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New SEP^SM Methodology Delivers Enterprise-Level Effectiveness of the Source-To-Pay Process

By Tajinder Vohra, Senior Vice President, Genpact

There is a great deal of talk these days about best-in-class sourcing and procurement. Only a very small number of companies, however, achieve elite status where their sourcing and procurement organization delivers the best possible performance, be it measured in total cost of ownership (TCO), working capital or availability of materials.

Elite sourcing and procurement organizations achieve their status by focusing on process effectiveness, which enables them to extract maximum value from virtually every aspect of their source-to-pay (S2P) process. This ensures that every sub-process – every activity they perform – is consciously and specifically designed to help the enterprise achieve its desired business outcomes. But while many sourcing and procurement organizations do pursue strategic transformation and continual performance improvement, the vast majority might never achieve the best possible performance because they:

- Fail to set enterprise-level strategies for identifying and systematically working toward desired business outcomes
- Overemphasize process efficiency measures – for example, cycle time and productivity – while underemphasizing measures of real S2P process effectiveness such as cutting costs and optimizing working capital
- Overemphasize technology, while underemphasizing process
- Neglect to manage, measure, control and remove waste and variation from their source-to-pay subprocesses and activities

CRITICAL CHALLENGES FOR STRATEGIC SOURCING AND PROCUREMENT ORGANIZATIONS
- Achieving enterprise-level S2P transformation and optimization
- Mapping complex linkages between activities and business outcomes
- Scientifically acquiring and implementing best practices and processes
- Understanding best possible – or S2P 2.0 – performance standards

SELF-TEST FOR S2P 2.0 PERFORMANCE
To evaluate whether or not your sourcing and procurement organization is on a path to S2P 2.0 performance – or the next level of S2P performance, ask these questions:

- Are we aware of what performance levels are possible and truly best-in-class for companies of our ilk?
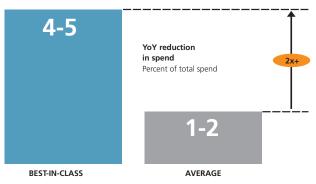
- Do we distinguish between process-efficiency and process-effectiveness measures?
- Do we approach our source-to-pay subprocesses – spend analysis, category strategy, sourcing, negotiating and contracting, procurement and payment – as interrelated and interdependent?
- Do we evaluate and adopt proven best practices for source-to-pay?
- Do we manage and measure process execution at a granular level and link it to business outcomes?
- Do we focus on removing variation in source-to-pay process execution and outcomes?
- Have we standardized and simplified our source-to-pay processes, subprocesses and key activities to reduce the total number of process steps and eliminate non-value adding activities?

If your answer to one or more of these questions is negative, read and learn about a proprietary methodology launched by Genpact called Smart Enterprise Process (SEP[SM]). This scientific approach combines Lean Six Sigma principles, a compendium of leading practices, performance benchmarks, diagnostics based on analytics and risk mitigation. It is a complete toolkit comprising policy, process, controls, information technology and ongoing performance management that can consistently deliver the best possible results.

WHAT IS S2P 2.0 PERFORMANCE?

Both empirical research and qualitative evidence show that best-in-class sourcing and procurement organizations achieve performance levels that are – at a minimum – two to three times higher than average organizations. For a typical US$5 billion revenue company, that can mean a spend reduction of US$50 million to US$150 million over three years and a margin increase of between 100 and 300 basis points (Fig 1).

FIG. 1 - SIGNIFICANT VARIATION IN AVERAGE VS. BEST-IN-CLASS PERFORMANCE

4-5

YoY reduction in spend
Percent of total spend

2x+

1-2

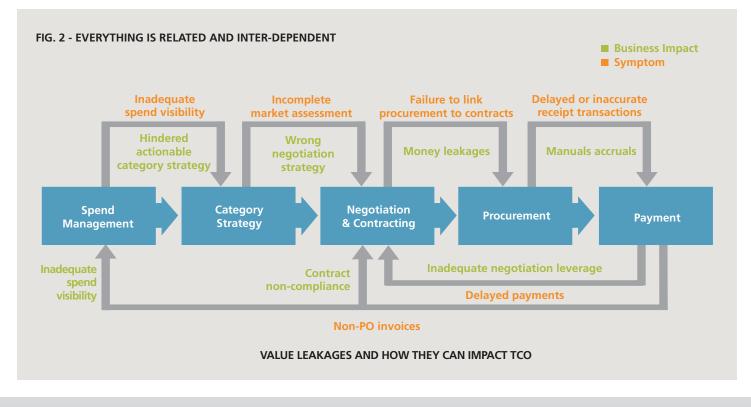BEST-IN-CLASS   AVERAGE

EVERYTHING IS CONNECTED

A critical challenge for most companies is approaching source-to-pay at a truly enterprise level. Let's say that a sourcing and procurement organization sets out to achieve the business outcome of reducing its TCO. But in its approach, the organization makes the common error of treating its source-to-pay subprocesses as discrete rather than interrelated parts of a connected whole. In doing so, it risks losing value at virtually every process handoff, as shown in Fig 2. So while the organization might succeed at delivering a lower TCO, it falls far short of delivering the lowest possible TCO.

FREEING UP WORKING CAPITAL

While cost savings is a primary focus of many procurement organizations, freeing up working capital is increasingly the focus of many businesses. SEP[SM] methodology succeeds in reducing working capital requirements by intervening across sourcing, procurement and supplier payment processes.

FIG. 2 - EVERYTHING IS RELATED AND INTER-DEPENDENT

■ Business Impact
■ Symptom

Inadequate spend visibility

Incomplete market assessment

Failure to link procurement to contracts

Delayed or inaccurate receipt transactions

Hindered actionable category strategy

Wrong negotiation strategy

Money leakages

Manuals accruals

Spend Management → Category Strategy → Negotiation & Contracting → Procurement → Payment

Inadequate spend visibility

Contract non-compliance

Inadequate negotiation leverage

Delayed payments

Non-PO invoices

VALUE LEAKAGES AND HOW THEY CAN IMPACT TCO

Businesses that follow a siloed approach are destined to achieve suboptimal performance while best-in-class performance can unlock significant cash. For every $1 billion in spend, a business that transitions from median to best-in-class, can unlock $200 million in cash – a significant business impact. For example, favorable contract terms are often negotiated by the sourcing organization, but inadequate vendor-master data controls result in incorrect terms being set up in transactional systems. Further, payment terms in contracts are often not referred to while processing non-PO invoices. In fact, payment terms are often simply overridden in accounts payable functions where there is pressure to clear backlogs. Insights from payment analytics, focusing on metrics like weighted average payment days, often show wide disparity between payment terms being negotiated and actual data in accounts payable systems.

Typically in large companies with complex buying needs, only 60-70% of supplier invoices are paid on time. The SEP^{SM} methodology evaluates the efficiency of the accounts payable function to determine and improve its readiness to pay from the day an invoice is received. By paying on time, companies place their sourcing and procurement organizations in a strong position to negotiate extensions of payment terms, reducing their working capital requirements by as much as 2-3%. For a company with an annual spend totaling $500 million, this would amount to $15 million more cash in hand.

By going one step further and paying suppliers early, companies employing the SEP^{SM} methodology can very often negotiate additional price reductions of 1-2%. Typically 10-15% of a company's existing supply base is willing to provide early payment discounts rather than borrowing capital at high interest rates.

As these examples illustrate, the SEP^{SM} methodology goes far beyond simply assembling cross-functional teams to foster cooperation among discrete corporate functions. Rather, it seeks a true integration of formerly discrete functions into a seamless end-to-end process view. It digs deep into S2P

processes and process gaps, and uses metrics and analytics to make certain that the value achieved in one process step is fully preserved and carried through to the next.

KEY SEP^{SM} FOCUS AREAS FOR DRIVING SOURCING AND PROCUREMENT PERFORMANCE

- Increase sourcing leverage by ensuring on-time payment
- Realize all early payment discounts
- Negotiate better payment terms with suppliers
- Drive contract compliance
- Increase total visibility into spend
- Control purchase specifications
- Manage demand
- Optimize existing IT investments (such as ERP)

LINKING ACTIVITIES TO OUTCOMES

Strategic sourcing and procurement groups destined for mediocrity also typically neglect to systematically – and scientifically – draw linkages between their many daily activities and the business outcomes they are trying to affect. While they may achieve a certain level of success, their achievements come more or less by trial and error, and so are not predictable, replicable, or sustainable over time.

A good example of this can be found in electronic procurement. Sourcing and procurement organizations frequently acquire e-procurement technology but fail to ensure that the technology is used, and used effectively.

So, for instance:
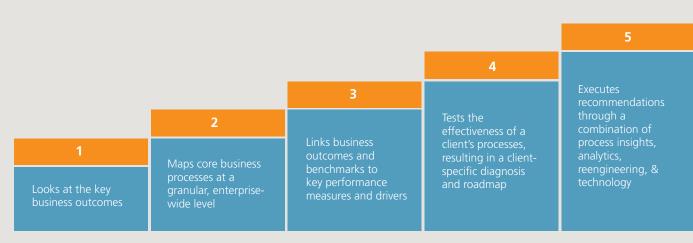- When they don't measure percent of spend under e-procurement, they get low adoption

FIG. 3 - A HOLISTIC, GRANULAR FRAMEWORK FOR MANAGING BUSINESS PROCESSES

1
Looks at the key business outcomes

2
Maps core business processes at a granular, enterprise-wide level

3
Links business outcomes and benchmarks to key performance measures and drivers

4
Tests the effectiveness of a client's processes, resulting in a client-specific diagnosis and roadmap

5
Executes recommendations through a combination of process insights, analytics, reengineering, & technology

- When they don't implement standard procedures and policies across their organization, they get inconsistent outcomes
- When they don't employ standardized, high-quality catalogs wherever possible, they get inefficiencies
- When they don't train the organization properly they get poor, inconsistent and even negative-impact results

Similar problems exist in electronic sourcing as well, where the acquired e-sourcing technology doesn't match up to expected outcomes. For example, when they don't implement a standard process for structuring e-sourcing events, they get inconsistent event outcomes. And as with e-procurement – inadequate training of the organization can engender poor, inconsistent and even negative-impact results.

All of these negative outcomes impede the organization's ability to achieve its ultimate business outcome, which is a lower TCO. What's more, without establishing clear lines of causality between activities and outcomes, it's virtually impossible for the organization to set aggressive (but realistic) performance objectives, track progress against those objectives, and actively undertake the initiatives that will achieve the objectives in the desired timeframe. Other challenges include identifying what to measure, understanding how various metrics link together to influence desired business outcomes, and designing metrics that drive to desired business outcomes without stimulating unexpected or workaround type behaviors.

Based in Lean Six Sigma and drawing from deep operational experience and expertise across 23 industries, 40-50 companies, and over 3,000 business processes, the SEP[SM] methodology replaces the trial and error approach with proven, scientific approaches. It breaks the enterprise Source to Pay process fi rst into subprocesses and then into activities, mapping complex sets of linkages to make certain that all activities and processes get executed with the single-minded objective of delivering the desired business outcome, as in Fig 3.

SEP[SM] documents – at each level – key performance measures or drivers that, when tracked consistently, enable a sourcing and procurement organization to set objectives and drive to those goals with full visibility into their progress. It also creates an ongoing ability to pinpoint where processes may be breaking down and likely to affect performance and business outcomes negatively.

ACHIEVING S2P 2.0 PERFORMANCE

Operating in a vacuum, our hypothetical sourcing and procurement organization will assemble its own proprietary mix of policies, perceived best practices, process changes or enhancements, procurement skill sets, and technology tools. Very often it will succeed in delivering better performance. But there is no guarantee the organization is making all the best choices along the way – proven choices that will keep it on the path to S2P 2.0, which designs processes that deliver better business outcomes

in a more sustainable, repeatable manner. Can companies operating in today's highly competitive global economy really afford the expense and risk associated with such unscientific approaches to process and performance improvement?

A critical challenge, though, is lack of access to competitive benchmarks or gold standards for S2P process performance by which sourcing and procurement organizations can set objectives and mark their achievements. The SEP[SM] methodology solves this challenge by drawing upon – and continuing to populate – a deep knowledge base that already includes sourcing and procurement benchmark data for:

- Three S2P business outcomes
- Some 20 S2P performance measures
- Approximately 70 S2P performance drivers
- A compendium of 200+ leading practices, and
- A toolkit comprising nine discrete diagnostics tools

The knowledge base contains operational metric drilldowns, which draw detailed linkages between business outcomes and process metrics. The 'best practices' compendium includes "How To's" for each practice. An 'insight' database comprises accumulated knowledge on the true drivers of business value. These information sets enable a sourcing and procurement organization to conduct combined qualitative and quantitative diagnostics. The diagnostics enable them to rapidly move to a point where they are delivering results rather than wasting time and expense trying to assess, acquire and adapt what may or may not be best practices.

KEY INSIGHTS

By applying the SEP[SM] methodology correctly and completely, it's possible for a company to achieve:

- A 30 to 40% increase in addressable spend visibility, leading to a 3 to 4% increase in total savings capture
- A 20 to 40% reduction in maverick spending, leading to a 1 to 3% increase in yearover-year savings capture
- A 5 to 10% reduction in working capital requirements
- Incremental ROI on existing IT and ERP investments
- Lean processes with virtually no non-value adding activities and consistent execution approaching Six-Sigma levels of performance (for example, process compliance at 4.37 Sigma)

All this can lead to a 2 to 3% increase in year-over-year cost savings by increasing crossfunctional alignment to a point where many nonprice levers can also be addressed effectively. For a very large company, achieving or even approaching S2P 2.0 performance levels through SEP[SM] can translate into millions – even billions – of dollars to be either banked or strategically reinvested.

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About Genpact's Procurement and Supply Chain Solutions

Genpact's Procurement and Supply Chain practice delivers end-to-end supply chain solutions, enabled by its deep domain experience, best-in-class technology and strategic partnerships. With over 3000 procurement and supply chain experts, Genpact has over 10 years experience in working with global companies to provide services that include Forecasting and Planning, Sourcing and Procurement, Fulfillment and Logistics and After Market Services. Genpact has been continually recognized as a top rated service provider and was ranked for the third consecutive year as the Top Procurement Outsourcing Vendor by the 2009 Black Book of Outsourcing.

For more information, please write to supplychain@genpact.com

Visit us at www.genpact.com/procurementandsupplychain

About Genpact

Genpact is a leader in managing business processes, offering a broad portfolio of enterprise G&A and industry-specific services, coupled with strong IT, analytics and reengineering capabilities.

For more information, visit: www.genpact.com