A.T. KEARNEY

Closing Procurement Loopholes

Compliance can deliver bottom-line savings



Why do chief procurement officers still have problems securing compliance to processes and strategies that can generate major bottom-line savings? To answer this question, A.T. Kearney conducted a global study of companies that have made strides in achieving internal compliance. This paper takes an in-depth look at what steps companies have taken and the extent to which they've succeeded in—or fallen short of—achieving their compliance goals.

Since the late 1980s, Fortune 500 companies have taken on the challenge of obtaining more value from their procurement organizations. Through a variety of strategies—including strategic sourcing, procurement transformation, process reengineering and lean change management—chief procurement officers (CPOs) have sought to transform the procurement function from a tactical, reactive, order-taking function to a creative, go-to-business partner for other business functions, including marketing, research and development (R&D) and manufacturing. With the introduction of new supply strategies, analytics and more business-savvy procurement professionals, today's CPOs lead divisions that have a major impact on their companies' bottom line. Some procurement departments directly influence more than 70 percent of their companies' spending decision, resulting in continual year-over-year savings anywhere from 5 to 20 percent.

Despite some successes, however, procurement leaders often struggle to get maximum internal compliance to their strategies and processes.[1] Even the most successful CPOs still find themselves in the position of evangelist, having to preach the virtues of compliance and how it drives value to the bottom line.

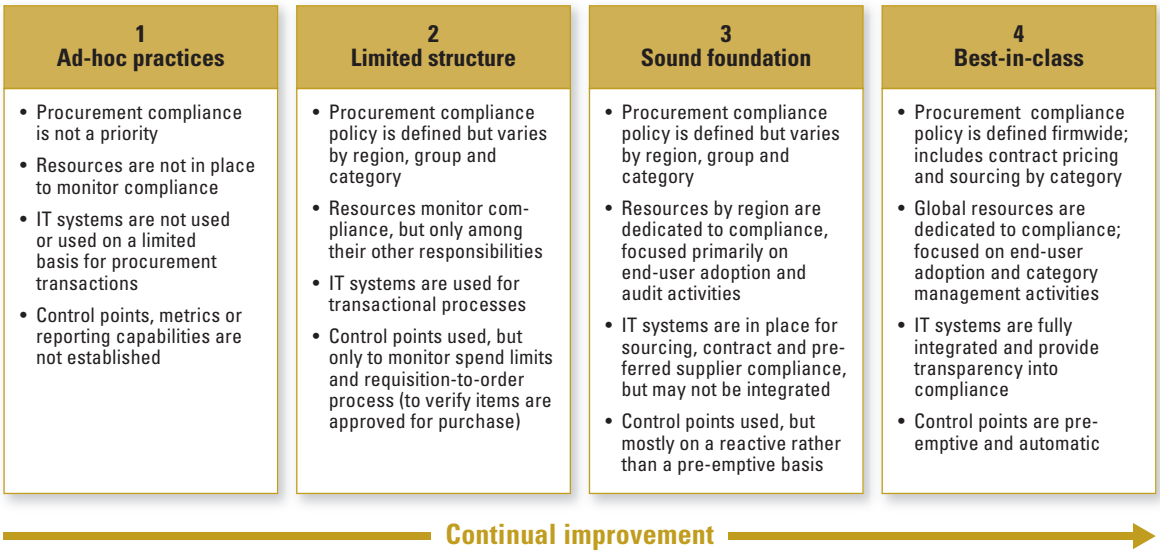
In a recent benchmarking study, A.T. Kearney set out to understand the strategies used and results achieved by global companies attempting to maximize compliance to internal sourcing and procurement processes. While none of the companies studied reached stage four, or best-in-class, in all aspects of their compliance programs, many demonstrated a best-in-class level of maturity in individual aspects *(see figure 1 on page 2)*.

Our latest research evaluates compliance in four aspects of the procurement process: sourcing, buying, contracts and preferred suppliers, and contract pricing *(see sidebar: About the study on page 3)*. We found that companies have used a variety of approaches to improve procurement, with mixed results. Companies typically focus on three principles in designing their compliance

[1] *A.T Kearney's 2008 Assessment of Excellence in Procurement study suggests that 50 percent of companies have implemented requisition-to-pay (R2P) processes and systems to help enforce compliance and demand management policies across most major types of procurement transactions, including catalogs, services and third-party vendors.*

Figure 1

A.T. Kearney "Stages of Excellence for Procurement Compliance"[1]



[1] *The bulleted items are excerpts from the complete Stages of Excellence for Procurement Compliance*
Source: A.T. Kearney Achievement of Excellence in Procurement (AEP) study, 2008.

programs: *pragmatism*, as they strive to sustain and improve sourcing and strategic supplier relationships that bring real value to the business, rather than merely monitoring and tracking compliance; *inclusiveness,* as they hold all business departments accountable, not just procurement, for adhering to corporate supply decisions; and *scorekeeping,* as they outline savings achieved and opportunities squandered largely through metrics and post-mortem reporting.

The following is a look at our findings in more detail.

Procurement Compliance: What Really Matters?

When asked to define "procurement compliance," our survey participants made it apparent very quickly that no universally accepted definition of compliance exists. Yet, while supply management professionals might not agree about the optimal scope of compliance programs, there is universal agreement that a compliance program should be in place and that it should be geared toward generating value to the business as a whole. Subsequent to our research and interviews, we came to the following conclusions:

Maturity matters. While specific programs vary from company to company, the scope of most programs appears to be influenced by the level of procurement maturity within the company. For example, companies with newer programs focus on pursuing compliance in administrative processes such as requisitions, purchase orders, contracts and signing authority. Companies with more mature procurement programs focus on improving compliance in their strategic processes,

such as in strategic sourcing and preferred supplier programs. The more mature programs also have institutionalized reporting structures and metrics to track compliance results.

Compliance must be holistic. Overall, study participants view compliance as more than a procurement-department initiative; rather, it is a holistic effort involving all aspects of the organization that influence supply decisions. All executives interviewed say they expect *all* of their employees to adhere to compliance guidelines in most aspects of procurement (including sourcing, the procurement process and contracts). They recognize, however, that validating supplier compliance to agreed-upon pricing in invoices is difficult for internal employees to control and that it should be suppliers' responsibility. Importantly, the interviews suggest that until IT systems have the more sophisticated functionality to monitor invoices and supplier compliance to contract prices, procurement professionals will have to continue to rely on spot audits.

Compliance begins small and grows. Ensuring compliance to transactional activities is the starting point for most companies' compliance initiatives. As their procurement organizations become more mature, and they invest in more robust strategic sourcing programs, compliance to the sourcing process will increase. This is true both for procurement professionals and internal stakeholders.

IT is key to supplier compliance. Companies that focus on expanding compliance to preferred suppliers cite IT investments as key to accomplishing this. Virtually all companies report being "proactive" to compliance in contract pricing—by matching purchase orders to established contracts at the line level. Yet they admit it is difficult to achieve and out of reach in the near term in all non-catalog categories.

Everyone plays. We also find that regardless of the level of supply-management maturity, procurement departments expect all staff to adhere to procurement policies and initiatives. More than

About the Study

The A.T. Kearney study evaluates compliance in four aspects of the procurement process:

- **Compliance to the sourcing process** by strategic sourcing resources and internal business partners, and adherence to the guidelines and processes set forth as part of an overall strategic sourcing program
- **Compliance to the buying process** by end-users buying goods and services, adherence to defined processes, and purchasing channels specified by sourcing and purchasing guidelines
- **Compliance to contracts and preferred suppliers** by end-users buying goods and services from preferred suppliers at agreed-upon prices
- **Compliance to contract pricing** by suppliers issuing invoices consistent with contract prices

The methodology includes a detailed benchmarking survey and one-on-one interviews with participants in various industries, including consumer products, retail, finance and insurance, pharmaceuticals, biotech and manufacturing. Approximately half of the companies in our study are global, with the remainder operating only in North America. Company representatives have direct knowledge of and responsibility for their organization's procurement-compliance efforts. Responses from surveys and interviews were evaluated against A.T. Kearney's *Stages of Excellence for Procurement Compliance*, which outlines the four stages of maturity for procurement compliance.

70 percent of companies expect procurement personnel—all internal end-users, internal business partners and suppliers—to abide by compliance guidelines. CPOs are often required to work closely with business-partner leaders and functional heads to ensure maximum understanding of procurement programs and participation by the entire company.

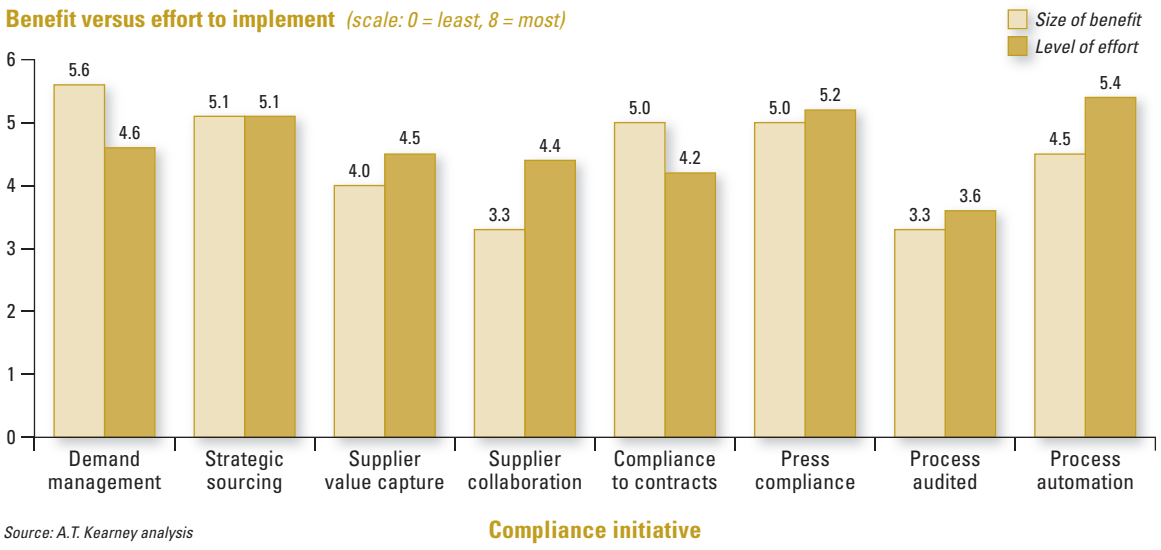
With this in mind, respondents consider change-management programs and senior-management reporting as the most effective strategies for generating companywide compliance. In one example, a company's CPO sent the executive management team a quarterly report listing individuals who failed to comply with policies. Several companies adopted penalties, such as "No-PO, No Pay" rules, to ensure employee compliance. In another company, employees submitting an invoice without a purchase order are required to get executive-level approval to get the invoice paid—an embarrassing situation, to say the least, for the employee. Having noted this, we must also report that the majority of the companies in our benchmark research have no or very limited escalation or repercussion policies.

Delivering Value to the Bottom Line

Companies gear specific compliance-program initiatives and priorities toward areas perceived as having the most potential impact on the bottom line. When we asked participants to name which initiatives would deliver the greatest benefits, they named four: demand management, strategic sourcing, compliance to processes and contracts as the most worthwhile. Unfortunately, these initiatives require a significant amount of effort to implement, which suggests a loose correlation between the perceived potential benefit and the level of effort required to achieve that benefit *(see figure 2)*.

Figure 2

Perceived benefit of compliance initiative versus effort to implement



Source: A.T. Kearney analysis

From the interviews we know that some companies are making trade-offs between these different initiatives, based on resource constraints and underlying business goals. Most organizations choose initiatives they think will drive the most benefits throughout the business as a whole.

Policies, Metrics and Controls

All companies in our study document their procurement-compliance programs in specific policies and procedures. The documentation typically includes high-level guidelines on how and when to engage with the procurement department, and policies are usually dictated by specific spend thresholds and business needs. Each organization uses a spend threshold to establish the level at which end-users are expected (or required) to engage the procurement or sourcing function. While there is a broad range in the size of spend thresholds, the size is usually based on the organization's ability to respond to requests and on the strategic value associated with spend at or above that threshold. In short, we found no significant alignment around the optimal spend threshold.

To manage complexity, all companies use a single spend threshold across all categories. Some participants note, however, that certain business needs or regulatory concerns can result in exceptions for individual categories. Examples of these exceptions include complex service categories with significant "rogue" spending (such as consultants), categories subject to government regulations, and categories with the potential to develop intellectual property *(see figure 3)*.

Figure 3

Company spend thresholds, rationale and exceptions

	Spend threshold *(company examples)*	Rationale *(from executive interviews)*
Spend thresholds for engaging sourcing	• $250,000 aggregate annual spend • $150,000 aggregate annual spend • $100,000 aggregate annual spend • $2,500 commitment to any supplier • More than $240,000 aggregate annual spend • None specified	• **Organization capacity constraints:** "We had to pick a threshold so not to overwhelm our resources." • **Spend analysis:** "We did a spend analysis to see what made sense of cut off in terms of volume and type of transaction." • **Benchmarking:** "We did some external benchmarking and it seemed like that was what others were using."
Business need or categories	• $50,000 for all aggregate spend in capital • All direct material spend • Packing and rolling equipment • All consulting spend • All spend associated with IP contract clause • None specified	• **Business need:** "The company was hiring too many consultants, so that is the spend that has to go through the procurement department." • **Regulated category:** "Direct materials are highly regulated and so it needs to be purchased using the right channels."
Other	• At end-user's discretion • Require a purchase order (PO) in advance of invoice ("No PO-No Pay" philosophy)	• **End-user discretion:** "If an end-user wants to use the procurement department, then it is encouraged." • **Purchase order:** "We do not have a culture of compliance, but we do require a purchase order for pay."

Source: A.T. Kearney analysis

In addition to policies, other program components such as control points, metrics and reports are used to monitor and report on compliance. Most often, metrics are geared toward measuring the business value of compliance efforts, including percent spend to preferred suppliers, bottom-line savings, and percent spent on and off purchase orders.

Executive reporting is consistently reported as the biggest influence on end-user behavior and *the* best tool for monitoring overall progress of compliance to sourcing and procurement guidelines.

Achievements To-Date

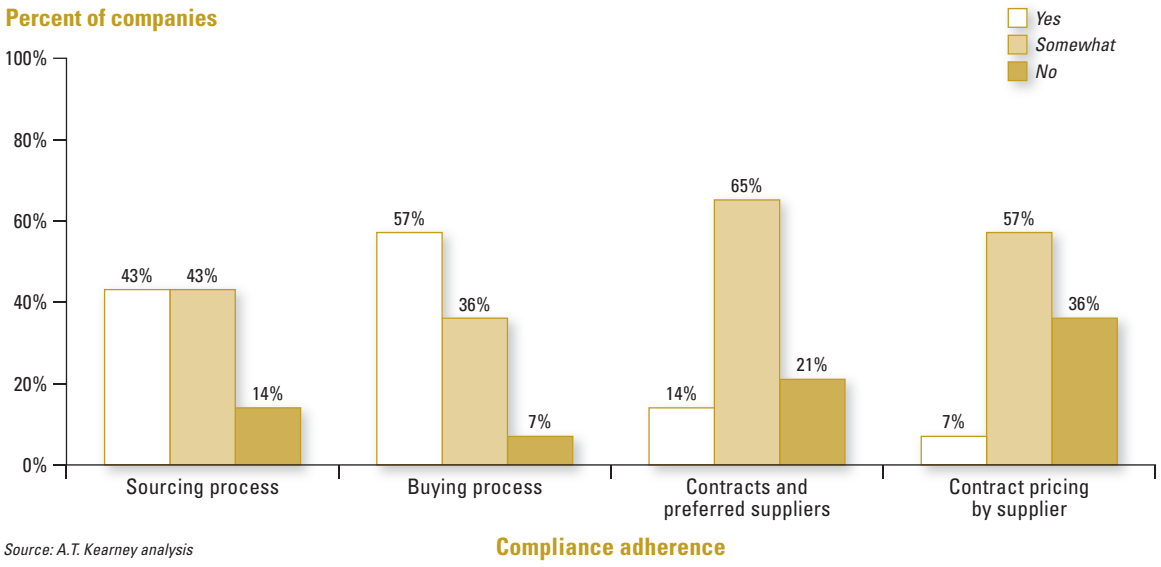
Not surprisingly, study participants cite insufficient resources as the biggest obstacle to implementing compliance programs. Many companies report that they do not have a fully staffed procurement team, which means they have to prioritize efforts, and compliance usually winds up on a lower rung than, for example, strategic sourcing initiatives *(see figure 4)*.

In addition, more than 70 percent of companies report that their CPO plays the lead role in compliance activities. Interestingly, however, even companies that have reached stage three or stage four compliance maturity do not have a large team dedicated to the design and maintenance of their compliance programs. Only one company reports having a dedicated compliance officer within its procurement function, while three companies have dedicated compliance resources.

Most companies report assigning fewer than three staffers to compliance—and in most instances they are not full-timers. Figure 5 illustrates resources allocated to compliance by roles. Category managers are often responsible for driving compliance efforts. That's because they use tools and technology to monitor and enforce compliance, so they are perceived as having the

Figure 4

Degree of compliance by procurement aspect



Source: A.T. Kearney analysis

most direct contact with stakeholders. Buyers (at buying centers) mostly play a minor role in enforcing compliance by reminding stakeholders about preferred suppliers and purchasing rules. However, buyers typically are not empowered to enforce compliance.

We should note that even when compliance staffers are in place, either on a part- or full-time basis, their responsibilities do not typically include audit functions or activities. Rather, their job is to realize savings, thus generating value for the business. We found that any audits that occurred in the procurement organization were predominantly to enforce compliance to contracts or preferred suppliers, and to ensure savings capture and risk mitigation. Also, when an internal audit function is involved in compliance, its targets are usually other business functions, and evaluating each function's compliance to procurement processes.

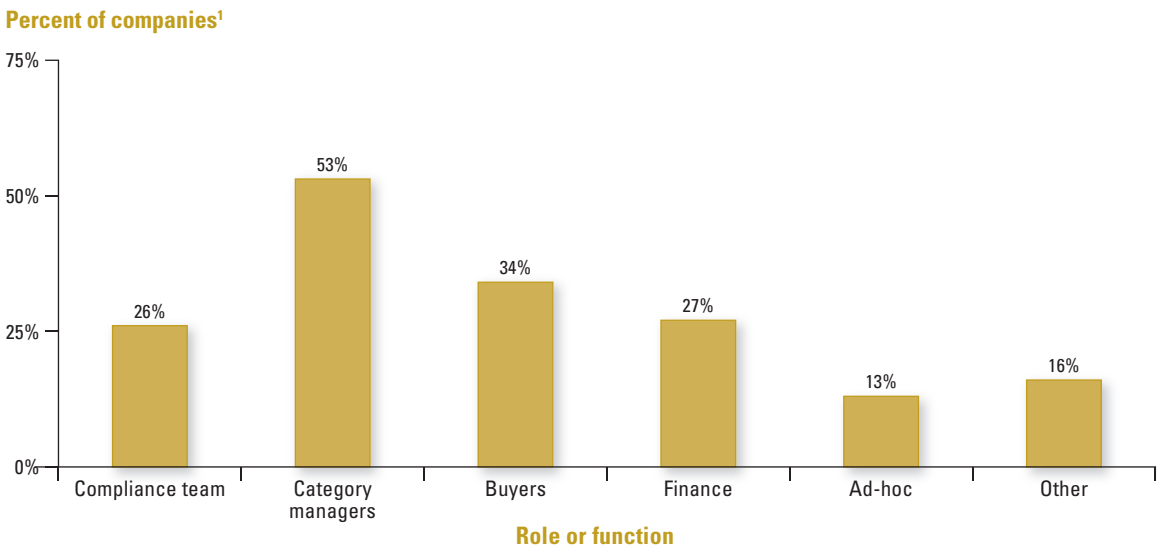
Finally, companies cite a lack of technology as a main reason for poor compliance. Most participants say they have not yet invested in the technology required to help improve compliance. On the upside, however, many organizations hope to roll out some form of technology in 2010 to support their compliance programs. The primary goal of these tools is to address challenges in receiving and tracking quality data (spend visibility) and to standardize the procure-to-pay process outside the geographic region where the company's headquarters is located.

What the Future Holds for Procurement Compliance

Executives report that their compliance programs have produced mixed results due to two main factors: competing priorities within the business and a reluctance on the part of procurement departments

Figure 5

Resources allocated to compliance by role



[1] *Total equals more than 100% because some participants picked more than one role or function*
Source: A.T. Kearney analysis

to be perceived as heavy-handed enforcers. Most, however, are optimistic about the positive role that compliance could play in the future, when company priorities shift and their procurement organizations are more mature. Today the focus is on getting key programs, metrics and tools in place so that tomorrow procurement can track and measure compliance—so the company's strategic sourcing and procurement programs can deliver bottom-line savings of between 5 and 20 percent.

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