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RESEARCH

Best Practices in Benchmarking High-Performing Procurement Teams

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Introduction

The best procurement organizations in the world are intently focused on creating value in their extended supply chains, and they are very good at measuring this value. Benchmarking complements this effort, helping procurement groups identify new sources of value, pinpoint new capabilities and make a case for change.

But benchmarking itself is part of a broader competency in performance management that keeps procurement aligned with stakeholders and their dynamic needs. So before delving into particular benchmarks, you need to learn to benchmark better to get any value out of them. You need to not just buy better but also measure better so that you're focused on doing the right things before focusing on just doing them the right way relative to others.

Suffice to say, benchmarking/performance management is not a simple exercise. To understand why, ask yourself the following questions on procurement benchmarking:

1. What should we benchmark in procurement? Should we just benchmark the things we currently do today ("doing deals and processing POs"), or should we be measuring things we ought to do, like harnessing supplier innovation?

2. What do our stakeholders want us benchmarked on? They may care less about year-on-year purchased-cost-reduction benchmarks than ensuring that their suppliers are helping them accomplish their objectives.

3. If we are only getting benchmarked on cost savings and departmental efficiency, are we missing the bigger picture of measuring and improving the performance of supply (i.e., the value of the goods and services that stakeholders are buying with their limited budgets)?

4. Should we tailor the benchmarks to various internal stakeholders, or should it be one size fits all? How do we do this while making the whole process scalable?

5. How many benchmarks do we need and how specific and comparable (i.e., "apples to apples" problems) should they be? Too many can be overwhelming, buy too few can offer too little guidance.

6. How should we choose among the various benchmark data sources and also ensure that these benchmarks are “fit for purpose” for us?

7. How should we organize benchmark activities? Should they be a standalone benchmarking effort or should they be integrated into ongoing performance management processes?

8. How do we use the benchmarks to create change without getting overly fixated on the metrics themselves? And how can we minimize the costs of collecting this data?

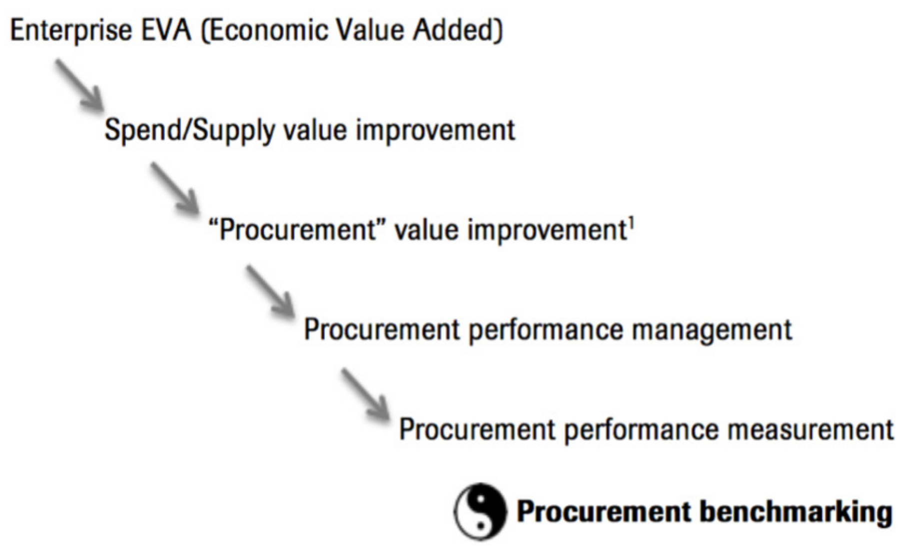
9. What about measuring best practices? Since they are “leading metrics” rather than lagging metrics, how should we integrate them into traditional performance benchmarking?

10. Is this whole effort even worth it? How can we get better ROI on the benchmarking process itself and how can we justify such measurement? Also, what is the role of technology in improving this whole area?

Procurement benchmarking is clearly not a simple topic. While all of the above questions can’t be answered in depth in this single report, there are some ways to approach this area that should prove helpful.

Link procurement performance to value chain performance and enterprise performance — and then pull in relevant benchmarks.

Procurement benchmarking is part of a larger competency of performance management, as shown below:



[1]There are two definitions of “procurement” here: 1) improvements to procurement processes independent of where they report into, and 2) improvements led by the procurement function, regardless of process area.

Procurement benchmarking is a form of procurement performance measurement, which in turn is part of performance management (e.g., closed loop savings management process) that ultimately is part of improving the value from spend (and supply) and its impact on enterprise performance. Your job in procurement benchmarking is not just to find external benchmarks to link to whatever existing departmental purchasing metrics that you have, but rather, to use benchmarking to highlight where to best focus your continued efforts on unlocking enterprise value. Here are some recommendations using the framework above to do this:

- **Start with business outcomes.** Use enterprise-level benchmarking, especially if you are a public company, and work with your finance department to align to whatever framework that you hopefully use (e.g., ROIC, EVA, ROA, etc.). Similarly, plug into supply chain benchmarks that may exist in your industry. Various consultancies have benchmarking diagnostics that are fairly robust (e.g., AT Kearney's ROSMA benchmark can be accessed for free by ISM and CIPS members).

- **Pull instead of push.** Rather than just driving sourcing savings through procurement-led vendor consolidation, align your metrics to those of budget/process owners (e.g., during the planning and budgeting process) and then work backwards to supply/supplier performance improvements that can be made, from which procurement can derive its value-add.

- **Use a "Procurement ROI" metric.** This is a great, fairly standard metric to consider because it's a composite metric, which helps reduce the number of metrics that you track. It's equal to the annual cost savings (and other hard-dollar benefits) driven by the procurement organization divided by the annual cost (or "investment") over the procurement function. Based on a recent ISM/Spend Matters study, a quartile analysis of Procurement ROI is shown below[2] :

Quartile	'Procurement ROI'
4Q	3.7X
3Q	5.3X
2Q	6.9X
1Q	11.5X

Source: Spend Matters, ISM, 2015

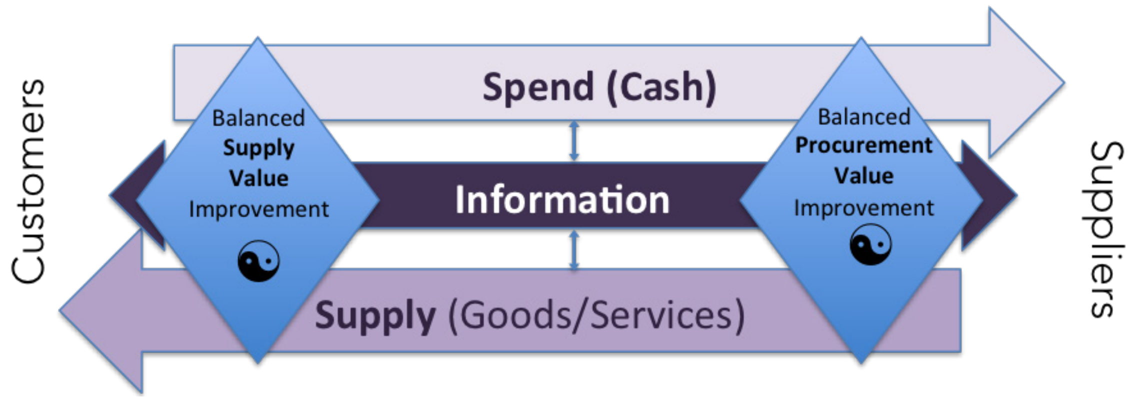
Go with the flows. Once you've identified the stakeholder metrics to align yours to, then you can build your balanced scorecard (i.e., cost, cycle time, quality, delivery, innovation, etc.) that looks at investments and improvements for three main flows:

- **Spend flows.** Assuming you have spend visibility (which you must!), you can normalize your spend (i.e., cash disbursed to suppliers) to revenues, employees or other metrics. And you need spend as a normalizing metric for benchmarking to firms of different spend sizes. You should also be able to translate spend data to cash flow statements and to the P&L.

- **Supply flows.** This is a process flow of goods and services from your suppliers where you look at supplier performance and supply chain performance. A supplier perfect order metric is a great one to consider.

- **Information flows.** This is a process flow of information and documents/data that should be efficient and meet stakeholder needs (i.e., effective). Some form of internal service level agreement (SLA) should be considered that includes internal responsiveness, customer satisfaction, error rates, cycle times and supporting of the spend/supply metrics mentioned before.

Graphically, these flows can be shown below:



The idea is to establish benchmarks that help the business understand where “supply value” (i.e., business impact derived from the supply chain and from suppliers) is being created or improved, and where procurement is creating value by improving this supply value rather than just sourcing and purchasing efficiently to meet internal stakeholder service levels. The yin-yang symbols in the figure above denote a “balanced scorecard” that represents the prioritized performance metrics of the stakeholders involved. These metrics then drive which benchmarks to use.

Mandatory: Strong Spend/Supply Analytics

The “information supply chain” at the center of the diagram above is not just a bunch of S2P document flows but rather the analytics that derive intelligence from the data (which is increasingly external and “outside-in”) and inform the strategies and performance targets themselves. It’s your view into your spend and your supply chain, and if you don’t have it, you simply can’t generate the relevant intelligence needed to run you business effectively (and you can’t benchmark effectively, either).

Spend/supply analytics enable performance analytics, which integrate to benchmarks. Increasingly, cloud-based solution providers are deriving data-driven benchmarks from their installed bases to help lagging firms have a clear line of sight to where they can improve relative to their peers. Analytics are at the core of a closed loop spend/supply management process.

Capabilities Drive Outcomes — Measure Leading Metrics, Not Just Lagging

If you want to achieve top performance, you need to measure the capabilities and supporting metrics that drive that performance. So, you should benchmark yourself on the capabilities that drive the metrics you’re looking to improve. It can be the level of procurement automation, staff training or stakeholder alignment practices. For example, many firms use “spend under management” as a key capability metric that measures what percentage of spending is flowing through contracts with preferred suppliers that were established by a procurement-led sourcing process. Our recent research, however, showed that while such “quantity of influence” is important, the “quality of influence” through implementation of best practices is even more important. Procurement organizations that were involved before requirements were locked down had 50% higher savings than those that were only first involved during supplier negotiations. Benchmarking your adoption of leading practices relative to others can help you identify techniques that can unlock more value.

Some procurement groups have also done this type of benchmarking internally to create friendly internal competition and to share best practices within the firm. When a team implements an innovative new practice or “service,” it’s then important to help enshrine this broader value creation within the procurement scorecard. Otherwise, misalignment occurs. Our research shows that while nearly 90% of procurement groups get credit for cost savings, only 45% get credit for spend reduction (i.e., demand/consumption reduction). If it’s important to do it, then measure it.

Measurement of procurement value beyond savings is already a trend underway. Based on research we conducted last year, value beyond cost savings will increase to almost 50% in three years from 42% of total procurement economic contribution. This expanded value scope requires collaboration with finance. It includes not just measuring cost avoidance (which is indeed critical for avoiding, or smoothing, future cost increases) but also agreeing to measurement and validation approaches, such as aligning supplier-related savings to contract duration rather than one-year-only credit. Such increasingly sophisticated value measurement capabilities also require new tools.

Make your Performance Measurement Process Scalable with Technology

The problem with benchmarking, or any performance measurement, is that there is no explicit ROI with it. Yet it's obviously critical to focus on the right things before measuring if you did them right. Measuring procurement value, including benchmarking, is becoming an exercise that spreadsheets and homegrown databases are not well suited for because you immediately have multiple “sets of books” surrounding performance. Increasingly, procurement organizations are looking to source-to-pay (S2P) application suites themselves to perform analytics, create improvement projects (or just sourcing projects), establish baselines/targets (which can tie to external benchmarks), monitor value improvement actuals and track value creation approvals within workflow. Some S2P providers are even moving toward integrating anonymized benchmarks from their cloud-based, user-installed bases to help highlight gap areas relative to their peers.

Benchmarking is About Transformation

Benchmarking may seem like a dark art in terms of finding relevant benchmarks, ensuring comparability, implementing at low cost and effort, and making it a sustainable endeavor. It’s hard to go through all of the tips and tricks of the trade here, but the most important aspect of benchmarking, besides addressing the broader performance measurement and management issues highlighted earlier, is really about transformation.

Procurement teams should aggressively pursue benchmarking to bring an “outside-in” perspective and fuel new value creation opportunities, instead of letting benchmarking be done to them by senior management and a benchmarking firm because they have underperformed. The best organizations are not afraid to measure themselves and make themselves better so that they not only perform well relative to others but also become “benchmark organizations” that other seek to emulate.

The bottom line is that world-class procurement performance comes from a benchmark-informed performance management system that aligns procurement-led supply improvements to measurable enterprise-level economic improvements.

About the Author

Pierre Mitchell leads the procurement research activities at Spend Matters. He has 25 years of procurement and supply chain industry and consulting experience, and is a recognized procurement expert specializing in supply processes, practices, metrics, and enabling tools and services. Prior to Spend Matters, he was the first industry analyst to put procurement research on the map for both AMR Research (now Gartner) and later at The Hackett Group. He has also led numerous operations and systems transformations at Fortune 500 organizations. Industry positions include manufacturing project manager at The Timberland Company, materials manager at Krupp Companies and engineer at EG&G Torque Systems. He holds an engineering degree from Southern Methodist University and an MBA from the University of Chicago. His recent writing can be found at: http://spendmatters.com/author/pierre/

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