Source-to-Pay: Advancing from Pure Cost Optimization to Value Generation

To turbo-charge business value from sourcing and procurement functions, organizations must transcend foundational approaches — focusing instead on refining strategies, heightening efficiencies and delivering more value across S2P operations, to internal customers, and throughout the extended supply chain.

Executive Summary

If the pundits are to be believed, 80% of businesses treat their sourcing, procurement and payment (S2P) processes as non-core functions, with the possible exception being the sourcing of direct materials. As a result, S2P does not receive the attention, much less the capital and strategic focus, it deserves.

There are also external forces at play — ongoing global economic uncertainty and a dearth of S2P talent at mid- to senior-management levels, for example — that exacerbate the problem. These issues, plus the lack of enterprise-level S2P optimization, directly impact gross margins and trigger a variety of other operational challenges. (See Figure 1, next page.)

This white paper explores in detail the challenges facing sourcing and procurement heads, as well as specific levers/strategies that can be incorporated to help overcome these roadblocks and enable purchasing teams to achieve excellence in sourcing, procurement and payment. By adopting the new S2P operating model described here, leaders will be equipped to deliver the highest level of efficiency in S2P operations, along with more value to internal customers and the extended supply chain.

The State of S2P

Our assessment of sourcing and procurement activities at organizations with global S2P operations reveals a host of challenges in six primary categories:

- **Strategy:** Inadequate S2P strategies (category management, sourcing strategy, supply risk planning) at an enterprise level.

- **Intelligence:** A lack of market savvy concerning products, technology advancements, new suppliers (inadequate supplier outreach capability) and global commodity indices.

- **Policy and process:** Shortcomings in the areas of spend management, cost modeling, working capital management, material procurement planning (including demand aggregation) and contract compliance.

- **Accountability:** Failure to establish SLAs and controls through S2P KPIs.

- **Structure:** S2P organizations struggle to find the best structure and model — decentralized, centralized or center-led. While structure alignment can still be attained, tribal category knowledge remains with a few experts and overall, inadequate sourcing skills is a recurrent problem.

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Challenges Facing Sourcing and Procurement

Inefficient supplier management practices

Maverick, spot purchases, contract non-compliance

Sub-optimal price discovery of goods & services procured

Single-sourcing, preferential supplier treatment

Cost overruns

Poor service levels

Inconsistent & incomplete catalogue & specifications

Lack of control & accountability
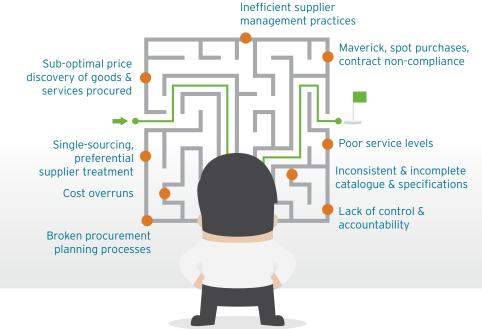
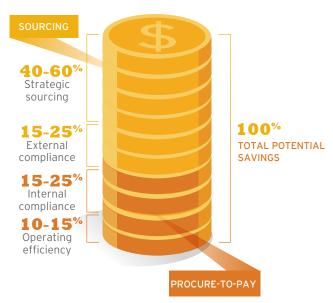Broken procurement planning processes

Figure 1

- **Technology:** The inability to strike the right balance between process efficiency and advanced technology (catalogue management, supplier relationship management [SRM], e-procurement, reverse auction, P2P buying channel, spend analytics) invariably leads to poor or no ROI on S2P technology investments — the result of bad choices and favoring "automation" over "value creation."

Organizations with semi-mature S2P practices have managed to plug the savings leaks and improve S2P efficiency-related benefits by implementing the fundamentals of S2P processes (see Figure 2). This includes ensuring compliance, institutionalizing approval-based P2P workflows, deploying foundational content management and embracing spend analytics practices. However, to move the needle beyond savings to value creation, S2P functions must up the ante on other critical aspects that can unearth larger opportunities and enable them to systematically capitalize on each. Avenues that have the potential to demonstrate greater value to the business include:

- **Supply risk management:** This remains an evolving practice (e.g., supplier audits) within many organizations, which makes

Realizing Savings Through Basic S2P Processes

S2P SAVINGS POTENTIAL

SOURCING

40-60%
Strategic sourcing

15-25%
External compliance

15-25%
Internal compliance

10-15%
Operating efficiency

100%
TOTAL POTENTIAL SAVINGS

PROCURE-TO-PAY

Source: Everest
Figure 2

Category Sourcing Can Result in Significant Savings

Category	Average Savings
Facilities	4-8%
HR related	6-20%
IT/telecom	6-25%
Marketing/sales products	3-23%
Marketing/sales services	6-20%
MRO supplies	8-20%
Office supplies	7-20%
Professional services	7-20%
Third-party logistics	6-22%
Travel related	8-23%
Utilities	5-15%

AVERAGE SAVINGS

Source: Ariba
Figure 3

sense given that other forms of risks – natural disasters, political and economic events, contracting, legal, operational and financial – are not collectively assessed. Moving from a qualitative approach to a continuous, fact-/data-based quantitative risk evaluation is among the key capabilities that can differentiate an organization's S2P function in terms of strategic value creation. Risk management should not be conducted in isolation; instead, it needs to be embedded within the core source-to-contract (S2C) and procure-to-pay (P2P) processes to minimize supply-exposure risks.

- **Category sourcing strategy:** This involves defining sourcing groups and specifying strategies (balancing business goals, requirements, buyer dynamics and supply market complexity) for direct and indirect services and projects – potentially resulting in a range of savings opportunities. (See Figure 3.)

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Finding the Right Buying Channel

CATALOGUE

LEVEL 1	LEVEL 2	LEVEL 3
Facility Management	Building Contractors	Heating / Cooling / Ventilation
	Electrical Installations	
	Indoor Infrastructure	Water & sewer / Road maintenance / Security / Furniture
	Office Equipment	
Professional Services	Consulting	IT consulting / Management advisory
	Financial	Financial consulting / Auditing
MRO	Consumables	Chemicals / Semi-finished steel
	Tools & Spare Parts	Components / Electrical engines
Capital Equipment	Production equipment	Assembly, automation, grinding, etc. / Measurement, testing, packing, etc.
Logistics	Air, Rail, Road & Sea Transport, Express Parcels	Import/export duty, costs for brokerage / Warehousing services / Etc.

X

BUYING CHANNELS

REQUISITION
- Catalogue
- Online contract
- E-mail/phone/FAX/verbal
- Special request
- OCR
- Non-OCR

INVOICE
- T&E card
- E-Invoice (EDI)
- Self-billing
- Scanned invoice
- Paper invoice

PURCHASE
- Non-PO
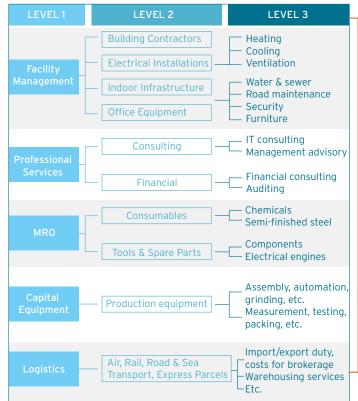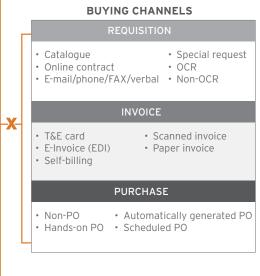- Hands-on PO
- Automatically generated PO
- Scheduled PO

Figure 4

- **Buying channel strategy:** Finding the optimal procurement channel is critical – taking into account different dynamics in terms of user efficiency (lowest transaction costs, reduced complexity of IT solution, etc.), control and visibility (spend information, compliance to contracts and specifications) and ease of use (easy ordering, quick delivery and easy invoicing). (See Figure 4, previous page.)

- **Supply chain financing:** This can be accomplished through multiple techniques, such as vendor-managed inventory (VMI) and buyer-led credit programs for suppliers. Using a combination of payment terms (early vs. late) and associated rebates, invoice consolidation and P2P automation can deliver additional cost savings.

- **Global shared service:** This operating model is responsible for defining and executing on sourcing strategy, P2P transactions (e.g., post-purchase requests), S2P analytics and local operations, including sourcing support, purchase requisitions, spot buys and contract execution.

Given these dimensions of an S2P function and their varying impacts on shaping the maturity of operations, it is evident that a chief purchasing officer's task is arguably a multifaceted one. From managing end users and the plant head's expectations (e.g., complex goods and service demands, delivery pressures), to maintaining a persistent cost-containment focus, to conforming to sustainability requirements while balancing supply risk, the CPO's role can be mind-boggling and complicated, particularly when it comes to playing catch-up with long-term challenges and S2P trends and staying ahead of the competition.

Thinking and Working Proactively

Considering the multidimensional complexities, what should CPOs focus on?

Besides the fundamentals, CPOs must get comfortable with next-set practices that will shape S2P strategies in the coming years. This will require them to master the following:

- **Real-time market intelligence:** Technology advancements in data capture and cloud-based distribution is making market dynamics more transparent, since real-time information about prices can be accessed across trading channels and online B2B marketplaces. The availability of relevant data is forcing procurement organizations to move ahead and build data models that predict changes in commodity prices. Likewise, they must use analytics to access supply risks and compliance data assimilated from internal and external sources, using advanced Decision Tree-based models that enable category managers to establish a robust risk profile of their critical parts/services and the associated savings. The collective multiple data sources will form the building blocks for a 360-degree view of the category – covering all aspects, such as risks; TCO and savings; product/service technology advancements/maturity; quality; compliance, and supplier performance – resulting in negotiation scenarios informed by robust analytical engines.

- **Evolving supplier partnerships:** Based on the principles of core competence, S2P leaders will recognize that there is much to be gained from their suppliers. For example, suppliers are more knowledgeable on key technological advancements in the product/services they provide – compelling category managers to evaluate them not merely on innovation, but also on how the suppliers integrate their own product/service lifecycle activities with customers' S2P activities. In addition to staying price-competitive and remain a provider of choice, suppliers will move up the value chain not just by catering to specific product or service needs, but also by delivering an all-encompassing solution.

> By bringing in "outside-in" views on technology; owning auxiliary activities around the product/service; using IT effectively; and participating in joint product design/development of innovative commercial models involving variable and outcome-based pricing, suppliers will begin to own a larger share of the partnership with their customers.

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The Future of S2P: Drivers of Change

1

FOUNDATIONAL
- Savings & P2P efficiency.
- Spend management.
- Material visibility, risk awareness.
- Supplier management.
- Internal compliance.
- Fact-based, one-on-one negotiations.

2

DIFFERENTIATOR (current state)
Sustained value creation
- Category-level enterprise coordination.
- Supplier development, enablement.
- Integrated SRM system.
- E-Sourcing.
- Market volatility management.

Supplier as extended partner
- Value-added services.
- Global supply competence.
- Traceability & visibility extending to production plans.
- External compliance.

3

EXCELLENCE (future state)
Real-time market intelligence
- Multi-tier visibility.
- Data models to predict commodity prices.
- Robust analytics engines for scenario-based optimization.
- Analytics-informed reporting and decision making.
- Variable and outcome-based pricing.

Evolved supplier partnerships
- Innovation from suppliers.
- Focus on end-to-end solutions.
- Enhancing service to internal customers.

New risk management strategies
- Mitigate risk through collaboration.
- Holistic risk strategies.
- Predictive regulatory and enforcement insight to customers.

S2P outsourcing maturity
- Increased outsourcing to service providers.
- New business models.

Figure 5

- **Risk management:** Procurement organizations will need to develop holistic strategies for managing risk, including total risk exposure, risk-mitigation investments and risk-transfer pricing. Newer risk-transfer options introduced by financial services companies will become the norm for CPOs and their S2P teams to consider during the risk-exposure planning process. Mitigating risk will involve external collaboration between the organization's S2P function, its suppliers and its key customers. The use of statistical analysis and simulation-based advanced risk models (e.g., Bayesian, Monte Carlo) — seamlessly integrated with the S2C activities — will become the norm for category managers, enabling them to evaluate multiple "business-value-at-risk" strategies.

- **S2P outsourcing maturity:** A heightened focus on S2P core competencies starts with an assessment of what the organization can source, followed by the identification of partners that it can rely on for support of non-core S2P activities (i.e., P2P and certain components of tactical sourcing activities). At the same time, as S2P sourcing matures, organizations should expect to see a second phase of development, where companies begin to jointly innovate with their partners — delivering Kaizen initiatives across S2P activities, and exploring new sourcing and supply chain financing models to drive competitive performance, manage risk and optimize working capital.

These factors will cause the S2P function to evolve — propelled by progressive capabilities such as an advanced commodity trading desk for category managers and multi-tier engagement with suppliers to afford end-to-end visibility across commodity supply chains. By adopting these sophisticated capabilities (e.g., hedge, forward contracts, etc.), S2P functional heads can demonstrate the financial impact on gross margin, EBITDA, cost of risk and capital.
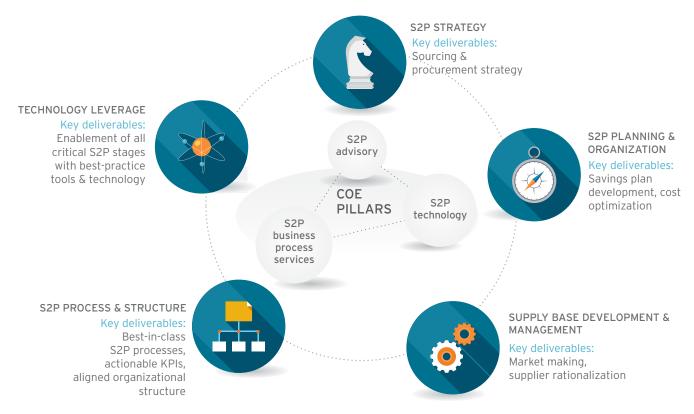
The S2P Transformation Framework

S2P STRATEGY
Key deliverables:
Sourcing &
procurement strategy

TECHNOLOGY LEVERAGE
Key deliverables:
Enablement of all
critical S2P stages
with best-practice
tools & technology

S2P advisory

COE PILLARS

S2P technology

S2P business process services

S2P PLANNING & ORGANIZATION
Key deliverables:
Savings plan
development, cost
optimization

S2P PROCESS & STRUCTURE
Key deliverables:
Best-in-class
S2P processes,
actionable KPIs,
aligned organizational
structure

SUPPLY BASE DEVELOPMENT & MANAGEMENT
Key deliverables:
Market making,
supplier rationalization

Figure 6

Embracing a Transformation Approach

It all comes down to CPOs needing to ask the right questions: "How do I transform my S2P function from a mere support activity to a strategic business enabler that eliminates bottom-line erosion, delivers competitive advantage for my enterprise, ensures stickiness with customers and supplier alike, and is viewed as a true partner to my business?"

Our S2P transformation framework addresses these challenges by providing both strategic and tactical intelligence to advance S2P functional capabilities. The framework's built-in S2P expertise, coupled with sourcing-category proficiency, can unearth every potential area of TCO erosion and help ensure sustainable value – leading to true S2P transformation. (See Figure 6.)

Elements of an S2P Opportunity Assessment

1. OPPORTUNITY ASSESSMENT			
1.1 Category Mangement	**1.2 Supplier Management**	**1.3 Change Management**	**1.4 Sourcing Review**
• Data classification. • Analyze procurement. • Demand/forecast aggregation. • Category portfolio analysis. • Sourcing strategy. • Identify cost-reduction opportunities. • Design activity impact analysis. • Business case preparation.	• Supplier on-boarding. • Supplier rationalization. • Supplier risk and financial analysis. • Supplier collaboration. • Supplier catalogue management.	• Risk management. • Training. • Communication.	• Savings tracking. • Sourcing and procurement efficiency. • Compliance. • Supplier performance tracking. • Working capital analysis.

Figure 7

Employing a Holistic Transformation Methodology

CORE COMPONENTS

- Service management.
- Governance.
- Vendor strategy.
- Streamlined processes.
- Technology.
- Performance.
- Management.

Spend Analytics
Category Strategy
Procurement Operation
Accounts Payable
Catalogue Management

KAIZEN
- Continuous S2P excellence.
- Develop new sourcing competencies.
- Drive innovation through S2P technology.

ADOPTION
- Pilot, rollout.
- Standardize services.
- Business value audit.
- Multi-vendor ecosystem.
- Industrialize.
- Quality assurance.
- Stakeholder engagement.
- Multi-BU/Geo. governance.

Figure 8

Our holistic approach aligns with a business's growth and margin objectives, and is built on three pillars: S2P advisory, technology, and business-process service. The tight interoperability of our framework's modular sub-components within these pillars helps to ensure positive outcomes of S2P operational/tactical initiatives, as well as business growth measured against KPIs and competitive, differentiation-related metrics.

The framework's components cover the core areas of S2P – from opportunity assessment (S2P strategy and planning) as shown in Figure 7 on the previous page, to market-making, execution and monitoring (S2P operational/tactical). Each of these elements are distilled into multiple levels of processes and activities, with a logical set of specific controls (metrics), organizational roles and enabling technology.

We believe that the focus should not be limited to automation and process digitization. A holistic transformation methodology (see Figure 8) should be capable of identifying and executing quick wins on a steady basis (a Kaizen approach), and institutionalize the larger transformation mandate (S2P policy, strategy, procedures, structure and change management).

Looking Forward

An organization's current S2P shortcomings, plus the ongoing challenges posed by globalization and other external factors, oblige S2P heads to make sound, proven choices in every aspect of S2P, from strategy to execution. With this in mind, we offer key recommendations for S2P leaders looking to enable true S2P transformation:

- **Make proactive investments to build a value-driven S2P strategy** (rather than focusing purely on cost-containment) – emphasizing business outcomes in a sustainable and repeatable manner.

- **Evaluate and design an optimal S2P operating model** that is supported by a robust governance structure, value-focused S2P processes and metrics, and best-in-class technology.

- **Adopt SMAC (social, mobile, analytics and cloud) technology options** such as cloud, omnichannel business collaboration, and real-time business intelligence on price volatility and business risks, driven by predictive analytics.

- **Innovate and automate S2P planning and execution processes** to drive faster time to market, introduce new products more frequently, and reduce legal, financial and operational risks.

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