Market Analysis

After the E-Procurement Hangover: Is BPO the Right Painkiller?

**Abstract:** The e-procurement function remains fragmented after the wave of e-procurement initiatives of the late 1990s failed to delivered on their promise. Outsourcing is now emerging as a solution.

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**Strategic Market Statements**

- Procurement BPO providers who rely solely on aggregate pricing arrangements will be unsuccessful in showcasing the value of outsourcing as a whole relative to incremental unit cost savings.
- Procurement BPO providers who do not have significant change management capabilities will be unable to deliver on their promise of process improvement.
Introduction

Gartner Dataquest has seen a significant upsurge in interest in procurement outsourcing from the provider and buyer community. Organizations are finding it is increasingly difficult to train and staff their internal purchasing organizations and to find the specialized capabilities required to maintain e-procurement environments (for example, catalog management and trading community development) internally. This report briefly investigates the potential demand for procurement outsourcing and looks at the competitive landscape of providers that offer procurement outsourcing.

Gartner Dataquest defines business process outsourcing (BPO) as the delegation of one or more IT-intensive business processes to an external provider that, in turn, owns, administers and manages the selected processes based on defined and measurable performance metrics. Examples of business processes that are outsourced to an external service provider include logistics, procurement, human resources (HR), finance and accounting, customer relationship management (CRM) or other administrative or customer-facing business functions.

Procurement outsourcing services can be segmented in the following ways:

- According to the type of goods and services purchased — Strategic supplies, capital equipment, commodity direct, services, blue-collar maintenance, repair and operations (MRO), white-collar MRO, and others, such as unique buys

- According to the processes involved in procuring goods or services — Product design, planning forecast, sourcing, order management, fulfillment, payment and supplier assessment

- According to the level of depth in outsourcing — Infrastructure, applications, technical help desk, tracking help desk, transaction processing, process administration and full management
Figure 1 presents a segmentation of the procurement outsourcing function.

Figure 1
Procurement Outsourcing Segmentation

Classes of Goods
- Strategic Direct
- Capital
- Commodity Direct
- MRO Services
- MRO Blue Collar
- MRO White Collar
- Miscellaneous

Personnel and Management-Intensive
- Full Management
- Process Administration
- Spot Buying and Payment Services
- Order Inquiry (Status, Procedure, and So Forth)
- Help Desk (technical)

Range of Outsourced Services
- Design
- Plan
- Source
- Order
- Fulfill
- Supplier Assessment
- Application Maintenance
- Transaction Delivery
- Applications
- Infrastructure

Buying Process

Technology and Infrastructure-Intensive

Source: Gartner Dataquest (October 2002)

A Timid Demand

The practice of procurement outsourcing is piecemeal and selective. Companies are relinquishing only small portions of their procurement function, and only when they think they do not have the resources to perform the function in-house or when they do not have the appropriate economies of scale to be cost-effective. However, enterprises are increasingly seeing that outsourcing offers an alternative to e-procurement implementation, which because of its high cost, requires sufficient economy of scale to realize a good return on investment (ROI).

In previous reports, Gartner Dataquest has delineated the rise and fall of e-procurement initiatives. Companies, encouraged by promises of significant ROI by software vendors, invested significant sums of money in implementing e-procurement software. However, many of these investments failed to show the ROI that enterprises were expecting. According to Gartner Dataquest, the following are main reasons for these failures, as outlined in "E-Procurement Odyssey: 2002 and Beyond" (SPA-
14-9364), and "E-Procurement Market Update: After the Meltdown" (M-13-8844):

- High cost of implementation
- Lack of alignment between procurement culture and procurement technology
- Business processes not changed to match automated procurement
- Catalog-aggregation expense
- Technical immaturity of supplybase

Procurement outsourcing spreads out the enormous implementation cost of e-procurement software over a longer time period. Unlike procurement implementation, which demanded up-front investment and required back-end support, procurement outsourcing can spread the implementation cost over time and offers true purchasing expertise. A recent upsurge in demand for back-office, noncore process outsourcing, such as HR and finance and accounting, has led companies to examine other potential processes to outsource. Procurement, particularly indirect procurement, appears to be a likely candidate for outsourcing because of the following factors:

- Easily perceived as a noncore function
- Often decentralized function, leading to process redundancies
- Need for economies of scale
- Need for automation
- Need for process re-engineering
- Need for cost-effective approaches for smaller, less influential organizations

A recent Gartner Dataquest survey shows that the percentage of enterprises outsourcing procurement is still very small. Close to 6 percent of 150 respondents surveyed in June 2002 say they currently outsource a portion of their procurement function (direct and indirect), and a similar proportion say they plan to outsource procurement in the next 24 months. However, a third of the respondents who are currently outsourcing expect to increase their procurement outsourcing budgets during the next 24 months.

Figure 2 illustrates the level of current and future procurement outsourcing within our sample.
Though the number of respondents that indicate willingness to outsource indirect procurement is low relative to that for finance and HR, it is not much lower than the number of respondents willing to outsource supply chain management services and sales, marketing and customer care processes, which also represent emerging areas of growth in BPO (see upcoming report "Users of BPO Report High Satisfaction With Existing Relationships," ITOU-WW-UW-0104.)

Gartner Dataquest's preliminary survey shows the following are the top drivers for indirect procurement outsourcing:

- Focus on core business
- Re-engineer business process
- Gain process knowledge
- Introduce innovation
- Shorten implementation time
- Improve service levels

The survey also shows that the three main reasons that enterprises outsourced indirect procurement were to address the following "pain points":

- Spent too much time in day-to-day operations and did not have time to focus on strategic management
Did not have timely and accurate reports on the performance of its business processes

Processes were not integrated within the organization

These drivers indicate that procurement outsourcing is driven by the requirements to focus on core business and to improve business processes. The first driver is common to most outsourced processes. The focus on business-process-related drivers, such as business process re-engineering and gaining process knowledge, are more prominent for procurement outsourcing.

Another driver that is significant for procurement outsourcing is innovation. Innovation is a technology-driven decision.

These drivers indicate that procurement outsourcing is in an early phase of outsourcing in which the focus is still on business process re-engineering through innovation, rather than on the benefits of re-engineering. In more mature forms of outsourcing such as HR and finance and accounting, the driver has shifted to benefits of re-engineering, such as reduction in overall costs. Reduction in costs does not yet factor in as one of the primary drivers of procurement outsourcing.

The survey also shows that the following are the most influential decision-makers for indirect procurement outsourcing:

- President/chief executive officer (CEO)
- Chief financial officer (CFO)
- Chief information officer (CIO)
- Business unit manager and purchasing manager

The strong role of CIO in purchasing decisions indicates that technology initiatives strongly influence procurement outsourcing decisions. The CIO gets a higher rating as a decision maker in procurement outsourcing than for any other BPO service. However, the role of the business side including the CEO, CFO and the business unit manager indicate that companies expect business benefits from procurement outsourcing initiative.

The top challenges identified by respondents with regard to procurement outsourcing include the following:

- Lack of perceived value
- Concern over the dependability of service
- Lack of management support
- Concern over data security

**Competitive Landscape: A Flurry of Contenders**

Procurement outsourcing is a new market with potential for increasing adoption. The contracts signed so far have been mostly with pure-play
providers or application service providers (ASPs), which indicates that the market is still immature. Most of the procurement contracts listed below have been signed since 1999. The concentration of contracts signed in the last few years shows the growing interest in procurement outsourcing.

The pure-play providers that have signed procurement outsourcing deals are:

- **ICG Commerce**
  - ICG Commerce uses its own Real Purchase software platform as well as platforms from other vendors.
  - ICG Commerce’s first procurement outsourcing deal was closed in March 2001.
  - ePValue, Accenture’s e-procurement venture merged with ICG Commerce in November 2000. Accenture now has an equity stake in ICG Commerce.

- **Alliente**
  - Alliente uses the Ariba Buyer software platform.
  - Alliente’s first procurement outsourcing deal was closed in September 2000.
  - Lucent Technologies has a minority stake in Alliente.

- **FacilityPro**
  - FacilityPro uses the SAP Enterprise Buyer Professional (EBP) application suite software platform.

- **Xchanging**
  - Xchanging offers both procurement BPO and jointly owned companies with 50/50 ownership with the client.

Table 1 gives examples of procurement outsourcing contracts. It is not meant to provide a comprehensive overview of all contracts in the marketplace.
Table 1
Examples of Procurement Outsourcing Contracts

<table>
<thead>
<tr>
<th>Company</th>
<th>Outsourcing Deal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pure-Play Providers</td>
<td>Lucent Technology</td>
</tr>
<tr>
<td>Alliente</td>
<td>Functions outsourced: Alliente manages procurement of indirect goods and services, including office supplies and equipment, industrial supplies and equipment, property services, furniture, travel services, and power and energy management.</td>
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<tr>
<td></td>
<td>Deal announced: September 2000</td>
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<tr>
<td></td>
<td>Avaya</td>
</tr>
<tr>
<td></td>
<td>Functions outsourced: Alliente will administer and manage procurement transaction processing and custom unique buying services for Avaya locations in North America, Europe and Asia/Pacific</td>
</tr>
<tr>
<td></td>
<td>Deal announced: March 2001</td>
</tr>
<tr>
<td>FacilityPro</td>
<td>Agere Systems</td>
</tr>
<tr>
<td></td>
<td>Functions outsourced: Shipping, receiving, storeroom operations</td>
</tr>
<tr>
<td></td>
<td>Date announced: March 2002</td>
</tr>
<tr>
<td>Xchanging</td>
<td>Lucent Technology</td>
</tr>
<tr>
<td></td>
<td>Functions outsourced: Material planning and quality control</td>
</tr>
<tr>
<td></td>
<td>Date announced: June, 2001</td>
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<tr>
<td></td>
<td>Heywood Williams</td>
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<tr>
<td></td>
<td>Functions outsourced: Direct and indirect spending of advertising, marketing car fleet, steel, aluminum, and zinc</td>
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<tr>
<td></td>
<td>Value of deal: 1 year £15 million with option of extension to 5 years</td>
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<tr>
<td></td>
<td>Date announced: February 2002</td>
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<tr>
<td></td>
<td>BAE SYSTEMS</td>
</tr>
<tr>
<td></td>
<td>Functions outsourced: Procurement of HR related services such as car fleet, non technical contract labor, recruitment, healthcare and specific fields of training</td>
</tr>
<tr>
<td></td>
<td>Value of deal: Approximately £80 million per year, to a 50/50 jointly owned company to be set up between BAE SYSTEMS and Xchanging</td>
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<tr>
<td></td>
<td>Deal announced: October 2001</td>
</tr>
<tr>
<td>Consultant</td>
<td>ANZ Bank Australia</td>
</tr>
<tr>
<td>IBM Business Consulting Services (formerly PwC Consulting)</td>
<td>Items outsourced: Computers, stationery, telecommunications and airline travel, operated by PwC Procurement Services, a subsidiary of IBM Business Consulting Services</td>
</tr>
<tr>
<td></td>
<td>Value of deal: Approximately $850 million purchases to be managed</td>
</tr>
<tr>
<td></td>
<td>Deal announced: June 1999.</td>
</tr>
</tbody>
</table>

Source: Gartner Dataquest (October 2002)

An overview of the recent contracts in procurement outsourcing highlights the following findings:

- Most major procurement outsourcing contracts, except the one with ANZ Bank in Australia, were signed with pure-play providers.
- Several engagements involve clients located out of the United States.
- Most procurement contracts have been signed only in the past three years.

Other vendors besides the pure-play providers have the capability to enter this market. They include consultants, independent software vendors (ISVs), business service providers (BSPs) and e-marketplaces.
Consultants
Consultants are very likely to enter the market if procurement outsourcing trend increases. Other consultants that have procurement capabilities include:

- IBM Global Services
  - IBM has a partnership with Ariba and has implemented two major procurement implementations since 2001.
  - IBM has not yet announced any procurement outsourcing deals, but its procurement practice is significant and has sufficient capability to compete strongly in the market.
  - The acquisition of PwC Consulting will bring on board additional procurement outsourcing capabilities and contracts. PwC BPO already has a procurement outsourcing contract with ANZ Bank in Australia.

- EDS through A.T. Kearney
  - EDS has a sourcing contract with the U.S. Department of Navy. EDS's eBreviate, which is part of A.T. Kearney, has a platform with procurement functionality. EDS also has a partnership with ProcureNet, which provides solutions for B2G procurement.

- Accenture
  - Accenture's ePValue procurement group has merged with ICG Commerce. Accenture also implements e-procurement solutions through its Supply Chain Management group. Accenture has partnership with Ariba.

These consultants have the BPO expertise and the technology platforms necessary to provide procurement outsourcing.

They could get more process expertise through partnership with pure-play providers.

Independent Software Vendors
ISVs have the capability to provide procurement outsourcing through partnerships with consultants or pure-play providers. However, they are not likely to provide procurement outsourcing directly.

- Ariba
  Ariba Buyer Procurement platform has a large installed base. Ariba also has partnerships with several consultants and pure-play providers, including IBM, Accenture and Alliente.

- Commerce One
  CommerceOne’s installed base for its procurement software is smaller than that of Ariba.
ISVs do not have the BPO expertise necessary for procurement outsourcing so the likelihood of their entering the outsourcing market is low.

The ISVs will be better advised to make their solutions attractive to providers of procurement outsourcing than enter the market directly.

**Business Service Providers**

BSPs have procurement platforms or specialized procurement applications. Many of these vendors have experience with hosting procurement and sourcing-related applications. However, they would need to partner with either a consultant or a pure-play for BPO expertise. Procurement BSPs include the following companies:

- CoreHarbor
- Elcom
- Emptoris
- ePlus.com
- eScout
- PurchasePro
- MarketMiles
- WorldCrest.

**E-Marketplaces**

These vendors come from marketplaces and sourcing backgrounds. They would need to partner with ISVs for software platform, pure-plays or consultants for BPO experience and process knowledge. E-marketplaces include the following:

- BT Ignite
- GE Global Exchange Services
- NewView
- ExoStar

**Recommendations for Service Providers**

The procurement process manifests many of the characteristics of the HR and finance and accounting processes, both of which have been successfully outsourced. Procurement is often highly decentralized (for example white-collar MRO) and perceived as a noncore service that can be made more efficient through automation. Outsourcing offers a cost-effective and nondisruptive method for such automation.

So it stands to reason that procurement outsourcing could be the next trend in BPO. This idea is also supported by the significant increase in the number of inquiries that Gartner Dataquest analysts have received on this topic in recent months.
The preliminary research by Gartner Dataquest, however, shows that the number of companies that currently outsource procurement is relatively small. Only 6 percent of the companies surveyed outsource a portion of procurement.

The supply-side analysis also indicates that the market is immature and still dominated by pure-play providers. This analysis also shows a high increase in outsourcing deals signed in the past two years.

Although the market is immature, there is potential for increased demand in procurement outsourcing, so providers will be well-advised to explore the following ways to benefit from such a trend:

- Providers with BPO expertise can explore ways to relate procurement outsourcing to HR and finance and accounting outsourcing, particularly for Fortune magazine’s top 500 global (G500) clients. Procurement outsourcing could be a cross-sell opportunity for providers already providing BPO.

- Clients expect a high level of procurement process expertise from their providers. BPO vendors must either develop this process in-house or partner with pure-play providers/consultants that have process expertise. However, the procurement function is different from HR and finance. It is a multienterprise process that requires specialized skills. Therefore, procurement process expertise may be difficult to grow organically. Providers will benefit from establishing partnerships or grow through acquisitions to ensure process expertise and comprehensive solution offerings, particularly for vertical, industry-specific processes.

- BPO providers should examine the opportunity to develop procurement outsourcing services as a business utility, foregoing lengthy implementation and providing economies of scale, particularly for mid-market clients. The use of Web services has the potential to make this move toward process utility happen, but before it does, companies are likely to experiment with an increase in complexity during the next three years. Large clients will continue to require more complex customization because of the need to simplify workflow and centralize procurement decisions. For enterprise-specific buying practices, companies might be unwilling to adopt generic "best practices."

- BPO providers need to address the change-management issue related to procurement up front with their clients. Many organizations struggle with change management for procurement for years, even when trying to make small changes in purchasing/procurement behaviors, executive support, planning, training, and so forth. These areas become even more critical in a comprehensive procurement outsourcing contract.
Providers must develop innovating pricing methodologies to showcase the value of outsourcing as a whole, relative to incremental unit cost savings. Suppliers must find better ways to package or create value around their offerings. Those with aggregate pricing arrangements may require sweeping changes.

Providers must be prepared to face the continued fear of losing control within many enterprise organizations, particularly those that have invested substantially in e-procurement and may be unwilling to admit defeat.

Key Issue
What are the key trends, drivers and inhibitors of the outsourcing market?