

High Performance in Procurement Risk Management

What 'Procurement Masters' are doing and how they are benefiting

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In the business world, risk is ubiquitous. Costs rise. Sales slip. Products malfunction. Delivery windows crack.

But despite these enduring realities, risk's nature and scope have accelerated in the 21st Century. Take procurement. According to an Accenture study involving more than 125 chief procurement officers, 70% believe procurement-related risk has increased due to financial turmoil.

To put a point on it, more than half the companies Accenture contacted have recently experienced moderate-to-high levels of risk in supplier-related quality, price and delivery (Figure 1). Accenture researchers also learned that almost half of all survey respondents' spend is exposed to volatility in raw materials, and that more than a quarter of all respondents are exposed regularly to currency volatility.

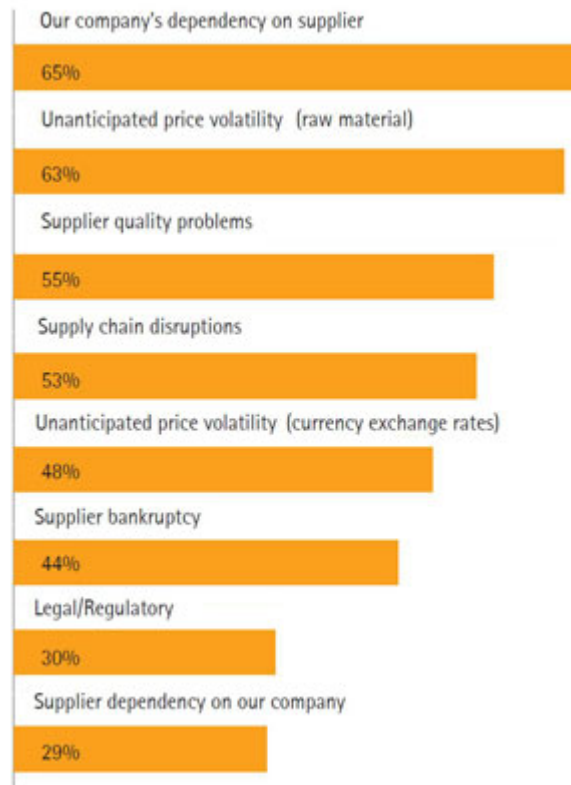


Figure 1: One hundred and twenty seven chief procurement officers were asked "For each procurement risk, indicate the extent to which your company faces that risk." Depicted is the percentage of respondents who indicated a moderate or high degree of risk.

It's Better at the Top

Many other salient observations were drawn from the study, and one of the most important was a profile of how high performers in risk management operate. Accenture identified 22% of the survey population as "procurement masters." The principal benchmark was cost savings: Masters save at least ten times as much as it costs them to operate their procurement organizations. Companies operating at a lower level save about four times as much. In other words, if it costs a company \$100 to staff and support an in-house procurement department, a procurement master will identify and capture annual procurement-related savings of \$1,000. A lesser-performing company (identified in the survey as a mid-range or low performer) will secure \$400 or less for each \$100 it spends in staffing costs.

Carrying this distinction forward, Accenture sought to learn how masters' practices differ. The remainder of this article shares research findings in five key areas of procurement.

Procurement Strategy

The research team observed that procurement masters are significantly more likely than the balance of the survey population to address supplier and price volatility risks when developing their procurement strategies (as opposed to later on). Masters also were found to be two-to-three times more likely to integrate risk management into their category strategies; develop innovative ways to monitor risk; and implement practices and tools to mitigate risk.

A good example is that masters are significantly more prone to apply dual-sourcing and risk-sharing initiatives to anticipate and avoid supplier quality risks (Figure 2). To sidestep supplier bankruptcy risks, procurement masters were found to be leaders in dual sourcing and supplier negotiations. The most significant strategy-development disparity was masters' higher use of risk-sharing clauses and back-to-back contracts (formal agreements stipulating that buyers can share, or even transfer, the cost of unforeseen problems across suppliers or sub-suppliers.)

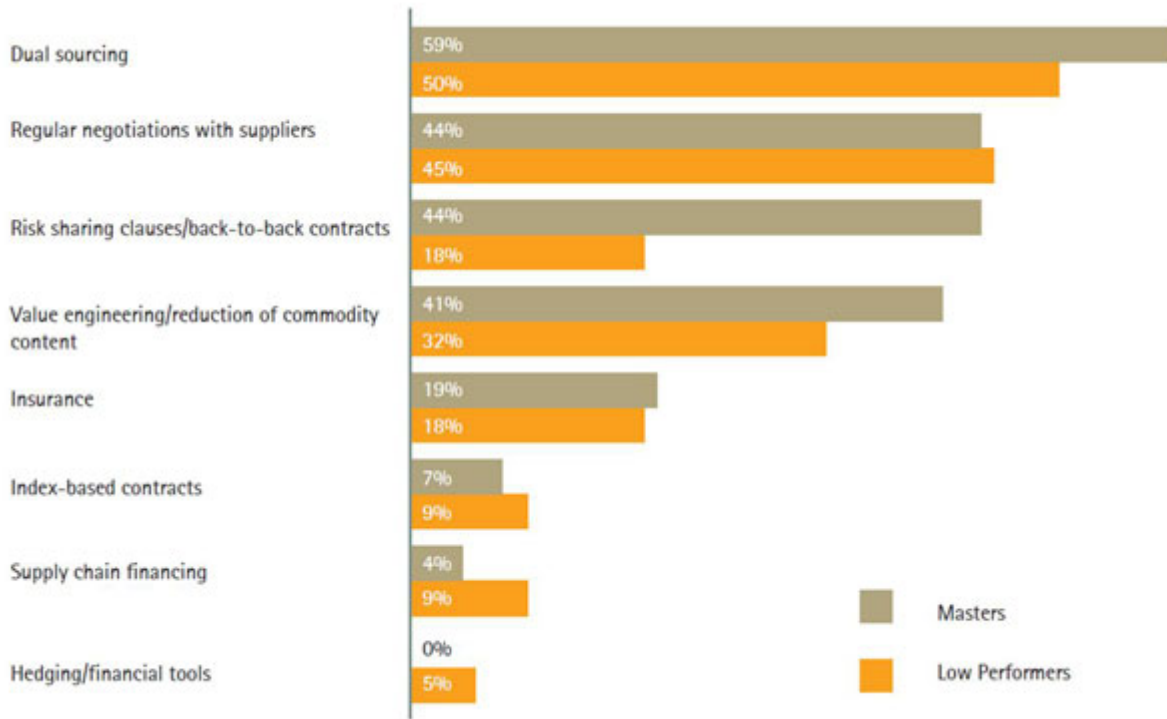


Figure 2: How companies deal with supplier quality issues.

Sourcing & Category Management

Integrating risk management initiatives into the strategic sourcing process (e.g., during supplier evaluation) is also more characteristic of procurement risk masters, and there are many tools and approaches for making this happen. These include supplier market analyses, current supplier portfolio analyses, supplier audits, supplier scorecards, supplier process failure mode & effects analyses (FMEA), historic & forecast pricing analyses, and logistical & transportation risk analyses.

Among the above practices, one of the most interesting may be supplier market analysis, an activity that is practiced predominantly by procurement masters. Supply market analysis involves a thorough assessment of supply market industry dynamics, (supply, demand, industry structure, industry profitability, supplier capacity utilization, etc.) in order to anticipate commodity price changes and potential supply problems.

Respondents' use of supplier scorecards also is noteworthy. While distinctions among high, mid-range and low performers were not dramatic in this area, it is remarkable that 67% of respondents identified scorecards as a key capability. It also should be mentioned that masters are less likely than others to maintain scorecards on all suppliers; instead they focus primarily on critical suppliers. And compared to the general survey population, masters are up to 50% more apt to update their scorecard information at least once a month.

Supplier Relationship Management

When it comes to procurement, risk management masters tend to be supplier relationship masters. Not only do they form deeper, more symbiotic connections, they also collaborate with suppliers to rapidly detect risk (e.g., through early warning systems) and neutralize risk-related issues before those issues become incidents. As risk management masters, they also adapt their supply relationships to various geographies and cultures.

To mitigate price volatility risks, survey respondents appear most prone to use negotiations and index-based contracts when forging and maintaining supplier relationships. But despite their prevalence, these tools are used less by masters than by the remainder of the survey population. The reason could be that these two strategies either are not considered permanent solutions or are not valuable as risk-abatement approaches. Lastly, survey results show that procurement masters invest more in developing and following up on their mitigation plans.

Workforce & Organization

Research findings show that most companies do not assign procurement professionals to full-time risk management work. However, there are distinct differences among masters, mid-range performers and low performers when it comes to centrally led coordination across regions.

Procurement masters are far more likely than low performers (75% versus 32%) to have developed a regionally dispersed but centrally led procurement risk management network. Procurement masters also are more likely to have defined beforehand (and by function) who should take part in mitigation plans when an incident occurs.

Technology

The range of risk management tools available to procurement organizations is vast -- too broad for any organization to not be discriminating about what applications provide the greatest value. In fact, the ability to make smart decisions about what tools and technologies best support their risk management efforts could be what best distinguishes high performers from the rest of the survey pack.

The best example of technology use in procurement may be predictive analytics. Masters continuously monitor raw material price developments, forecast them and use technology to enable fast scenario planning. Basically, these organizations are better equipped than most to foresee a particular hurdle's effect on their cost structure and the relative profitability associated with a specific component, system or end product.

Also relating to technology, masters were shown to focus intently on the use of externally acquired and managed data. Particularly noteworthy are the extent to which they emphasize externally acquired information to help assess suppliers' financial situations, perform market analyses, gauge supplier performance and make tax and legal decisions.

Responding to Risk-related Issues

Many conclusions can be drawn from the research:

- Procurement organizations have traditionally under-estimated the effect of risk on their performance.
- Many companies remain ill-equipped to cope fully with procurement-related risk. The most common and potentially dangerous procurement-risk areas relate to supplier reliability and price volatility.
- Companies must recognize that anticipating and rapidly reacting to market forces is nearly always more effective than investing primarily in non-relationships founded solely on price.
- Acquiring specially developed risk-focused tools and services (e.g., predictive analytics) is a good way to contain and proactively manage risk.

However, the research's most important takeaway may be the clearly articulated importance of fully assessing supplier risks (including financial and logistical concerns) and then constructing a formal mitigation plan. Think of that plan as a "risk management framework" -- a clearly parsed, end-to-end approach for anticipating, monitoring and mitigating risk, and then applying those activities to a procurement organization's key parts (e.g., strategy, sourcing & category management, requisition to pay, supplier relationship management). This clear segmentation of risk-related processes allows companies to develop formal plans and responses that help whittle down procurement risk's otherwise-daunting impacts (Figure 3).

At the Anticipation stage, for example, leaders align risk programs with category strategies, make use of risk-sharing clauses, excel at predictive analytics and apply value engineering concepts to look at alternative materials. At the Monitoring stage, they work closely with select suppliers, design formal supplier relationship management programs, make maximum use of external data sources, and identify and assess the level of risk at key stages of the strategic sourcing process. For Mitigation, leaders stand out in the formation of decision processes (e.g., who makes and follows through on a mitigation decision) and the use of formal metrics and measurements.



Figure 3: A risk management framework applied to procurement.

Accenture's research demonstrates that a company's ability to anticipate and prepare for procurement risk events can make a big difference. But is this importance likely to abate in the near future? Given that 85 percent of respondents believe volatility will remain high, the implication is clear: Formal and sustained attention to procurement risk management is definitely in order.

For a copy of the research report, please [click here](#).

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