Procurement Costs and How Businesses Can Reduce Them

Every business needs goods and services to operate. And while these goods and services carry their own price tags, procurement—i.e., the act of obtaining them for your business—carries its own additional costs as well. Today's "bargain" quickly becomes anything but if it's shipped haphazardly, arrives late, damaged, or both, or doesn't include what you originally ordered.

Finding ways to reduce procurement costs is an important part of maximizing your return on investment (ROI) in order to generate both cost savings and value for your business. By understanding how procurement costs are created and the tools and process improvements you can use to reduce them, you can: bolster your company's bottom line; strengthen your inventory and supply chain management; and build strong supplier relationships, too.

Procurement Costs: An Overview

While it's often been treated simply as part of the cost of doing business in the past, procurement actually represents a powerful opportunity for companies to lower costs while building value.

In order to take advantage of this opportunity, it's important to have a clear grasp of what's involved.

Procurement is the act of buying raw materials, goods, and services for a business, as guided by formalized procedures, internal controls, and processes related to not just finance, but inventory management, supply chain management, and supplier relationship management as well.

Procurement costs are those expenses incurred during the act of procurement. Procurement costs serve as a very useful key performance indicator (KPI) in determining the overall cost effectiveness and efficiency of the procurement function.

Some of the most common procurement costs include:

- **Base costs**, i.e. the individual price paid for goods and services. Companies often seek to leverage economies of scale to reduce base costs, as well as strategic negotiations during the contract phase.
- **Purchasing costs**, generated by your procurement team conducting their duties. This includes not only purchasing itself, but all of the indirect labor required to support it, such as data entry, file management, communication and collaboration with other departments, etc.
- **Transportation costs**, or the costs of acquiring goods and services. Companies strive to reduce transportation costs by developing strong, mutually beneficial, long-term relationships with carriers.
- **Contract and negotiation costs** are incurred during the negotiation process. A part of the cost of doing business, they can be substantial for lengthy negotiations (which also require consultation with legal team members) so it's important to balance the benefits gained from securing optimal payment terms and pricing against the labor costs of obtaining them.
- **Taxes and customs costs** crop up when companies obtain inventory from overseas or otherwise foreign suppliers. As with contract and negotiation costs, the need for specialized staff and a significant time commitment for complex or especially large transactions must be carefully weighed against the pricing and terms offered by the supplier.
- **Inventory brokerage costs** are associated with outsourcing inventory management. As legal professionals will be involved and additional fees are charged for the buying and selling of inventory (especially if the

inventory has to travel internationally), these costs can quickly become substantial as well and must be carefully managed.

By minimizing their procurement costs through targeted improvements, procurement professionals can strengthen profitability and competitive advantage while also centering procurement (along with accounts payable (AP)) as strategic value creation drivers for their organizations.

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Best Practices for Slashing Procurement Costs

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1. **Set the Stage for Success with Procurement Software**

Having the wrong procurement tools can cost you plenty in wasted time, resources, and frustration. For some companies this might mean a continued reliance on outdated formats and processes such as paper documents and manual workflows. For others, it might mean a combination of last-gen digital technologies such as basic optical character recognition and a spreadsheet-based accounting program such as Microsoft Excel.

Regardless, for companies looking to move away from what doesn't work and embrace what does, choosing a comprehensive, cloud-based procure-to-pay (P2P) solution like PLANERGY is an essential first step.

Powered by the "Big Three" of digital transformation technologies—artificial intelligence-based robotic process automation, centralized, integrated data management, and advanced analytics—a top-notch P2P software suite makes it easier to improve procurement performance (and cut procurement costs) by:

- **Improving data transparency and management.** A lack of spend transparency makes it incredibly difficult to manage procurement costs effectively, because every analysis, forecast, budget, and policy is based on incomplete or inaccurate data.
  Similarly, data silos create communication problems and further hamper transparency by locking essential information in different areas of your software environment. This problem is often further compounded by a range of non-integrated applications with mutually unintelligible data formats, so the procurement team has to spend valuable time chasing down information, reformatting it for review and analysis, and then reformatting the results for distribution to a range of stakeholders using different applications.
  A centralized, cloud-based data management platform with leveled, role-appropriate access puts everyone on the same page and ensures they can get all of the data they need, in the formats they need, when they need it. And by integrating all the applications already in use, it destroys data silos and ensures information can flow freely and accurately for timely analysis and maximum utility when leveraging actionable insights.
  All of these improvements translate to lower costs by eliminating waste, improving accuracy and response times, and improving data quality for reporting and spend analysis.
- **Automating core procurement processes.** The purchasing process isn't the only part of the procurement cycle that needs review and refinement, but like the rest of your procurement processes, benefits immensely from automation.
  Integrating various systems—contract management, inventory management, supplier portals, etc.—makes it possible to automate everything via eProcurement, from the creation of the initial purchase requisition to routing approvals to verification of the vendor invoice against the shipping documents and original purchase order using automatic three-way matching.
  Automation eliminates the need for manual data entry in many cases, and greatly reduces both the need for human oversight and the risk of human error. High-volume, repetitive tasks are performed more quickly and accurately than even the most ambitious procurement team could

manage, and staff are free to devote their time and talents to more value-driven endeavors such as supplier relationship management or strategic planning.

- **Improving inventory management.** Direct integration cuts costs by ensuring inventory levels are accurately reflected in your procurement and payment systems, reducing the risk of duplicate orders and stock loss and ensuring existing inventory gets used rather than becoming cash-wasting dead stock. Companies can maintain healthy but not bloated inventory levels, lowering costs without putting them at risk of shortages. And for organizations who outsource inventory management, accurate inventory levels reduce labor costs and overhead by minimizing the need for verification or corrections.
- **Allowing procurement teams to optimize indirect procurement as well as direct.** Long vilified as too complex and low-margin to justify dedicated category management, indirect spend has, in the age of digital transformation, at last come into its own as a genuine value center for all kinds of businesses.

  Whether they're well-established brick-and-mortar manufacturers or startups created by digital natives with no physical products, companies are discovering just how important it is to optimize indirect procurement in order to maintain their competitive footing and protect their bottom line.

  Thanks to advanced category management capabilities, full integration with supplier systems, and support for guided buying, a best-in-class procurement solution can help procurement teams of all sizes optimize all of their indirect spend and build strong, strategic partnerships with indirect suppliers that can lead to better pricing, terms, and shared initiatives that drive innovation or improve competitive performance—adding value to cost savings.
- **Eliminating maverick spend.** Like invoice fraud, maverick (or rogue) spend is a cost familiar to anyone who's struggled with opaque spend data and a lack of reliable internal spend controls. Guided buying and integration with contract management means every order is placed with the best possible supplier, at the best possible pricing and terms. Better still, every transaction is captured by the system, ensuring total spend transparency and further reducing costs by improving data quality.
- **Improving risk management.** Beyond cutting maverick spend and

tightening contract compliance, a centralized P2P solution provides large-scale risk reduction by allowing procurement professionals to optimize their supply chains for both flexibility and resilience.

With context-based contingencies and versatile sourcing strategies, companies can realize immediate savings by adjusting their supply chains to reflect current conditions while still protecting themselves against major business disruptors that can create cataclysmic costs.

- **Optimizing cash flow management.** Full spend transparency, better analysis and forecasts, and lower processing costs and lifecycle times make it possible to manage working capital much more effectively. Being able to take advantage of early payment discounts, delay payment until the actual due date, or even skip a payment with your best suppliers can help you protect your company's liquidity while still having cash on hand to invest or take advantage of special opportunities for additional savings.

2. **Combine Cost Savings with Cost Avoidance**

The "hard savings" that come from lower costs are very appealing on the balance sheet. They're highly visible, easy to recognize and quantify, and are readily connected to a healthier bottom line. Securing better pricing on essential raw materials, for example, might generate a clear increase of $15,000 for a given year.

But cost savings aren't the only benefit that come with optimizing your procurement processes. The "soft savings" created by less tangible improvements are still significant, and may prove even more important to your company's long-term viability and business continuity than the "flashier" cost savings.

For example, if your procurement team leverages their supplier relationship management skills to reduce or eliminate an annual pricing increase during contract renewal, the money you don't spend will instead be available for investment, other purchases, or covering unexpected costs. To cite another example, investing in sustainable materials or highlighting your company's ethical procurement practices can help you retain customers that might otherwise drift to a competitor while simultaneously attracting new clients who prioritize ethical sourcing in their spend decisions.

Neither of these are readily quantifiable in the short-term, but they absolutely produce additional revenue—and your reputation as a green, ethical company can lead to unexpected benefits such as strategic partnerships with new suppliers, special consideration for government contracts, and other highly profitable opportunities that would otherwise be out of reach.

3. **Prioritize Process Improvements**
   - **Consolidate spend by standardizing wherever possible.** Standardizing equipment at all levels can go a long way toward cutting procurement costs (e.g., office supplies for general use, limited computer configurations, nametags, etc.).
   - **Actively pursue mutually beneficial relationships with key suppliers.** Formal contract negotiations aren't the only opportunity to secure greater savings and value. Collaborate proactively to identify new opportunities to improve efficiency and performance while reducing costs for both parties. For example, switching from paper-based invoicing to fully digital invoices integrated with your systems can reduce resource demand for you and your supplier while boosting efficiency. The supplier gets paid more quickly, and both parties reduce their labor and material costs.
   - **Measure and refine performance over time.** One of the most useful aspects of a comprehensive eProcurement suite is the ability to track every stage of the source-to-pay process via metrics, measure performance and compliance, and then take action to improve both. Carefully and regularly monitoring your procurement processes using key performance indicators—particularly if your systems are integrated with your suppliers'—can provide the insights you need to trim lifecycle times, remove costly inefficiencies, or adjust your supply chain to reduce risk and expense.

Lower Your Procurement Costs and Increase Procurement Performance

When it comes to protecting your bottom line, making sure you're not spending more than you need to when you're buying goods and services, managing inventory and suppliers, and paying the bills matters. Invest in a comprehensive P2P solution, streamline your processes for efficiency and accuracy, and remember to consider not just procurement cost savings, but the value created by optimizing all your procurement processes. By doing so, you'll help center procurement and AP as powerful centers of strategic insight and growth for your business, and enjoy significant cost reductions while improving profitability and giving your business a leg up on the competition.

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