



**Expense Reduction
Analysts**

The Psychology of Procurement

Uncovering the barriers to business growth
in tough economic times



Contents

The Psychology of Procurement Uncovering the barriers to business growth in tough economic times	00
Contents	02
Executive summary	03
Business strategies for turbulent times and beyond	04
Psychological barriers to business growth strategies	05
The key to smarter spending and smarter procurement	07
A smarter spending psychology	08
Conclusion	09

Executive summary

As the UK teeters on the edge of recession, CEOs and financial directors (FDs) are facing the tough challenge of mastering the delicate balance between cutting and managing costs to survive today, and investing to grow tomorrow. Unfortunately, many Boards only consider the short-term picture and immediately default to a defensive cost-cutting mentality. This mindset often means that more effective and sustainable strategies such as effective procurement and smarter spending are either ignored or are incorrectly implemented by inexperienced employees.

With this in mind, Expense Reduction Analysts (ERA) commissioned this research piece – **based on a survey of 100 FDs in the UK and Ireland, across nine key industry sectors at enterprises with revenues between £10 million and £500 million.**

The research uncovered the following psychological barriers to business growth strategies:

- A lack of understanding at board-level of the strategic value of procurement
- A lack of internal procurement skills
- Resistance to internal procurement by internal departments
- Inefficient supply chain partnerships

Taking into account the research findings, ERA's team of industry specialists have come together to create this report to highlight how organisations can begin to overcome the psychological barriers to business growth by implementing:

Next generation procurement

- to ensure effective procurement becomes a part of every organisation's DNA – led from the board room to the shop floor to the supply chain
- ensure that procurement is not an empty seat in the board room

A smarter spending psychology

- ensure **all staff adopt a smarter spending psychology** – just because your staff are good at purchasing core products, it doesn't mean they will be good at 'indirect spend'
- ensure performance management is aligned to a smarter spending psychology
- it's essential that **internal and external reporting** provides accurate measurements and detailed business intelligence to allow the FD to provide strategic guidance for future procurement strategies
- conduct **regular evaluations of your supply chain** and build **closer relationships between your staff and suppliers.**

In addition to providing insights to help businesses grow, this report aims to help organisations realise the strategic value of procurement aligned with smarter spending habits – and highlight the factors influencing the psychology of FDs and businesses at a time when the traditional options for delivering success and growth are having limited success.

Business strategies for turbulent times and beyond

While the causes of tough economic times vary, the strategies available to businesses in recession have remained fairly consistent. The Chartered Institute of Management Accountants (CIMA) identifies retrenchment, investment and ambidextrous as three broad strategies for businesses to adopt during difficult economic conditions.

However, none of these paths help businesses ensure the psychology, and culture of employees and supply chains, is up to the challenge. We believe both have a major influence on an organisation's behaviour, and particularly on the psychology of FDs when tackling a business's financial performance.

In fact, the majority of FDs surveyed (77%) stated that their company would implement a defensive approach when dealing with financial difficulties.

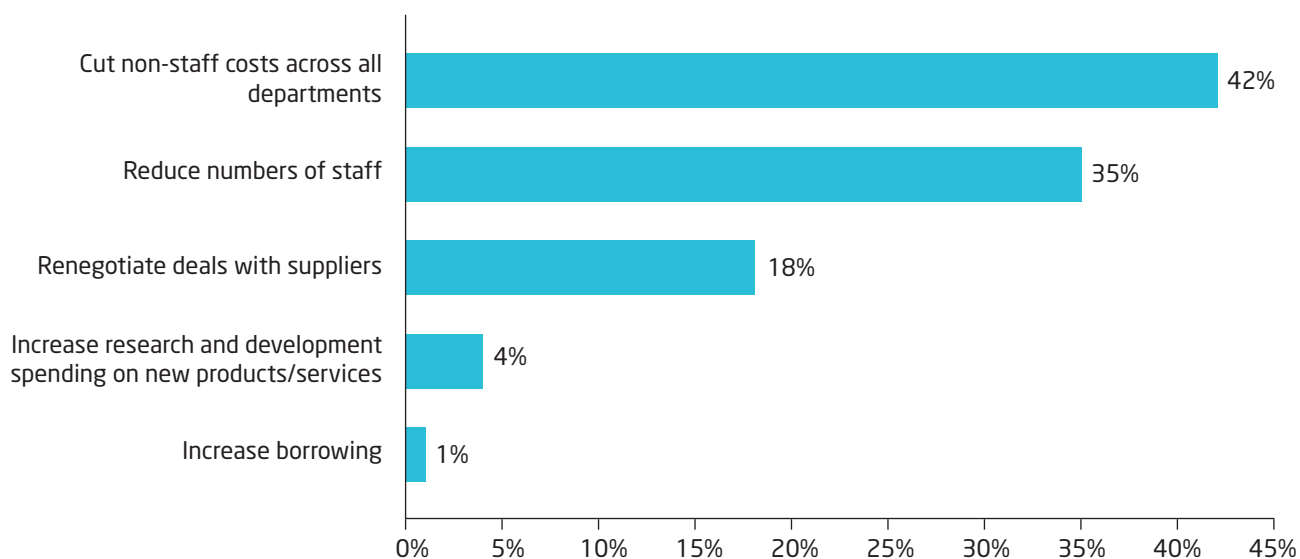
And only 4% would look to increase research and development spending on new products and services.

Given the current economy, this defensive approach and lack of innovation by companies is a natural reaction and unsurprising. But look behind the data and it quickly becomes clear that FDs have to work within a defensive environment because they're hindered by internal and external factors which prevent them from implementing more strategic business strategies.

'Purchasing isn't discussed at board level at the moment, but I'm ambitious to get it there. It's because of the history of the company. When you've been growing at a double-digit rate year after year, you don't focus on the cost and you don't focus on value for money, because it's all about doing something to grow the top line.'

Danone Baby Nutrition, Ireland

Hypothetically, if your company was in financial difficulty, which of the following actions do you think it would be most important for the business to take?



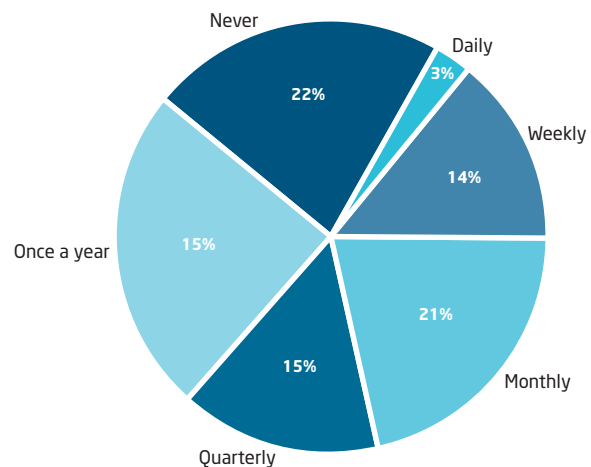
Psychological barriers to business growth strategies

Understanding of procurement at board-level - for any business to grow, it needs cash. And if you asked the CEOs of FTSE 100 companies how they raise money, their responses would likely be a mix of more borrowing, increasing sales and profits or cutting costs. If you then asked them how procurement could help improve cash flow, the majority would associate it with cost-cutting initiatives.

This lack of understanding of the potential benefits procurement offers can have a major impact on business performance. If the board only ever uses procurement initiatives to cut costs, they will only ever achieve short-term benefits, and not reap long-term sustainable results.

The UK government has been banging the cost-cutting drum for the last few years. But using the £31.8 billion wasteful spending by Whitehall departments since 2009 as an example, it's clear that this cost-cutting rhetoric hasn't had a positive effect on growth, or indeed on the psychology of those buying and delivering our public services.

In the private sector, the board often looks to the FD to manage and control the spending behaviour of their organisation. But our research found that **almost half of the FDs surveyed stated that their company discussed procurement at board level only once a year or never.** Naturally, this has a huge impact on the spending psychology of both the FD and the company's employees.

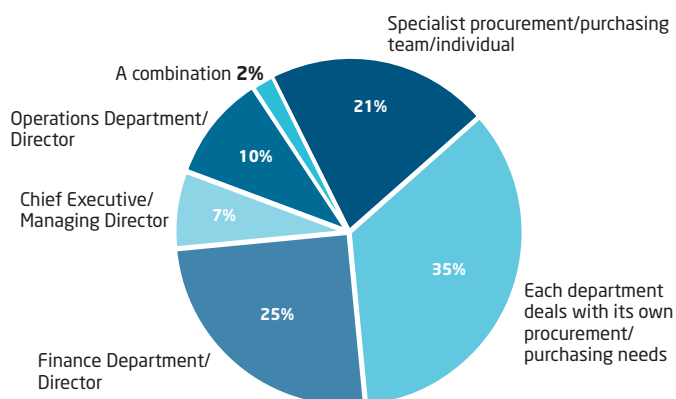


It's clear from this statistic that the boards of UK and Irish businesses do not understand or appreciate the impact their approach to procurement is having. And as long as they hold this belief, FDs will find it extremely difficult to change procurement psychology and improve long-term spending habits to help free up cash flow.

With this in mind, if procurement is to deliver true strategic value, then the FD must be given a seat at the board room table in much the same way as sales and marketing directors have been over the last couple of decades.

- **Lack of internal procurement skills** - the knock-on effect of a lack of understanding of procurement at board level is a lack of procurement skills among other employees. If board-room psychology dictates that procurement is only ever used to cut costs, then it's no surprise that enterprise-wide investment in procurement initiatives, expertise and skills will be minimal.

To illustrate this point, the survey found that **4 out of 5 organisations don't have a specialist procurement team or individual, while more than 1 in 3 leaves responsibilities to individual departments.**



This lack of expertise is compounded by the fact that **52% of FDs feel employees suffer from a lack of time, experience and energy when it comes to securing the best deals from suppliers.**

And only 1 in 10 felt their employees had excellent attitudes to procurement with the right level of experience and time to find the best deals.

In addition, 58% of FDs stated that some departments have resisted efforts to establish professional procurement practices, while 57% felt some departments believed procurement was hindering the effectiveness of their department for the sake of cost cutting.

Taking all these points into account, you begin to see how the psychological approach of the board room is impacting on the culture and behaviour of the employees spending the cash.

More importantly, as the banks aren't as open to lending, if businesses are to achieve the growth that their investors and boards demand, then money has to be raised in part by changing the spending habits of staff.

'We need to get deeper into departments that aren't embracing our processes.'

Thistle and Guoman Hotels

- Inefficient supply chain partnerships - in addition to the many internal psychological barriers to growth, management of the supply chain is another key component impacting on business performance.

If we consider the lack of understanding at board level and a lack of skills, time and experience in the workforce in relation to smarter spending habits, it is obvious why many supply chains aren't effective.

A successful supply chain is dependent on mutual trust and understanding. And like any marriage counsellor will tell you, you get out what you put in! So we were surprised to find that only 21% of FDs surveyed viewed their suppliers as partners.

However, there is more to this figure than meets the eye. If you consider the impact that the recession has had on all elements of the supply chain - with costs rising and sales falling on all sides - it is easy to explain the lack of warmth towards suppliers.

Unfortunately, if a business has a history of using procurement as a short-term cost-cutting tool to renegotiate deals with the supply chain, it is unlikely to treat that business as a long-term trusted partner. And this trust is crucial to a smarter spending psychology that delivers a successful supply chain, willing to deliver flexibility on pricing and innovation in goods and services.

The key to smarter spending and smarter procurement

Next generation procurement -
One common thread that this research has highlighted is that procurement rightly or wrongly has a negative reputation in organisations of all shapes and sizes. This perception problem is a big challenge for FDs, boards and procurement departments to redress.

However, if an organisation buys into the strategic value of procurement - and really thinks beyond procurement as a simple cost-cutting tool - it has the potential to positively impact on the psychology, culture and business performance of every organisation.

An example of how change can have a positive impact is the effect digital and social media has had on businesses. The companies that have adopted the right psychological and cultural approach to digital and social media have an open customer communications culture. They have become more accessible, offer better customer service, better products, more competitive rates, and smoother transactions.

Businesses must also ensure that effective procurement becomes part of their DNA - from the board room to the shop floor to the supply chain. A positive psychology should be extended to every company purchase, from the major IT spends to the small sundries like office stationery. And the organisation needs to help FDs to set policies and benchmarks so performance can be measured and ensure targets are met.

An effective next-generation procurement psychology should always be underpinned by the creation of a smarter spending culture across the whole of an organisation. This will go a long way to removing the negativity generally associated with procurement.

71%

of FDs believe procurement is not viewed as a strategic function

'Organisations must start thinking long-term instead of short term. Cutting costs may keep businesses afloat temporarily, but it won't enable them to compete long-term. A smarter spending strategy, combining effective cost control and development for innovation and investment is the only way businesses will be able to successfully ride this storm.'

Rob Allison, managing director, ERA

A smarter spending psychology

As we've found from this survey, procurement's value is often misunderstood and in some cases is viewed extremely negatively by some internal departments. So to help organisations change their procurement psychology, we've provided some smarter spending tips to help break down some of the barriers to business competitiveness and growth.

'Best practices have been adopted throughout the business as we've increased the sophistication of what we have done. We started with the low-hanging fruit to prove the worth of the procurement department. Then, when we had proved our success, we put the polish on.'

Thistle and Guoman Hotels

- **Changing the board's procurement psychology** - the FD needs evidence to stand any chance of changing the board's procurement psychology. It's essential that internal and external reporting provides the right intelligence on what needs to change and the likely outcomes. This gives the FD the data to provide strategic guidance to the board for future procurement strategies.
- **Ensure your employees understand your procurement psychology** - the right results don't just fall into place because the board implements a new procurement strategy. Staff will need support and training to help them adopt a smarter spending mindset. Changing a procurement psychology is a cultural change - and that takes time and commitment. Just because your staff are good at purchasing core products, it doesn't mean they will be good at 'indirect spend'.

And make sure this training includes everyone...

'We had a Plan A or a Plan B to remain profitable. Plan A involved increasing sales and margins and controlling costs. Plan B was to make pay cuts to save money - we presented both to our colleagues. They embraced Plan A, which involved setting up a cost control group.'

UnicarePharmacies

- **Evaluate and improve communications with your supply chain** - set about building closer relationships between your staff and suppliers to ensure both parties understand the change in your procurement psychology. The cultural change will lead to better relationships, and ultimately more flexibility on pricing and innovation in goods and services. Regular third-party evaluation will ensure that your new procurement methodology delivers lasting value.

'The survey results demonstrate a disconnect between the finance director and procurement. This illustrates a cultural issue which should be addressed - if nothing else, finance directors must be equipped with procurement knowledge and the appropriate skillset. Ultimately, finance should drive and influence procurement, enabling businesses to free up cash, drive growth and deliver more sustainable and profitable smarter spending habits.'

Rob Allison, managing director, ERA

Conclusion

Good procurement is not simply about cutting costs. It needs to go much deeper. Regardless of the economic environment, attitudes towards procurement need to change from the top to the bottom of organisations.

Businesses should not rely simply on cost-cutting strategies to survive, increase competitiveness and drive growth. A smart partnership with suppliers, married to a culture of smarter communication with customers, employees and the supply chain, is more likely to free up cash, drive growth and deliver more sustainable and profitable smarter spending habits.