

Fact-Based Decision Making In Procurement



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INTRODUCTION

Let's begin with an analogy from television crime dramas. Fans of the genre would know that many of TV's favourite detectives solve crimes by relying on their "gut feeling"; a "hunch" or their brilliant instincts. This "a-ha" moment makes for great viewing, but we know that in real life, crimes are solved based on hard facts. Criminal cases are built piece-by-piece, backed up by exhaustive research and forensic science.

Once upon a time in procurement, a Chief Procurement Officer (CPO) may have been able to make decisions by relying on their instinct; after all, instinct is simply the product of years of distilled experience. But today, in the age of Big Data, fact-based decision making is recognized as a source of competitive advantage.

Essentially, it comes down to risk-management: CPOs can no longer afford to risk relying on their instincts or guesswork. They need reliable facts (data) on which to base their decisions and have confidence in the actions they've taken.

A tale of two CPOs

Take, for example, two CPOs in different organizations who are overseeing a strategic purchase of lithium batteries. The first CPO's team has made some similar purchases in the past. Under pressure to act fast, they decide to go with the same supplier they've always used, and make the purchase as soon as possible. Unfortunately for this CPO, two things happen at once: the supplier goes bankrupt, and prices for lithium batteries skyrocket. The organization is left without lithium batteries, holding up production and causing the procurement team to scramble for a solution.

The second CPO takes a more cautious approach. Her team researches not only the top suppliers of lithium batteries, but examines all publicly available information about potential suppliers' financial health to ensure they will be able to meet their commitments. They also conduct research to build up a picture of global lithium and lithium battery supplies, and are able to correctly predict that there will soon be a shortage of lithium, which will drive up prices in the short term. The CPO uses this information to choose a low-risk, trusted supplier and to make the decision to wait until the shortage is over before making the strategic purchase. Three months later, the team successfully procures the lithium batteries at a great price.

But all this research takes time, right? And time is money - did the second CPO lose her advantage by taking too long to make a decision? If only human procurement practitioners were involved, the answer would be yes. But this is the 21st century, and a task such as supplier financial health or category market analysis can be done in next to no time with the aid of smart procurement solution. In other words, gathering facts before making a procurement decision doesn't necessarily mean lengthy delays.



THIS SHORT PAPER WILL SHOW YOU:

- Why fact-based decision making is crucial in procurement
- At what points of the source-to-pay cycle fact-based decision making should take place
- The main hurdles to fact-based decision making and how to overcome them
- How procurement solutions can help do so
- Actionable tips to implement fact-based decision making in your procurement function



WHY FACT-BASED DECISION MAKING IS IMPORTANT IN PROCUREMENT ?

In this section you will learn:

- ❖ The key points in the source-to-pay (S2P) cycle in which fact-based decisions are made
- ❖ The risks involved in using guess-work in procurement
- ❖ Five benefits of fact-based decision making

Facts - or trusted data - make the difference between a good decision and a poor decision in procurement. The source-to-pay cycle as illustrated below has five key points at which fact-based decisions need to be made :





Understanding requirements- Clarifying

The first decision is to understand and clarify the business requirements for the goods or services being procured. While a stakeholder may have a clear idea of what they need, the procurement professional should take into account:

- ❖ Individual stakeholders' requirements
- ❖ Input from other relevant parts of the organization
- ❖ The procurement function's goals, targets, policies, risk appetite and requirements
- ❖ Information revealed after undertaking a spend analysis for that category
- ❖ Alignment to enterprise-level goals, targets and requirements

WHY IS THIS IMPORTANT?

Project-management experts at Clayton Utz write that "Defining exactly what is to be achieved will likely be the hardest part of planning and implementing a project ... [but it] is critical for ... determination of best value for money."

Undertaking a sourcing event that is based on requirements that are poorly thought-through, incorrect or unaligned to business needs will ultimately waste time and money, leading to a poor outcome.



Sourcing- Deciding on the supplier:

Supplier selection is the most visible decision made by procurement, and arguably the most important. Yet some organizations continue to select suppliers based on experience and intuition rather than using fact-based assessment techniques. Supplier discovery methods and evaluation criteria will differ between organizations.

WHY IS THIS IMPORTANT?

The importance of choosing the right supplier cannot be overestimated, and it is no exaggeration to say that this decision has the potential to make or break your business. In its guide to choosing the right suppliers, Invest Northern Ireland warns that underperforming suppliers can:

- ❖ Reduce sales revenues and margins
- ❖ Damage your brand and reputation
- ❖ Reduce the quality of your organization's products or services
- ❖ Disrupt operations, and
- ❖ Increase costs



Negotiation- Making high-quality decisions at speed during a negotiation:

The best negotiators are those that have done the most homework. Experts from MIT write that 90% of negotiation is in the planning. While much of the planning will focus on creating a strategy, it's important to dedicate time to reviewing as much of the available facts and data that you can find, including:

- ❖ Your organization's business requirements, relevant strategic goals and spend limits
- ❖ Anything you can find on the other party's financial position and their business priorities

Having this data at hand will enable you to negotiate flexibly - for example, if a supplier rejects your initial position, your knowledge of your organization's priorities and spend limits will enable you to put in a second offer with confidence, rather than having to make a risky guess or pause the negotiation while you investigate alternatives. Knowledge of data such as the suppliers' past performance metrics will also give you valuable leverage in a negotiation.

WHY IS THIS IMPORTANT?

Negotiations rarely go smoothly and will require a series of decisions from both negotiating parties. Without a solid grounding of facts upon which to base these decisions, you will be at a distinct disadvantage from the outset of the negotiation. Harvard Law School warns: "If you haven't done the necessary analysis and research, you are highly likely to leave value on the table and even to be taken advantage of by your counterpart."



Supplier Management- Managing supplier performance with trusted data

Again, this is no time for guess-work. Effective supplier performance management relies on high-quality data to track a suppliers' performance against a contract and evaluate whether they are meeting their KPIs. CIPS advises that organizations should "Gather factual, and therefore objective, information about performance."

Suppliers will perform better in the knowledge that their performance is being carefully tracked, measured and evaluated.

WHY IS THIS IMPORTANT?

Trusted data and good reporting practices are vital for when a supplier is underperforming. An organization needs to be able to prove with indisputable facts that a supplier has failed to meet its KPIs before taking the next step as determined in the contract (such as fining the supplier or cancelling the contract). Without this data, an argument over contract performance may end up in court.



Continuous Improvement- Using data for continuous improvement:

"What gets measured gets improved." This famous quote from business guru Peter Drucker explains why data is vital for continuous improvement. At the conclusion of a sourcing event, procurement professionals need to understand:

- ❖ What the procurement team could have done better
- ❖ What the supplier could have done better
- ❖ Were stakeholder and overall business requirements met?
- ❖ Whether or not to use the supplier again in future.

WHY IS THIS IMPORTANT?

These four questions are best answered with reference to supplier performance and contract data. Without this a decision such as whether to change a procurement process or whether to re-engage a supplier will essentially be based on guess-work, leading to poor outcomes.



THE THREE RISKS INVOLVED IN PROCUREMENT GUESS-WORK

Guess-work is by nature a risky thing to do, particularly in organizations where probity and accountability is prioritized. If a mistake is made, procurement professionals will ultimately have to give a reason for a poor decision and “I acted on instinct” won’t be viewed favourably as an excuse.

Here are three of the key risks that guess-work in procurement can lead to:



Incorrect assumptions

Ideally, there should be no assumptions involved in a procurement decision-making process. The problem is that assumptions can sometimes differ widely from the real facts shown by the data.

CASE STUDY-

A procurement manager at a multinational pharmaceutical company was considering extending a strategically important contract with a supplier. For reasons of their own, the manager’s team had always praised the supplier’s performance and downplayed the fact that the supplier had failed to achieve some KPIs last time they were engaged. The manager therefore assumed the supplier would continue to do a good job, but if they had fact-checked these claims by examining the supplier’s past performance data, they would have known that this would be a poor decision. Re-engaging the same supplier turned out to be a less than optimal outcome for the procurement functions and wider organization.



Making strategic decisions that are not supported by data

Strategic procurement decisions at the CPO level might involve centralization, decentralization, and supplier consolidation or supplier diversification. Making these decisions because they are regarded as “best practice” (or because the majority of other organizations are doing it) is not recommended. Decision-makers need to gather data upon which to base these decisions.

CASE STUDY-

A newly-minted CPO in a well-known UK-based retail organization made the decision to spend their first 100 days focusing on consolidating the supplier base. However, if they had paid attention to the results of a spend analysis, they would have realized that what their organization really needed in terms of risk management is a wider array of suppliers. Significant time and resources were spent on consolidation before this decision was reversed 12 months later.



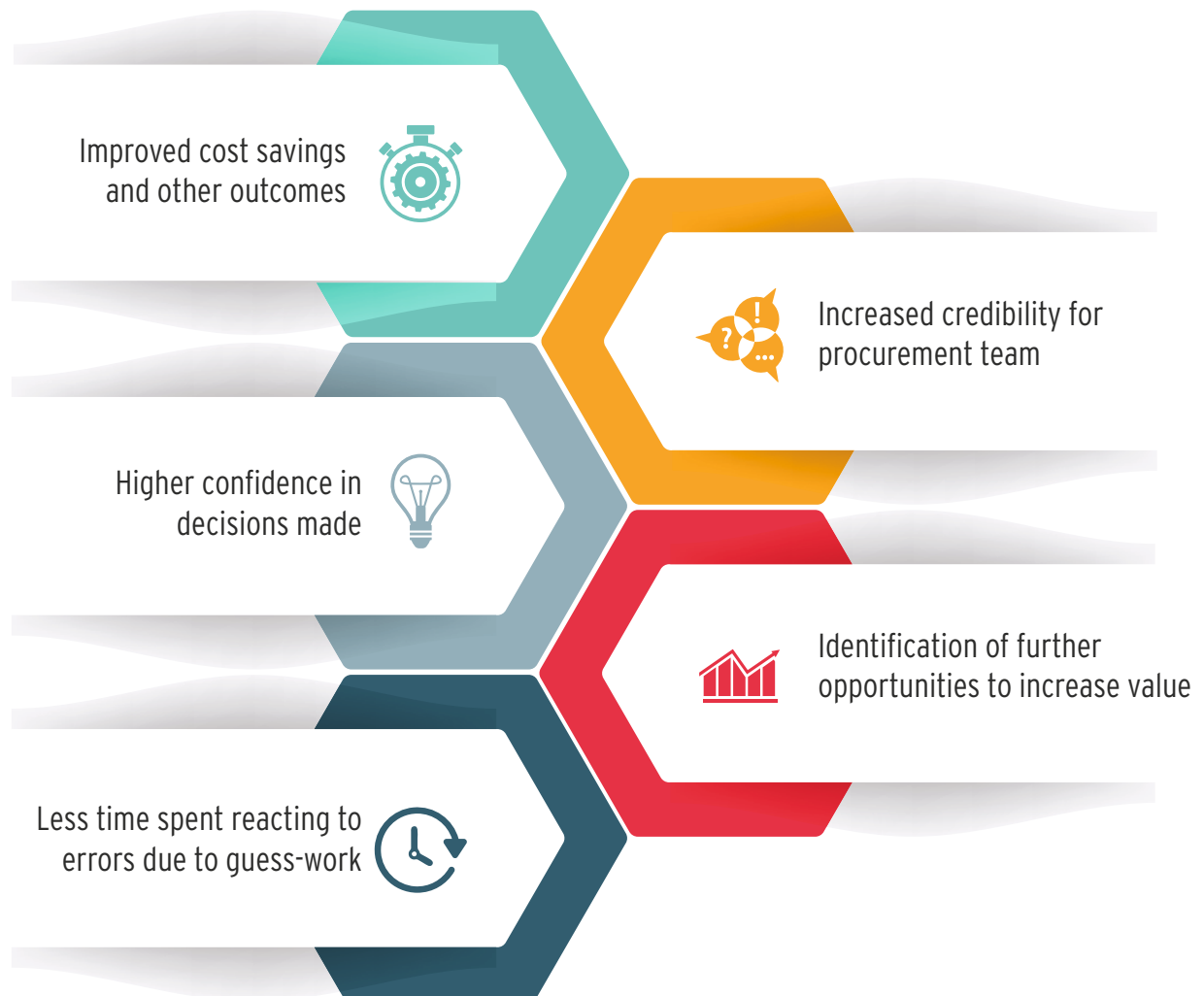
Guess-work is influenced by unconscious bias

Everybody is affected by unconscious bias. By definition, it is beyond our control, so most businesses are responding by building processes and systems that remove bias from the picture. In recruitment, for example, AI is used to purge CVs of any information pertaining to age, race, gender and other details before a human sees them.

CASE STUDY-

A buyer working in a regional council was questioned on why they chose to extend a contract with a supplier without going to tender. It was revealed that the procurement professional had a personal preference for the local, long-term supplier due to familiarity and a friendly relationship with the suppliers' representative. This bias led him to extend the relationship without checking the facts (such as the supplier's past performance data) or exploring other options that may have provided the organization with cost savings and other value.

5 BENEFITS OF FACT-BASED DECISION-MAKING





FIVE HURDLES TO FACT-BASED DECISION MAKING AND HOW TO OVERCOME THEM

In this section you will learn how fact-based decision making is hampered by:

- ❖ Insufficient data and visibility
- ❖ Unclean data
- ❖ Slow data
- ❖ Unactionable data
- ❖ Data that is unaligned to business goals

You will also learn how procurement solutions can help overcome these hurdles.



Insufficient data or visibility

Deloitte's latest Global CPO Survey found that 46% of procurement leaders believe a lack of data integration is one of the main barriers to the effective application of technology in procurement. It is also a barrier to good decision-making.

The first step to overcoming this problem is to understand why your organization doesn't have enough spend data. It's not enough to complain that buyers are refusing or failing to enter data into your system. Instead, investigate why they are not doing so. It may be:

- ❖ A cultural issue: users simply "don't care" about entering data
- ❖ An education issue: users do not know how to enter data
- ❖ A process issue: users can easily place orders without the system capturing any data
- ❖ A solution issue: the procurement solution is difficult to use and frustrates users



Unclean data

Deloitte reported that 45% of respondents saw "quality of data" as a barrier. As above, unclean data can often be linked to a cultural issue where end-users do not appear to care that the data they enter is inaccurate. The other reason may be that data is entered incorrectly in an attempt to hide errors or inflate results. In the era of sophisticated procurement AI, feeding incorrect data into the system will lead to incorrect results and recommendations being made.



Slow data

When you are driving down the highway, it's no good to you if your vehicle's speedometer shows the speed that you were driving yesterday. Wherever possible, data should be real-time to enable procurement managers to react fast to events and make decisions based on the very latest available information.



Unactionable data

Although some would argue that any data is helpful to an organization, it's important to be somewhat selective in the type (and format) of data that is collected. A very useful rule-of-thumb is this: All procurement data must be actionable.

Make data actionable by:

- ❖ Measuring the right things
- ❖ Linking it to a KPI or organizational goal
- ❖ Presenting it in a dashboard format that enables decision making
- ❖ Conveying the context around your data set



Data that is unaligned to business goals

One of the reasons that many procurement functions lack influence in their organizations is irrelevance. Procurement functions often have a unique set of targets and goals, but if these are not linked to enterprise-level goals and targets, procurement risks chasing KPIs that are regarded to be of little benefit by the executive team.

This applies to data as well. Data, whether it's held in a spread sheet, or in a procurement solution package or on a dashboard, should be presented in a way where each visualization of the data is clearly linked to an overall business goal. For instance, your number of diverse suppliers should be linked to your organization's wider Diversity and Inclusion strategy, and the procurement team should be able to use this data to articulate just how much they are contributing to the business hitting this target.

Having a clearly presented data set that shows how procurement is performing in relation to enterprise-level targets will help CPOs decide what to prioritize next?

Overcoming fact-based decision-making hurdles with procurement solution

Here's the good news. All five of the hurdles described above can be addressed and overcome with intelligent source-to-pay solution. Procurement solution is becoming increasingly sophisticated every year, and can be used to:

- ❖ Gather data and improve visibility of data
- ❖ Provide structure and consistency around data and flag where data seems incorrect (unclean)
- ❖ Provide visibility of real-time data, increasing the velocity of decision-making
- ❖ Present data in a format that enables and improves decision-making
- ❖ Help procurement teams align (tag) data to enterprise-level goals and targets

Implemented and used intelligently, procurement solution has the potential to solve a lot of the frustrations that many organizations experience when it comes to procurement data. Once your data is under control and trusted, this enables procurement leaders to make strategic decisions with confidence that would otherwise have been based on data that is insufficient, incorrect, obsolete, or unaligned to business goals.

FACT-BASED DECISION MAKING CHECKLIST

Review where key decisions are made in the source-to-pay cycle

1

Identify, minimize or eliminate guess-work in procurement

2

Educate the team on the risks involved in guess-work

3

Reduce human bias with systems and processes

4

Increase amount of data and improve visibility

5

Cleanse and standardize data

6

Make sure data is real-time

7

Ensure data is actionable

8

Align data to business goals

9

Invest in procurement solution to ensure all decisions are based on trusted data

10

About us

Zycus is a leading global provider of complete Source-to-Pay suite of procurement performance solutions. Our comprehensive product portfolio includes applications for both the strategic and the operational aspects of procurement - eProcurement, eInvoicing, Spend Analysis, eSourcing, Contract Management, Supplier Management, Financial Savings Management, Project Management and Request Management. Our spirit of innovation and our passion to help procurement create greater business impact are reflected among the hundreds of procurement solution deployments that we have undertaken over the years. We are proud to have as our clients, some of the best-of-breed companies across verticals like Manufacturing, Automotives, Banking and Finance, Oil and Gas, Food Processing, Electronics, Telecommunications, Chemicals, Health and Pharma, Education and more.

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