Direct Vs Indirect Procurement: Differences, Definitions, and Examples



IN THIS ARTICLE

- What Is Direct Procurement?
- What Are Examples of Direct Procurement?
- What Is Indirect Procurement?
- What Are Some Indirect Procurement Examples?
- Overlooked Cost Savings in Indirect Procurement: A Common Theme
- What Is the Difference Between Direct and Indirect Procurement?
- How Do You Manage Direct and Indirect Spend Differently?
- Does the Classification of Spend As Direct and Indirect Still Make Sense?
- Direct Procurement Strategies Can Also Work for Indirect Procurement
- Automation Works for Direct and Indirect Procurement

Procurement is a complex operation. It aims to deliver optimal purchasing value while providing the necessary raw materials and services to run the organization.

Direct and indirect procurement are separate but related parts of the procurement function.

Read on to learn more about what both direct and indirect procurement are, their similarities and differences, and how you can optimize your business operations to capture maximum value from both.

What Is Direct Procurement?

Direct procurement is the acquisition of the raw materials that a company needs to create a final product. Businesses that sell tangible goods rely on the materials purchased through direct procurement to create revenue.

However, some virtual businesses such as software companies will incur direct procurement costs (such as data storage) that aren't tangible.

Direct procurement processes focus on extracting the most value from sourcing materials, minimizing risk, and fostering long-term relationships with trusted suppliers. Efficient raw material sourcing leads bigger profit margins and competitive advantage.

Additionally, a company's reputation depends on direct procurement. It determines the quality and availability of the finished product, which influences the way the company is perceived.

Brands cannot rise above the quality of their raw materials, especially when that quality is low.

What Are Examples of Direct Procurement?

Direct procurement (also called direct purchasing) drives the core business and directly affects the bottom line. Some real-world examples of direct procurement in different industries includes the following:

1. ## Automotive Manufacturing

   Purchasing steel, glass, rubber, and other raw materials to produce cars.

2. ## Clothing Retailers

   Purchasing fabrics, threads, and other textile materials to manufacture the clothes they sell.

3. ## Restaurants

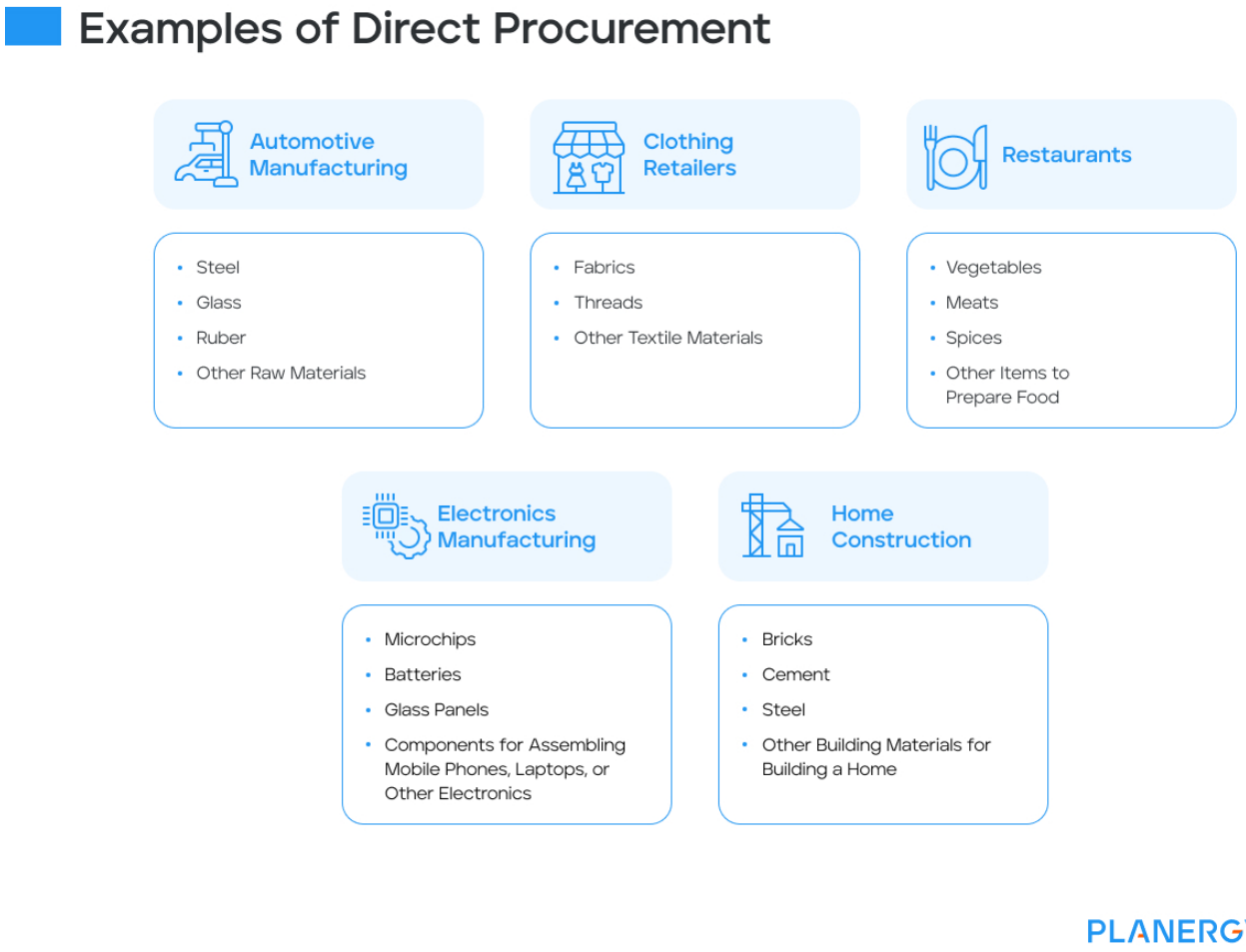
   Procuring ingredients like vegetables, meats, spices, and other items to prepare food for customers.

4. ## Electronics Manufacturing

   Buying microchips, batteries, glass panels, and other components needed to assemble mobile phones, laptops, or other electronics.

5. ## Home Construction

   Purchasing bricks, cement, steel, and the many other building materials needed to build a home.



In each of these examples, procuring the correct amount of these essential items for the best price and quality impacts the organization's ability to perform and make a profit.

eProcurement software like Planergy can help businesses like these automate their direct procurement processes and streamline their supply chains. This can create dramatic improvements to efficiency, cost control, and profitability.

> *Most procurement teams focus on direct procurement while ignoring indirect procurement because it is more difficult to track. This can lead to greater hidden costs and lower profitability.*

What Is Indirect Procurement?

Indirect procurement is procuring the goods and services needed to keep an organization running smoothly.

While direct procurement focuses on the goods or services integral to the production process, indirect procurement focuses on pretty much everything else, such as office supplies, accounting services, and software subscriptions.

These services and supplies support infrastructure, and are necessary for a company's functioning, but do not directly contribute to producing the products or services that the company creates.

No company can escape the need for indirect procurement. These indirect costs are everything a company needs to operate that will not be sold to consumers or other businesses.

What Are Some Indirect Procurement Examples?

Indirect procurement costs are similar in all industries, as the costs of doing business (such as accounting) are not going to drastically change.

Below are some common examples of indirect procurement categories for any kind of business:

1. ## Office Supplies

   Items such as pens, paper, staplers, post-it notes, whiteboards, printer ink, paperclips, etc.

2. ## Computer Hardware and Software

   Computers, servers, and software licenses are typically essential to the day-to-day business or even manufacturing or mining companies, but don't contribute directly to production.

3. ## Professional Services

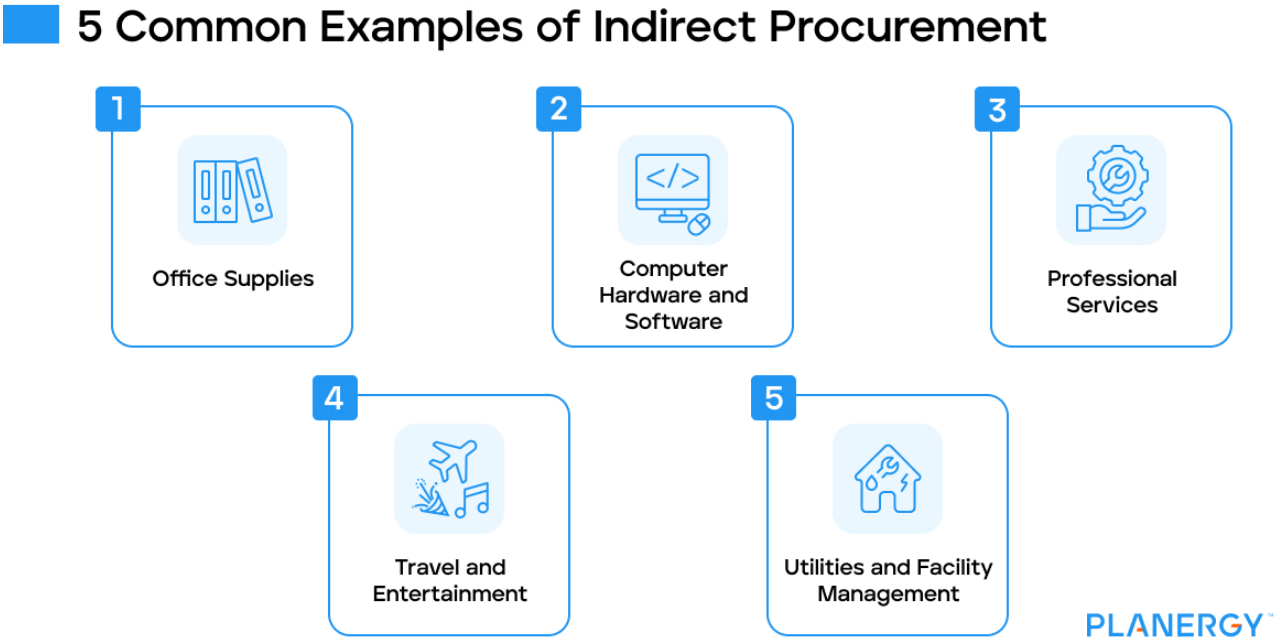
   External agencies for services like cleaning, security, marketing, or IT support.

4. ## Travel and Entertainment (T&E)

   Booking flights, hotels, meals, and entertainment for business trips or client meetings is a common example, and often one that companies look to cut when it gets out of hand.

5. ## Utilities and Facility Management

   Electricity, water, heating, property and equipment maintenance are all essential indirect costs that companies have to pay (unless they are fully remote).



Overlooked Cost Savings in Indirect Procurement: A Common Theme

Indirect procurement is a business process that’s often overlooked in cost savings initiatives. Proper expense tracking requires a similar centralized structure to direct purchasing.

Yet even large companies can fall short and lose control of spending when departments have independent budgets and spending protocols.

Optimizing indirect spend management can use similar strategies to direct procurement.

Indirect spend categories can be sourced and negotiated in the same way raw materials are handled, leveraging company-wide requirements to secure lower bulk prices and better service.

Preferred suppliers can be identified and nurtured for better communication, deals to meet upcoming needs, and seasonal or end-of-year pricing.

However, there are challenges to cost analysis for the indirect procurement process. Indirect spend includes intangible goods that have less easily measured value.

For example, when a company hires a motivational speaker, the cost they are willing to pay depends on the perceived value of the speaker, which is impossible to directly measure as ‘future profits influenced’.

When dealing with indirect goods and services, budget goals may vary by team or project.

The procurement management strategy for one project may focus on reducing hours, while another project may need to address exorbitant travel costs with better travel and expense management.

Indirect spend management requires both cost avoidance and spend reduction strategies.

Using a comprehensive procure-to-pay software like Planergy helps businesses manage indirect spending and find new ways to to create cost savings.

What Is the Difference Between Direct and Indirect Procurement?

Direct procurement means purchasing goods, materials, or services that are directly used in the products or services that the company offers.

Conversely, indirect procurement is purchasing goods and services required to support the organization’s operations but don’t contribute to the production

process.

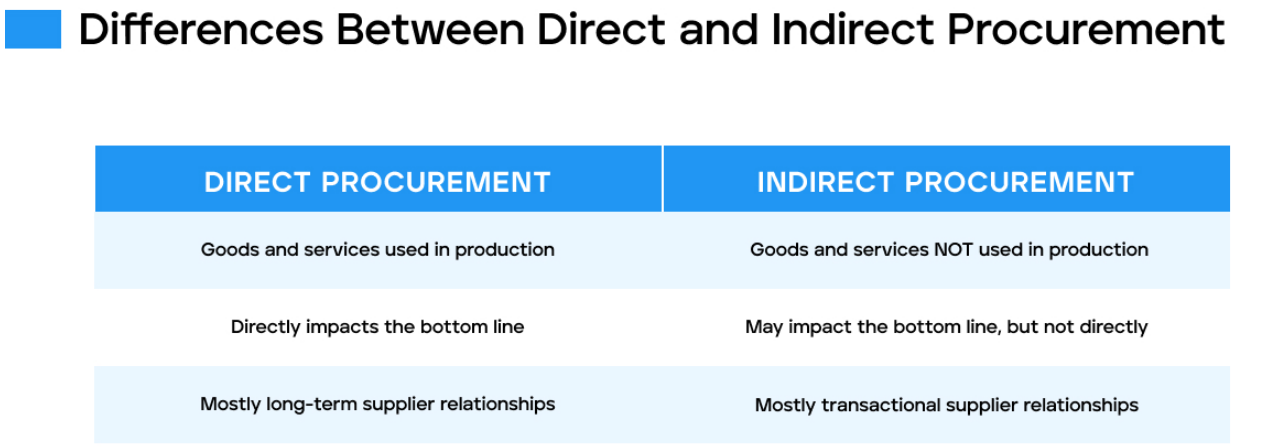
A key difference between the two that direct procurement has a clear effect on the cost of goods sold (COGS) and profits, while indirect procurement doesn't.

Inefficiencies in direct procurement disrupt the production process and affect the bottom line in a straightforward way. Indirect procurement doesn't impact production, but inefficient management still hurts the company.

Direct and indirect supplier relationships also differ (more on this in the next section). Direct procurement usually involves long-term relationships with key suppliers, as quality, reliability, and timeliness are extremely important.

Indirect procurement usually involves a larger range of suppliers and more transactional relationships.

Differences Between Direct and Indirect Procurement	
Direct Procurement	**Indirect Procurement**
• Goods and services used in production • Directly impacts the bottom line • Mostly long-term supplier relationships	• Goods and services NOT used in production • May impact the bottom line, but not directly • Mostly transactional supplier relationships



How Do You Manage Direct and Indirect Spend Differently?

Managing direct and indirect spend requires separate strategies, as they have differences in their nature and impact to an organization. Below, we'll go over typical strategies used in both.

Direct Spend Management

1. Long-Term Suppliers

Given the direct impact on the products and services, relationships with suppliers for direct procurement are often long-term, strategic, and need careful management.

2. Inventory Management

Stock levels for large quantities of raw materials need close monitoring and management to avoid production disruptions and to avoid excessive inventory carrying costs.

3. Quality Control

Direct spend purchases are reflrected in the quality of finished goods or services, so ensuring high quality is critical to a company's reputation.

Indirect Spend Management

1. Multiple Suppliers

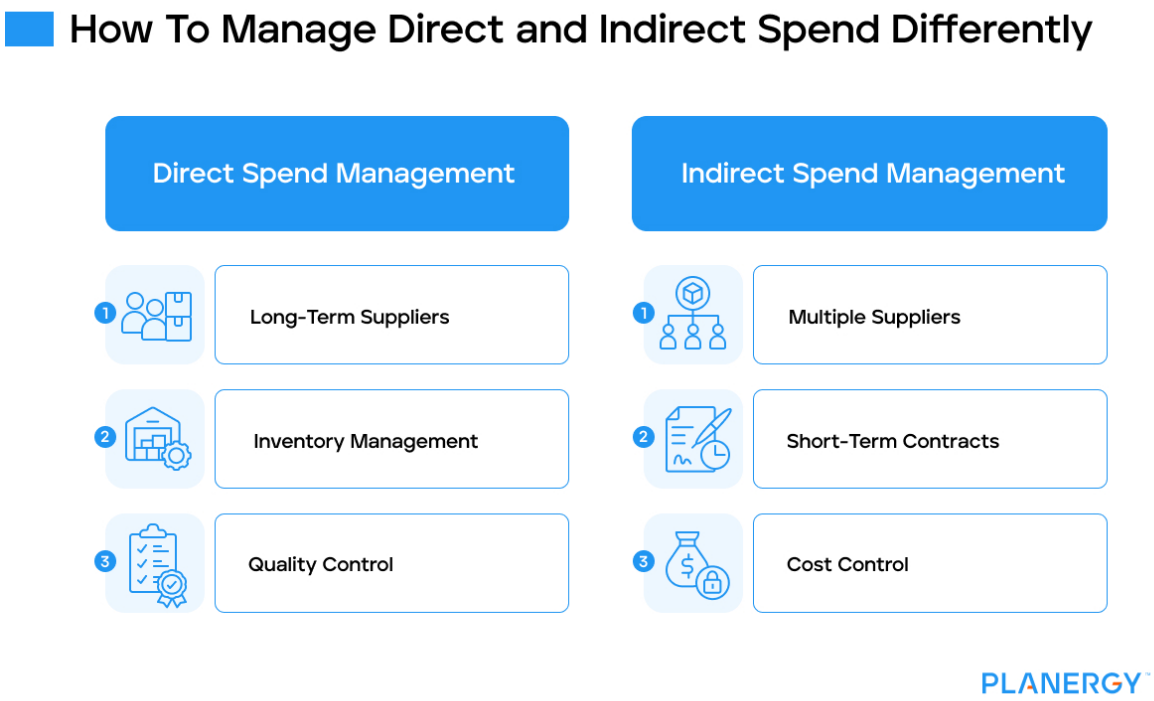
Indirect procurement often involves a wider range of suppliers offering a plethora of products and services. This requires companies to find and manage a larger base of suppliers, which doesn't always allow for deeper relationships and special discounts.

2. **Short-Term Contracts**

   As indirect procurement is typically more transactional, companies may work with a supplier on a one-time or short-term basis.

3. **Cost Control**

   The focus of indirect procurement management is most often on achieving cost savings by finding lower-prices and controlling maverick spend.



Despite these differences, both types of spend require clear purchasing procedures, strategic planning, robust supplier management, and transparency.

Leveraging procure-to-pay software, like Planergy, can provide the necessary tools and functionalities to effectively manage both types of spend and reveal cost savings opportunities.

Does the Classification of Spend As Direct and Indirect Still Make Sense?

The answer is maybe not, depending on your company.

When manufacturing physical products was the big fish in the world's economy, prioritizing direct sourcing of raw materials or goods for resale over indirect spend was obvious.

But just as manufacturing came to eclipse agriculture in economic importance, so has the service economy come to drive manufacturing to the margins.

When companies are driven by virtual goods like software and mobile apps, the indirect expenditures once dismissed as "administrative spend" suddenly become important.

They present the best opportunity for cost savings, supply chain optimization, and spend analysis. Improving those costs leads to a smarter, leaner, more effective procurement strategy.

While it's always been an important variable in procurement, indirect spend is drawing focus because many companies are creating revenue without manufacturing anything tangible.

Consider this: the World Bank reports that services accounted for 64% of the world's gross domestic product (GDP) and 77.6% of the United States' GDP.

Given that most companies aren't making tangible items, it makes less sense to categorize purchases as 'direct' or 'indirect'.

For service-based companies, purchases that support creative efforts, provide strong brand support through customer service and social media, and help create and deliver intangible goods or services may be considered "direct spend."

In other words, it's not necessary to differentiate between direct and indirect spend for these types of companies.

Direct Procurement Strategies Can Also Work for Indirect Procurement

Historically, direct and indirect procurement have been handled differently. But there is a growing trend to apply strategies traditionally associated with direct procurement.

Strategies like strategic sourcing, spend analytics, and supplier performance management can equally benefit an indirect procurement strategy for managing indirect spend categories.

Adopting these strategies can yield considerable benefits.

Strategic Sourcing

Indirect procurement is usually characterized with a reactive, transactional approach. However, applying strategic sourcing principals can create a proactive, strategic approach that delivers more value.

Strategic sourcing involves looking at the entire procurement process holistically, understanding the company-wide needs, analyzing spend data, and identifying opportunities for supplier consolidation, better terms, or alternate sources.

Applying this to indirect spend requires analyzing all indirect costs and aligning these purchases with the organization’s needs.

Because of the high volume of suppliers typically involved with indirect spend, this isn’t possible without a sophisticated procurement solution that helps you analyze and gain insight from spend data on many different suppliers.

Spend Analytics

Spend analytics is routinely used for raw production materials but can provide useful insights when applied to indirect spend.

A thorough analysis data can uncover patterns, trends, and insights.

These can be used to identify vendor consolidation opportunities, potential savings areas, and maverick spend.

This enhanced spend visibility helps you manage your indirect procurement with informed and data-driven decisions. You can also fragment indirect spend into spend categories and subcategories for deeper, category-specific strategies.

Just like with strategic sourcing, spend analytics only works well with a solid procure-to-pay software system that’s able to provide real-time analysis and reports on all of your company’s spend.

Supplier Relationship Management

In direct procurement, supplier relationship management and efforts to improve supplier performance are closely managed due to their impact on the production process.

This focus on supplier performance and relationships can be used in indirect procurement to improve quality and reliability.

Through supplier relationships, organizations can uncover opportunities for process improvements, negotiate better terms, and minimize risks associated with their indirect spend.

However, managing indirect procurement suppliers again requires a software that allows procurement teams to scale communication efforts with a larger number of suppliers, and also track supplier performance of a larger number of suppliers.

Without that, it would be too difficult to manage the relationships of a large number of suppliers.



Automation Works for Direct and Indirect Procurement

The best way to handle both direct and indirect procurement workflows is through an automated system capable of tracking every detail.

Procurement management software, like Planegy, enables you to create efficient processes for each aspect of the procure-to-pay process.

This helps you avoid bottlenecks and enables your team to concentrate fully on adding value.

What’s your goal today?

1. Use Planergy to manage purchasing and accounts payable

We’ve helped save billions of dollars for our clients through better spend management, process automation in purchasing and finance, and reducing financial risks. To discover how we can help grow your business:

- Read our case studies, client success stories, and testimonials.
- Visit our Spend Analysis Software page to see how Planergy can empower you to get more value from your spend.
- Learn about us, and our long history of helping companies just like yours.

Book a Live Demo

2. Download our “Indirect Spend Guide”

Download a free copy of our guide to better manage and make savings on your indirect spend. You’ll also be subscribed to our email newsletter and notified about new articles or if have something interesting to share.

download a free copy of our guide

3. Learn best practices for purchasing, finance, and more

Browse hundreds of articles, containing an amazing number of useful tools, techniques, and best practices. Many readers tell us they would have paid consultants for the advice in these articles.

Related Posts