



Procurement innovations helping CFOs Cope with mounting cost pressure

CFO's across industry sectors are being challenged to reduce costs—and for different reasons. Commercial enterprises are being challenged to profitably grow in an environment of rapid technological innovation and globalization, neither of which have created turbo-charged earnings growth as profits have stagnated since 2012¹. In the Federal Government, civilian agencies are facing massive

¹ Federal Reserve Bank of St. Louis Economic Data

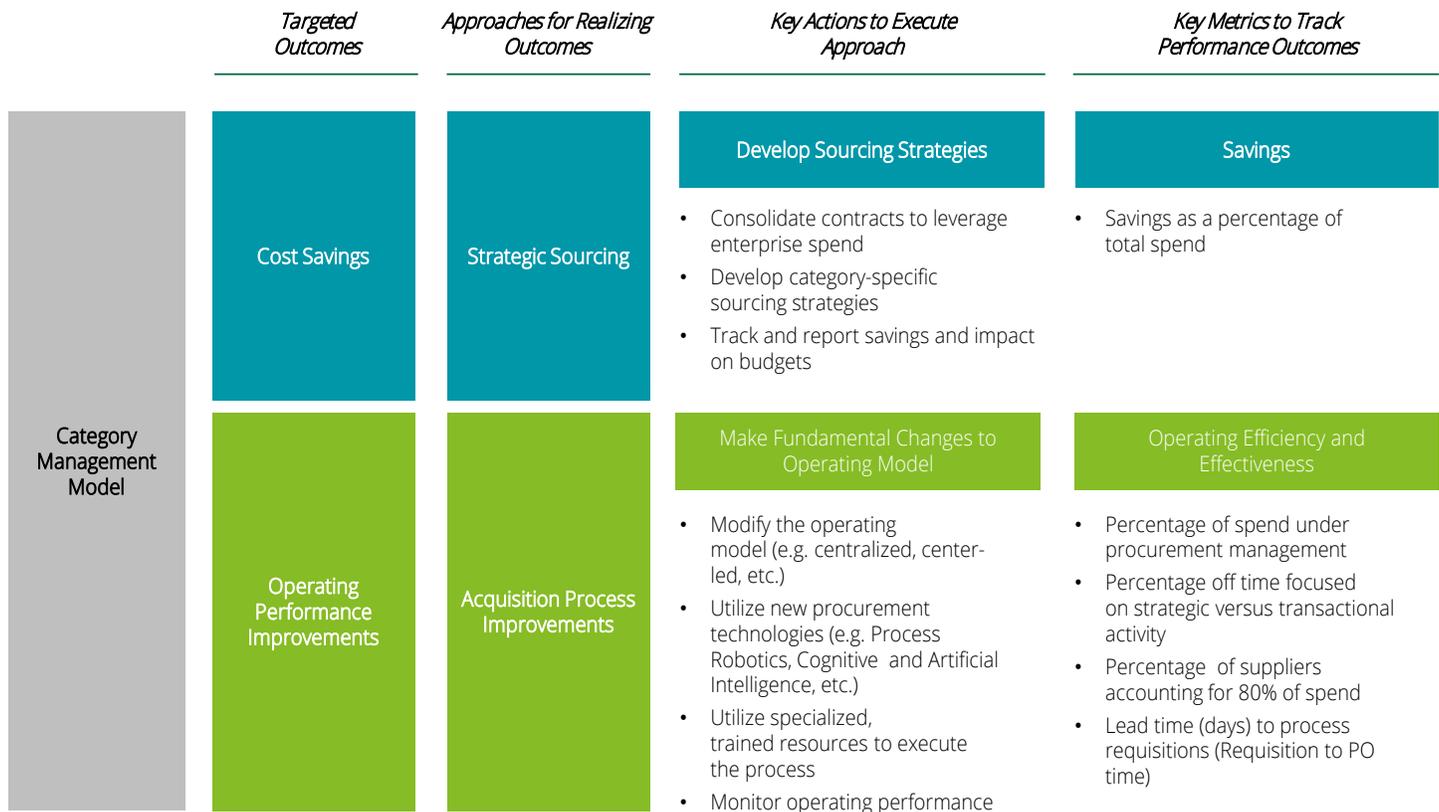
budget cuts² that threaten mission-critical programs. In the meantime, state governments have faced unprecedented austerity measures while Puerto Rico is climbing its way out of bankruptcy.

In this pressure-packed climate, how have CFOs responded to the need to cut cost?

² Federal News Radio. March 1, 2017 "FY18 budget cuts could slice into civilian agency programs, personnel"

For some, the answer has been Category Management, a strategy that targets sustained reductions in the cost of products and services purchased from vendors (see Figure 1). This includes the cost goods sold (e.g. metals, plastics, packaging, etc.) and overhead costs (e.g. IT hardware and software, facilities, office supplies, etc.). These costs are a natural target because a dollar increase (or decrease) results in a dollar increase (or decrease) in operating profit and cash flow.

Figure 1: Category Management Outcomes, Approaches, and Metrics



Category Management originated from a legacy cost reduction strategy called strategic sourcing. While it is not new, it has evolved over the last five years in ways that are creating even more cost reduction opportunities for CFOs. While the primary focus of this more comprehensive approach is supplier cost reduction, it has an added benefit of lowering operating costs for the entire procurement lifecycle – from spend analysis to contract close out.

In the early 2000s, commercial enterprises more aggressively harvested the benefits of Category Management. Public-sector entities began exploring it shortly thereafter. In 2016, the U.S. Federal Government embraced it in a big way by launching a government-wide Category Management effort to target cost reductions on a \$270 billion spend base¹ and by naming a team of 11 federal procurement specialists to lead the effort.²

1 Contract Management Magazine, June 2017 “Strategic Sourcing is a Team Sport”

2 Federal Times, February 26, 2016 “OMB names 11 to lead Category Management Centers of Excellence”

To fully benefit from Category Management, CFO’s should consider using specialized procurement resources, consider modifying their organization’s operating model, and modernize their procurement technologies.

Category Managers Lead the Way

Category Management programs are run by a new breed of professionals, Category Managers, specially trained in strategic sourcing and procurement operations. Category Managers manage to a broader set of performance metrics that go beyond vendor savings and includes operating efficiency metrics such as: procurement operating cost as a percentage of total savings; spend managed per procurement employee; and, purchase orders processed per procurement employee. This added responsibility for operating performance keeps sourcing savings balanced with the cost required to achieve them.

Category Managers are also proficient in assessing markets. For example, they are more equipped to spot market trends that can be used to increase the level of vendor competition and to drive down cost. As supply markets continue to rapidly change, procurement organizations with strong Category Managers who can capitalize on

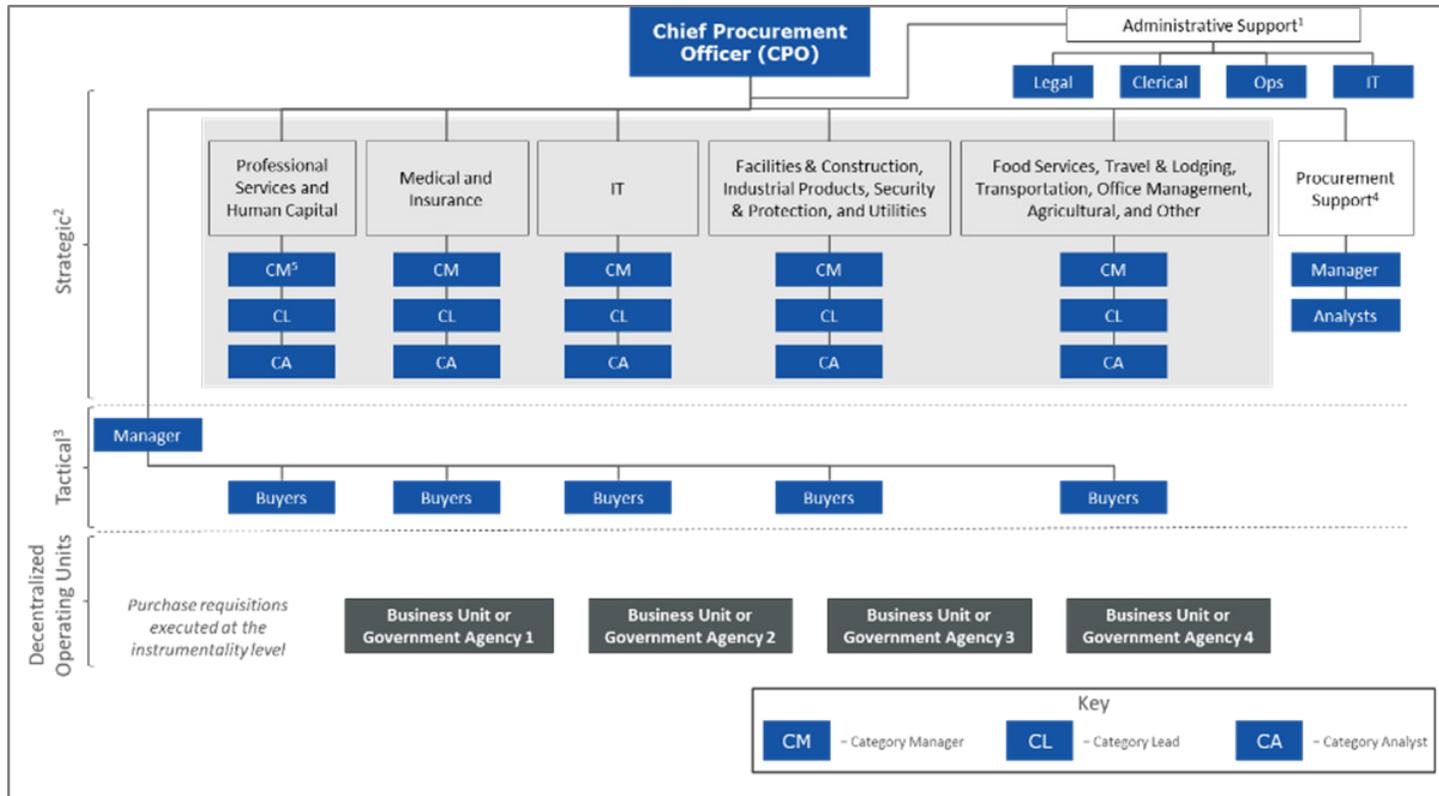
market trends will be the first to profit and save.

A New Centralized Procurement Operating Model

In the past, strategic sourcing efforts lost steam because benefits slowed soon after realizing profits from easy opportunities. In addition, these programs did not have the organization structure needed to sustain the benefits.

The Category Management operating model provides a formal structure (led by Category Managers) that focuses on strategic sourcing and procurement operations excellence. This is achieved by organizing procurement personnel around expense categories and centralizing strategic sourcing and transactional procurement activity. At the same time, category-specific centers of excellence that house different capabilities for specialized categories (e.g. IT, medical equipment, etc.) are established outside of the central procurement organization. A key to the operating model is that regardless of whether activities are operated centrally or from centers-of-excellence, the processes, technologies and performance measurements are standardized and led from the center.

Figure 2: Centralized Procurement Operating Model



The Government of Puerto Rico is currently using such an operating model as a major component of its fiscal recovery strategy as highlighted in its fiscal plan released in April of 2018¹. The existing procurement organization was fragmented and decentralized and the objective was to build a “centralized, transparent, and efficient procurement function”. Puerto Rico’s new centralized procurement operating model will be housed under the Office of the CFO and will require that all procurement strategic and tactical activities be centrally executed while following new processes and legislation.

Advances in Procurement Technology

Category Managers and centralized procurement operating models are also enabled by new technologies that unlock millions of dollars tied up in procurement operations. Big companies and government agencies implemented on-premise enterprise procurement applications that are now being replaced by easier-to-use, cloud-based solutions operated today at

1 Puerto Rico Fiscal Agency and Financial Advisory Authority (AAFAF): <http://www.aafaf.pr.gov/assets/newfiscalplanforpuerto-rico-2018-04-05.pdf>

a fraction of historical cost, saving millions in IT infrastructure investments and maintenance fees. These tools – along with the procurement technology pioneered by companies like Ariba and Oracle almost 20 years ago – will continue to be the mainstay of many procurement organizations for the foreseeable future. They’ll continue to increase worker productivity and, with the lower technology cost, provide a higher return on investment.

These enterprise procurement applications are also being augmented with new tools that leverage advances in cognitive data processing and robotic process automation (RPA) technologies. These new technologies are helping Category Managers meet aggressive savings and operating cost reduction targets, while also freeing up time for them to think more strategically. While advances in RPA can make procurement operations more efficient, cognitive tools can make Category Managers more effective at identifying savings opportunities with better enterprise-wide spend analytics.

Agencies like the Department of Health and Human Services (HHS) are using RPA to take time and cost out of their procurement

contract close-out process². It’s a high-volume, transaction-oriented, manual process that relies on data from multiple non-integrated systems—all characteristics that make RPA a viable solution. Automating this work through RPA will help improve procurement employee efficiency and limit contract-close-out backlogs. Cognitive computing is already changing the way enterprise-wide procurement spend data is being analyzed and categorized. It’s transforming rules-based systems from “if-then” rules-based logic to cognitive, experience-based reasoning so that analytical tools won’t confuse a “high-heel Sandal” tape dispenser with a shoe – because the system can put “high-heel Sandal” in context with “tape dispenser” and categorize the expense as office supplies. This is how our brain works, except we get tired and systems don’t, and the systems can process hundreds of thousands of descriptions in minutes.

2 HHS Turns to Blockchain to Reimagine Acquisition: <https://fedtechmagazine.com/article/2018/10/hhs-turns-blockchain-reimagine-acquisition>

Conclusion

Strategic sourcing has evolved into a more comprehensive Category Management approach for sustained operational cost take-out. Category Managers are actively focusing on both vendor and operating cost reductions, and new, more centralized operating models are helping maintain the focus.

While many organizations are still armed with traditional enterprise procurement tools that have evolved into better cloud-based solutions, new cognitive and RPA technologies are playing a role in helping Category Managers meet difficult savings and procurement operating cost take-out targets.

For any CFO facing cost pressure, Category Management should be a primary pillar in a broad operating cost reduction

strategy. It's being used in commercial and public-sector enterprises because it's one of the few programs that can become self-funding – the savings realized can pay for a new operating model, new personnel and enabling technology. The first step in the journey to transition to a Category Management model is to develop the business case showing the payback on investments in a new operating model, new technology and more talented personnel. It'll be the first step in a worthwhile journey toward sustained benefits.

Article authors and contributors include Kevin Chambers, Principal, Deloitte Consulting LLP and Gary Sutton, Specialist Leader, Deloitte Consulting, LLP. Federal CFO Insights are developed with the guidance of Federal CFO Program Leaders Alla Bishop, Partner, Deloitte & Touche LLP; Cindy Stockman, Specialist Executive; and Grant Mooney, Manager, Federal CFO Program Manager, Deloitte Consulting LLP.

Contact us:

Kevin Chambers Principal

Deloitte Consulting LLP
Tel: + 937 671 2434
Email: kchambers@deloitte.com

Gary Sutton Specialist Leader

Deloitte Consulting LLP
Tel: + 630 596 3922
Email: gasutton@deloitte.com

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