operational improvements, facilitating scenario planning, supplier collaboration, and risk management.



Key Performance Indicators (KPIs) for Procurement

Monitoring KPIs is crucial for evaluating the effectiveness of procurement operations. These metrics provide insights into supplier performance, operational efficiency, cost management, and inventory management. Tailoring the selection of KPIs to fit the specific needs of the business can help optimize procurement strategies.

Cost Management KPIs

These KPIs gauge the effectiveness of cost and procurement strategies:

- **Cost Reduction:** Measures savings achieved through strategic efforts.
- **Cost Avoidance:** Tracks potential future savings from strategic decisions.
- **Procurement ROI:** Assesses the profitability and cost-effectiveness of procurement investments.
- **Spend Under Management:** Indicates the extent of control over expenses.



Operational KPIs

Focused on the efficiency of the procurement process:

- **Spend vs Budget:** Assesses budgeting accuracy and alignment with stakeholders.
- **Purchase on Time and Budget:** Measures the proportion of orders completed on time and within budget.
- **Emergency Purchase Ratio:** Indicates the percentage of unplanned orders, potentially signaling extra spending or poor planning.
- **PO Cycle Time:** Tracks the purchase order lifecycle from creation to payment, aiding in supplier categorization.
- **Total Number of Suppliers:** Reflects dependency on suppliers, influencing negotiation power and risk.
- **Total Cost of Ownership:** Provides a comprehensive view of direct and indirect procurement expenses.

Inventory-Related KPIs

These metrics evaluate the effectiveness of inventory management:

- **Inventory Aging:** Indicates how long items remain in inventory, suggesting strategy adjustments.
- **Inventory Carrying Cost:** Accounts for all expenses related to storing inventory.
- **Inventory Turnover Ratio:** Measures how quickly inventory is sold or used.

Supplier-Related KPIs

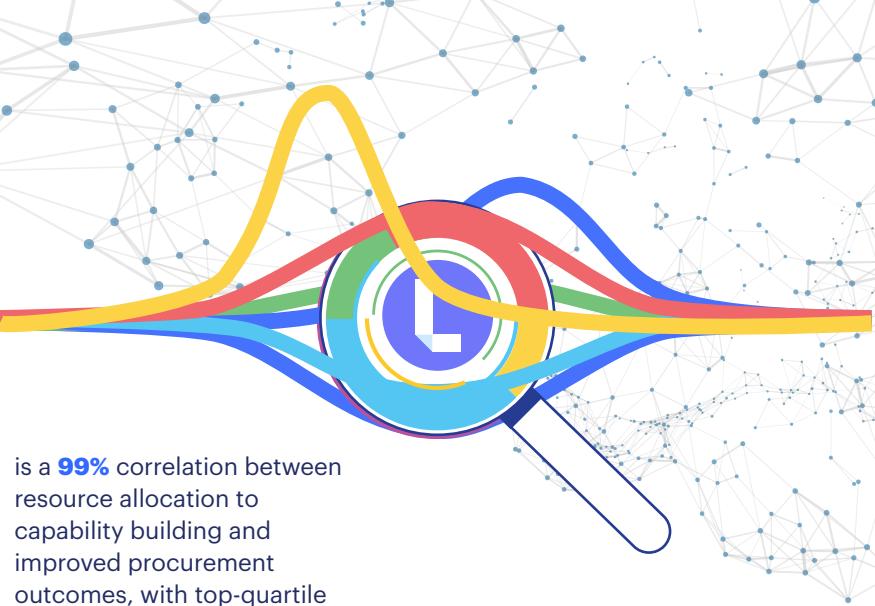
These KPIs evaluate supplier performance, aiding in the selection of reliable suppliers and future contract negotiations:

- **Supplier Availability:** Estimates a supplier's ability to meet demands, including emergency requests, showing reliability and responsiveness.
- **Supplier Lead Time:** Measures the time from receiving a purchase order to delivering the requested items, indicating order processing and delivery speed.
- **Supplier Contract Compliance Rate:** Evaluates a vendor's adherence to business requirements and negotiated contract terms.
- **Supplier Defect Rate:** Assesses the quality of items from a vendor, in percentage or defects per million.
- **PO Accuracy:** The ratio of correctly fulfilled purchase orders, indicating delivery accuracy.
- **Supplier Quality Rating:** A collective performance measure for comparing suppliers.

The Future of Procurement: AI and Analytics

To address the challenges posed by volatility, companies are encouraged to take a broad set of actions across several time horizons. In the immediate term, procurement must ensure supply and price stability. For the medium term, the focus should be on utilizing a range of levers to minimize costs and enhance supply chain resilience.

Investment in capability building and supplier relationship management can yield significant returns. According to one research study there



is a **99%** correlation between resource allocation to capability building and improved procurement outcomes, with top-quartile organizations achieving double the savings of those in the lowest quartile.

The question then is: how should businesses quantitatively measure supply chain resilience and optimize their capacity building initiatives?

Embracing an End-to-End Perspective

Effective procurement decisions necessitate an end-to-end understanding of the value chain. This involves considering the implications of decisions on both the buyer and supplier sides, including the negotiation of payment terms and the identification of cost-saving opportunities.

Focusing solely on spend data provides an incomplete picture of procurement's impact. A collaborative approach across departments can help align procurement strategies with overall business objectives. For instance, incorporating data from sales, finance, product development, R&D, and operations is essential for achieving a single truth source across the procurement function, and generating actionable insights.

However, adopting a holistic view is not just about data integration; it also involves aligning decision-making processes across departments. It'll require breaking down silos and ensuring data interoperability across departments.

Subsequently, this alignment ensures that procurement decisions consider the broader implications across the entire value chain, from payment terms to cost-saving initiatives, thereby fostering consistency and avoiding strategic missteps.

Integrating Data for Comprehensive Insights

The deployment of advanced analytics in procurement is not without its challenges. Despite the potential benefits, many companies struggle to implement advanced analytics at scale. Data fragmentation across procurement, finance, and customer relationship management (CRM) systems often prevents a unified view of procurement data - which is crucial for effective analytics.

Additionally, many organizations face challenges in addressing embedded costs due to complexities in material selection, supply chain depth, and supplier negotiations. The complexity of developing and sharing deep category-level knowledge hampers the scalability of analytics efforts. Addressing these challenges requires a commitment to data integration, automation, and the development of a single source of truth that encompasses all relevant data points along the supply chain.

Leveraging Advanced Analytics

The adoption of advanced analytics and AI in procurement is increasing, with a significant portion of Chief Procurement Officers reporting the use of these technologies. These tools offer comprehensive insights into spending patterns, supplier performance, and market trends, facilitating better decision-making and innovation.

Strategic Application of Procurement Metrics

Developing a procurement performance dashboard equipped with a balanced scorecard can facilitate the strategic application of these KPIs. This approach enables procurement teams to visualize performance, make informed decisions, and drive continuous improvement across the procurement function. By embracing advanced analytics and focusing on key metrics, category managers and COOs can unlock significant value for their organizations, paving the way for a future where procurement is a pivotal contributor to business success.

Building a Digital-First Procurement Function

The Need for Actionable Insights

Digital solutions in procurement should not only support spend optimization but also provide actionable insights and transparency. Companies need to prioritize the development and implementation of digital tools that facilitate decision-making and value capture, particularly in times of crisis.

The Imperative for Automation

To navigate these challenges, automation emerges as a critical solution for managing vast datasets and executing routine tasks with enhanced precision and efficiency. However, the application of automation on a large scale remains an untapped potential within many procurement functions.

The path to next-generation procurement involves identifying key business needs and the digital tools that can address them. By focusing on these priorities, organizations can ensure effective value capture and accelerate their recovery from current and future challenges.



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