

## The Next Trend in Outsourcing

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*A comprehensive study of over 260 businesses conducted by the Aberdeen Group reveals that companies engaged in procurement outsourcing lower their expenses through actual reduced product/service costs and lower requisition and time costs.*

Traditionally-outsourced functions like payroll processing, legal services, local delivery and fleet maintenance continue to expand. Outsourced call centers are the norm, as are recruiting and human resource functions.

According to a November 2007 report by the Aberdeen Group, a premier management research firm, one of the biggest growth areas in BPO is procurement outsourcing. This study of over 260 companies, in a variety of industries, found that purchasing departments are seeking the involvement of third-party experts to drive down corporate operating costs. In fact, 40% of the organizations survey indicated that they would be outsourcing part, or all of their procurement functions in the next two years.

What are the key drivers for this move to outsource procurement? The top four reasons cited were:

1. Pressures to lower procurement transaction costs
2. Increased global competition
3. Need to gain access to improved pricing
4. Pressures to re-focus personnel on more strategic activities

These key drivers are certainly reflected in Alliance Cost Containment's (ACC) experience with clients throughout the US. Typically, procurement is keenly focused on direct purchases, like raw materials and key components. Tactical or indirect purchases, such as office supplies, freight, packaging, telecom services, utilities, and maintenance supplies, may not be scrutinized unless major price increases or service lapses force them to the forefront. Or, there may be insufficient in-house expertise to address these specialized niches. Worse, every small requisition may be put out to bid, spending valuable time to generate a small savings and generating a false sense of economy.

Companies engaged in procurement outsourcing lower their expenses through the reduction of transaction costs, as well as by achieving lower absolute costs on the items purchased. As part of this study, Aberdeen measured the cost of the requisition-to-order cycle. For companies with the lowest amount of outsourced procurement, the average cost of each requisition-to-order cycle was \$33.00. For those with the highest levels, the average cost was \$14.15, or a savings of over 57% in staff resources. In the full cycle of procure-to-pay, costs may be as high as \$75 per transaction. In a niche with a high volume of transactions, like office supplies, with an average order size of only \$125, this incremental cost is extraordinary.

In our experience, clients can find considerable reductions of transaction costs through a number of initiatives. Vendor consolidation reduces redundant transactions and increases leverage. On-line order entry reduces the "window shopping" time, as well as order generation time, and drives purchases to lower priced, contracted items. In fact, the savings achieved in process improvement may actually be greater than the savings found in price reductions. Or, the process change may achieve both goals. As an example, we recently encountered a company that used a substantial amount of freight services. After introducing them to a computerized ordering system, which shops for multiple bids simultaneously, on-line, rather than having the client manually call a number of carriers, the company now has a significantly shorter

requisition-to-order cycle, providing both lower soft and hard dollar costs.

Third-party procurement specialists frequently offer clients volume purchasing agreements with blue-chip suppliers in key commodities, with prices that the client could not access as an individual company. Aberdeen found that for each dollar brought under outside procurement management, companies were able to realize cost savings of between 5% and 20%. This is consistent with ACC's experience. For example, with use of the freight broker above, we were able to provide client savings of nearly 40%, compared to their previously-negotiated in-bound freight rates with carriers. In another recent case, we were able to provide our client access to our national contract with one of their largest incumbent suppliers. This resulted in an immediate discount of 12.6%, due to the power of ACC's aggregated national volume.

The Aberdeen study also states that companies enjoying the greatest success from procurement outsourcing share some common characteristics:

1. They have evaluated their core purchasing competencies and have differentiated strategic purchases from tactical purchases.
2. They have established monitoring procedures internally, and with their procurement outsourcing partners, to measure savings and track results.
3. They have established procurement procedures and a defined group of pre-approved suppliers.
4. They are utilizing category experts in areas like telecom or utilities, when in-house expertise is not available, for market intelligence that provides strategic insights to senior management.

As with most forms of outsourcing, procurement outsourcing will be driven by the need of companies to focus on the true nature of their businesses. Are you in the business of designing and manufacturing world-class products, or are you in the business of buying pens and paper? Are you in the business of selling high-value products and providing great customer service in your stores, or are you in the trucking business? Companies that invest more heavily in improving core competencies, while outsourcing non-core functions to others with the appropriate expertise, are able to gain the maximum leverage from their capital and human resources in the pursuit of their strategic goals. And the financial impact of procurement outsourcing can be felt in a number of ways:

1. Improved cash flow
2. Greater access to credit
3. Improved valuation
4. Reduced pressure to increase top line revenue by compromising quality or margins

Rudy Moeller and Mark Braverman are Principals at Alliance Cost Containment (ACC). Rudy and Mark each have over 25 years experience in purchasing, operations, IT, advertising and sales in their previous careers both as owners and executives of several privately owned companies.

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Alliance Cost Containment is an expense reduction and cost containment firm focused on reducing expenses for organizations related to commonly purchased items and services: freight, telecom, office supplies, MRO, janitorial, packaging, printing, and more.

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