

What Is Direct Procurement?



In traditional procurement paradigms, spend is classified into two distinct categories.

Direct procurement, which is also commonly called *direct spend* or *direct cost*, refers to the procurement of raw materials, goods, and services that directly support the production of whatever goods or services the procuring company produces.

Its partner, *indirect procurement* (also referred to as *indirect spend* or *indirect cost*) instead refers to the procurement of services and goods that contribute to operating, maintenance, and support costs—the “business of doing business,” as it were.

Both types play important roles in the success of any organization. But the global marketplace is evolving, both through the ever-expanding impact of digital transformation and the rapid shift away from traditional brick-and-mortar, manufacturing-centric businesses toward service-focused industry.

As a result, procurement professionals around the world find themselves beginning to re-evaluate their answers to the question, “What is direct procurement?”, and reconsider its role in maintaining profitability, performance, and competitive advantage in supply chain management and optimization.

Direct Procurement's Changing Role

Until the very recent past, direct procurement has had a starring role in the daily life of the procurement function.

Direct materials, obtained with maximum cost savings and minimal risk, were “job one,” and the focus of most procurement business processes, from supplier management to spend analysis to overall procurement strategy.

And yet, the exploding growth of the service economy, documented so thoroughly in academia and alternately decried and celebrated in the press, is challenging direct procurement's primacy—or, at the very least, it's definition.

Part of the issue lies in the way service-oriented businesses operate.

Production-driven businesses in the manufacturing sector continue to define and direct spend as “procurement of raw materials essential to production,” and prioritize it accordingly.

Examples of direct procurement in these companies include ingredients for food production, raw materials such as metals, wood, and stone, and subcontracted services.

At these companies, procurement processes, including supply chain management and inventory management, are often customized to avoid or minimize delays, maximize cost savings, and optimize logistics for maximum profit margins, efficiency, and competitive performance.

The direct purchasing lifecycle can be long, complex, and require more “hands on” interaction from human stakeholders than indirect procurement at these companies.

Other challenges and opportunities presented by direct procurement include:

- **Inventory Management.** Using direct procurement, raw materials must often be held in reserve (i.e., in stock) to ensure seamless, delay-free production. Indirect procurement is demand-based, simplifying inventory management immensely.
- **Cost Management.** Direct procurement benefits from the use of what is

known as *should-cost analysis*, a method of calculating the actual expenses incurred by a given supplier in providing direct materials, and then comparing it to the quoted price during negotiations. Indirect procurement uses *zero-based budgeting*, which requires justification of all spend without comparison to past budgets.

- **Centralized Organization.** Traditionally, direct procurement relies on a centralized system, where category managers focus their time and talent on direct purchasing for specific goods and services. Indirect spend has historically been much less organized, but the introduction of procurement software with artificial intelligence and process automation tools is rapidly making it possible to gain control over, and visibility into, both types of spend while maintaining centralized data management and distributed access.
- **Supplier Relationship Management.** Because their scope has historically been much more narrow and strategic, direct procurement teams have a tradition of deep, well-developed supplier relationships built through concerted effort. Protection production and supply schedules leads to a collaborative approach. In the past, indirect spend was much more transactional and focused on cost reductions, but as with organization, the growing availability of sophisticated procurement software with data management and analysis tools has made it possible to shift indirect spend to a more strategic, collaborative footing.

All that said, companies offering virtual goods or professional services as their products, either directly to consumers or to other businesses, are largely focused on indirect procurement processes.

Without the need for raw materials to feed production, procurement teams at these companies invest most of their time, energy, and resources in managing what would be considered indirect procurement in a traditional model.

In addition to office supplies, professional services, and maintenance, repair, and operations (MRO) this indirect spend may include “direct materials” such as software components or specialized hardware that support the “production” of the company’s virtual goods or services, but are still considered indirect expenses under legacy procurement paradigms.

As a result, comparing direct and indirect procurement to divide spend may not

be as useful to these organizations when building their procurement strategy and business process management plans.

Moving beyond a bifurcated approach to procurement requires an understanding of how modern procurement teams are meeting their obligations to stakeholders while still shifting their overall focus from cost savings alone to building value and injecting efficiency, speed, and performance into the organization as a whole.

A More Nuanced Approach

Moving beyond a bifurcated approach to procurement requires an understanding of how modern procurement teams are meeting their obligations to stakeholders while still shifting their overall focus from cost savings alone to building value and injecting efficiency, speed, and performance into the organization as a whole.

Looking beyond the direct procurement/indirect procurement divide, let us consider a new way of categorizing spend. More specifically, let us take the term “direct procurement” and split it into three distinct categories:

Cost-Driven Direct Procurement

This category is for companies that sell goods and services to customers at prices determined by the cost of producing those goods or delivering the service.

Textile manufacturers, food manufacturers and resellers, and construction companies may favor this procurement strategy.

Market-Driven Direct Procurement

This category is for companies that sell goods and services to customers at prices determined by the price charged by competitors for producing those goods or delivering the service.

Companies with tight margins and narrow competitive breathing room many prefer this approach.

Value-Driven Direct Procurement

This category is for companies that sell goods and services to customers at prices determined by the calculated benefits and value provided to the customer through the use of the goods and services on offer—with the added consideration of the procurement function’s role in building value for the company as well as the customer.

Medical manufacturers, software firms, and chemical companies often pursue this strategy for direct purchasing and pricing, but it can be applied to nearly any industry with the right toolset.

Recontextualizing direct spend in this fashion makes it much easier to use modern tech tools such as procurement software to introduce process automation, deep data analysis, and improved collaboration and transparency to their procurement workflows.

In particular, value-driven direct procurement is “industry agnostic,” and much easier to achieve with the help of such tools.

Companies looking to optimize their spend, minimize waste and delays, and build strategic supplier relationships can dedicate their time, talent, and resources not to direct or indirect procurement alone, but more effective spend management in general.

Defining Direct Procurement for Your Business

Direct or indirect, your company’s procurement is vital to your growth and success.

Analyzing and optimizing *all* your spend to focus on value for your business and your customers can be the start of incredible improvements in your organization’s overall performance, bottom line, and supply chain management.

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