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The CPO's Strategic Agenda

Managing Performance, Reporting to the CFO

February 2007

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Executive Summary

The most effective CPOs manage their performance like any other executive. They have standard metrics that help them gauge the health of their operations and benchmarks for relative comparisons. However, CPOs are challenged to demonstrate their impact in commonly understood and accepted enterprise financial terms. The convergence of procurement with finance is helpful, but CPOs need to take advantage of the CFO relationship to drive this bottom-line financial value. As part of our *CPO's Strategic Agenda* research series, we have explored this opportunity in detail with over 500 procurement executives from around the globe.

Key Business Value Findings

While there are many KPIs and benchmarks available, there is one that matters most: **cost savings** (Figure 1).

- Tangible cost savings is by far the most important procurement metric (**75%** response), but it has meaning on multiple levels, the most strategic being the most difficult to measure.
- A reasonably distant second metric is operational costs for the procurement function (**56%** response). Procurement ROI (i.e., cost savings divided by operating costs) is a frequently used measure for the relationship between operational costs and cost savings.
- Gathering, analyzing and sharing spend data is critical for performance management and correlating it to enterprise financial metrics, not to mention increasing spend under management and gaining the trust of key stakeholders.

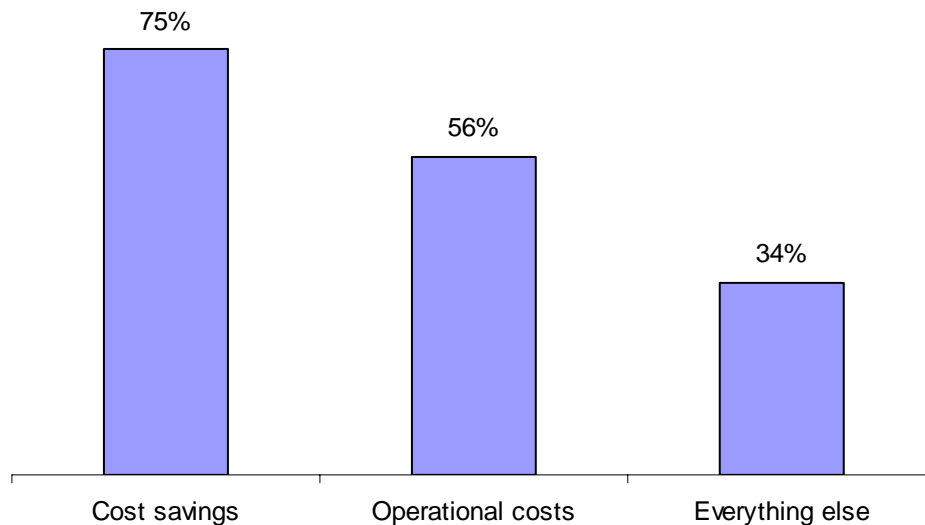
Implications and Analysis

The process of getting procurement cost savings to the bottom-line still involves a bit of artistry. Technology can help, but there's no "secret recipe" to make it easy. The future promises continued evolution of procurement and the measurement of its performance.

- In order to "book" savings, internal negotiations must occur between procurement, finance and budget holders. This must be done with prudence and a spirit of partnership so that the relationship is continuous.
- Technologies exist for procurement, finance and corporate performance management (CPM), but the intersection doesn't have a traffic light yet. In other words, much of the work for procurement performance management, and "booking" savings in particular, still occurs offline.
- There are procurement performance management horizons yet to be reached. This includes equal focus on top-line revenues, in addition to bottom-line costs. The convergence of finance and procurement will be eclipsed by the convergence of sales and procurement as leading organizations continue their business process innovation.



Figure 1: Procurement Performance Metrics



Source: [AberdeenGroup](#), February 2007

Recommendations for Action

- Focus on bottom-line cost savings and operating costs. Correlate all other procurement KPIs back to these two or don't measure them at all.
- Understand your top enterprise financial metrics and correlate your cost savings to them. Use this information to earn the trust of the CFO and budget holders and to get involved in the budgetary process.
- Use technology for spend analysis and procurement process automation. Leverage these technologies to increase spend under management and decrease procurement operating costs.

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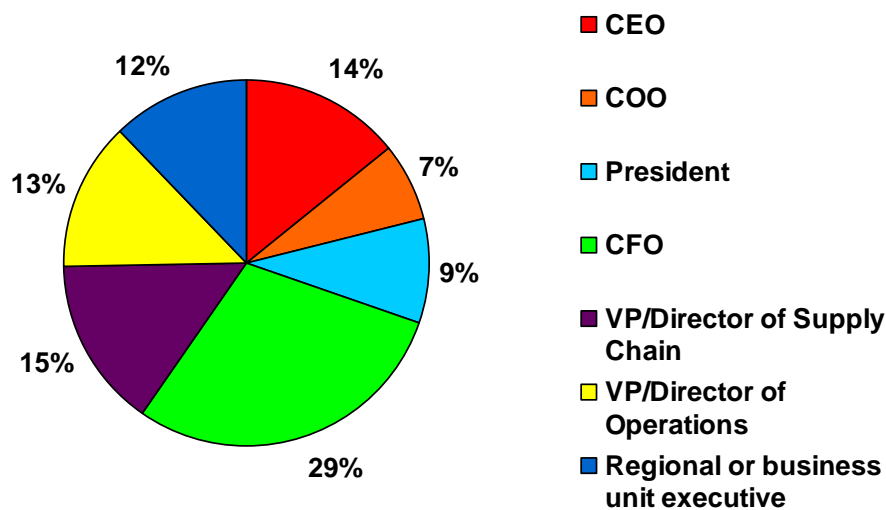
Chapter One: Issue at Hand

Key Takeaways

- CPOs are searching for ways to translate procurement performance into enterprise financial terms that matter to CFOs and other executives.
- Many CPOs in our research have a direct reporting relationship with their CFO and a professional pedigree that includes finance, yet most CPOs fail to fully leverage their “financial” situation.
- Measuring cost savings is more difficult than it sounds and “booking” it is even harder.

Procurement has emerged as a strategic function within the organization in recent years. It is at the crossroads of so many different business processes that it can no longer be considered unnecessary. These enterprise touch points include product design, engineering, packaging, logistics, warehousing, receiving and quality sampling. With so many critical junctures at its fingertips, the question of necessity is answered, but the question of strategic value-add often remains a mystery. CPOs must continue to transform the entire spectrum of their function, not only to unsheathe themselves from the ignominious distinction of a “necessary evil” within the organization, but also to ensure that factors such as cost reductions, cost avoidance, risk mitigation and compliance are adequately communicated and correlated to bottom-line enterprise financial metrics.

Figure 2: Who Do CPOs Report To?

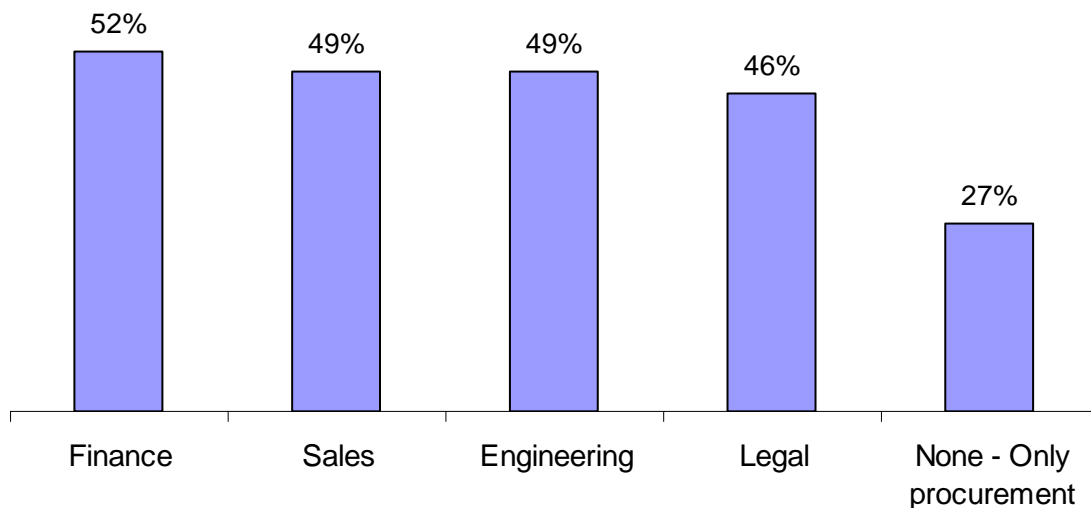


Source: AberdeenGroup, February 2007



CPOs report to CFOs more often than any other role within the enterprise (29%, Figure 2). One of the main challenges with this data point is that most CFOs aren't fluent in the language of procurement. Internal finance departments are focused on hard numbers in industry-standard financial reports, not negotiated savings, supplier performance or even spend under management. The finance-oriented pedigree of so many procurement executives should be a boon, but is more often a false sense of security (Figure 3). CPOs become so steeped in their own world that they often forget the financial fundamentals.

Figure 3: Functional Pedigree for CPOs



Source: [AberdeenGroup](#), February 2007

Pure procurement key performance indicators (KPIs) are beneficial, but only where they support your overall financial goals. Having too many can cause confusion and lack of focus on what is most important—delivering tangible financial value to the enterprise.

"We report on purchase price variance each week for all of our raw materials. We're normally within 5%."
– CPO, Large European Food Producer

Following is a list of the top KPIs from our recent [The CPO's Strategic Agenda: Managing People, Managing Spend](#) report (Table 1).

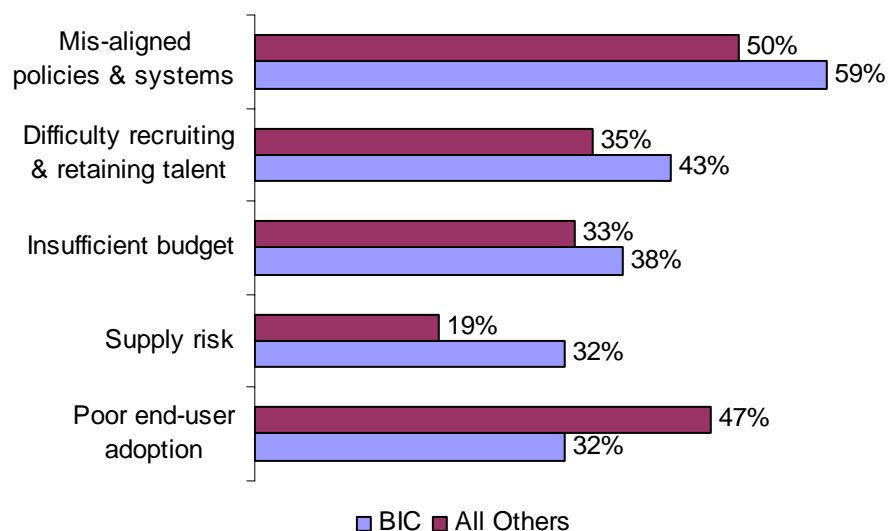
Table 1: Top 10 Procurement Key Performance Indicators (KPIs)

KPI	% Selected
Negotiated cost reduction savings	75%
Implemented / realized cost reduction savings	67%
% of total spend under management	61%
Cost avoidance	60%
Procurement ROI (savings / operating costs)	56%
% of suppliers = 80% of spend	50%
Supplier performance (price, delivery, quality, service, etc.)	48%
Contract compliance	37%
Requisition, PO or invoice transaction volume	36%
Subjective feedback (structured, survey-based)	35%

Source: [AberdeenGroup](#), February 2007

The complete list of KPIs is much longer and includes additional metrics like end user adoption, spend per procurement employee, percentage of spend sourced, and missed payment discounts. CPOs cannot accurately measure and respond to every single one of these KPIs. Even if they did, they might still be missing the bigger picture. So what else is driving CPO behavior? We asked about the top pressures that CPOs are experiencing.

Figure 4: Top Five Pressures



Source: [AberdeenGroup](#), February 2007



Connecting the Technology Dots: A CPM Hurdle for CPOs

With 59% of Best in Class enterprises stating their top pressure is misaligned policies and systems, it is clear that somewhere within the organization there's a disconnect (Figure 4). Corporate performance management (CPM) solutions often only deal with the finance division—offering critical data and related features for forecasting, budgeting, planning and reporting. These CPM solutions, more often than not, avoid procurement. Financial solutions offer technology to assist with the flow of accounting information and financial reporting, but there is only a brief hand-off from procurement and rarely a reciprocating transaction. Procurement-centric technologies often operate in a financial vacuum, and sourcing is particularly vulnerable. While solution providers have closed the gap between upstream supplier negotiations and downstream contract management, there is still a gap further downstream in finance related to budgeting and financial performance management. Spend analysis technologies are a potential bridge over these troubled waters, but it is still a rapidly evolving space. CPOs and CFOs are left to connect the dots across these systems, but usually opt for a spreadsheet and a binder.

"There's always some pushback [from the finance division] regarding recognition of cost savings. We have to make a detailed business case for our CFO. This is part of the wedge that exists between finance and procurement."

– Director of Supply Chain Management, Large Energy and Utilities Supplier

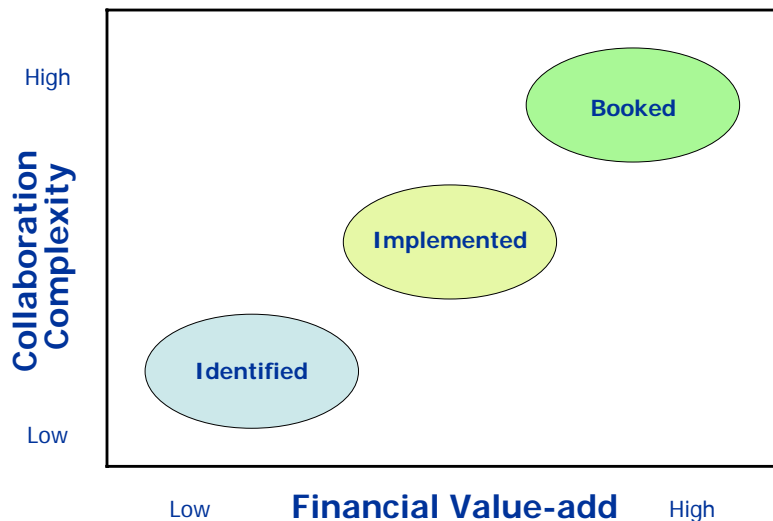
Chapter Two: Key Business Value Findings

Key Takeaways

- Cost savings is by far the most important procurement metric, but it has meaning on multiple levels, the most strategic being the most difficult to measure.
- Operational costs for the procurement function are of secondary importance, but only as a function of the primary cost savings measurement.
- Gathering, analyzing and sharing spend data is critical for performance management and correlating it to enterprise financial metrics.

Cost savings is to procurement what location is to real estate investors: the first, second and third most important thing. The complexity comes as you try to equate this to enterprise financial metrics.

Figure 5: Cost Savings Spectrum



Source: Aberdeen Group, February 2007



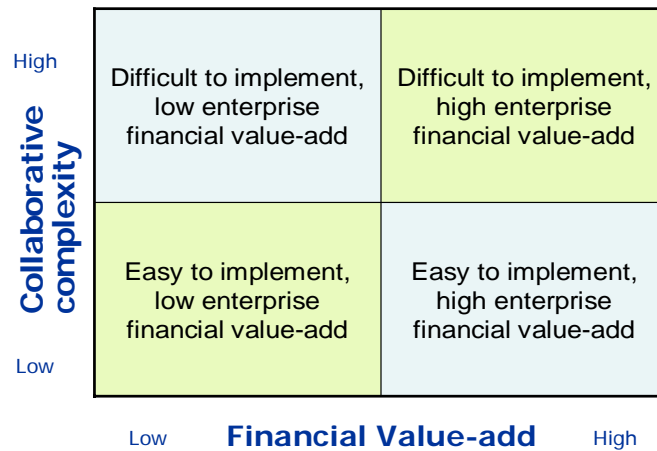
Cost Savings, Cost Savings, Cost Savings

There are three levels of cost savings to be achieved (Figure 5). As the collaboration complexity of implementation increases, so does the enterprise financial value-add (Figure 6).

1. **Identified** – Beyond simple identification of a savings opportunity, this level is characterized by sourcing activity, negotiated pricing and other contractual terms that provide clear savings potential.
2. **Implemented** – With new terms and contracts in place, enterprises can realize the potential of previously identified savings opportunities. This level is characterized by purchasing, receiving, invoicing and payment activity along with contract compliance and strong end user adoption.
3. **Booked** – Once savings have been implemented, they can then be financially recognized in budgets and other financial statements. This level is characterized by close involvement with finance and the internal customer or budget holder.

Case Study: Large Manufacturer	
Enterprise: Large retail-products manufacturer with \$1.5 billion in spend.	
Strategy Employed: Centralized ERP system to monitor direct materials and report on purchase price variance (PPV) on a weekly basis.	
Description: Looking to drive immediate cost reduction measures and report them to the CEO once a month, the enterprise generated forecast data into savings sheets, testing themselves against it on a weekly basis.	
Results: With a goal of year-over-year cost reduction, the system allowed the company to put a performance indicator on themselves to see how close they were to their pre-measured standards. Cost savings were recognized and built into the following year's budget.	

Figure 6: Cost Savings Characteristics



Source: AberdeenGroup, February 2007

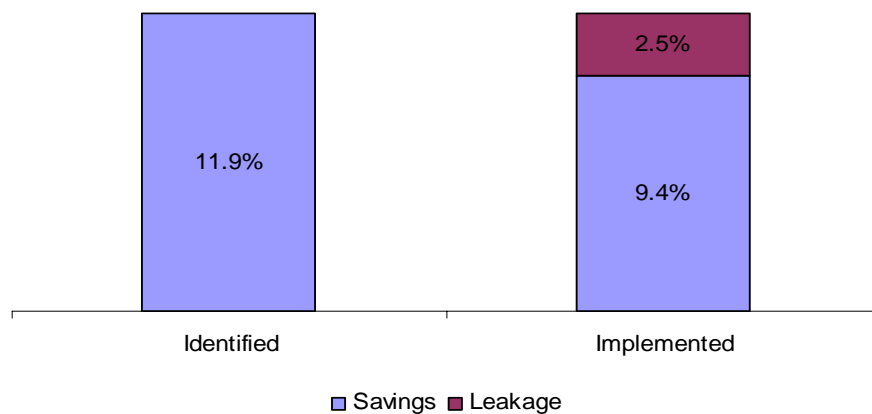
It is important to note that savings can come from both cost reductions and cost avoidance. Cost reductions are much easier to account for, but the financial impact from cost avoidance is also real. In fact, in volatile or inflationary markets, cost avoidance or cost containment might be the pinnacle of procurement achievement. Accounting for non-reductions can be done through comparisons to similar circumstances from historical data or from other external data points. For example, while the price of a volatile commodity fluctuates in the market, the fact that costs remain constant and lower on average can be a very good thing, even if there is a slight decrease over time. Unfortunately, CFOs are reluctant to recognize the positive impact of non-reductions and they typically serve a more qualitative purpose—establishing trust and providing good internal customer service.

“Cost avoidance is always measured. From the original negotiated contract, we’re always aware of cost avoidance. Expenses have risen over the last four years and some quite dramatically. We analyze our spend on a year-over-year basis and look at where best to create reductions vs. avoidances.”

– *Manager of Purchasing, Integrated Facilities Services Enterprise*

In some industry segments, like public sector, overall budgets have a tendency to increase year-over-year and the important thing to measure (and report on) is the cost-per-X or line item savings. There are also subtle differences across commodities like direct materials, IT equipment and business services. While cost savings rates might appear smaller for a direct materials sub-category, the cost of a single skilled person to achieve them may provide an impressive procurement ROI.

Figure 7: Savings Leakage



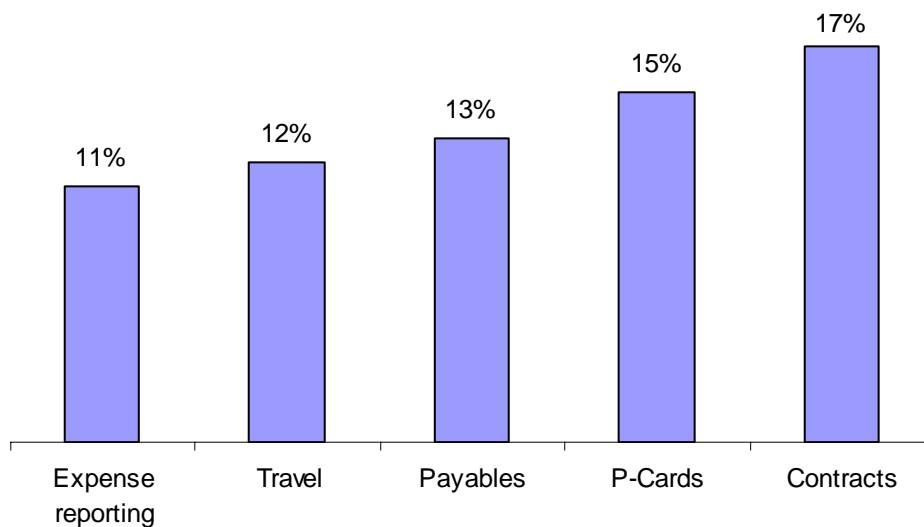
Source: [AberdeenGroup](#), February 2007



Quote-to-Cash for Procurement

Achieving the first level of negotiated cost savings is relatively easy—it is the quote from the supplier. Assuming there is a qualified sourcing professional at the helm, an effective spend analysis application and a good sourcing tool are the primary requirements. It is relatively easy because it is largely under the control of procurement. However, simply identifying an opportunity for savings doesn't mean that actual savings have occurred or ever will. The same holds true for negotiations that reflect new pricing and terms. Until these are used, POs are issued and payments sent, the negotiated savings potential hasn't been fully realized. Average procurement organizations experience savings leakage of up to **2.5%** from identification to implementation (Figure 7). The average cost of this leakage per negotiation is **\$107,037.83**. And, just as with the revenue recognition process on the customer-facing sell-side (i.e., quote-to-cash), the tangible impact of the savings that are fully implemented isn't felt until they hit the bottom-line.

Figure 8: Areas of Planned Procurement Involvement Over 24 Months



Source: [AberdeenGroup](#), February 2007

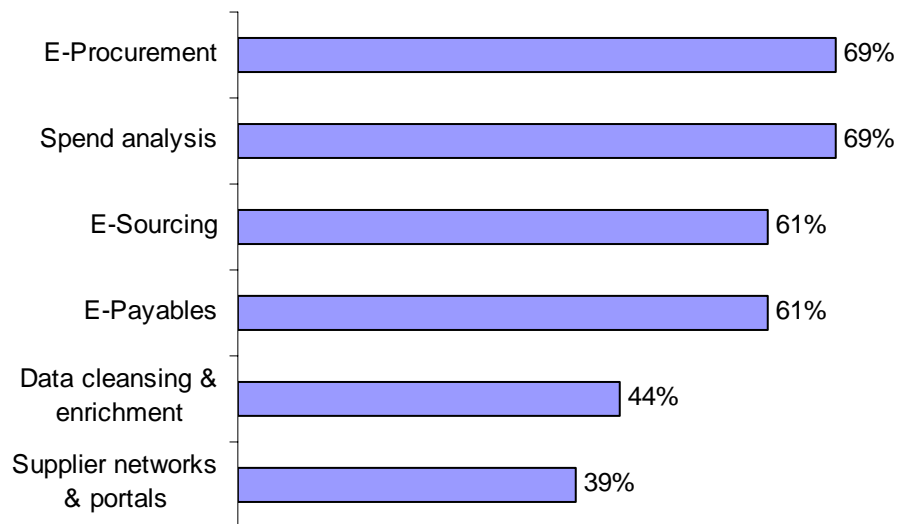
The Cost of Savings

The amount of savings generated by procurement should far exceed the operational cost of the function. Procurement ROI is a common metric to calculate this.

Cost savings / Procurement operating costs = Procurement ROI
For example, a procurement organization with annual operating costs of \$2.5 million that saves \$15 million annually would have an ROI of 6.0, or 600%.
(\$15m / \$2.5m = 6.0)

Payroll and related expenses are the number one operational budget item for CPOs. While the mix of desired skills for procurement professionals continues to shift heavily in favor of strategic functions like analysis, sourcing and supplier development, **41%** of CPOs don't plan for overall headcount growth in the next 12 to 24 months. Yet, at the same time they *do* plan to expand their influence into many other spend categories and enterprise functions (Figure 8). The only way to accomplish this is through effective technology deployment. The list of most commonly automated functions highlights areas of technological maturity, impact and end user acceptance (Figure 9). Noticeably absent from the list are corporate performance management (CPM) and financial analysis tools that go beyond payables.

Figure 9: Current Procurement Technology Utilization



Source: [AberdeenGroup](#), February 2007

Spend Data: Fuel for Procurement KPI Engines

In order to accurately measure cost savings, it is critical to have spend data that spans the entire source-to-settle lifecycle (i.e., sourcing, contracting, requisitioning, purchasing,



receiving, invoicing, and payment). Once the data is captured, the spend can be managed. Once it is managed, savings can be identified, implemented and ultimately, booked.

Case Study: Resort Management Company

Enterprise: Resort management enterprise responsible for operations of several major ski and year-round resorts.

Strategy Employed: Deployed purchasing and inventory modules through an enterprise cost management solution.

Description: This enterprise had been operating off a homegrown cost management system that was created in 1998. In 2006, they went live on a new total spend management solution that included purchasing and inventory modules.

Results: The new system was leaps and bounds ahead of the enterprise's old solution, allowing them to run reports on a much faster basis. This solution was also capable of "zooming" in on virtually any defined parameter of the company's spend, resulting in pinpointing exact information, such as cost per hotel room and the ability to look at costs for each resort individually.

What About All of the Other KPIs?

Just like the earlier example which shows the correlation between a typical procurement KPI (operational costs) and the #1 KPI (cost savings), similar relationships exist with other KPIs (Table 1). For example, the *percentage of suppliers = 80% of spend* plays a dual role. On one hand, it is a great operational metric that helps determine the number of supplier relationships that must be managed by a procurement team. Obviously, the more spend that goes through a core group of suppliers, the easier it is to manage and procurement ROI increases. At the same time, *percentage of suppliers = 80% of spend* is a rough indicator of negotiating leverage. The more spend you have with a given supplier, the more leverage you have for pricing and other terms. Of course, extreme strategies like sole sourcing often increase supply risk, but mitigation measures and exit strategies can counter this. Like many KPIs, *percentage of suppliers = 80% of spend* also varies widely across commodities. Most organizations have their top commodities under control (*15 to 20% of suppliers = 20% of spend*) while others are sorely neglected (*more than 20%*). In some cases, the number of suppliers is intentionally high or is irrelevant (e.g., highly fragmented supply or highly commoditized products and easily enabled suppliers).

"Our technology system has shown that we've brought in savings. We're currently measuring the compliance end [of spend under management] and seeing what percentage of our dollars are under contract as compared to what's not."

– Purchasing Director, Large Professional Services Firm

Talking the Talk

One of the missing links to finance is often the simple ability or willingness to speak their language. CPOs know what matters most to the enterprise at large, but other members of the procurement team may not. Even if they do, their talk may still be procurement-centric rather than speaking at the lowest common denominator for the enterprise. For publicly-traded enterprises, this often equates to EPS (earnings per share), EBITDA (earnings before interest, taxes, depreciation, and amortization) and simple cash flow. However, the positive impact of cost-cutting on net income is valid for enterprises of any shape or size. For public companies, an increase in net income leads to greater EPS and ultimately a higher market value. For other enterprises, the increase in net income simply means more profit and/or the ability to provide more products or services to external customers. Other financial metrics to be considered include ROIC (return on invested capital) and EVA (economic value add). If ROIC is greater than the cost of capital, then EVA is positive and value is added to the organization.

The Negotiation after the Savings are Implemented

Ninety percent of the CPOs we spoke to described the final step in the process of “booking” their savings as an internal negotiation. The parties involved are senior members of procurement, finance (CFO and controller) and the budget-holding organization. There are many resemblances to the negotiations of the late ‘80s and early ‘90s before online sourcing tools became so prevalent—laborious, offline processes riddled with spreadsheets and paper. Procurement brings their savings binder and tries to convince the budget holder to carve implemented savings out of their budget for the current or upcoming period. The budget holder is reluctant to lose funding of any sort and wants to reallocate rather than remove money. Finance is the referee that understands both sides, yet holds a bias toward procurement. This process typically alienates the budget holder and they get in the back of the line the next time procurement comes knocking on their door to “save” them more money.



Case Study: Large European Financial Services Enterprise

Enterprise: Large European financial services enterprise dealing with impacts from recent acquisitions and significant growth.

Strategy Employed: Bottom-up budgets and multi-year action plans to deliver savings along with creative use of technology for sourcing to leverage volume and drive competition.

Description: Performance management used to be a top-down process (i.e., cost savings mandate) because there was no other way. Additionally, management was very interested in tracking savings from operational synergies resulting from acquisitions, in addition to driving normal improvements in procurement and sourcing. With the support of the CFO, the procurement team is aggressively moving to a bottom-up approach where budgets are built together with procurement, finance and the internal customer. The CPO is driving a standardized e-sourcing tool that streamlines the process and enables savings through spend consolidation and supplier competition.

Results: Procurement is on track to contribute **€130 million in tangible savings** for the period from 2005-2008 (based on 2005 financial results).

In some cases, procurement has earned the respect of finance and they are given responsibility that reflects that. A good indicator of this trust is the role procurement plays in the budgeting process. We came across several examples where procurement is an integral part of the process. In one example, we found procurement at the budgetary fountain-head—nothing went to finance or anywhere else without first going to procurement.

Best in Class examples, however, were those where procurement was not only involved in the budget process, but also as an integral business advisor to the budget holder. The budgetary negotiation wasn't a quarterly or an annual event; it was a weekly one where procurement was measuring their performance in terms of the budget they helped define.

Chapter Three: Implications & Analysis

Key Takeaways

- In order to “book” savings, internal negotiations must occur between procurement, finance and budget holders.
- Technologies exist for procurement, finance and corporate performance management (CPM), but the intersection doesn't have a traffic light yet. In other words, much of the work for procurement performance management, and “booking” savings in particular, still occurs offline.
- There are procurement performance management horizons yet to be reached. This includes equal focus on top-line revenues, in addition to bottom-line costs.

As shown in Table 2, research participants fall into one of three categories (Laggard, Industry Average, or Best in Class) based on their characteristics in six key categories: 1) cost savings, 2) procurement ROI, 3) spend under management, 4) budgetary process, 5) finance relationships, and 6) technology utilization. Note that most Best in Class procurement organizations have only recently arrived at their current performance level. As these organizations mature, the performance framework will change. For example, it is not realistic to expect continually increasing cost savings rates.

Table 2: Procurement Excellence Competitive Framework

	Laggards	Industry Average	Best in Class
Cost Savings Rate	<ul style="list-style-type: none"> • 0-2% • Minimal visibility 	<ul style="list-style-type: none"> • 2-5% • Reported with visibility outside of procurement 	<ul style="list-style-type: none"> • 5% or more • Tied to enterprise financial metrics (i.e., “booked”)
Procurement ROI	<ul style="list-style-type: none"> • 100-300% 	<ul style="list-style-type: none"> • 300-700% 	<ul style="list-style-type: none"> • 700% or more
Spend Under Management	<ul style="list-style-type: none"> • 0-30% • Includes common categories (office equipment and supplies) 	<ul style="list-style-type: none"> • 30-70% • Includes core categories (raw materials, production supplies, fleet, etc.) 	<ul style="list-style-type: none"> • 70% or more • Includes complex categories (services, marketing, benefits, etc.)
Budgetary Process	<ul style="list-style-type: none"> • Independent of procurement 	<ul style="list-style-type: none"> • Based on input from procurement 	<ul style="list-style-type: none"> • Procurement is an integral part of budget planning and on-going management



	Laggards	Industry Average	Best in Class
Finance Relationship	<ul style="list-style-type: none"> • Ad hoc interaction 	<ul style="list-style-type: none"> • Regular interaction • Relationship with the CFO or controller 	<ul style="list-style-type: none"> • Continuous interaction • Relationship of trust with the CFO
Technology Utilization	<ul style="list-style-type: none"> • Basic or partial supply management suite 	<ul style="list-style-type: none"> • Broad supply management suite (sourcing, contracts, e-proc, payables) • Linkage to finance • Spend analytics 	<ul style="list-style-type: none"> • Full supply management suite • Strong linkage to finance • Corporate performance management systems in place

Source: AberdeenGroup, February 2007

Cost Savings Consistency

Best in Class sourcing produces repeatable savings on a consistent basis rather than inconsistent spikes of seemingly exceptional performance. Furthermore, there is often an inverse relationship between the amount of cost savings achieved in a given year and the maturity of the sourcing function within an enterprise.

Spend Under Management

Definitions vary for this particular metric, but ours is relatively simple:

1. Core spend management business processes occur online, within a technology-based system (i.e., sourcing, procurement, payment)
2. Contracts resulting from sourcing include more than just a price and standard terms and conditions
3. Spend must be accessible to procurement (e.g., excludes payroll)

Budgetary Process

Internal negotiations with finance and budget holders must be conducted with prudence and a spirit of partnership so that the relationship is continuous. Best in Class procurement teams aren't just involved in the budgetary process, they are business partners.

“Procurement is the first step in our budgetary process. We provide inputs to get the process started and then review budget proposals. Nothing goes to Finance until it has been through procurement. Once a budget is approved, we conduct frequent reviews and make adjustments where necessary.”

– CPO, Best in Class Consumer Packaged Goods Company

End-users are quickly alienated if procurement and finance “team up” in an adversarial, cost-cutting exercise. Booking savings doesn’t necessarily mean budget reductions. It merely means getting recognition at the most fundamental financial level. Budget re-allocations and top-line revenue growth are more than acceptable outcomes that may not result in overall year-over-year decreases, but they most certainly reflect financial value-add and/or line item cost improvement (price, predictability, lifecycle cost, etc.).

Technology Assistance

There is a technology void for procurement performance management. As much as technology helps the CPO with secondary goals of operational efficiency, it has yet to deliver on the primary goal of “booked” savings. Technologies for spend analysis, sourcing contract management and budgeting are all very helpful, but together or apart there is still a void. CPM (corporate performance management) technology providers understand finance and are perhaps closest to addressing the procurement opportunity, but most have yet to take the final step. Spend analysis solution providers are also likely candidates to assist the CPO with their performance management. ERP providers, large and small, also have a cat-bird seat at the party, but often still need an invitation.

Strategic partnerships that bring the best of procurement technology together with the best of CPM will be an important step toward the ultimate solution. Over time these relationships will serve to educate the partners and onlookers so that respective solutions become more robust. Eventually, procurement performance management features will be standard issue in procurement technology offerings. Hopefully, this won’t occur just as CPOs prepare to take the next major stride toward becoming a strategic enterprise function, and the features will have been well worth the wait.

Case Study: Forest Products Company

Enterprise: Multi-billion dollar forest-products enterprise.

Strategy Employed: Focus on specific categories for spend optimization and cost savings.

Description: Disparate systems for different business processes, spend categories and business units led to multiple challenges: difficulty rationalizing data which hampered ability to leverage spend, and matching holds in A/P resulting in lost discounts.

Results: Implemented standalone procurement system for target categories, like IT. Focused on better spend data to drive category-specific sourcing improvements. Resulting success is a beacon to other parts of the organization in spite of attempts to consolidate systems and remove the standalone application.



Procurement Performance Management Future

The convergence of finance and procurement will likely be eclipsed by the convergence of procurement with sales as leading organizations continue their business process innovation. Procurement will become a contributor to top-line revenue, not only as cost savings are reallocated to better deliver on customer commitments or expand offerings into new markets, but procurement will actually help *sell*. Part of this innovation will be the convergence of technologies for CRM (customer relationship management) and SRM (supplier relationship management)—some of which can be readily used today. For example, several supply professionals are using sales opportunity tracking and qualification tools for their suppliers. Sales people are using sourcing and supplier identification tools to initiate partnerships to win new business. Balance of trade as a negotiation consideration is further evidence of the ever-increasing complexity of supply chain relationships and sales-procurement convergence.

Another part of the convergence will be a process and methodology evolution—everything from sales tactics being used by buyers to highly leveraged savings-based compensation plans for procurement executives. But perhaps the most important innovation will be the mental and organizational shift that brings these enterprise functions closer together. Stay tuned for continuing developments in this space, but don't let it distract you from the objective du jour—*cost savings, cost savings, cost savings!*

“Our procurement team members sit side-by-side with our sales force. They understand customer demand as well as the supply chain. This not only helps our suppliers, but increases satisfaction and win-rates with our customers. I am disappointed when sales people visit me without any involvement from their procurement team.”

– CPO, Multi-national High-Tech Company

Pressures, Actions, Capabilities, Enablers (PACE)

There is a clear relationship between the pressures CPOs identified, the actions they have taken, and their subsequent competitive performance.

Table 3: PACE (Pressures, Actions, Capabilities, Enablers)

Priorities	Pressures	Actions	Capabilities	Enablers
1	Identified cost savings	Capture and aggregate spend data Leverage and commit spend Implement basic sourcing strategies	Spend analysis expertise Supplier identification and qualification Negotiation skills	Spend data classification, cleansing and analysis Supplier data management E-sourcing
2	Implemented cost savings	Capture detailed contract data Monitor compliance Establish contract lifecycle policies	Contract management skills Cross-department collaboration w/ A/P End-user education and support	Contract repository and authoring Purchasing and payables systems Strong procurement policies
3	"Booked" cost savings	Negotiate internally Focus on cost-per-X and/or overall budget reductions Account for avoidance and containment	Negotiation skills Understanding of financial processes and metrics Cross-department collaboration w/finance and budget holders	Financial systems support beyond A/P Corporate performance management Supply management technology suite
4	Lower procurement operating costs	Automate tactical operations Shift headcount to strategic, value-adding functions Measure procurement ROI	Process automation and streamlining Human resource optimization Technology adoption	Supply management technology suite Integration to related systems in finance

Source: [AberdeenGroup](#), February 2007



Chapter Four: Recommendations for Action

Key Takeaways

- Focus on the top two KPIs: 1) cost savings, and 2) operating costs. Correlate all other procurement KPIs back to these two or don't measure them at all.
- Identify your top enterprise financial metrics and correlate your cost savings to them.
- Earn the trust of finance and budget holders and get involved in the budgetary process.
- Gather, analyze and distribute spend data to help drive cost savings.
- Use technology to automate and streamline procurement processes, thereby decreasing operating costs.

CPOs have tremendous opportunities and threats facing them on their path to becoming an increasingly strategic enterprise function. Whether moving gradually from Laggard to Industry Average, or Industry Average to Best in Class, the following actions will help guide procurement executives through the necessary steps for performance improvement.

Laggard Steps to Success

1. *Adopt spend analysis solutions to gather and evaluate performance statistics and identify opportunities for improvement*

Carefully select and implement a spend analysis solution that allows you to gather data from multiple sources without significant manual intervention, cleanse and enrich the data as necessary, analyze the results with out-of-the-box reports and dashboards, and make the results easily accessible throughout the enterprise. In addition to internal reviews, results should be shared on a regular basis with suppliers.

2. *Use technology to automate and streamline procurement processes, thereby decreasing operating costs*

Supplier networks, e-sourcing, e-procurement and e-payables are leading choices to improve efficiencies. Implement or expand implementations in any and all of these areas. With significant automation comes the opportunity to redeploy human resources to more strategic functions. Lower operating costs will increase procurement ROI.

Industry Average Steps to Success

1. *Adopt the top two key performance indicators for procurement*

Resist the urge to track any KPI unless it can be correlated back to increased cost savings or decreased procurement operating costs. If a KPI doesn't serve either one of these two purposes, it isn't worth measuring. Set targets for incremental improvement on a quarterly basis relative to historical performance.

2. *Earn the trust of Finance and budget holders*

The old adage about someone not caring how much you know until they know how much you care is almost true for CPO relationships. It needs to be updated: “Budget holders don’t care how much you know unless it relates directly to them and then and only then, they want to know how much you care.” Learn as much as you can about your internal customers and partners and then approach them in their own language around topics that matter to them. Build on this credibility by adding incremental value with each subsequent. At first you will be a “free” resource and then you will be an indispensable part of their team.

Best in Class Next Steps

1. *Link procurement performance metrics to enterprise financial goals*

Identify your top enterprise financial goals, like EPS. Correlate your cost savings to those goals. Include them as part of a regular review process with internal executive management, including the CFO. Where possible, benchmark yourself against your competition or organizations with similar characteristics.

2. *Get involved in the budgetary process*

Building on a relationship of trust, provide spend data that will help with the budgeting process. Offer to help construct and then review budget proposals prior to finance submission. Regardless of your up-front involvement, facilitate regular reviews of performance relative to established budgets by providing more data and offering to discuss ideas for cost savings in areas that are at greatest risk of overspending.

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Author Profiles

**Vance Checketts,
Vice President
Global Supply Management
AberdeenGroup, Inc.**

Vance Checketts is a recognized expert in the areas of procurement and supply management with a deep background in the application of technology and the underlying business process. Prior to Aberdeen he was at Oracle where he was responsible for the development and sales support of their procurement applications. Prior to Oracle, he held senior roles managing direct and indirect procurement. He has lectured and published with various industry organizations, including IFPSM, ISM, and Haas School of Business at UC Berkeley. He holds an MBA from Brigham Young University. He oversees and contributes across the entire scope of Aberdeen's Global Supply Management research team.

**Christopher J. Dwyer
Research Editor
Global Supply Management
AberdeenGroup, Inc.**

Christopher J. Dwyer is a Research Editor in Aberdeen's Global Supply Management channel and focuses on analysis within supply management sub-areas such as sourcing, procurement, direct materials and category spend management. He has extensive writing and editing experience, previously holding roles as a reporter and editor for multiple New England-based community newspapers. He graduated from Suffolk University in 2004 with a Bachelor's Degree in Print Journalism and Communications.

Appendix A: Research Methodology

During the latter part of 2006 and early 2007, Aberdeen Group gathered research data from CPOs and procurement executives at over 500 enterprises across a wide range of industries and other demographics.

In addition to online surveys, Aberdeen conducted telephone interviews with select survey respondents, gathering additional information on specific strategies, experiences and results. Data from the *2006 CPO Summit* event was also incorporated into the body of research.

The study aimed to identify the key performance indicators for CPOs and present them in a framework that allows for a competitive comparison with other enterprises.

Responding enterprises included the following:

- **Job function:** The research sample included respondents with the following job functions: procurement and supply chain (87%), business process management (5%), IT (4%), finance (1%) and customer service (1%).
- **Job title:** The research sample included respondents with the following job titles: director (31%), manager (26%), vice president (17%), CPO (14%), consultant (4%), staff (3%), president or CEO (1%) and CIO (1%).
- **Industry:** The research sample included respondents that were broadly distributed across 32 different industries.
- **Geography:** 65% of the research respondents were from North America, 30% were from Europe, Middle East and Africa and 5% were from Asia-Pacific.
- **Company size:** 64% of respondents were from large enterprises (annual revenues above US\$1 billion); 27% were from midsize enterprises (annual revenues between \$50 million and \$1 billion); and 9% of respondents were from small businesses (annual revenues of \$50 million or less).

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Table 4: PACE Framework

PACE Key
<p>Aberdeen applies a methodology to benchmark research that evaluates the business pressures, actions, capabilities, and enablers (PACE) that indicate corporate behavior in specific business processes. These terms are defined as follows:</p> <p><i>Pressures</i> — external forces that impact an organization's market position, competitiveness, or business operations (e.g., economic, political and regulatory, technology, changing customer preferences, competitive)</p> <p><i>Actions</i> — the strategic approaches that an organization takes in response to industry pressures (e.g., align the corporate business model to leverage industry opportunities, such as product/service strategy, target markets, financial strategy, go-to-market, and sales strategy)</p> <p><i>Capabilities</i> — the business process competencies required to execute corporate strategy (e.g., skilled people, brand, market positioning, viable products/services, ecosystem partners, financing)</p> <p><i>Enablers</i> — the key functionality of technology solutions required to support the organization's enabling business practices (e.g., development platform, applications, network connectivity, user interface, training and support, partner interfaces, data cleansing, and management)</p>

Table 5: Relationship Between PACE and Competitive Framework

PACE and Competitive Framework – How They Interact
<p>Aberdeen research indicates that companies that identify the most impactful pressures and take the most transformational and effective actions are most likely to achieve superior performance. The level of competitive performance that a company achieves is strongly determined by the PACE choices that they make and how well they execute.</p>

Table 6: Competitive Framework

Competitive Framework Key
<p>The Aberdeen Competitive Framework defines enterprises as falling into one of the three following levels of procurement practices and performance:</p> <p><i>Laggards (30%)</i> — Procurement practices that are significantly behind the average of the industry, and result in below average performance</p> <p><i>Industry Average (50%)</i> — Procurement practices that represent the average or norm, and result in average industry performance.</p> <p><i>Best in Class (20%)</i> — Procurement practices that are the best currently being employed and significantly superior to the industry norm, and result in the top industry performance.</p>

Appendix B: **Related Aberdeen Research & Tools**

Related Aberdeen research that forms a companion or reference to this report includes:

- [*CPO's Strategic Agenda: Managing People, Managing Spend*](#) (November 2006)
- [*CPO's Summit: \\$1.46 Trillion On Tap*](#) (November 2006)
- [*Source-to-Settle: Compliance Clues for the CFO*](#) (October 2006)
- [*CFO's View of Procurement: Getting More to the Bottom-line*](#) (September 2005)

Information on these and any other Aberdeen publications can be found at www.Aberdeen.com.

Aberdeen Group, Inc.
260 Franklin Street
Boston, Massachusetts
02110-3112
USA

Telephone: 617 723 7890
Fax: 617 723 7897
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February 2007

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