Transparent e-Sourcing

Making audits pleasantly predictable

SourceDogg

White paper

in association with

Lime Associates
Medical Purchasing & Supply Solutions

Contents

Introduction.

In this month's white paper we revisit the issue of transparency in sourcing. Transparency has been a recurring theme in previous SourceDogg articles over the last two years. Various studies and reports show that when it comes to managing their purchasing and supply chains many firms suffer from a lack of oversight and awareness on who is spending what. This is certainly not in a firm's interests and can impact everything from profitability to share price. The development of e-procurement technologies has opened up new possibilities for firms to inject greater transparency into supply chain management; and this is achievable without incurring major costs or disrupting existing financial and enterprise resource planning systems. Surprisingly, firms have been slow to realise the benefits of e-sourcing tools and so transparency remains a problem for many. In the following sections I will discuss some of the main procurement transparency issues affecting firms today and the potential of e-sourcing to address these.

Is transparency only relevant to public sector organisations?

Procurement transparency makes business sense for all firms irrespective of their sector or size. Public sector organisations operate under EU Directives and national guidelines that require open, transparent, and non-discriminatory procurement processes. There is a legal compunction on them to ensure transparency over how they procure goods and services. Contravention of the regulatory regime can result in organisations facing costly legal proceedings, not to mention the reputational damage that stems from such actions. Quite apart from the legal aspect, there are also sound business reasons why public sector organisations should aim for transparency, which we will come to shortly. Outside the public sector environment procurement is at the discretion of the individual firm. Multinational corporations tend to have in place operating policies and procedures for their national subsidiaries to follow. Smaller firms often have less formalised and codified approaches to procurement. Depending on the sophistication of the firm and its internal operating systems, transparency may be integral to procurement or may not register at all.

The business case for procurement transparency

The case for greater transparency in procurement is, first and foremost, a business one. Directly, lack of transparency can result in firms losing money through maverick spending. Indirectly, firms with a less than clear picture of their total spend profile are potentially missing out on opportunities to identify savings opportunities and to restructure their supplier portfolio. Let's look at each of these two points in more detail.

Maverick spending: maverick spending or non-compliant spending refers to instances where employees circumvent established

> “Non-compliant purchasing **leads** to higher costs, with repercussions for a firm’s market **competitiveness**”

company policies and procedures on the procurement of goods and services. Research indicates that non-compliance is an on-going problem for many firms.[1] Among recently surveyed firms compliance with preferred supplier lists was 66% and compliance with contracted rates was 64%. That a significant minority of firms experience non-compliance points to a failure of oversight and transparency in procurement processes. Put slightly differently, employees would be much less likely to engage in such behaviour if a fully transparent system was in place. The cost implications of non-compliance to firms are serious. It is estimated that firms worst affected by maverick spending end up incurring $10,000 more per full-time procurement employee than firms unaffected by this problem.[2] Non-compliant purchasing leads to higher costs, with repercussions for a firm’s market competitiveness.

Incomplete information: as well as struggling to achieve compliance with procurement policies, many firms admit that they are less than well informed on their overall procurement spend profile. In other words, they are uncertain as to what is being spent and by whom. This does not bode well for efficient spend management and likely leads to firms missing opportunities to consolidate their supply base. Industry reports suggest that more than 40% of firms were uncertain of their spending patterns and did not have access to reliable data on indirect procurement spend.[1] The percentages for small and medium-sized firms are even higher. Even among firms that did claim to have a high level of expenditure visibility, 33% did not trust the accuracy of their data.

33% *of firms*

did not trust the accuracy of their data

1 American Express & A.T. Kearney. (2011). “European Indirect Spend Management Study.”
2 Estimated by APQC, which is an international resource for benchmarks and best practices.

The difference e-procurement makes

e-Procurement brings transparency to the procurement process, thereby curbing maverick spending and improving visibility of spend. Firstly, by directing employees to source all goods and services through an e-procurement solution maverick spending is likely to decrease. This is because e-procurement services can be configured to ensure that company practices are clearly flagged and easy to follow. Under this arrangement no employee can claim ignorance over procurement procedures. Approval features can also ensure additional managerial oversight. In cases where procedures are not complied with the system can pinpoint the individual employee or department responsible. One of the strengths of e-procurement is that an audit trail is always available for post-transaction analysis. Thus, problems can be quickly brought to managerial attention and remedial action taken.

A lack of visibility can be particularly prevalent among more sizeable operations; as Dale Neef recognises, '[l]arge companies seldom can identify their suppliers across the entire enterprise or break down with any precision the nature of their spending with key suppliers by operating divisions.'[3]

"One of the strengths of e-procurement is that an audit trail is always available for post-transaction analysis"

Secondly, e-procurement systems enable data capture and subsequent data analysis. This data analytics feature is indispensable to understanding purchasing patterns. Weekly, monthly and annual reports can be generated to show how much each department is procuring and whether this fluctuates throughout the year. Data analytics can also

3 Neef, Dale (2001). e-Procurement: From Strategy to Implementation. Available at: http://books.google.ie/books?id=xjkrw73x3y-sC&printsec=frontcover&source=gbs_ge_summary_r&cad=0#v=onepage&q&f=false

“On many levels e-procurement has a ***critical role*** *to play in underpinning transparency.”*

be used to profile the firm’s supply base and examine if consolidation of existing supply lines is feasible and desirable. Likewise, comprehensive data on procurement spend can aid in future planning and even risk management; for example, by identifying if the firm is becoming too dependent on any one particular supplier.

Improved transparency through e-procurement can also deliver intangible benefits. Transparency and probity are indicators of a more underlying approach to risk management within the firm. Where transparency is shown to be problematic and firms have received some form of public censure because of it, investors and other stakeholders might well interpret this as a sign of weak governance and poor risk management. Conversely, a high level of transparency is likely to signal to interested parties that corporate governance is taken seriously and is seen as integral to the overall financial health of the firm. ‘Transparency is good for business … [it] enhances market trust and credibility with key stakeholders because the perceptions of a company’s stakeholders are vital to the reputation of that company.’[4]

In addition, recent supply chain-related scandals in the press have brought public scrutiny to sourcing practices, demanding traceability and transparency from buyers. ‘Diverse transparency interests demand traceability … In response to crises such as the European horse meat scandal and the factory collapse in Bangladesh, [companies] are facing a slew of regulations.’ [5]

A more transparent procurement system is also likely to generate goodwill among potential suppliers. Where suppliers perceive that a contract has not been fairly awarded, they will be disinclined to tender for future business. e-Requests are becoming

4 Slob (2009). Global Supply Chains: The importance of traceability and transparency. Available at: http://somo.nl/publications-en/Publication_2789

5 Lee (2014). Starbucks, Levi’s, other top companies talk transparency trends. Available at: http://www.greenbiz.com/blog/2014/01/07/starbucks-levis-transparency-trends-engaging-stakeholders

increasingly popular as a transparent way for buying firms to interact with the marketplace. With e-requests participating suppliers know their submissions will be judged and scored objectively, transparently and on a like-for-like basis. This helps to reduce the opaqueness surrounding the award of contracts, particularly in a public sector context.

As such, e-procurement plays its part in educating potential public sector suppliers; full visibility of the process allowing them to refine their response practices. 'E-procurement can … be expected to provide real-time information on the various steps involved in the procurement process to enable potential suppliers to make informed decisions about whether to bid and how to improve the relevance of their bids by better addressing the government's needs and priorities.'[6]

6 Pani & Agrahari (2007). e-Procurement in Emerging Economies: Theory and Cases.

Conclusion

Transparency is integral to professional procurement practice. It is not an optional extra or something that firms can pay lip service to. Low levels of transparency and oversight are associated with maverick spending, which increases procurement costs and reduces firm competitiveness. Equally, a lack of clarity and visibility over spend profile denies a firm the opportunity to manage procurement strategically by consolidating its supply base and benchmarking its spending outlay against industry standard setters. Transparency in procurement is also a litmus test of the transparency and probity of the firm generally. It indicates to both internal and external stakeholders how much emphasis is placed on financial accountability, maintaining good external relations, and adhering to guidelines, whether regulatory or corporate. On many levels e-procurement has a critical role to play in underpinning transparency. It provides the control, functionality, monitoring, audit trails, and data collection that individually and collectively promote transparency in big firms and in small firms. More and more it is becoming a key lever for firms to manage procurement strategically.

About the Author

Anthony Flynn works as a researcher in Dublin City University Business School (DCUBS) and specialises in the area of procurement.

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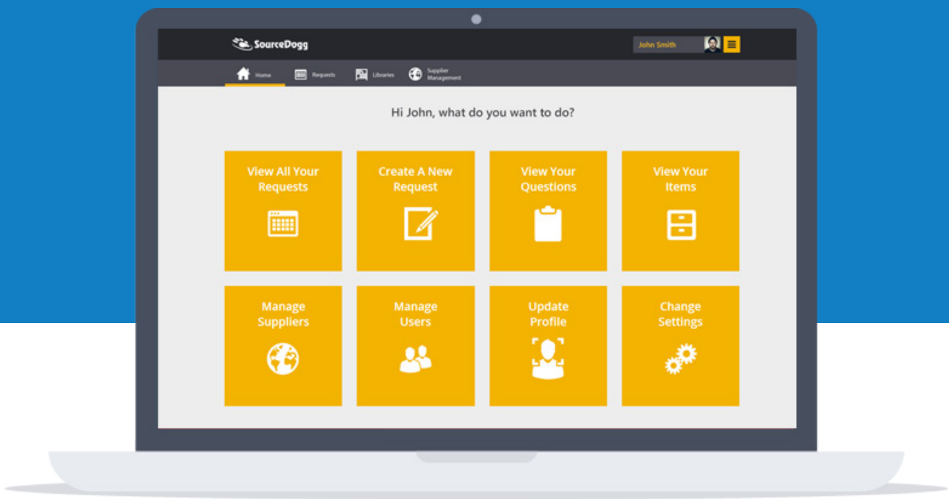

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