



**institute for
supply management**

Session Code: AF

Stop Misallocating Purchasing Resources!

Presented by

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Key Points

- Purchasing services is difficult
- Purchasing of services is growing in importance, but resources to manage it are not
- Huge opportunity for organizations to improve their services purchasing (cost, value) by dedicating more resources
- Critical control issues are magnified as we outsource and offshore services
- Discussion of the types of resources needed

Services present a challenge...

- **Purchasing Services is DIFFICULT**

- Percentage of companies reporting that the purchasing of services compared to the purchasing of goods is:

Very easy	0
Easy	0
About the same	31%
Difficult	63%
Very difficult	6%

Services present a challenge

- **Managing Purchased Services is also DIFFICULT**
 - Percentage of companies reporting that managing the purchasing of services compared to the purchasing of goods is:

Very easy	0
Easy	3%
About the same	22%
Difficult	66%
Very difficult	9%

Services are also a significant amount of total organizational spend

Spend as a percentage of total spend

Services	33%
Direct	51%
Indirect	21%*

Numbers do not add to 100% due to the inability to separate bundled spend in some cases

Source: CAPS Research, Service Purchasing Benchmarking 2002

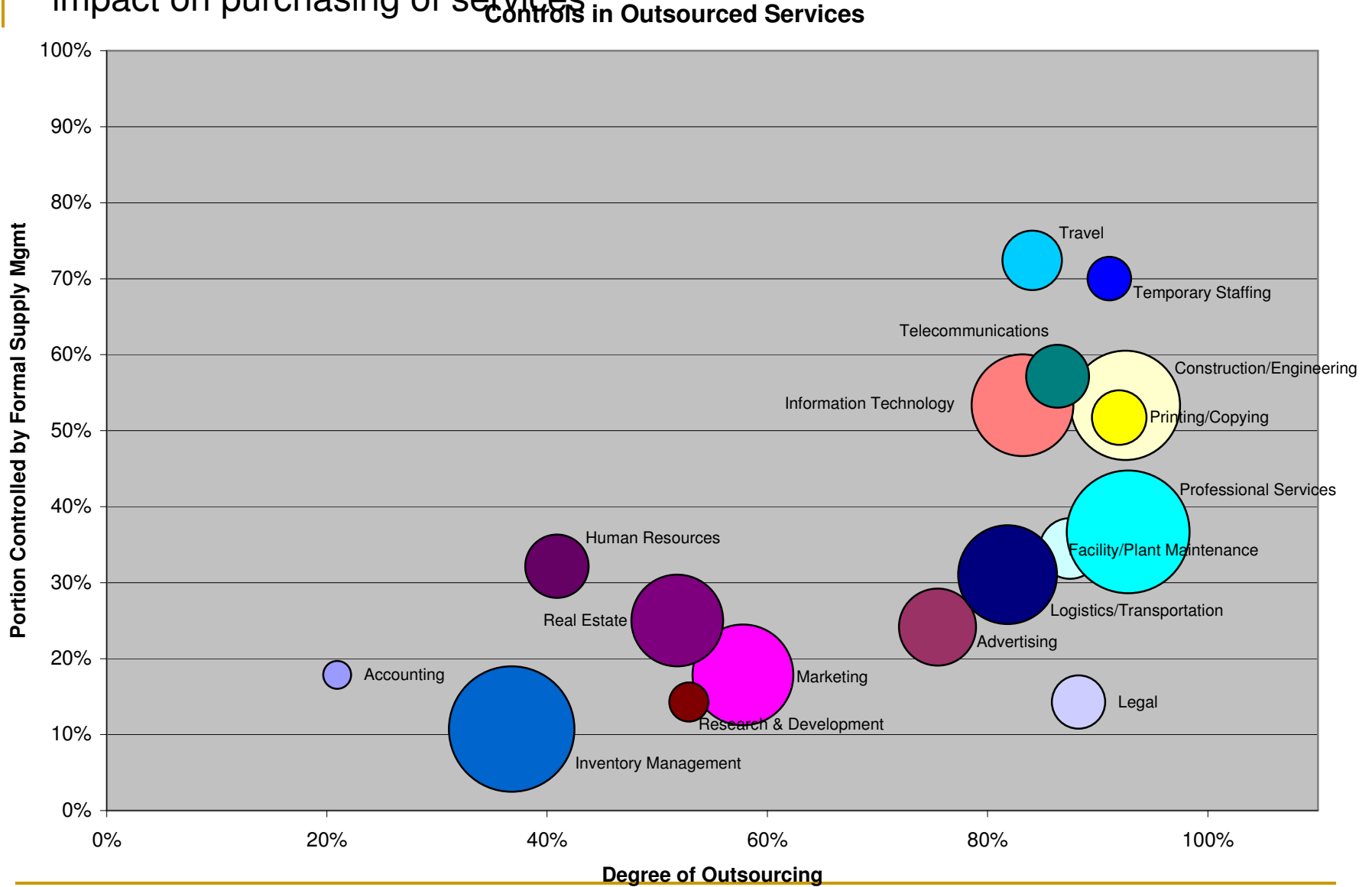
But we don't devote commensurate resources to services

- Active suppliers per buyer by spend category

Services	74
Direct	32
Indirect	62

Service buyers manage more than twice as many suppliers, often in very diverse areas of spend

Despite the difficulty of purchasing services, supply management often has limited impact on purchasing of services



Source: CAPS data, 2002, 2003

Key problems

- Many services are purchased outside of the realm of professional purchasing, which generally creates lack of control
- Service cost structures and delivery models are often complex and supplier-specified.
 - Because we don't understand cost drivers or cost structure of services, we pay too much.
 - We rely too much on suppliers for reporting and data analysis

Incorrect controls assumptions

- The beneficiary of the services won't approve the invoice unless it meets the terms of the contract
- Adequate investment in controls is made by supplier
- Outsourced provider is a specialist, so their systems will replace, and improve upon ours
- Outsourced controls (e.g. freight audit / payment firms) can correct these gaps

Types of Service Non-Compliance

- Unapproved Supplier
 - Order placed with unapproved supplier
- Approved Supplier, Wrong Specification
 - User orders non-standard service
 - Supplier provides incorrect service
- Approved Supplier, Wrong Price
 - Supplier overcharges for service
- Approved Supplier, Other Defect
 - Multiple billings, invoicing error, etc.

Behavior That Results in Overpayment to Contracts

- Usurping Procurement Leverage
 - Hidden Cost Adders
 - Cost of Money—Delayed Payments to Suppliers
 - Billing and Calculation Errors
 - Substitution of Lower Skilled Staff or Inputs
 - Providing Levels of Service Below Commitment
 - Not Monitoring and Measuring the Right Outputs
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Usurping Procurement Leverage

Audit Firms Overbilled Clients For
Travel,

Arkansas Suit Alleges (WSJ 9/17/03)

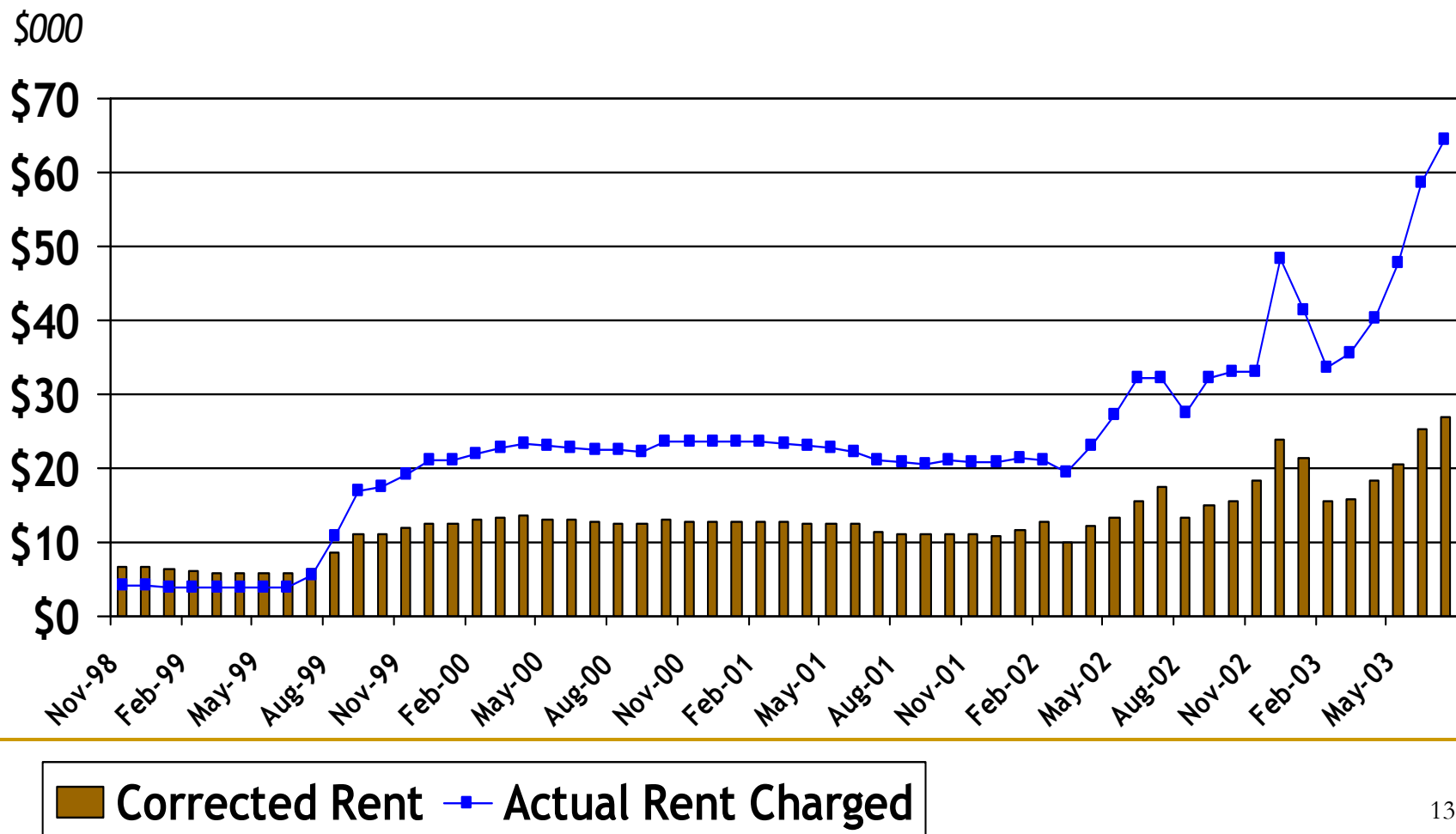
The suit alleges that the firms systematically **billed their clients for the full face amount** of certain travel expenses, including airline tickets, hotel rooms and car-rental expenses, **while pocketing undisclosed rebates and volume discounts** they received under contracts with various airline, car-rental, lodging and other companies.

At times, the rebates retained by the various firms were for up to 40% of the purchase price of travel-related services, the suit has alleged, citing internal firm documents filed with the court.

Billing errors – leasing example

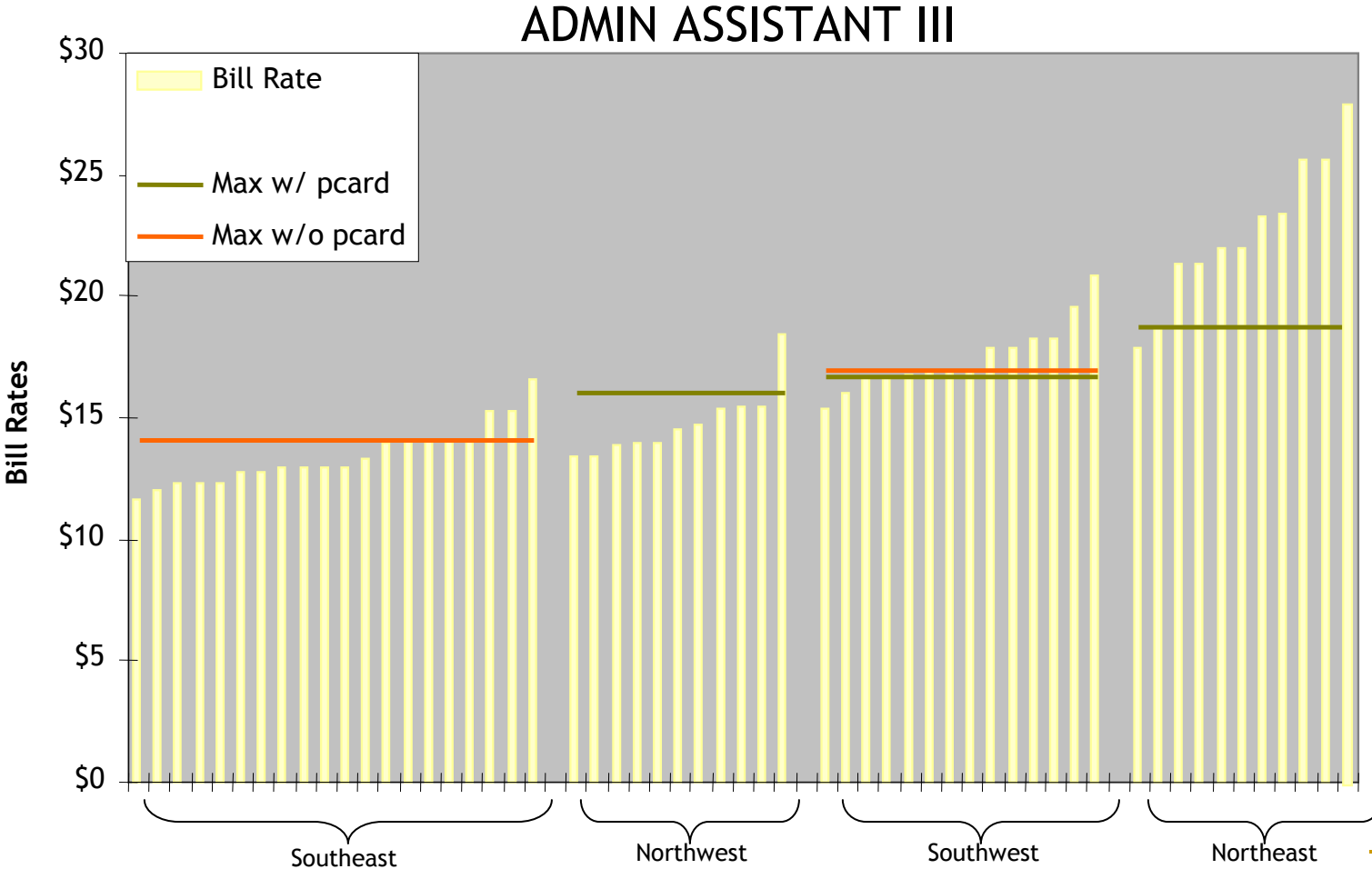
Actual charges vs. corrected rent – vehicle leasing

Over \$600,000 in overcharges



Contract non-compliance - Temp labor example

Bill Rates: Actual Rates vs. Contract Rates



Assumptions about services marketplace

- Procurement and the internal client know, in advance, the most efficient bundle of services to request.
- Procurement's role during the sourcing process is to create a fair, controlled marketplace in which to determine the market-clearing price.
- There is little value in collaborating with supplier on how they deliver the services required. The most efficient supplier will win the business.
- Over time, the supplier will work to reduce the costs of providing services, and the buyer can earn a portion of that economic value through periodic re-sourcing of the commodity.

Flaws with competitive bid process for services

- Competitive bidding may tell you what a service *does* cost, but it does not tell you what a service *should* cost, or its value
- Lack of visibility to services cost structure leads to very limited, win-lose negotiations
- Price-only negotiations stem from the premise that a supplier's operation is efficient
 - Focus is eliminating the "excess profit" from supplier proposals
 - Ignores the fact that suppliers incur costs for (and charge for) certain activities that may not be relevant or value-adding in the buyer's particular situation

Problem Impacts are Magnified with Offshoring

- Clarity is absolutely critical when offshoring
 - Greater risks with incomplete contracts
 - Expectations, business customs vary
- Suppliers may also be learning the business
 - Controls may be weak---developing
- More difficult and costly to intervene in case of problems
- Threat of scope creep appears greater with offshored services due to lure of low prices

Potential impacts of current services purchasing

- Due to lack of control, we may not get what we pay for
- Leave money on the table by not understanding cost drivers—price focus
- We lose the opportunity to explore alternate sources when selection is made by users
- We don't leverage service supplier's ideas to improve service delivery value and cost
- May inadvertently go too far with outsourcing, and lose critical skills, knowledge or leverage

What to do?

- Get a handle on your total services spend
- Allocate appropriate resources
- Measure effectiveness of controls
- Re-introduce business controls
 - Possible or periodic supplier audits

What to do?

- **Develop better contracts**
 - Specific payment milestones
 - Clear SLAs and measurements
- **Increase the professionalism of services purchasing**
 - Add support by cost analysts, just as in manufacturing
 - Disallow services purchasing without the involvement of service professionals to help develop contract, SLAs, measures

What to do?

- Clearly define the boundaries of the work to be managed by the suppliers
- **PUT YOUR BEST PEOPLE IN SERVICES PROCUREMENT**

Additional Steps

- Conducted structured interviews on outsourcing and offshoring services in a variety of industries
- About to distribute another CAPS Research Services Benchmarking Study
 - Will gather key background/demographics- pay, reporting relationship, scope of duties
 - Look at trends in services offshoring and outsourcing
- Graduate student (Wendy Tate) doing her dissertation research in supplier selection and management for offshored professional services

Thank you for your time and attention!

- Questions, comments
- Please leave a card if you would like to participate in our benchmarking study this summer
- Contact me/leave a card if you would like to talk to Wendy about your Supplier Management practices for offshore services