

### **Procurement outsourcing – a means of managing fixed costs more effectively**

According to a recently released survey by Accenture nearly half the companies surveyed in Europe and the US are considering outsourcing part of their procurement operations by the end of 2006. This will more than double the number who currently outsource aspects of their procurement process.

The past decade has seen an enormous rethink into the internal organisation and make up of a company. The days of the lumbering heavyweight seem numbered as these large vertically integrated monoliths give way to the more dynamic and flexible enterprises needed to compete and survive in the modern global marketplace. These new businesses are tightly built around their core competencies and place more dependency on long term external partnerships. By keeping themselves lean and nimble they are much better equipped, in the words of Muhammad Ali, to “float like a butterfly, sting like a bee!”

With skilled workers in demand and natural resources becoming more precious the backdrop for business is forever changing. Couple this with the rapid progression of technology and squeezed product life cycles then today's executive is posed many tricky questions. This is accentuated in the face of fluctuating market demands. The executive must carefully consider ways to scale their resources to meet these market demands whilst retaining the flexibility to slim down during periods of famine. They must first understand what the key drivers in their business are and then distil the core competencies required to support them. Finally they must allocate the appropriate resources.

Today most successful companies are differentiated by their intellectual property wealth, knowledge and expertise as well as their ability to embrace the capabilities provided by third parties for their own gain. Through careful outsourcing they are able to convert fixed costs into flexible ones enabling internal investment to be channelled towards core competencies.

It is now common for companies to outsource many of their business processes such as information technology, payroll, manufacturing and procurement.

So what then is procurement outsourcing? Well it's certainly more than procurement consultancy. Consultants advise on how something might be done whereas the outsourcing provider actually goes and does it. We're reminded of the description that a consultant is someone that borrows your watch to tell you the time!

Procurement outsourcing offers a company value they are unlikely to obtain on their own. For instance, most companies could never afford to employ a host of commodity experts. However anyone that has ever tried to make sense of mobile phone tariffs will tell you a three year degree course would only get them half way to becoming an expert and only then if they did nothing else. Yet the size of spend associated with this commodity can be extremely large requiring careful management to obtain the best deal possible. Given the intricacies presented by the wide range of commodity types purchased it would seem unreasonable to expect any one person to become expert in all. Moreover, irrespective of how large and professional a company's procurement department, an individual commodity spend may be insufficient to leverage better pricing and service anyway. This is where the procurement outsourcing provider can make a real difference.

Although difficult for some companies to admit, procurement is simply not a core competence or for that matter, a key driver. Nonetheless, the effect of cost reduction can make a dramatic impact to a company's bottom line. We describe elsewhere that a 10% cost reduction can produce a larger impact to profit than a 40% increase in sales. The procurement outsourcing provider is able to carry specialist commodities skills in-house and importantly can create the critical spend mass to drive down pricing to effect profit improvement. After all, this is their core competence and it therefore makes sense that their "procurement engine" is cheaper to run compared with establishing and maintaining an in-house version.

No company is too large or small to consider outsourcing at least part of their procurement requirements. As a long term partner the outsourcing procurement provider will get to understand the business better and will help drive shareholder value by bringing innovative and flexible methods to better manage the spend. A point also worth noting is that they are able to apply their buying power to resolve supply issues with relatively more ease than the small end user.

So to sum up, procurement outsourcing can prove both more cost effective and efficient than providing an equivalent service in-house. As a means of reducing fixed cost whilst still improving profit, procurement outsourcing is well worth investigating further.