SAP Thought Leadership
Sourcing and Procurement

INTEGRATED SOURCING AND PROCUREMENT

ENABLING PROFITABLE GROWTH IN WHOLESALE DISTRIBUTION

THE BEST-RUN BUSINESSES RUN SAP™

Leading wholesale distributors are more likely to engage in collaboration with other internal units, have standardized sourcing processes, and automate their spend analysis systems.

CONTENT

4 Executive Summary

5 The Evolving World of Wholesale Distribution
5 Changing Priorities of Supply Chain Executives

6 Integrated Sourcing and Procurement
6 Procurement Operations
6 Staffing
6 Information Technology
7 Contract Lifecycle Management and Compliance
7 Cost Recovery – Supplier (Vendor) Rebates
7 Strategic Sourcing
8 Using Dashboards to Manage Supply Risk
9 Spend Analysis

10 Best Practices in Sourcing and Procurement
10 Achieving Higher Effectiveness and Efficiency

12 Procurement Shared Services
12 Charmer Sunbelt Group and Shared Services

13 Sourcing and Procurement Solutions from SAP
13 SAP's Strategy for Procurement
14 SAP Integration
14 SAP for Wholesale Distribution
14 SAP BusinessObjects Spend Performance Management
14 SAP Extended Sourcing for Retail and Wholesale Distribution
14 SAP Contract Lifecycle Management
15 Further Support for Key Processes
15 Next Steps

EXECUTIVE SUMMARY

NEW GOALS FOR SOURCING AND PROCUREMENT ORGANIZATIONS

Growing profitability and delivering value to stakeholders are key business objectives for a wholesale distributor. Historically, sourcing and procurement organizations have focused on reducing costs and ensuring supply availability and quality. However, leading wholesale distributors now expect the procurement function to deliver value by improving profitability, increasing supplier collaboration, and thereby fostering competitive differentiation.

These distributors are making comprehensive changes in personnel, processes, and technology; investing for the long term; and focusing on how the financial and physical supply chains can contribute to corporate objectives. Delivering differentiated products and services along with effective pricing is crucial for wholesale distributors to succeed. Involving the sourcing organization in the decision-making process and leveraging it to enhance supplier collaboration is critical to gain competitive advantage.

This outlook is gaining acceptance, and most successful distributors have embarked on a strategic sourcing and spend management program. This program's effectiveness is measured by its ability to achieve year-over-year savings for the business – which in turn helps achieve higher operating income growth.

Successful distributors not only operate efficiently but also deliver effective results. With low gross margins, wholesale distributors must ensure that there is no margin leakage across the value chain.

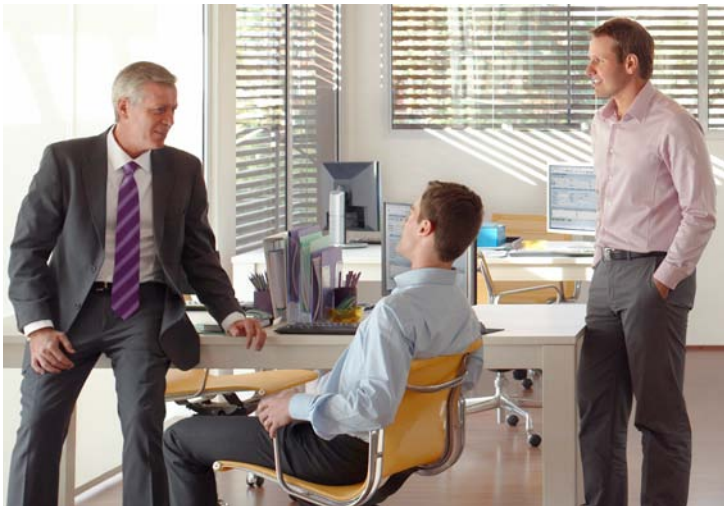
This thought leadership paper highlights the importance of an integrated sourcing and procurement function for wholesale distributors today and presents various best practices that can enable growth and profitability. Further, the paper shares data from a large number of companies (the total sample size of the database being over 400) participating in benchmarking surveys on supplier relationship management conducted by SAP over the past five years.* These results are in no way a projection or guarantee of future performance; however, they do provide insight into opportunities that may exist to improve your company's performance.

*Benchmarking information is provided by SAP on an "as-is" basis without warranty of any kind and is subject to the "General Disclaimer" and other terms of use stated at www.sap.com/company/legal/copyright. Any results or comparisons shown are for general information purposes only, and any particular data or analysis should not be interpreted as demonstrating a cause-and-effect relationship. Comparable performance on one given key performance indicator does not guarantee comparable performance on another key performance indicator.

THE EVOLVING WORLD OF WHOLESALE DISTRIBUTION

IMPLICATIONS FOR EXECUTIVES IN SOURCING AND PROCUREMENT

Successful companies employ solutions that enable standardized contract creation; transfer negotiated terms and conditions to operational contracts; and provide portfolio visibility, systemic governance, and compliance management.



Changing Priorities of Supply Chain Executives

Changes in the wholesale distribution industry have major implications for executives in the sourcing and procurement function, shifting their focus to further drive lean procurement operations, provide better and real-time business insights, and show leadership in spend, supplier, and compliance management (see Figure 1).

To meet these new procurement business needs and achieve the overall objective of profitable growth, leading distributors are moving away from traditional operating models and looking to provide:

- Shared services
- Margin management
- One face to the customer using a single version of information
- Proactive service consistency
- Fee-for-service revenue extensions
- Standard operational processes across the enterprise

Leading wholesale distributors are more likely to engage in collaboration with other internal units, have standardized sourcing processes, and automate their spend analysis systems. These wholesale distributors drive efficient and effective sourcing and procurement based on a comprehensive purchasing platform that supports end-to-end operational processes in all key areas, thereby contributing to operational excellence.

Procurement business needs:	Require organizations to:
▪ Identify and analyze cost savings opportunities ▪ Improve end-to-end supplier management ▪ Maximize savings from sourcing ▪ Enforce contract management and compliance ▪ Improve direct, indirect, and services procurement	▪ Improve spend visibility and management ▪ Centralize supplier onboarding, management, and performance ▪ Deliver integrated sourcing and increase speed to value ▪ Manage the complete contract lifecycle ▪ Centralize all goods and services procurement operations

Figure 1: Business Needs and Procurement Requirements

INTEGRATED SOURCING AND PROCUREMENT
KEY PROCESSES

Procurement Operations

For most distributors, nonstandardized procurement processes and disconnected manual or paper-based systems lead to noncompliance with corporate policies and contracts and affect the delivery of savings.

Efficient procurement operations with a standardized, automated, and integrated procure-to-pay process – including daily requisitions (with spot sourcing), an order-and-pay process, online access to catalogs, automated rebate tracking, and processing and optimizing tasks focused on value-added activities – help to reduce operating cost (see Figure 2). They also increase realized savings, maximize contract compliance, and improve procurement productivity.

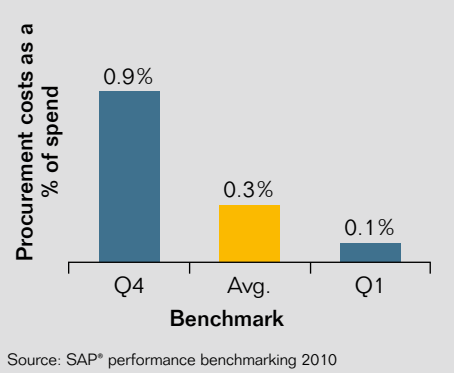


Figure 2: Costs as a Percentage of Spend

Staffing

Wholesale distributors can improve efficiency by reducing the sourcing and procurement organization's headcount required to manage spending. Industry experience shows that, on average, up to 90% of the cost of running a procurement organization can be attributed to its staffing levels. Leading companies have significantly fewer procurement employees than average companies (see Figure 3).

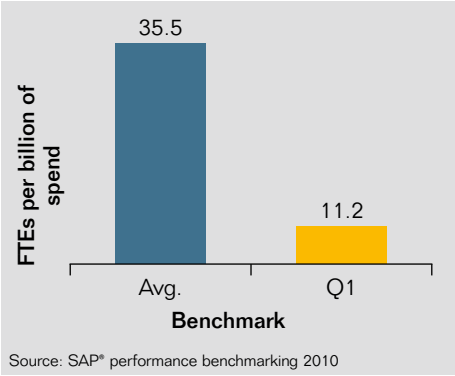


Figure 3: Staffing Benchmarks

Organizationally, leading wholesale distributors align the sourcing and procurement function with business needs. These companies implement a category-aligned organizational approach instead of a less-efficient functional or hybrid model. When employees are more efficient, the distributor can take advantage of their skills to perform other value-added functions.

Information Technology

Corporate IT landscapes are challenged by disparate and aging applications. Different databases lack standard definitions. Sluggish, error-prone manual processes impede high performance. All these issues are detrimental to the sourcing and procurement process.

Technology is crucial in operating sourcing and procurement organizations. State-of-the-art technology enables successful organizations to reduce resources for transactional activities by automating processes and gaining efficiency. It also facilitates strategic processes such as supplier collaboration. The use of tools for monitoring and managing spend and supplier relationships has become an important differentiating factor between leading and average companies.

In SAP's experience, the following is true of IT implementations in sourcing and procurement:

- Companies with a single, enterprise-wide system are more effective than those with fragmented IT landscapes.
- Running more recent software releases contributes to higher savings.
- Companies with enterprise resource planning (ERP) solutions already in place plan to implement or upgrade to solutions that facilitate expertise-level activities such as spend analytics and supplier collaboration, qualification, and negotiation.
- Basic sourcing and supplier collaboration technologies have limited adoption to date. Only a few companies source their materials through electronic auctions or "request for" processes (RFXs), with even fewer managing a supplier portal.

Companies with high best-practice maturity in operating a single integrated procurement system have an ability to save approximately 2% of annual spend, which in turn can mean the difference between loss and profitability (see Figure 4).

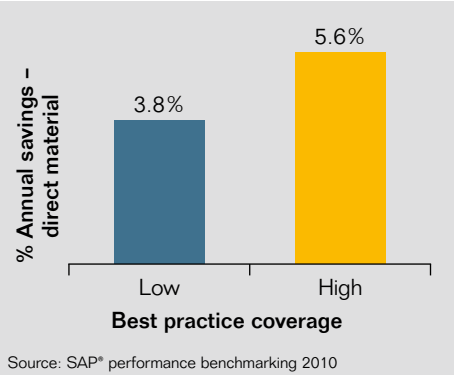


Figure 4: IT-Enabled Savings

Contract Lifecycle Management and Compliance

With thousands of transactions and hundreds of suppliers, wholesale distributors are faced with an uphill task of ensuring there is no leakage of possible savings due to breach of contracts. Various issues facing wholesale distributors today include cumbersome contract creation, approval, and management processes, as well as a lack of integration with the contract repository.

Successful companies employ solutions that enable standardized contract creation; transfer negotiated terms and conditions to operational contracts; and provide portfolio visibility, systemic governance, and compliance management. These help to increase the amount and percentage of captured cost savings in contracts, increase the percentage of compliant transactions, and cut down contract-creation cycle time. Cost of goods sold is reduced by decreasing off-contract buying and increasing vendor cost recovery.

Additionally, leading companies also have access to accurate and timely reports on contract compliance to give visibility to off-contract activity. These companies manage more of their spend strategically and ensure that business departments adhere to contracts by implementing automated requisitioning tools and establishing blanket contracts.

Cost Recovery – Supplier (Vendor) Rebates

Wholesale distributors get multiple types of purchase-based rebates. Typically these rebates are part of an agreement and incorporate value- or quantity-based bonus scales, but there can also be remunerations without any agreement reference. Some key elements of managing supplier rebates are:

- **Supplier rebate processing** – Bundling purchases the right way helps achieve benefits from the bonus scales. Rebate agreements must be continuously monitored to ensure achievement of targets at the end of agreement periods.
- **Price protection** – Some wholesalers struggle with updates of supplier price lists several times a year, requiring a permanent revaluation of stock. Suppliers compensate wholesalers for such variations or for obsolescence of stock.
- **Special buy** – In some cases, wholesalers are allowed to order a certain quantity with a special price on stock, but suppliers monitor to which customers this material is delivered.

Rebates are settled subsequently and periodically. These subsequent remunerations are an essential part of a wholesale distributor's profit recognition and must be tracked very carefully by both suppliers and wholesalers. By completely automating the process, the often-tedious task of handling vendor rebates is simplified, which helps in tracking vendor rebates electronically and keeping more accurate books, ultimately contributing to a healthier bottom line.

Strategic Sourcing

Wholesale distributors are challenged with the achievement of negotiated bottom-line savings. These savings can be hampered by inconsistent use of best practices, noncompliance issues, limited ability to locate global suppliers, not comparing best available offerings aligned to procurement needs, and manual tasks in the sourcing process.

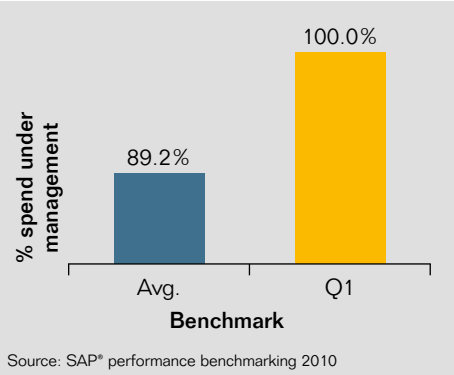


Figure 5: Increasing Spend Under Management – Direct Material

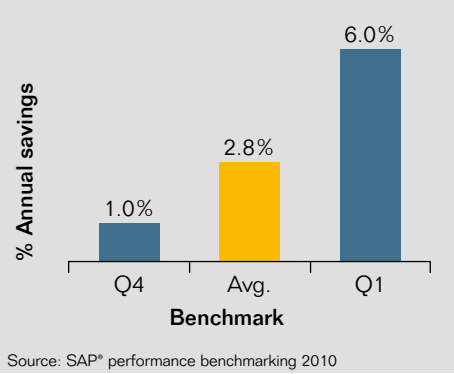


Figure 6: Purchasing Annual Cost Savings – Direct Material

Leading distributors manage these risks through a disciplined strategic sourcing process, including supplier selection, consolidation, management and effective supplier network collaboration. This strategic approach helps to do the following.

Identify cost reductions – Improving the percentage of sourcing captured in the system and bringing a higher amount of spend under management help to maximize the amount and percentage of negotiated savings; increasing competition through bidding and request for quotations (RFQs) results in gain from lower prices and favorable terms. Leading wholesale distributors can accurately measure direct spend using a single repository of data and can aggregate purchases across multiple business units for an accurate analysis (see Figure 5).

As a result, these wholesale distributors are able to more than double their annual savings compared to average performers (see Figure 6).

Automate and streamline end-to-end sourcing activities – Integrated processes help turn negotiated terms into contracts that are ultimately leveraged in the operational procurement process. Additionally, various departments (such as accounts payable and purchasing) work closely together with clearly delineated roles and responsibilities to manage vendor relationships and resolve disputes.

Centralize processes – The extent of centralization of procurement functions is debatable, with each model presenting distinct advantages and disadvantages. SAP's experience shows that most companies adopt some level of decentralization, allowing some decisions by the business units. According to a benchmarking study by SAP, an average company centralizes about 69% of its sourcing and procurement functions.

Improve supplier management and collaboration – This involves identifying best supply sources for continuity and quality by conducting a regular review of suppliers against key performance indicators (KPIs) and using weighting and scoring matrices to analyze and award bids.

Mitigate supply risk – Sourcing cycle time can be reduced through regular analysis of supply strategy and the portfolio. Also, as distributors source globally, they need better visibility into supply chain movements to manage longer lead times and achieve customer expectations for on-time delivery performance. In addition to the physical supply chain, procurement can also play a role in delivering value through the financial supply chain by taking a holistic view of the requisition-to-pay process, managing the process end to end – from needs identification to supplier delivery and payment – thereby improving cash flow and reducing errors.

Using Dashboards to Manage Supply Risk

Collaborative business models and mutually supportive vendor relationships are built on heightened visibility and transparency throughout the vendor ecosystem. Any supply consistency issues can result in inventory shortage and contract violations, thereby weakening customer loyalty. Decision

Leading companies use recognized best practices for all sourcing and procurement subprocesses. What's more, they develop a balanced approach, implementing best practices for both strategic and transactional activities.

makers need access to integrated, real-time data from inside and outside the enterprise – information they can use to proactively insulate the supply chain from risks associated with supplier disruption.

Enabling aggregation of master data into a centralized master data store, company personnel can search across linked applications to create unified analytics and reporting. Interactive dashboards deliver a 360-degree view of supplier and inventory risks and associated mitigation activities in role-specific formats. Because these dashboards consolidate information about suppliers, products, and customers from disparate sources into a unified view, they help decision makers quickly identify risk exposure and mitigation possibilities.

In addition, dashboards combine internally tracked supplier performance data with externally available credit ratings and financial health indicators to provide a comprehensive view into the risk profile of any particular supplier.

Spend Analysis

Disaggregated spend; inconsistent spend categorization; limited supplier information; and poor reporting, measurement, and analysis capabilities lead to higher costs and reduced gross margins. Prime reasons why wholesale distributors need to focus on spend performance management are to reduce cost of goods sold, increase purchasing control through full visibility into spend, and reduce supply risk.

Identification of additional savings opportunities (such as off-contract buying and price variances) along with optimizing spend through central procurement (shared services model) and leveraging procurement optimization opportunities such as load building (line buying) and investment buying (deal buying) can further help reduce the cost of goods sold.

Some key challenges that must be overcome in this endeavor are:

- Low visibility into spend due to complex IT landscapes leveraging multiple legacy systems
- Decentralized master data maintenance leading to inconsistent, duplicated, and nonharmonized spend data
- Infeasibility of creating unique strategies for each spend category and supplier

Companies whose systems can aggregate purchases across all business units for an accurate global analysis of supplier spend data are able to reduce costs (see Figure 7).

Also, companies that regularly conduct spend reviews to identify new areas of contract opportunity are able to increase strategically managed spend by 15 percentage points (see Figure 8).

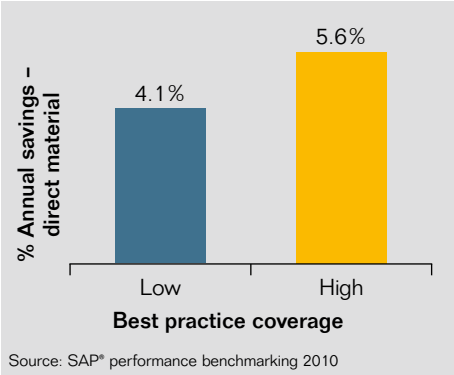


Figure 7: Best Practice Coverage Impact – Annual Savings

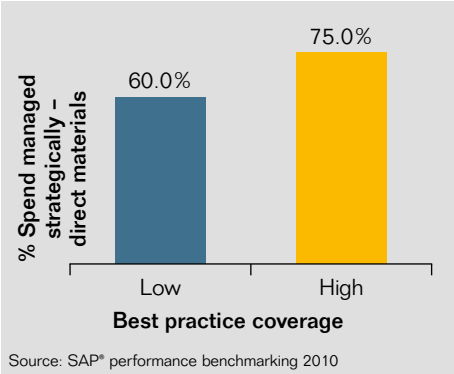


Figure 8: Best Practice Coverage Impact – Spend Managed Strategically

BEST PRACTICES IN SOURCING AND PROCUREMENT

STRATEGIC, EXPERTISE BASED, AND TRANSACTIONAL

Achieving Higher Effectiveness and Efficiency

SAP divides sourcing and procurement into three key subprocesses: strategic, expertise based, and transactional. Focusing on reducing effort in transactional activities and moving staff toward a higher share of expertise-based and strategic management activities helps improve overall efficiency and effectiveness of the process.

The key strategic best practice is operating a single, integrated procurement solution that supports spend analysis and reports to help monitor purchasing operations through aggregating, cleansing, classifying, and analyzing corporate spending data.

Expertise-based and transactional best practices include:

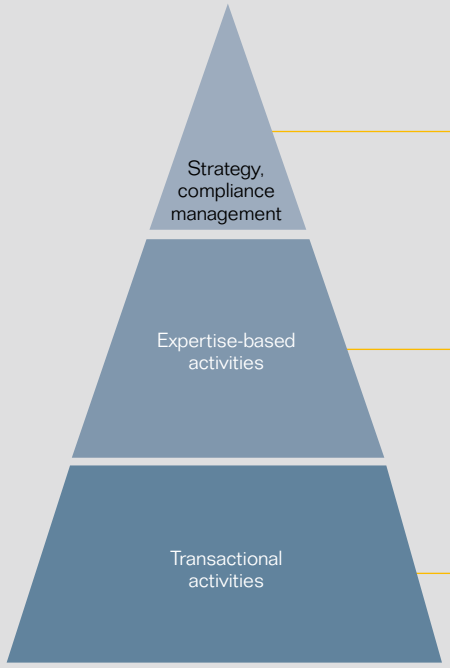
- Facilitating order collaboration with a supplier portal for order acknowledgements, advanced shipping notifications, confirmations, and inventory-level checks
- Using real-time reverse auction processes to achieve accurate market prices for commodity spend
- Leveraging IT solutions to track quantitative and qualitative KPIs such as supplier performance, and regularly sharing these results with suppliers; also supporting XML industry extensions and electronic data interchange (EDI) interfaces

SAP® benchmarking surveys have examined best practices related to staff management, spend management, and the use of technology. These surveys show that leading companies use recognized best practices for all sourcing and procurement subprocesses. What's more, they develop a balanced approach, implementing best practices for both strategic and transactional activities.

Best practice adoption is highest in the strategy and leadership area and in the transactional material receipt function; it is weakest in supplier enablement, contract management, and supplier collaboration. Going forward, leading procurement organizations will look to more deeply integrate their physical and financial supply chains to drive competitive differentiation (see Figure 9).

Moving up the process maturity curve helps wholesale distributors reach top-quartile benchmark levels of performance successfully and quickly (see Figure 10).

> "Sixty-five percent of all companies with SSOs have cut costs by 21% or more, with some seeing savings of over 60%."
>
> **The Hackett Group,** Finance Shared Services Performance Study, 2009



Strategy and compliance	Q1	Avg.
Supplier relationship management and procurement strategy and leadership	4.5	3.0
Compliance	3.0	2.2

Expertise-based activities	Q1	Avg.
Sourcing: category management	3.2	2.3
Sourcing: supplier evaluation and negotiation	3.4	2.2
Supplier performance management	2.8	2.0
Contract management	3.0	1.8
Supplier collaboration	3.1	2.1

Transactional activities	Q1	Avg.
Requisitioning	2.5	1.7
Order processing	3.5	2.5
Material receipt	4.0	2.7
Financial settlement	3.3	2.5
Supplier data management	3.5	2.3
Supplier enablement	2.5	1.1

Coverage: 1 = No coverage today – organization does not employ this best practice; 5 = Best practice is fully adopted

Source: SAP® performance benchmarking 2010

Figure 9: Best Practice Coverage Scores of Various Activities

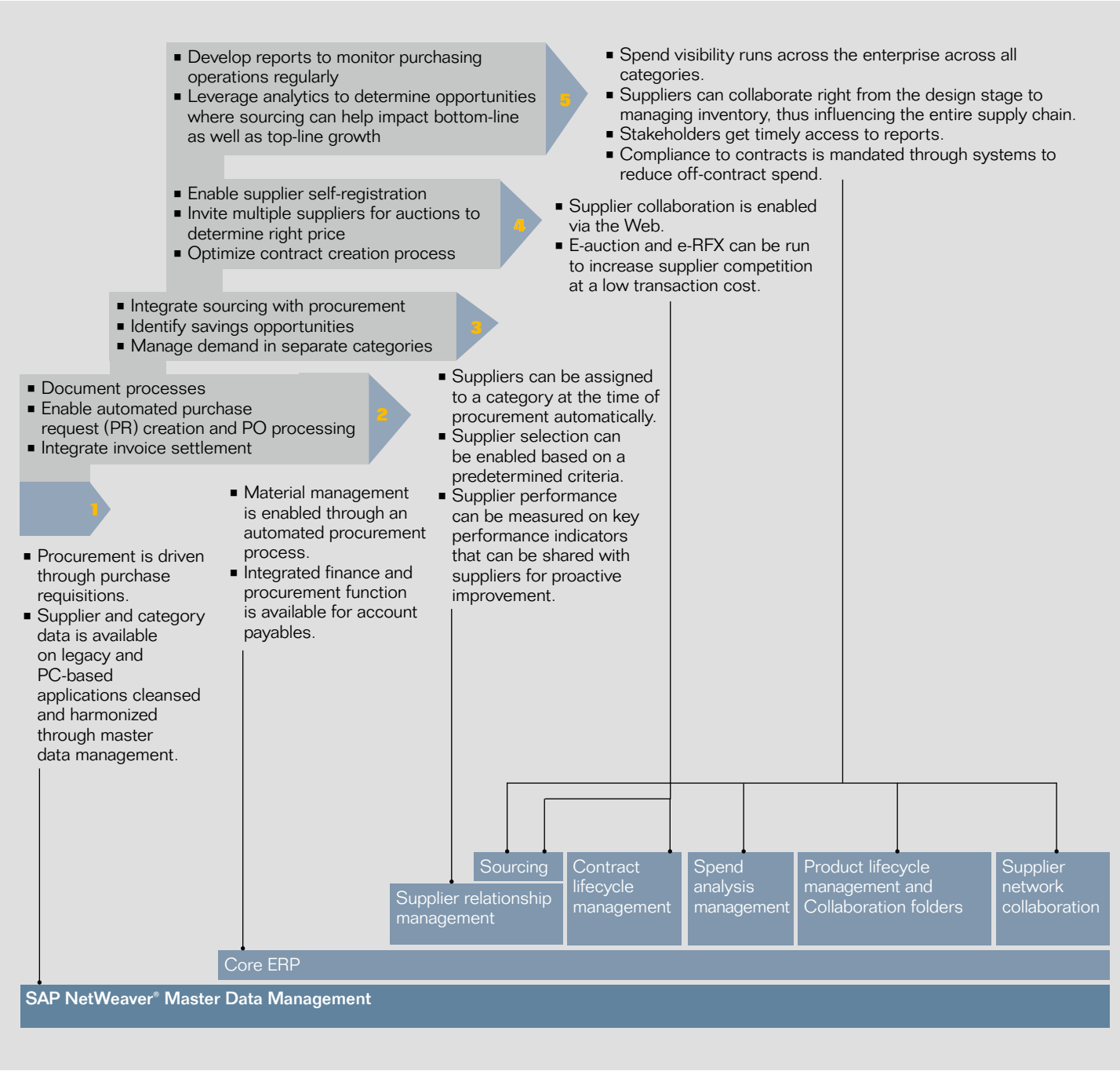


Figure 10: Process Maturity Curve

PROCUREMENT SHARED SERVICES

ASSESSING THE BENEFITS

SAP solutions enable standardized requisitioning, ordering, supplier collaboration, and invoice and payment processes for all categories of spend. They automate source-of-supply determination and also dramatically improve productivity.

Lowering costs and running processes more efficiently are two major reasons why a company uses shared services. Gaining deeper business insight is another. Here's how this works in procurement.

A shared services organization (SSO) aggregates data around particular functions, putting into perspective a company's relationship to its suppliers by region, division, and individual supplier.

Because the company can see overall turnover and turnover per supplier, it can determine whether there are better or cheaper suppliers in other regions. It can negotiate prices and scope of supplies and services. And it can put a collaborative sourcing strategy into full effect to realize significant economies of scale.

Procurement shared services centers often go beyond immediate cost reductions to help the enterprise develop a sustained competitive advantage. When integrated into the solution portfolio of an SSO, an SAP application for sourcing (such as the SAP Supplier Relationship Management application) can help companies reap maximum benefits.

Large wholesale distributors consisting of multiple subsidiaries or regional offices have a great potential to gain from moving procurement of some key product categories to a central location.

SAP's customers have realized substantial bottom-line benefits after moving to a shared services model for procurement, with some achieving up to a 5% reduction of total maverick spend, and about a 10% increase in staff efficiency.

Charmer Sunbelt Group and Shared Services

The Charmer Sunbelt Group (CSG) has been honored with a prestigious shared services award. The Shared Services Outsourcing Network (SSON) presented its annual Best New Captive Services Delivery Award to CSG for demonstrating winning practices in captive and outsourced shared services. "While we are proud of the award, of greater importance is how shared services will continue to make Charmer Sunbelt the distributor of choice for our suppliers and customers," said Charlie Merinoff, CEO of CSG.

For CSG, the shared services organization is an important part of the overall company strategy and vision. The original economic threshold set by the company has been exceeded by 25%, with a future projection of exceeding the threshold by 45%.

SOURCING AND PROCUREMENT SOLUTIONS FROM SAP

MEETING THE NEEDS OF WHOLESALE DISTRIBUTORS

SAP's Strategy for Procurement

SAP has a wide range of products and solutions to cater to the changing needs of the wholesale distributors. In addition to providing on-premise software systems, SAP also offers a first-choice solution for those companies that require defined on-demand or mobile solutions. With present and future SAP technologies integrating all these systems, SAP is positioned to support the forward-thinking wholesale distributor (see Figures 11 and 12).

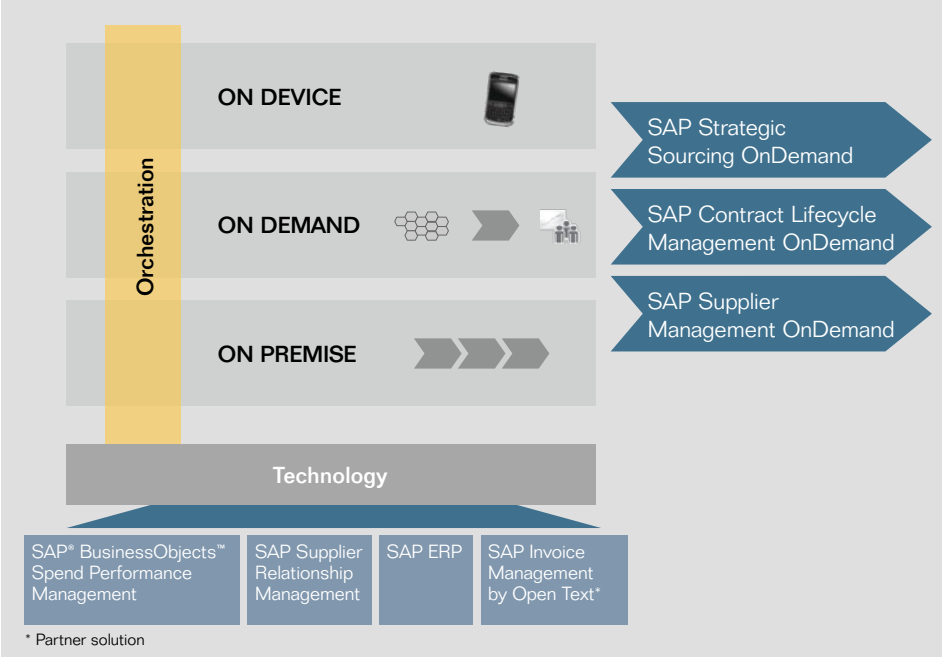


Figure 11: Solutions for Procurement from SAP Enabling the Full Source-to-Pay Process

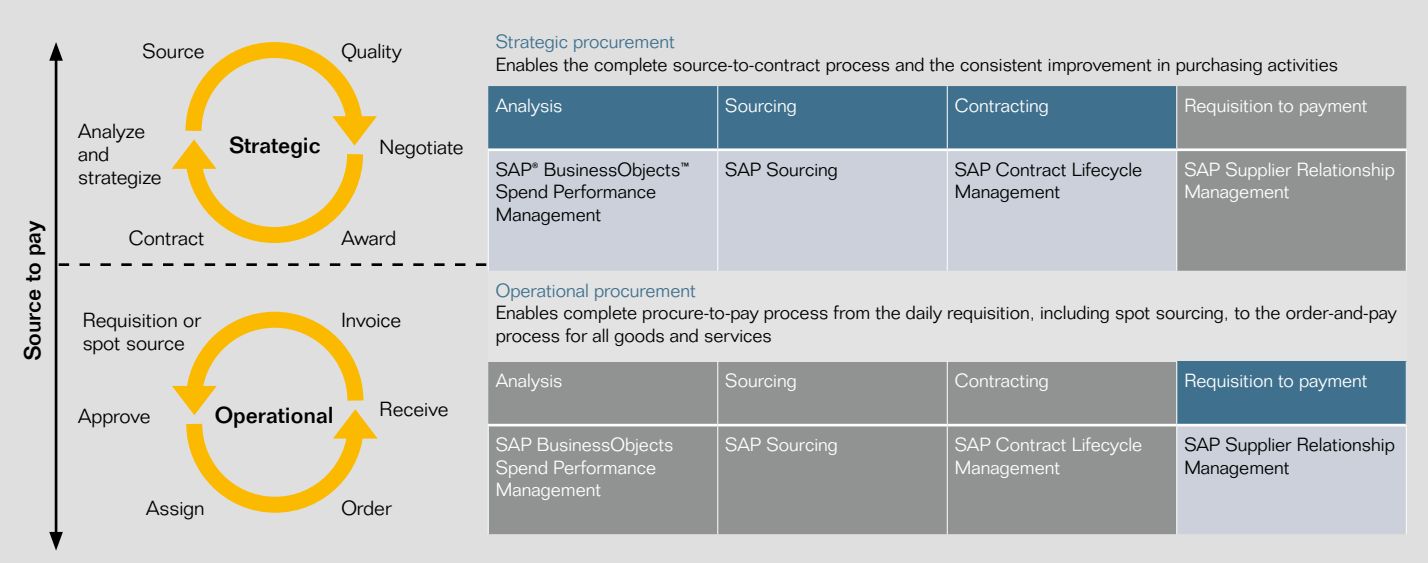


Figure 12: An Integrated Solution to Support Strategic and Transactional Processes

SAP Integration

The robust and open SAP NetWeaver® technology platform integrates systems running SAP and non-SAP software, enabling you to exchange information and execute transactions as if they were a single system. Application-to-application and business-to-business processes are connected and managed by SAP NetWeaver. The platform integrates front-end mobile activities with back-end business processes to support online connections. In short, the integration is managed by a single platform, rather than dozens of costly interfaces.

SAP for Wholesale Distribution

The SAP for Wholesale Distribution solution portfolio includes comprehensive procure-to-pay process solutions that fulfill fundamental business requirements while providing specific functionality tailored to the needs of the industry.

SAP BusinessObjects™ Spend Performance Management

The SAP BusinessObjects™ Spend Performance Management application supports three key activities – consolidate, cleanse and classify, and consume. This application also integrates with the SAP Sourcing application, helping turn an identified opportunity into a sourcing event (pulling over all relevant items, suppliers, and pricing). Some benefits include:

- Achieving faster time to value and lower total cost of ownership
- Providing fully aggregated, cleansed, and usable data
- Saving time with self-service tools and reusable content

SAP Extended Sourcing for Retail and Wholesale Distribution

The SAP Extended Sourcing for Retail and Wholesale Distribution package provides the ability to manage projects, model global sourcing best practices, run collaborative RFX and auction events, and manage supplier registration and information. It also offers both data and process integration with the SAP ERP application, specifically the material management functionality. Companies can use validated supplier and item data in events, and then turn RFX results into either contracts or purchase orders in the back-end system to complete the process. This is a key differentiator for the SAP software; with a niche provider, this level of integration otherwise would cost a lot of money to develop.

SAP Contract Lifecycle Management

The SAP Contract Lifecycle Management application within SAP Supplier Relationship Management addresses three critical areas: contract creation, contract visibility/repository, and contract compliance. Contract creation allows companies to build templates and process maps for as many contract types as they like and supports the actual contract document development (with Microsoft Word integration) based on legal department–driven clause libraries that roll up into sections and templates (which lowers risk related to use of language). The internal and external negotiations that take place on these draft documents is fully supported, with tools such as check in and out, versioning, redlining, version compare, and review and approval workflows so that all key stakeholders are correctly involved in the process. Contract visibility and a repository help companies gain full visibility into the contracts portfolio and report on key parameters such as minimum volume commitments, risk ratings, category coverage, and expirations as opportunities for resourcing or up-sell. This might also help support compliance by giving some personnel the access-controlled ability to search contracts in support of various business activities (such as PO or invoice management, order management, and so forth). Contract compliance includes the ability to manage audits and performance reviews and KPIs against each contract. It also enables pushing the data from the contract itself, such as structured line-item pricing and other terms, into SAP ERP for execution to help ensure the right pricing is applied at the time of order creation instead of having to reconcile to contracts later in the process.

> "We deliver a dashboard report to executives, district managers, and branch managers every morning with all the key business metrics. Using this information, the execs are moving our business forward at a faster pace than ever before."
>
> **Scott Clifford,** VP, CIO, Graybar Electric Company Inc.

Further Support for Key Processes

SAP solutions enable standardized requisitioning, ordering, supplier collaboration, and invoice and payment processes for all categories of spend. They automate source-of-supply determination and also dramatically improve productivity. Additionally, through the SAP Invoice Management application by Open Text, SAP supports "any source" invoice reconciliation and management process to add efficiency in the accounts payable department, centralizing all the procurement activity in the organization.

Next Steps

Integrated sourcing and procurement functions within wholesale distribution companies have great potential to reduce costs, contribute to the bottom line, and deliver against enterprise strategic goals. By implementing strategic sourcing strategies and by implementing both strategic and tactical best practices, companies can improve effectiveness and achieve year-over-year savings.

The companies that pursue this approach understand the potential of efficient sourcing and procurement operations and are transforming them from a back-office function into strategic business process. These savvy companies will not only hold the line on costs, they will also improve their enterprise's chances of success in today's highly competitive markets.

To learn more about how SAP can help your organization enable integrated sourcing and procurement, visit us online at www.sap.com/usa/industries/wholesaledistribution.

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