

## Implementing Metrics For World Class Performance



“If you can’t measure it, you can’t manage it!”

Performance metrics are the most effective means to monitor progress and ensure organizational success, particularly within procurement. These can range from simple measures of annual global spend through yearly savings targets to elaborately detailed supplier scorecards. Implementing performance metrics begins with a clearly articulated procurement vision. The vision must be understood by your staff, and the metrics used should directly correlate with the achievement of that vision. For the metrics to serve as useful motivators and milestones, the key metrics should be fairly limited in number and within the realm of your staff to impact.

For best practices companies, the procurement vision often targets aggressive cost saving targets, transactional efficiency measures, supplier satisfaction scores, diversity initiatives, and more. We recommend the following general categories of measures for procurement:

- Cost management targets (year to year sourcing savings, cost savings returned per dollars invested in procurement, procurement costs per billion in revenue)
- Transactional efficiency (%age electronic processing, cost per purchase order, purchase orders per FTE, 1<sup>st</sup> time match rate, error rates, etc.)
- Quality measures (external supplier survey, internal customer feedback, rejected shipment %age, purchase order errors, procure to pay cycle times, etc.)
- Financial control measures (supplier audit results, contract compliance, disbursement audit findings, aging of vendor credits, etc.)
- Success of diversity initiatives (new diversity suppliers, diversity spend as %age of overall spend, annual spending with first & second tier diversity suppliers)
- Cash management (days payable outstanding, cash discounts captured & missed, on-time payment performance, etc.)

As you develop the metrics, it is important to keep in mind the scope of your procurement activities, and the resources available to execute your vision. Are you responsible for procurement on a regional, North American or global scale? Are you responsible for direct materials, indirect materials, or both? How much of the procurement is goods versus services? Do you have to contend with multiple purchasing/payment platforms? Is there integration between your purchasing and A/P systems? Which divisions and/or spending are within your authority to impact? What type of relationship do you have with Accounts Payable (cooperative, adversarial, detached)? Is your procurement staff predominantly transactional in nature or strategic?

### **Where Are We Today?**

Once you have established the scope of procurement activities, you are ready to get started. Networking with your peers both within and outside of your industry will offer perspective on preferred metrics, and achievable performance levels. To further assist in this regard, there are a number of organizations that benchmark performance within procurement, including Exult Process Intelligence Center (EPIC), Center For Advanced Purchasing Studies (CAPS), and Purchasing.com. At bare minimum, your company’s baseline metrics should include the total annual spend, total number of suppliers (including

signature authorization vendors), annual spend by commodity, proportion of spend with procurement involvement, cycle time from requisition to payment, and the costs to staff procurement. Comparing your metrics to those of “best in class” organizations will quantify the opportunity gap between current and world-class performance, and judge the level of capital investment required to migrate from your current to future state.

### Gaining Executive Support

To secure initial commitment from the CFO, it is best to translate your procurement vision into a clear Return On Investment (ROI). Initially, the ROI will be a function of the spend multiplied times a conservative percentage of cost savings (usually 1-5%). To establish global spend, start with a copy of your annual report. Conceptually, all incoming revenue dollars ultimately are paid out for direct payroll, paid out for goods & services, or drop down to the bottom line. Below is a simplified formula that can quickly gauge that spend number. Depending upon your industry, the procure-to-pay spend typically ranges from \$0.30 to \$0.80 per dollar of revenue.

$$\text{Global Spend} = \text{Revenue} - (\text{Profits} + \text{Direct Payroll})$$

Direct payroll can be estimated by multiplying the number of employees times an assumed direct payroll expense (i.e. 20,000 employees \* \$50,000 per employee = \$1 Billion). This base of spend should be further refined to reflect leverageable spend (excludes expenditures such as taxes, intercompany, & banking). By focusing first on “low hanging fruit”, your initial successes will fund deeper procurement initiatives.

### Establishing A Commodity Framework

A commodity framework is the primary means to group like purchases to spot redundancies & leverage opportunities. Will you be using internal commodity codes, GL account codes, SIC codes, NAICS codes, UNSPSC codes or something else to categorize spend? Each of these has its pros & cons relative to maintainability, objectivity, precision, spend coverage, and its ability to control “maverick” spend. Ultimately performance metrics on the overall vendor base will be required at a more granular level, usually grouped by commodity code. Below is a chart that highlights the advantages and disadvantages of several common commoditization approaches:

	General Ledger Accounting Codes	Internal Procurement Commodity Codes	Standard Industrial Classification (SIC)	North American Industrial Classification System (NAICS)	United Nations Services & Products Standard Coding (UNSPSC)
Highly Objective & Consistently Applied	NO	NO	YES	YES	YES
Comparable Across Companies/Industries (i.e. mergers & acquisitions)	NO	NO	YES	YES	YES
Ability To Create Comparative Metrics Versus Peers & "Best In Class" Companies	NO	NO	YES	YES	YES
Industry Directories Widely Available	NO	NO	YES	NO	NO
Effective In Flagging "Maverick Spend"	YES	NO	YES	YES	YES
Estimated Number of Codes	2,000-3,000	300-700	11,800	18,000	13,000
High Level of Granularity	NO	NO	YES	YES	YES
Applies To All Spend (versus just PO-driven)	YES	NO	YES	YES	YES
Highly Customizable By Procurement	NO	YES	YES*	YES*	YES*

### **Capturing Accurate & Complete Spend Data**

Without accurate & complete spend data, performance metrics are of little value. Capturing accurate & complete spend data is the Achilles heel of most procurement initiatives. Spend data is housed in diverse sources such as Enterprise Resource Planning (ERP) systems, legacy platforms, outlying locations, overseas payment offices, outsourced freight providers, procurement card databases & more. Further complicating this is a lack of standardization across these sources regarding corporate linkage, commodity codes, diversity codes, vendor naming standards or address standards.

Fortunately every payment system generally captures the same data elements relative to both invoice and vendor files. This is one area where we recommend seeking outside help in scrubbing and cleansing your internal data. Firms are available that can take your 5-7 disparate disbursement systems and within 30-45 days, present cleansed data segregated by commodity in a format suitable for a sourcing team to pursue. Check references and find a strong partner with proven experience.

### **Deliver On Your Procurement Vision**

In the proper hands, performance metrics are your signposts along the path to world class performance. Learn from the experience of others to deliver results to your stakeholders. No one in the organization is better positioned to deliver increased profits, and boost shareholder value than procurement professionals.

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