



**Procurement Outsourcing (PO)  
Market Update: May 2006 – Preview Deck**

**Topic: Unlocking the Potential of PO**

# Purpose and approach of the research

PO has not taken off although it started around the same time as other BPOs like HRO and FAO. The PO market continues to show tremendous value potential, but is still in the pioneer stage of market maturity. Given the huge untapped potential and the current state of the PO market, the Institute's focus for this effort was:

- To understand and highlight the key barriers that have prevented the PO market from achieving its potential
- To ask relevant questions and provide initial hypotheses to address the primary concerns of the key stakeholders

As a part of this initiative, we interviewed leading PO suppliers and collected buyer perspectives from Everest's consulting teams serving buyers.

# Scope of the report

- Sized the untapped potential of PO for buyers and suppliers
- Identified the primary concerns that have prevented PO from taking off
- Analyzed the key reasons underlying these concerns
- Identified the breakdown in key outsourcing practices that are required to address these concerns
- Developed key questions and initial hypotheses that highlight the actions required to address the breakdown
- Started interacting with the industry to find answers to these key questions

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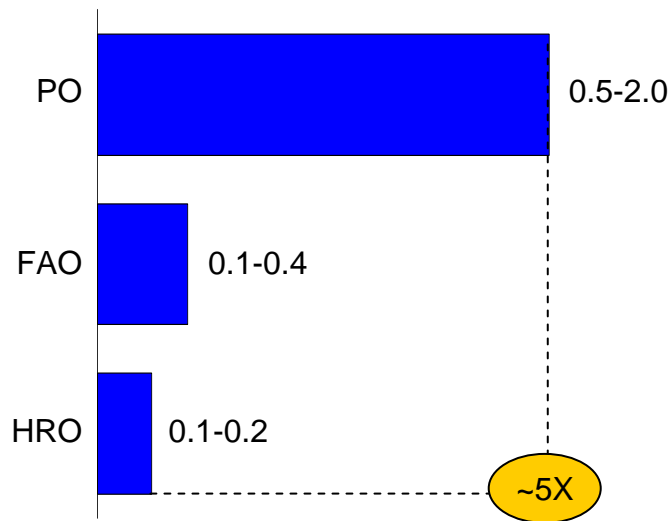
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- **PO has higher potential than HRO and FAO, yet it has shown slower growth**
  - PO savings represent 0.5% to 2.0% of sales; nearly five times the savings of HRO and FAO
  - Even at a penetration level of 15%, PO can potentially generate US\$90-120 billion of savings and US\$20-25 billion in supplier revenues
  - However, PO's current penetration (0.2%) is less than half that of HRO (0.7%) and FAO (0.7%), even though all the markets started about the same time
  
- **PO has not reached its potential due to four major concerns during design and implementation stages of the solution**
  - In the design stage of a PO transaction, it is difficult to *select a supplier* with the right set of capabilities
  - During the implementation stage, there are concerns with loss of *buyer control*, difficulty in defining an approach to *realize savings*, and complexity in *managing change*
  
- **Concerns with supplier selection will resolve over time as suppliers increase their capabilities. The remaining three concerns require changes in key outsourcing practices to remedy**
  - Supplier selection is a timing-related concern as sourcing-related solutions are nascent and suppliers have only recently begun to explore PO offerings
  - The other three concerns are not being effectively addressed, as there is a breakdown across the five key outsourcing practices: *CXO sponsorship*, *scope definition*, *pricing structure*, *governance model*, and *retained organization*
  
- **We have developed key questions based on our experience to highlight actions required to address these concerns**

# PO has higher potential than HRO and FAO, yet it has shown slower growth

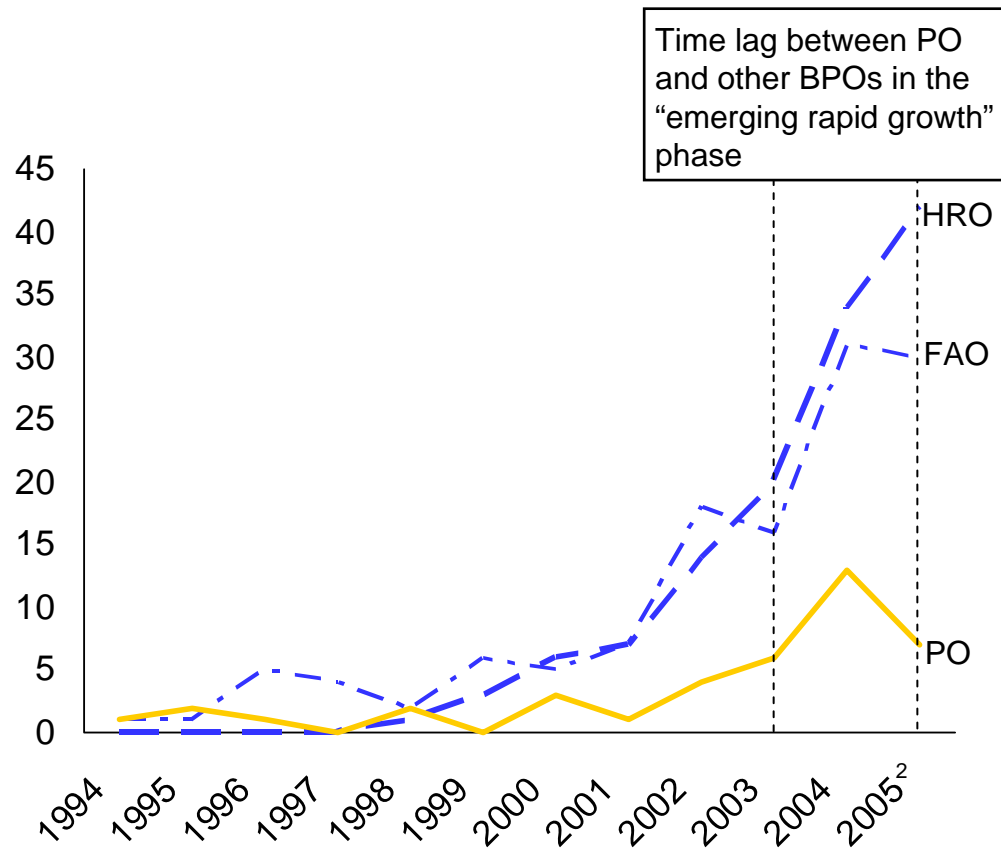
## Pre-tax return on sales from outsourcing<sup>1</sup>

Percentage



## Annual change in number of transactions over time

Number of transactions



1 High-level estimates based on costs influenced as a percentage of sales and annual savings

2 2005 data is annualized

Source: Everest Research Institute


# PO has not reached its potential due to four major concerns

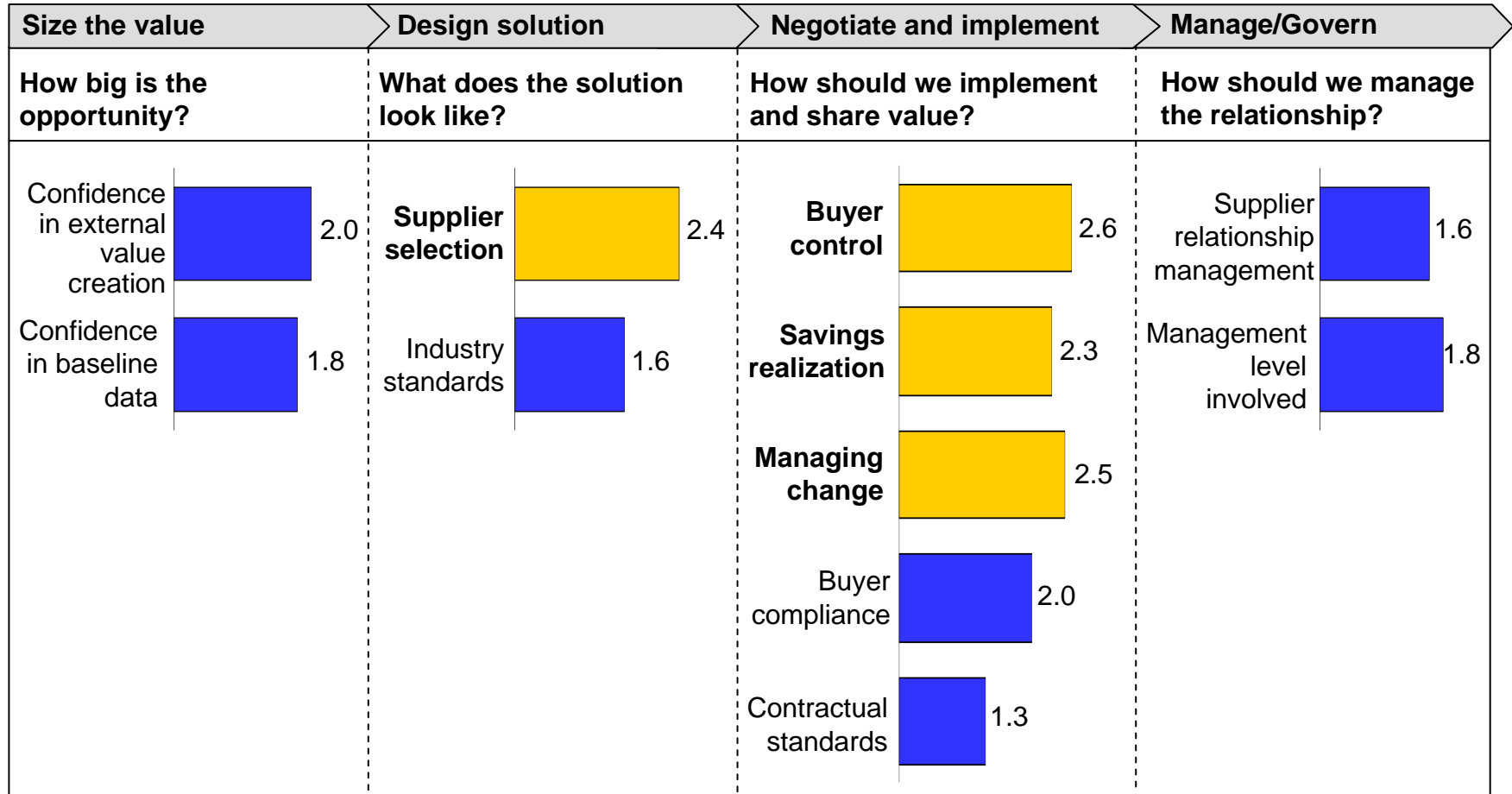


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## Elements required to support outsourcing

Level of concern<sup>1</sup> on a scale of 1 to 3 (1=Low, 3=High)

 Elements of high concern



<sup>1</sup> Aggregate scores from survey responses

Sources: Everest Research Institute; PO supplier interviews; Everest experience

# The following questions need to be answered by the industry to set standards and best practices for addressing these concerns in PO

## Addressing the supplier selection concerns

### Key questions

1

#### Capability building

- How can suppliers build capabilities to both demonstrate and capture potential value?

## Addressing the breakdown in outsourcing practices

### Key questions

2

#### CXO sponsorship

- How should CXO involvement be leveraged during implementation to lend credibility and ensure buyer adoption?

3

#### Scope definition

- Can certain processes and categories be outsourced first to minimize loss of control and create a learning environment?

4

#### Pricing structure

- Can risk-reward standards emerge that balance upfront investment sharing with future gain-sharing?

5

#### Governance model

- Can conflicting demands be prioritized to create organizational alignment around change?

6

#### Retained organization

- How can the service management skills required for the retained organization be better articulated to support the overall initiative?

Source: Everest Research Institute



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Everest Research Institute has the resources, experience, and capabilities to provide companies with the strategic intelligence, analysis, and insight that are crucial to making the right decisions in today's outsourcing marketplace.

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