It is said that astronomers didn’t find black holes sooner as they had their telescopes focused on the tiny points of light which are the stars, rather than on the big black bits in-between.

Paul Rogers tries to shed some light on what KPIs procurement managers should focus on when measuring procurement performance.

On my first day as a purchasing manager, the CFO invited me into her office, and explained that there was a 28-day backlog of requisitions in the purchasing office, and my first priority was to reduce the backlog. In retrospect, this highlighted her low expectations of the contribution of purchasing! With the benefit of twenty years experience, here are seven key performance indicators for the procurement function.

1. **Cost Reduction**

We can talk about ‘value’ but for virtually all procurement departments ‘hard dollar’ cost savings are the principal measure of procurement performance. Let’s say that the current price is $1.10 each and the new price is $1.00 each, there is a potential hard dollar saving of 10c.

It is a potential saving for two reasons. Firstly if some end-users don’t use the deal, and buy at $1.20, what’s the saving then? [We will deal with compliance later on.] Secondly, if the budget is for usage of 100 units @ $1.00 each, and actual usage is 120 at $1.00 each, is that a saving? ‘Aha!’ You say, ‘that’s a usage variance, and should not be used to measure procurement performance!’ But what would happen if procurement claims a saving of 10c x 120 = $12, but the end user’s budget is overspent by $20? Isn’t this precisely the sort of disconnect that leads to cynicism about procurement ‘savings’?

I have always valued Harrison’s formula:

\[
\text{Real savings} = \text{delta on price/cost} \times \text{consumption} \times \text{compliance}
\]

The point is that real savings require a team effort by the procurement function and the business, and it is divisive for one party to claim they have made a saving if real costs have risen. Plus, if the business doesn’t use our arrangements, we can’t claim to have made a saving. Typical values for cost reduction savings as a percentage of total spend managed range from 1.5% to 2.5%.

2. **Cost Avoidance**

Let’s say that in the example introduced earlier, the successful supplier’s original offer was to
increase the price from $1.10 to $1.15, and the procurement team negotiated the offer down to $1.00. The cost avoidance element is $1.15 - $1.10 = 5c each and the cost reduction element is $1.10 - $1.00 = 10c each. Some businesses allow cost avoidance claims, others don’t. This is a ‘soft saving’ as the money isn’t real and doesn’t flow to the bottom line. However in many public sector procurement departments, this figure is an important measure of what might have been the cost had the procurement function not intervened. Typical values for cost avoidance savings as a percentage of total spend managed range from 1.0% to 2.0%.

Typical KPIs might be as:

Cost avoidance = ([proposed price increase - negotiated price] x consumption)  

Cost avoidance = ([quoted price - negotiated price] x consumption)

3. **Value-Add**

If strategic procurement ‘isn’t just about price’ then improved value from quality, delivery, service, or innovation become increasingly important as costs are optimized. Supposing we secure the services of the supplier’s ‘A-team’ to work on our project, instead of the proposed team. Is that a saving? No, but it may lead to earlier completion, or fewer problems, so it is a value add, an improvement in value for the business which is non-cashable but has an intangible benefit. In some cases, procurement teams may also contribute to increased revenue, which is clearly not a saving, but a tangible profit contribution.

4. **Procurement Ratios**

How much does the procurement function cost as a proportion of the spend managed? Ratios vary from sector to sector, but in most industries the value varies from .5% to 1%. So if the procurement function costs .5% of the managed spend, is that good news? Well, it depends upon what return the business gets from those staff, and what proportion of the total spend is influenced by procurement. Effectiveness measures might address the ROI of procurement; typically the return on investment should be 500% or more across a wide range of categories. Not a bad investment! But any attempt to sell that message can only occur after the metrics and measures have been agreed and endorsed by budget holders, as otherwise they will dismiss any such claims as merely ‘funny money.’
# Measuring Procurement Performance

**5. Procurement Process**

Typical KPIs might be:

\[
\text{Cost of procurement \%} = \frac{\text{Cost of procurement department[s]}}{\text{total spend managed}}
\]

What proportion of total third party spend is influenced by procurement? This is a good indicator of the organizational acceptance of procurement’s value. Typical values are between 75\% and 95\% depending upon the sector and the maturity of the procurement function.

What proportion of spend is managed through low cost transaction methods? Typical values vary by maturity of the initiative and company policy, but a realistic range for the proportion of spend managed through procurement cards is from 2\% to 10\%, and depending upon the maturity of the platform, 5\% to 75\% of spend managed through e-procurement.

**6. Stakeholder Satisfaction**

Is compliance with procurement-negotiated agreements – especially for indirect spend - a proxy measure for stakeholder satisfaction with procurement? Sometimes! Of course there are always some mavericks, but no matter what the governance rules say, if stakeholders aren’t using the arrangements it is a symptom of poor engagement, poor communication or a dysfunctional procurement process. Establishing why stakeholders are not using arrangement requires some sort of survey.

**Good practice is to survey** what the stakeholders think is important and how they rate procurement against each dimension. Stakeholder surveys can be instructive, as procurement departments often struggle with the question ‘who is our customer?’ Is it the internal client or the shareholders, or the ultimate consumer of the organisation’s services? While I had a boss who urged me to make procurement ‘as popular as a rattlesnake in a lucky dip’, most procurement departments seek to ensure that they keep most stakeholders onside, consistent with making a contribution to business performance. Surveying suppliers can also yield interesting results, if we can penetrate beyond the inevitable ‘tough but fair’ platitudes that suppliers usually volunteer as their ‘tell-the-buyer-what-we-
think-they-want-to-hear’ platitudes.

Absolute numerical ratings are pretty meaningless, what matters is the trend, and the qualitative feedback.

7. Innovation

If we want to be the ‘customer of choice’, how do we measure the benefits of being a ‘preferred customer’? One measure must be the ideas and innovation that we garner from our suppliers. The procurement department might not be the cause of supplier innovation, but should be an enabler of idea sharing. Even codifying the ideas, capturing them and sharing them is potentially a source of competitive advantage. Measures could be input, such as the number of ideas, and the value of benefit realized from implementing the ideas adopted.

Typical KPIs might be:
Number of ideas captured this period.
Value of benefits realised this period.

How many KPIs are appropriate? Well for the measures to be key, we can’t have dozens and dozens; seven is about right. And make sure that the measures you choose enjoy the support of the stakeholders, especially the senior leadership team. There’s nothing so deflating as reporting on key measures of strategic procurement, only to be asked ‘Why does it take so long to set up a contract?’

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