MEASURING PURCHASING’S EFFECTIVENESS

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It’s often been said that “You can’t manage it if you don’t measure it.” Applied to the complex world of purchasing and supply management, this means that all the diligent work that is put into strategic sourcing, negotiations, cost reductions, and customer and supplier management must be evaluated against goals, industry benchmarks, or another designated scale. And perhaps just as important — taking those measurement results and using them to determine appropriate action.

It can be particularly challenging because it requires professionals to take a step back from day-to-day activities and analyze the “big picture.” But you need this broad perspective to truly assess the progress and contribution you’re making to the enterprise’s bottom line and the strategic goals of your firm. Doing this well can not only be critical to gaining executive support and resources for initiatives, but it is also imperative for identifying problem areas, which, of course, is the first step to improvement. Of course, the challenge lies beyond just what to measure, but how to approach an entire measurement program, including establishing the process, ensuring compliance, and how to interpret and act upon the results.

A recent CAPS Research Critical Issues Partnership Event focused on this topic. A group of executives discussed and shared their views and experiences on the topics itemized below. This report is a summary of their discussion.

• What is appropriate to measure, how must measures be constructed, and what metrics are important?
• How can measures be used, not only for procurement/supply improvement, but with others in the organization for demonstrating supply’s value, forecasting, and performance impact?
• What are other general issues and challenges surrounding performance measurement programs?
**ESTABLISHING APPROPRIATE MEASUREMENTS AND METRICS**

While traditional associations exist between purchasing or supply management with cost and price measures, a great deal of this event’s discussion centered about additional, more strategic measures. To many, this is a refreshing indication of the broader perspective and role that supply is taking on in progressive companies. Where cost measures are discussed, it’s usually in terms of total costs, as executives realize that isolated measures may be impressive, but aren’t as meaningful without being put into a broader context. (For more information on measuring cost avoidance versus cost savings, see the 2006 CAPS Research Critical Issues Report *Defining Cost Reduction and Avoidance* available on the CAPS Research Web site at www.capsresearch.org.)

**Total Costs**

The conventional approach for assessing total costs requires documenting the price of the item or material, but then supplementing that amount with any other costs, such as transportation, distribution, warehousing, financing, servicing, maintenance, and the like. The most comprehensive lists of all aspects of total cost of ownership can be upwards of 250 items/elements! Generally, a firm will have to examine which elements apply for their situation or material. Typically, one might find that when comparing two similar products, the price of one might be significantly less, but when adding all the total cost elements, a better choice might be another. With the growth of global sourcing, aspects such as international taxes and fees need to be considered. When using a total cost system as a means of measuring purchasing and supply performance (e.g., from one year to the next on similar products, materials or services), care must be taken that comparable elements of total cost are included in both measures.

In terms of scope, one retail company takes the approach of tracking from point of origin for goods all the way to the point of where that material reaches the back door of the retail locations. It admits that the next step would be to track until that material is in the hands of the customer, but for this firm, the store operations component would be responsible for bringing that portion to the equation.

An important aspect to keep in mind when determining total costs is the cost and resources associated with finding and analyzing every last detail of data. In particular, if the line item or aspect that you’re trying to pin down and include is of relative low dollar amount, consider whether the extra effort is even worth the trouble. Could that time or those resources be spent elsewhere, i.e., is capturing 80 to 90 percent of total cost data worthwhile enough?

As mentioned, the measurements that today’s supply executive are concerned with extend far beyond price and costs. They include:
Supply’s contribution to innovation
Profit and loss (P&L) impact
Risk Mitigation
Revenue contribution
Growth
Accuracy of predictive indicators
“Soft” areas such as professionalism, effectiveness of training
Supply management competencies and skills

**Profit and Loss (P&L) Impact**

Another area that executives shared the desire to measure is supply’s impact on the financial statements that are so prized by the company’s top executives — chiefly the P&L statements. This aligns with other current trends of wanting to “speak the language” of the CEO and having supply contributions be validated by finance.

Part of the challenge in this area arises because financial calendars and financial statements tend to create strict time-period increments, for example: this quarter, this fiscal year. Unfortunately, sourcing, business unit needs, and goods and services in the supply chain don’t always fall neatly into such increments.

Revenues from products for a given period on the P&L statement might have used materials that were purchased several time periods ago. At any given time, various goods or services could’ve been negotiated for cost savings, but each might be in a different spot in the pipeline. The result is a final product comprised of all those total-cost aspects, each of which might’ve been realized or credited during various time periods.

Some supply managers suggest that another way to illustrate savings is to isolate the three distinct opportunities for creating savings. These are 1) during a contract renewal/creation; 2) by proactively working with the stakeholder/business unit; or 3) reacting to or resolving any issues as they arise. Bucketing distinct savings into these three areas allows a supply manager to show some chronological, time-period specific savings, even if these events don’t always completely coincide with a P&L statement period.

A constant concern related to recognizing savings is allocation. If savings are genuinely produced due to a particular action, does that decrease in funds reflect on any balance sheet, or is it absorbed by a larger financial picture? In this instance, it can be difficult to validate and justify savings and bottom line contribution. Sometimes, navigating through this tough issue can take a bit of pragmatism. One executive said that rather...
than being “territorial” about the savings, in the right culture and management environment, there can be a consensus that “we’re one company” and the steps taken for savings benefited the firm, regardless of exactly “which pocket they ended up in.”

**Processes and Strategies**

Purchasing and supply processes and strategies are other areas where measurements are being pursued. These measurements tend to have more importance to the supply management department or unit itself, rather than to other functions or board room executives. However, measuring them can give supply managers and executives a good temperature reading on the overall health of a category spend area. It can give some indication of whether a strategy is “moving in the right direction” to meet demand needs. Solid processes and strategies then become the means to achieving objectives important to the entire organization.

For example, executives might not have definite unique metrics to evaluate each particular sourcing strategy, but as one individual put it, “We want to look at the strategies that we have in place for each spend category. The output or results [of assessing costs, supply reliability, contract terms and performance, customer satisfaction, etc.] should be some indication of how smartly we did the sourcing strategy planning in the beginning. Should we continue in this direction? Do we need to change strategies for this spend area?” Of course, just because you’ve installed a solid process doesn’t mean that all the tactical elements within perform perfectly. Each activity should also be examined.

Another example of how a strategy might be assessed relates to sales promotions. If the company runs a sales promotion, how well did the strategy for ensuring adequate project play out? Obviously, inventory levels needed to be kept up, but what was the cost of that? Was there any direct or indirect impact on other sourcing areas during that time period? Did the promotional product cannibalize any core product sales?

**Compliance**

Compliance with purchasing and supply management processes and procedures is a common measurement. Are there users participating in “maverick” purchasing? Even in the most progressive and best-in-class environment, it might be unrealistic to have 100 percent of spend controlled by purchasing. There may be executive projects that fall outside of supply control. Or, in some industries, some spend categories are notoriously controlled by users (e.g., research and development resources in the pharmaceutical industry). Anecdotal estimates of 80 percent and above indicate an impressive compliance rate.
Ensuring that purchasing within the prescribed procedures is as easy as possible for users appears to be a common success factor. Online catalogs, multiple options (of all approved materials or suppliers), and ease of transactions all contribute to improved compliance.

**Establishing Relevant Measures — Globally**

One of the biggest challenges in establishing purchasing and supply performance measurements for a global firm is determining what metrics can be applied across the entire firm (to add in accurate benchmarking and assessment at the corporate level), but also be unique enough to accommodate unique situations that might exist for particular countries or regions (to allow smaller operational areas useful data that would aid improvement). Executives say that measures and metrics developed in a particular country or region may not be as relevant to or inclusive of the operating environment in another region. The specific scope, the technical data, the key performance indicators (KPIs), and even the language must be both universally relevant, but at the same time useable and applicable across borders and divisions.

Furthermore, it’s not enough to simply have standard measurement and metrics; great care must taken that definitions are at least understood by, if not identical for everyone. Sometimes the KPIs can be the same, but different targets are applicable for various regions, due to regulatory, tax, or labor issues.

Here are some ways that firms have coped with this situation:

- Some establish a set of universal measurements, for example 10, that apply to all purchasing and supply management units. Then, if a local or regional level needs more specific metrics for their circumstance, those can be added. The challenge is to ensure those local measurements are still robust and useful.
- Some company structures are such that a particular region has been given responsibility for a particular category — based on competency demonstrated in that area. For example, the sourcing unit in one country may specialize in packaging. That unit sources, procures, and manages the packaging contract for all business units. This means that the measurements about packaging need only be applied to one country, one language, and one operation.
- Some have found it just not possible to compare various regions to each other on a fair basis. In those instances, the measurements can at least be used to compare performance at a given location from time period to time period.

**The Importance of Accuracy**

There is overwhelming consensus on the need for accurate data if purchasing and supply performance measures are going to have any credibility. While accuracy should...
be a goal for any type of data, the most often cited example relates to accurate spend and cost data. If purchasing and supply is trying to measure (and achieve) performance improvements by influencing a larger amount of spend, understanding spend categories, or ascertaining spend with various suppliers, accurate spend data is critical.

Sometimes, having inaccurate or incomplete data can even prompt drastic or dramatic measures by executives. It might be very eye-opening for an executive to learn how little is known about spend data; financial or executive support for better systems or compliance might follow if it can be demonstrated that having that data in hand would ultimately improve sourcing — and ultimately company — performance.

Another instance where accurate data plays a crucial role relates to supplier evaluations and purchasing’s ability to correct or assess supplier behavior in terms of delivery, performance, or price. Some models require users to detail these elements so that purchasing can take appropriate action. Without thorough feedback from users, it is more difficult to improve supplier performance.

**Measures Illustrate Priorities**

One discussion point among executives centers around what exactly is being measured, why a particular measure is important to the audience, and what does data interpretation say about your priorities.

When a price savings is measured, but the commodity market price also decreased, how much can then be attributed to buyer performance and how much is attributed to the market? If you are measuring buyer performance and want to showcase that, do the finance executives place high value on that? Or, are they just more concerned with the price figure?

Most firms will have separate numbers that are being used to report savings, different from numbers that might be used to measure purchasing performance (to award merit pay, bonuses, etc.) What does this say about aligning priorities?

In terms of forecasting benefits, you may predict a newly negotiated contract will bring a certain amount of savings. However, if compliance isn’t up to standards and the contract is not being employed as often as it should, you won’t be able to truly recognize those savings, so the compliance measure must be taken along with the forecasted savings measure.
Focus Study Research
In 2005, CAPS Research published the Focus Study, *Strategic Performance Measurement for Purchasing and Supply*. In it, the authors delineated eight specific critical factors in creating and managing performance measurements for purchasing operations. The factors were identified after researching organizations with successful and effective purchasing measurement systems. Other resources incorporate similar findings when evaluating the critical processes and steps of measuring purchasing effectiveness. Below is a summary of those findings. (To see the entire study, go to the CAPS Research Web site at www.capsresearch.org.)

1. Measures must be aligned vertically and horizontally with:
   - Key corporate objectives
   - Individual performance objectives
   - Strategic objectives of SBU’s
   - Strategic objectives of functional groups

2. Measures must be comprehensive — they must cover all areas where purchasing and supply can impact marketplace success:
   - Hard dollar cost savings
   - Quality
   - On-time delivery
   - Inventory levels
   - New product development
   - Direct and indirect spend addressed

3. Measures must be dynamic and aggressive
   - Adjusted regularly for changes in priorities
   - Represent a challenge to the organization, though an achievable one

4. Measures must be transparent and broadly communicated to ensure they are used to drive decision making.

5. Measures must be tied to incentive compensation — meaningful performance-based incentives.

6. Measures must be supported by resources to:
   - Develop measures
   - Benchmark supply markets and competitors
   - Set meaningful targets
   - Measure performance
7. Measures must be supported by systems able to:
   - Report on most measures
   - Roll up and disaggregate along multiple dimensions (e.g., commodity, SBU, region, supplier and timeline)

8. Measures must be championed by strong leadership committed to a performance measurement process that:
   - Identifies the right measures and targets
   - Meets targets
   - Used to set budgets, plans and resource allocation
   - Brings savings to the bottom (or reinvests appropriately)

**USING MEASUREMENTS FOR EFFECTIVENESS AND IMPROVEMENTS**

The exercise of establishing supply performance measurements and measures and collecting the data can take on a life of its own. But the true value of any measurement program comes when the data is analyzed, and that information is used to identify problem areas, illustrate contribution, or make improvements to performance. It’s simply not enough to have the information — putting it to work to ultimately increase value is what will make the entire exercise worthwhile.

Measurements can be used to benchmark performance from one company to the next, or to compare performance of divisions or regions within a single company. Some interesting aspects to consider:

- When comparing one company to another, the number of potential companies is only limited by the need to find comparable size and/or industry firms (although some measures might be applicable to multiple industries). However, highly detailed or sensitive information will rarely be made publicly available.
- On the contrary, detailed data created within a single firm, to benchmark performance of divisions or regions, may be easier to come by, but the comparison is then just an internal view.
- When comparing one firm against another, it’s important to have a good understanding of the details of the metrics, so that you can ensure you’re comparing apples to apples. Does “total spend” refer to spend within the corporation, spend within a division, or some other variation?
Research firms that have benchmarking data available (such as CAPS Research) often hear an ironic claim from knowledge-hungry companies: Everyone wants solid benchmarking data by which to compare themselves. However, they often claim that the aggregate data comes from too diverse a set of firms; they’d prefer data from more firms similar to themselves. Yet, that would severely limit the number of companies in any given survey, which would weaken the validity of the benchmark as the “norm.” It’s a catch-22 situation with no easy solution.

**Using Measurements to Operate in a Predictive Mode**

The application of purchasing and supply performance measurements that perhaps has the greatest potential to create value and bring benefits to the firm is to use measurements for predicting savings and operational activities.

One executive summed it up by saying, “You can look at all kinds of detailed data, but it seems that management just wants to know what it’s going to look like at the end of the year. They want to be shown where those trends are going to go. It’s being predictive versus just stating the actuals of what happened.”

In general, it’s been difficult to strictly rely on contract terms to predict savings performance. Many use a combination of forecast measures and audits of the most recent activity to create a more accurate savings forecast. One firm found that its actual savings were routinely coming in about 10 to 12 percent of the original forecast. That in itself has been a measure to make a better forecast.

Savings performance is often calculated at the beginning of a contract term, but some have found that they need to further dissect the forecast to align with financial calendars (e.g., establish six-month savings forecasts, even if contracts are for a larger term).

One strategy is to distinguish contracts depending on what stage they are in, and then weight savings predictions accordingly. If a contract is in a draft stage or is in the early stages of a longer-term contract (with the potential for more variability), the weight is lower. For active contracts and those where some savings has already been realized, the weight is higher.

At least one firm uses a rolling system of predicting performance. The supply area is required to predict savings five years out as a percent of spend, but are only locked into a commitment one year out. The business units have this amount taken out of the budget. Supply commits to meet the goal, although there is sometimes variation (from prediction to actual) on exactly which line items create the savings. The commitments are adjusted for validated commodity price shifts.

Those firms that have experienced the early stages of new implementations (e.g., of strategic sourcing initiatives) know that it’s easier to predict better performance in the first years when the low-hanging fruit is still available. Whereas 4 to 10 percent might be realistic early on, a more mature program might only have a (realistic) goal of 2 to 3 percent.

Other predictive areas that were touched on during the Critical Issues event include using performance measurements to help predict volume, predicting savings based on innovation improvements, and, as an extreme, measuring the value of supplier intelligence, i.e., having the ability to either foresee financial problems or future capacity issues so that measures can be taken well in advance.

**SURVEYS AND SKILLS** The above section focuses on purchasing and supply management financial performance and outputs of the function’s activities. However, some of the most significant measures that supply executives are concerned with include individual competencies, the team’s interactions with internal customers, and overall satisfaction with customer service levels.

Many use survey mechanisms to get feedback from users and customers about supply performance. Here are some strategies and advice with regard to gathering and analyzing this data.

When conducting a survey routinely (e.g., annually), keep the wording of questions the same. This will help greatly if you want to assess performance improvements year-over-year. Along those same lines, some recommend including at least some of the same survey respondents in consecutive surveys. The data from a repeated sample group that recognizes the same questions/metrics can be very valuable. In particular, those people can be contacted later for specific follow-up and details about their repeated responses and experiences with supply.

When developing a survey, how do you determine who should be included? One recommendation is to ask division or team leaders to appoint survey respondents who are frequent users of supply services. The key here is that you want to ensure respondents will give useful feedback. Avoid the inclination to only include users who you know have had a positive experience.

At least one executive has noticed a high correlation between a user’s perception of the supply management function and that person’s perception of an individual with whom they work with from the function. To accommodate this phenomenon, 360-
degree surveys can be used. In these instances, feedback about an individual experience is supplemented by feedback from users, peers, superiors, and subordinates — that is to say “all sides of the story.”

The point to remember about surveys and user feedback (particularly when developing or presenting results to the supply team) is that it’s not always a matter of “good” and “bad” or if performance was better or worse than before. The point of the feedback is to determine where improvements can be made for what the customers need. What are the opportunities for supply to add value or increase performance? To get an in-depth assessment of user expectations, a survey can be followed up with one-on-one conversations to best understand the environment and opportunities.

Third-Party Survey Assistance
In order to help customer satisfaction surveys remain objective, some companies employ a third party to help with the feedback or benchmarking process. There are advantages and disadvantages to this approach. While there would be a cost for these services, a third-party approach will not be as much of a time/resource constraint on supply employees. If there are any face-to-face interviews, a third-party approach can alleviate any awkward situations. However, some are concerned with the fact that third parties, with their expertise in survey mechanism, aren’t as sensitive to the user who has to spend time filling out surveys. There’s a balance between wanting to be thorough, yet wanting the process to be user-friendly and not burdensome.

It is possible to use a third party for survey development, roll out, and feedback facilitation, while including some of the supply team to assist with interviews where first-hand knowledge can enhance the conversation.

At least one firm uses a third party for assistance, but it is a team internal to the organization; it’s beneficial to have someone who understands the environment or culture of the firm. Additionally, it can be useful to involve inhouse personnel with, for example, consultants who might be hired to assess competencies. If there is no inhouse involvement, there’s more a chance that afterward, the suggestions are just written off as “something else the consultant said we should do,” rather than acknowledging that the drive for change came from the organization.

Supply Management Skills and Competencies
Assessing and measuring appropriate skills and competencies of supply personal can be one of the most important steps to building a successful operation. Unfortunately, it can also be very difficult.
Surveys can ask users about competencies of supply personal or ask them to characterize traits they encountered. The key is to be articulate with the definitions. What does “helpful” look like? What are the characteristics of someone who is “straight-forward”? If you’re measuring someone’s business acumen, what specifically are the knowledge and practice areas this person would have mastered?

The human resource department may play a role in articulating these definitions. They should be involved, at the very least, so that if they are involved with any pre-screening of potential new hires, they can understand the traits and skills for which procurement is searching. Several distinctions might be made, e.g., between strategic or tactical. Behavior-oriented questions can be posed during the interview process.

One firm described an exercise it went through: Some attributes were identified that were core to the company, such as leadership and customer focus. The procurement area then itemized some skills that would be important in that specific function. For each job level, they detailed the skills needed. Then, they assessed all the current employees and determined if individuals were matching up with the elements their positions required. It was difficult, because in some instances, they found a person wasn’t a good fit for procurement at all, or that a person had a higher-level job than he or she was really qualified for. Making adjustments based on this data was contrary to the typical company culture, but they worked hard to place them elsewhere in the firm, and there was buy-in that these moves were vital to the business. They now feel that they have more credibility to say that they stand strongly behind the employees in the appropriate positions.

Executives fully acknowledge that this area can be vague, difficult to navigate, and touchy at times. However, they say there is a direct link between taking the time to do this hard work — upfront if possible or as a new initiative — and purchasing effectiveness in other areas discussed in this report.

Executives fully acknowledge that this area can be vague, difficult to navigate, and touchy at times. However, they say there is a direct link between taking the time to do this hard work — upfront if possible or as a new initiative — and purchasing effectiveness in other areas discussed in this report. Properly hired and trained individuals will perform better, ultimately increasing the performance of the function.

**CASE STUDY: REPSOL YPF** Repsol YPF is a regionally integrated oil and gas company with more than 36,000 employees worldwide, producing more than 1 million barrels of oil a day and a refining capacity of more than 1.2 million barrels a day. It operates more than 6,000 services stations in South America and Europe, and has a presence (for either exploration or production) in 24 countries.
Repsol’s Procurement Environment
The procurement organization at Repsol has been in place since 2002. Oil trading is not included in procurement responsibilities. (There is a dedicated company within Repsol specifically for that.) The company has more than 40 different ERP systems where procurement data is reported or housed. This is, admittedly, not ideal, but a reality. It is essentially a hybrid model, with local, business-centric units, as well as global, procurement-oriented units. Governance and integration are driven by a corporate unit. The vision for the procurement area is: “To become a competitive advantage for Repsol YPF and to provide an excellent service to our Clients, delivered by the most qualified professionals and the best practices.”

The Goal of Purchasing Effectiveness
For Repsol, the challenge of purchasing effectiveness means finding the right balance between delivering high quality results, but doing so “inexpensively” in terms of resources and personnel. In the following table, the items on the left are the effects or deliverables they’re trying to achieve, and the column on the right identifies the resources available or means to those effects.

<table>
<thead>
<tr>
<th>Effects</th>
<th>Resources</th>
</tr>
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<tbody>
<tr>
<td>• Head count control</td>
<td>• Standardization of processes</td>
</tr>
<tr>
<td>• Satisfying (true) customer requirements</td>
<td>• Far better information</td>
</tr>
<tr>
<td>• Deploy and tune new tools</td>
<td>• Better procurement</td>
</tr>
<tr>
<td>• Reduce TCO</td>
<td>professionals</td>
</tr>
<tr>
<td>• Get real cash savings</td>
<td>• Increasing help from new</td>
</tr>
<tr>
<td>• Meet deadlines</td>
<td>tools</td>
</tr>
<tr>
<td>• Increasing audit requirements (SOX)</td>
<td></td>
</tr>
<tr>
<td>• Comply with internal norms and procedures</td>
<td></td>
</tr>
<tr>
<td>• Meet legal requirements</td>
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</tbody>
</table>

Repsol has developed a Procurement Balanced Scorecard to help measure purchasing effectiveness (see charts below). It includes all the elements they consider meaningful, but the Repsol executives say that it also must be flexible and be able to accommodate any changes that come for the company. Furthermore, you must make sure the scorecard includes items that you will eventually be able to take action upon. There are many measures you might be able to obtain through systems and tools, but the point is to use the data to make improvements, not just collect data for data’s sake.
Procurement Balanced Scorecard

- 35 measures
- Monthly update
- Drill-down functionality
- In process of finalizing Accuracy check

- % spend managed by procurement
- % savings
- % aggregation
- ...

- Satisfaction level survey
- Average procurement lead time
- ...

- % spend managed per employee
- Volume per purchase order
- Procurement cost vs managed spend
- ...

- Training hours per procurement employee
- Procurement Personnel rotation
- ...

As is illustrated in the charts above, much of the data is financial or hard data that is pulled from the ERP systems. Repsol said that when trying to roll up data from all the various ERP systems, it was difficult to synthesize. They investigated the USPSC system, but found it wasn’t detailed enough, so they developed their own. It took two to three years to get the accurate data and finalize all the codes.

Many firms aim for the goal of having all procurement data in one system, but admit this can be hard because even with global commodity codes, there always seems to be some local data “left over” that doesn’t fit and is in a different system.

Repsol took a look at the effects that the procurement area was trying to produce and identified which ones were the most important to management. They determined that the most important areas were headcount control, getting real case savings, and complying with internal norms and procedures (to include SOX requirements). These areas could be labeled into the following areas for measurement (respectively):

- Productivity measurements (related to the “financials” piece of the scorecard)
- Savings reporting methodology (related to “financial” and “operational excellence piece of scorecard)
- Process and information standardization (related to the operational excellence piece of scorecard)

Then, for each of these areas, Repsol identified sub areas to measure, the current status of performance, and proposed actions for improvement. The plans for each of these areas are detailed in the following charts:
# Productivity Measurement

<table>
<thead>
<tr>
<th>Objective</th>
<th>Measurement</th>
<th>Proposed Actions</th>
</tr>
</thead>
</table>
| Increase Managed Spend per Buyer  | • Average € awarded per Buyer  
• Average € in POs per Buyer     | • Aggregate procurement volume  
• Create frame agreements for low volume spend  
• Increase e-Tools deployment for clients (less procurement work) |
| Reduce non productive time        | • Number of RFQs per Buyer  
• Time shoot analysis (%dedication)  
• Qualified suppliers            | • Reduce paper usage (electronic workflow)  
• Deploy e-RFQ tool  
• Buyer Portal to distribute, share and evaluate technical offerings  
• Avoid invoices without Purchase order  
• Specifications & Contracts libraries  
• Standardize Supplier qualification |
| Increase intrinsic productivity   | • Buyer qualification                                                     | • Job Skills definition  
• Organizational Design  
• Buyers assessment  
• Development plans  
• Specific training initiatives |
Critical Issues REPORT


Savings Reporting Methodology

Contract awarded

- Prudence: in case of doubt, no savings reported
- Corporate level procedure
- Savings reported to a non procurement office
- Total Cost of Ownership may be reported, but must be fully supported and auditable
- Clear difference between cost savings and cost avoidance

Is there a valid previous price? YES

- Price vs inflected previous price (if recurrent, cost saving)

Is there a valid market index? YES

- Price - Market Index gap vs Previous Price - Market Index gap

Has it been a competitive bid? YES

- Price vs (3) most competitive bids average

Is there a decreasing trend in prices (e.g. IT)? NO

- Price vs Initial bid
## Process and Information Standardization

<table>
<thead>
<tr>
<th>Area</th>
<th>Starting Point</th>
<th>Proposed Actions</th>
</tr>
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| **Procurement Personnel** | • Not identified across the company  
• Loose link with Procurement  
• No specific career development                                                                                                                          | • Initial definition of organizations and jobs  
• Procurement function identified in HR systems across companies and countries  
• Currently updated by HR, and available through the Balanced Scorecard  
• Reinforced link with functional dependence on Procurement |
| **Procurement Plan**   | • Partial, related to production and investment cycles  
• Business Unit level  
• Developed and tracked by the same procurement unit                                                                                                           | • Normalized, aggregable information  
• Comprehensive, aspires to plan most of the activity  
• Comparison planned vs awarded  
• Corporate level consolidation: global tracking, cross buying opportunities                                                                                           |
| **Processes, Procedures and Systems** | • Different procedures, different systems... different processes  
• Lack of information that could be handled globally                                                                                                         | • Business Warehouse for procurement activity: Reliable, accurate, global  
• Global supplier qualification and evaluation System  
• Process Standardization project                                                                                                                                     |
CASE STUDY: 3M  
3M is a diversified technology company serving customers and communities with innovative products and services. Each of its six businesses has earned leading global market positions. The six businesses are:

1. Consumer and office business
2. Display and graphics business
3. Electro and communications business
4. Health care business
5. Industrial and transportation business
6. Safety, security and protection services business

The company had more than $22 billion in sales for 2006. It operates in more than 60 countries, sells products in more than 200 countries, and has more than 40,000 employees internationally.

Sourcing Environment
3M operates with 15 global commodity teams, divided among direct, indirect, and outsourced manufacturing and hard goods. Beginning in 1998, global sourcing has undergone a transformation that has included procurement process re-engineering (1998), the launching of a corporate sourcing initiative (2001), the deployment of cost-competitive country engineers, and several rollouts of tools and systems. The mission of the global commodity teams is to: “build a thorough understanding of the commodity characteristics, develop global commodity strategies, implement changes and continuously monitor performance.”

Measurement Best Practices
To detail its sourcing performance measurement model 3M referenced the CAPS Research Focus Study Strategic Performance Measurement for Purchasing and Supply, mentioned earlier in this report.

Performance measures must be aligned vertically with corporate goals and horizontally with strategies, business units and other functional units.

Below is an example of how sourcing activities align with customers/clients, shareholders, and employee imperatives.
Sourcing Strategy

2007 Sourcing Imperatives

**Customer/Clients**
- Sourcing4Growth
- Accurate & Timely Transaction Processing
  - Purchases
  - Payments
- Globalization & Optimization of Processes & Systems (GBP)
  - Procure to Pay
  - Contract Management
  - Supplier Measurement
  - Business Sourcing Management
- Measure and Improve CSAT & OTIF
- Assure Business Continuity

**Shareholders**
- Attain $xxxM Global Cost Reduction Target
  - 15 Global Commodity Teams
  - Drive Sourcing Strategies & Tactics
  - Multi-Sourcing
  - Six Sigma with Suppliers
  - CCC
  - Indirect Cost
  - eAuction

**Employees**
- Great Business Conduct & Ethics
- Leadership Development
- Strong Communications
- Performance Management
- Recognition
- Training
- Mentoring
- We are Part of the External Face of 3M

**Growth**
- Support Growth
- Drive Global Sourcing Results Using GSS & Six Sigma
- Implement Global Business Processes
- Improve Leadership & Employee Development
- Protect the Corporation

**Cost/Productivity**
- Service
- Improved Competitiveness
- Engaged Employees

**Cash/Working Capital**
- Growth
- Cost/Productivity
- Cash/Working Capital

**Critical Issues**
"Business and Supply Chain Continuity," January 2007; www.capsresearch.org
Another example illustrates another of the CAPS Research principles.

Measures must be transparent and broadly communicated to ensure they are used to drive decision making.

To follow this guideline, 3M uses monthly global dashboards. For example, the dashboard for indirect tracks categories such as fleet, IT, logistics, capital projects, and professional services. For each of these areas, there is a place to indicate projections of savings based on early (staged) contract assessments, active contracts, and post-contract. A global commodity team will also use a dashboard to determine goals and results year to date, as well as a snapshot from the past month. Metrics such as cost-competitive-country spend shifted, e-auction spend, and dual sourcing credits are recorded. The transparency of these tools then allows the leaders to take action and further determine and rectify the factors that might’ve played into a given score.

Even with best practices in place, all firms are running into the same complicated issues that make measurements such a challenging area. Some examples:

Inventories. The capital value of inventories may appear as part of a cash measure, but procurement might not have been responsible for keeping those inventories at such levels. Did the unit need to do so because supplier delivery performance was unpredictable? Or, was there a promotion anticipated that then didn’t materialize?

Contract fulfillment. If you have made a commitment with a supplier for certain capacity (and based savings on these figures), what happens if a legitimate reason surfaces for modifying that capacity (design change, regulation change, promotion)? You will not realize the original anticipated savings, but not through any fault of the purchasing performance. Who is tracking the impacts of actions from other parts of the company?

Reporting Complexity. With multi-national operations becoming the norm, savings reported in one operations center might actual be realized in another area. For example, steps taken at a European facility might make some portion of the operation in Asia more efficient. The European action created the savings, but someone just looking at the European numbers won’t be able to ascertain that.

The point in all of these examples is that every metric has a subsequent explanation that goes along with it. What transpired for the metric to be what it was, what were the influences that occurred to alter a metric from plan, history, or forecast?
CASE STUDY: MERCK  

Merck is a global research-driven pharmaceutical company dedicated to putting patients first. Established in 1891, Merck currently discovers, develops, manufactures, and markets vaccines and medicines to address unmet medical needs. The company has approximately 60,000 employees worldwide, conducts research in nine priority disease areas, and invested more than $4 billion in research and development in 2006.

Sourcing Environment

The vision for Merck’s global procurement area is: Challenge internally and optimize externally to deliver breakthrough business solutions that enable Merck to win.

The Merck global procurement group has more than 350 strategic sourcing and site professionals. Seventeen countries have integrated “shadow” procurement groups. The vice president of global procurement reports to the president of the Merck Manufacturing Division. The group manages approximately $7.4 billion in external expenditure and processes about half a million purchase orders and requisitions annually. Some of the tools that Merck uses to assess purchasing effectiveness include a performance scorecard, customer surveys, and an internal procurement dashboard. Details about the scorecard are shared below.

Performance Scorecard

Merck uses a scorecard to help translate its strategy objectives into operational terms; the idea reiterates what others have also professed: such a tool should be used for strategy execution, not just simply for measuring. In addition to helping the group drive desired behavior, and plan, set targets, and align strategic initiatives, the scorecard helps to elevate the status of strategy execution. It also creates “one version of the truth.”

There is also a corporate scorecard; all divisions link their own to it as well. There is a dedicated group at the corporate level that ensures everyone is using it properly and that all the scorecards roll up properly. Senior management can easily access any scorecards for quick visibility. In the past, as long as a division met its own numbers, or as long as a country/region met its own objectives, that was adequate. However, now the philosophy is that “we are one Merck”; this encourages people to do what is best for the entire company, not just a specific area. The result is what maximizes shareholder value.

The scorecard asks two fundamental questions:

1. How do you measure success in achieving your strategy?
2. What programs/activities are you undertaking to achieve your strategy?
The scorecard has four distinct components:

1. **Objective**: Statement of what strategy must achieve (the answer to this aligns with global procurement’s strategy map, i.e., typically an initiative that will help them demonstrate world-class procurement excellence).
2. **Measure**: How success in achieving the strategy will be measured.
3. **Target**: The level of performance or improvement needed.
4. **Initiative**: Key initiatives/programs required to achieve targets.

The general criteria for selecting measures on the scorecard necessitates that the measures be:

- Useful for strategic communication
- Repeatable and reliable
- Appropriate for frequency of performance updates
- Applicable for target setting
- Useful for establishing accountability — the accountability should reflect authority and capability.

When selecting measures, try to include a mix of different types, such as absolute numbers, indices, ranking, ratios, rating and percentages, to get a balanced perspective. Measures should also include both financial and non-financial, external and internal, and lagging (outcome) and leading (driver) metrics.

Merck as a company has a notion of a “limited” number of measures — at the top level of the company that might mean just three or five. The procurement group has approximately 10 broad measures, but some of those are very basic across the firm, such as maintaining a budget. The total number of measures in place is much greater once you get into the details.

When developing the elements of the scorecard, consider the following questions for each section of measures, targets, and initiatives.

**Measures:**

- Are they aligned with delivering on the company’s strategic objective?
- Are these our highest priorities and only our highest priorities?
- Are they limited in number so as to focus the organization’s activities?
- Do they drive a change agenda and result in desired behaviors?
- Do they track outcomes as opposed to activities?
- Can our employees understand how their work contributes to the successful achievement of these metrics?
Targets

- Are they aggressive, so as to transform the business over a three- to five-year horizon?
- Are they realistic?

Initiatives

- Do they serve to close the gap between where we are today versus where we want to be in 3-5 yrs?
- (Note — not every measure requires an initiative — only those where the performance gap is sufficiently large to warrant it)

When it comes to reporting on the scorecard, the key is to link the measures to analysis and recommendations — again the focus on action. To track performance, the question is: how are the objective and its measure(s) performing? The analysis then becomes: why is the measure performing as it is? What activities support this objective? The recommendation would come from the question: What actions or decisions are needed?

There are monthly business reviews, which are regularly scheduled performance reviews within departments, divisions, and support areas discussing the performance of leading measures and aligned initiatives. These would include the scorecard manager and the function’s management team. The purpose is to identify problems and remove roadblocks as well as manage the leading measures.

Below is an example of portions of the Merck global procurement scorecard.
<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>GP OBJECTIVE DESCRIPTORS</th>
<th>MEASURE</th>
</tr>
</thead>
<tbody>
<tr>
<td>FINANCIAL</td>
<td>Maximize Shareholder Value</td>
<td>Budget</td>
</tr>
<tr>
<td></td>
<td>Grow Earnings</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Increase cash flow</td>
<td></td>
</tr>
<tr>
<td>CUSTOMER</td>
<td>Become the Most Trusted Industry Leader in Delivering Value to Merck by our customers</td>
<td>% spend with diverse suppliers (US/PR)</td>
</tr>
<tr>
<td></td>
<td>Generate a positive impression</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>OBJECTIVE</td>
<td>GP OBJECTIVE DESCRIPTORS</td>
<td>MEASURE</td>
</tr>
<tr>
<td>INTERNAL BUSINESS DRIVERS</td>
<td>Contribute to achieving an industry leading cost structure for Merck</td>
<td>Expense Savings</td>
</tr>
<tr>
<td></td>
<td>Capital Savings</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Utilize standard, global, integrated processes, information and systems</td>
<td>Actual vs plan for integrating procurement resources</td>
</tr>
<tr>
<td></td>
<td>Support deployment of “source to settle” activities for SAP deployment in targeted region</td>
<td></td>
</tr>
<tr>
<td></td>
<td>% spend covered by formal strategy</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Formal strategy coverage for top 80% spend (suppliers making up 80% of total spend)</td>
<td>Critical Supplier Performance</td>
</tr>
<tr>
<td></td>
<td>Leverage sourcing management process to enhance flexibility and productivity</td>
<td></td>
</tr>
<tr>
<td>CULTURE</td>
<td>Create a High Performance Culture</td>
<td>Improve Culture Survey results</td>
</tr>
<tr>
<td></td>
<td>Create a High Performance Organization</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Develop Transformational Leaders</td>
<td>Talent Management</td>
</tr>
<tr>
<td></td>
<td>Optimize organizational structure, accountability &amp; decision making</td>
<td>Actual vs plan for implementing an optimized organizational structure and governance model</td>
</tr>
</tbody>
</table>