PANDORA'S E-PROCUREMENT BOX

a report by
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Pandora was the first woman on earth, created by Hephaestus at the command of Zeus to punish lucky people for Prometheus' theft of fire. In spite of Prometheus' warnings, his brother Hermes took Pandora as his wife. She found a box containing all kinds of disasters. Out of curiosity Pandora opened the box and all its diseases and disasters were let loose on the earth. Only hope clung to the rim as Pandora swiftly closed the box.

This ancient myth springs to mind after three years of experience in the field of e-procurement. It may be exaggerated to associate e-procurement with diseases and disasters. Ariadne's clue, a means of bringing clarity into a confusing situation, might be more appropriate. But then again, the hosannas of e-procurement are deafening. So there is a real need to cry out, in order to be heard.

E-procurement emerges

What is happening? In the mid-nineties much was made of conducting business on the Internet. At the time most projects were sales-driven and consumer-focused. Researchers predicted a multibillion-dollar electronic commerce market within only a few years. However, the great majority of consumers did not leap on the Internet to do their home shopping. The excitement of Internet-based commerce shifted to the B2B (business-to-business) market. This was simply a logical move, because there are far fewer players in this market yet sales volumes are much higher. Once again a multibillion-dollar market was prophesised.

Initially, the approach adopted on the Internet was sales-driven and failed to make a break-through. In 1996 GE gave birth to a Web-enabled procurement system. A 1997 survey conducted by McKillen and Associates uncovered massive potential for improvement in relation to all non-product related (NPR) spending. The buzz shifted to procurement as the Internet's real hot spot. This represented a sound and logical insight. It drew widespread attention, initially from the technology sector. New IT companies were founded to produce

Web-enabled procurement applications. Some of them have developed a truly global reach within only three to four years. No wonder this did not go unnoticed by the financial sector, especially venture capitalists and the stock markets. The new economy surfaced. E-business predictions of great promise materialised in unprecedented share price explosions.

So far, so good. There is a business case for e-procurement. The e-procurement solutions offered by the IT industry seem to be convincingly logical, enabling companies to reap great benefits from their NPR expenditure.

There is even more to this story. The e-procurement applications deliver an end-to-end solution, connecting end users with suppliers. The focus of these solutions is predominantly on streamlining and automating all highly manual <u>internal</u> processes, from requisition to payment. New opportunities were also discovered in the <u>external</u> procurement processes, leading to virtual markets with several characteristics: horizontal and vertical markets, (reversed) auctions, exchanges and hubs.

E-procurement extolled to the heavens

The global marketplace is becoming extremely excited. Enormous interests are at stake, as staggering amounts of funds have since shifted to the new economy. Both the IT and the financial sectors are receiving considerable media attention. Research firms are producing a flow of e-business survey results. The e-procurement application suppliers are bombarding the market with intensive sales campaigns.

In 1999 the ERP market collapsed, resulting in a severe shortage of contracts for the numerous ERP consultants. Widespread occupational resettlement occurred in the sector. The constituted order of consultancy firms wholeheartedly embraced e-procurement. They bombarded their customer base with meetings, seminars, publications, and direct sales in their efforts to initiate e-business projects. Where the market failed to respond

rapidly enough, the IT suppliers and consultancies, both groups having substantial earnings at stake, engendered an atmosphere of anxiety by stressing the need for their 'victims' (targeted prospective customers) to act before their competitors did. Many 'business brains' must have found themselves spinning and tumbling under the pressure they experienced, even more so when their stock market price appeared to be acutely sensitive to the announcement of an attractive and prompt e-strategy.

Is the sun hiding behind the clouds?

It is striking to note that the hosannas are growing louder by the day, whilst an attentive observer cannot fail to observe this year's signs:

- AMR Research has concluded that over half of the 600 US marketplaces surveyed, had not yet processed a single transaction;
- Deloitte reported that only 10% of US organisations had done business through an auction, in most cases limited to a one-off experience;
- Gartner recently published a report on e-procurement entitled 'Blessing or ink-black nightmare?'.

Based on these signs and my own experience in the field, I can vouch for the fact that the path towards success in e-procurement is a narrow and tortuous one. Organisations should realise that this path has never been walked before.

Real-time e-procurement experience

I ran into a series of e-procurement traps. Several of them have not been thoroughly investigated. You may consider some of them to be the untested opinions of a procurement professional. The aim, however, is not to provide proof of e-procurement challenges, pitfalls and risks, but to summarise findings, impressions and obstacles, to present food for careful thought before one leaps into e-procurement adventures.

But first of all, let me stress that e-procurement as such is a legitimate business case. Organisations do spend a lot of money on non-product-related issues. The majority of this spending occurs throughout the organisation and is spread over dozens of spend areas and often thousands of suppliers. NPR procurement is a manual and costly process. Automating this forgotten business process would yield great benefits. If so, then what are the obstacles to e-procurement's break-through?

First generation e-procurement systems only offer basic functionality

IT technicians and consultants have revealed the potential for improvement referred to above. Logical analysis and thought have led them to develop systems that are apparently sound. Where they fail, is in their approach to procurement. The IT solution was designed by streamlining what was perceived to be an administrative process.

- Whereas NPR procurement is professionalising and is moving away from simple spot-buying to supply management and integrated sourcing, many e-procurement solutions downgrade this process to mere shopping.
- Only through the implementation of an e-procurement system does one notice that each and every spend area establishes its own unique set of rules and demands. As a result of this, systems need to be adjusted on the fly. System complexity consequently increases as each spend area is added.
- Different spend areas demand their own sourcing strategies. E-procurement systems do not respond to this.

Undoubtedly next generation e-procurement systems will offer templates that are specific to each spend area.

The e-procurement business is far more complicated than it seems

- NPR spending covers some 50 to 80 different spend areas. There is little doubt that a negligibly small number of companies can justifiably claim to control the majority of these spend areas. In the past few years only leading-edge companies around the world have devoted attention to their major NPR spend areas and this with varying degrees of success. There is a golden rule for implementing e-procurement: only automate those spend areas that are well-organised, managed and controlled.
- An e-procurement system transcends all organisational boundaries. Implementation demands that every business unit and department actively support and embrace it. It will be a real challenge to convince everyone that automating the purchase of stationary deserves high priority.
- Many spend areas relate to other existing IT systems. The demand for connectivity could easily eclipse IT input in the e-procurement system itself.

First generation e-procurement systems are of USA design

Global application suppliers offer their systems to each and every part of the world. This may be good for them, but one size does not fit all. Europeanising a US solution involves more than the introduction of multiple languages and currencies.

- These systems are designed for automating US processes as analysed. At the very least, it is questionable as to whether European processes are quite similar, for instance. My impression is that there are distinct differences between the optimal US situation and its European equivalent. Indiscreet implementation of the standard e-procurement processes could cause organisational paralysis.

- The European market is far less computerised than that of the US. In Europe considerably more effort will be required to introduce suppliers to the system, while the economic base required to bear the transformation costs involved, is much smaller than in the US. This is a burden borne by e-procurement pioneers.

Content management is a major burden

E-procurement depends heavily on content: content consisting of millions of products, thousands of suppliers, and numerous conditions and contracts. Not flat, product-based catalogues, but procurement-enriched content. Organisations tend to have even more suppliers than employees. Corporate ownership of content covering more than a handful of spend areas, is something that is well out of reach, even for major corporations. The future lies in the hands of third-party content providers, setting global classification standards for content and creating economies of scale through their customer base.

E-procurement could be a threat for suppliers

Mechanisms that force transparency in a world in which suppliers use every effort to differentiate themselves from their competitors, can count on violent resistance. Especially in markets, dominated by one or only few suppliers, opportunities for e-procurement are poor. Yet even in more open markets, serious doubts still persist about e-procurement's added value for suppliers.

In those markets where e-procurement does prove to be beneficial, companies are tempted to continue to extend their dominant position, for instance by bundling their procurement volume with that of other companies. This,

however, might end up into conflict with the competition authorities.

The Internet stands for anonymity, e-procurement demands the opposite

The more professional purchasing becomes, the more careful purchasers are about whom they conduct business with. E-procurement and the Internet can create market transparency and track the lowest price. A professional purchaser, however, sources his requirements using many more criteria than price alone. Mutual trust between trading parties is – in almost all cases – crucial. Unknown or even anonymous suppliers (or customers), payment systems that are not fully secure, and unreliable supplies constitute serious obstacles. Mass Internet procurement is facing an as yet unforeseeably long incubation period. Virtual sourcing exploiting the openness of the Internet is not likely to evolve into big business. Favourable exceptions are found in activities relating to:

- low-interest routine products,
- safeguarded trading communities,
- automating existing transaction-intensive relationships.

Many virtual markets offer technology instead of a value proposition

The above-mentioned e-procurement traps are similar and perhaps even more of a threat to virtual markets. Technology alone will definitely not convince and attract customers. In the case of those scarce virtual markets that do have an attractive business proposition, the question remains as to whether they can endure the e-business incubation period.

Promises, promises

E-procurement savings are normally expressed as 5% or so in the form of improved procurement conditions plus 60-70% in process savings. E-procurement system suppliers and consultants tend to compute these savings in relation to the total NPR procurement volume and the total number of NPR transactions. Surely, this makes the e-procurement investment extremely appealing. The reality, however, resists this conclusion.

It is most likely that initially the system will only manage to cover those spend areas that are already well-managed. This means that relative savings will be most modest precisely for the volume and transactions that are most suitable for e-procurement.

Secondly, the following shortcomings will prevent savings from being computed in relation to the total NPR procurement volume:

- during implementation it will prove to be impossible to incorporate specific spend areas in an e-procurement system, as they would excessively complicate the latter, their suppliers will not or will not be able to cooperate, their content will be impossible to manage, and/or their financial volume will be too small;
- for those spend areas that are incorporated into the system, only part of the volume will be channelled through it, mainly because individual users (or even complete business units) fail to make (full) use of the system.

The experience of the pioneers (in the USA) shows that at best 40% of the total procurement volume is e-procurable.

Summarising sane and insane e-procurement strategies

Without a doubt, e-procurement investments that can be justified, are:

- those made with the mere objective to learn (more) about business on the Internet. By the time the new economy becomes more mature, your organisation will be sufficiently skilled to develop a sustainable e-business value proposition.
- use of a procurement card for the majority of petty cash purchases and small spend areas.
- specific solutions for public tendering. Tender regulations are inflexible and are therefore stable enough to sustain this kind of solution.

Depending on the prerequisites, some specific to the industry, some to the organisation in question, the following e-procurement investments might be worth investigating:

- use of an e-procurement application to automate and streamline those few major spend areas, that
  ◊ involve a few suppliers with whom your organisation has a stable relationship,
  ◊ are very transaction-intensive,
  ◊ represent a substantial financial volume,
  ◊ are well-managed and under control and
  ◊ can be rendered in content catalogues.
- vertical markets could turn out to be valuable sources, initially and especially for large volumes of commodity-type product-related components and raw materials. However, here one needs to look before one leaps, as the virtual market is still in its infancy. I would not bet a lot of money on a specific case.
- (reversed) auctions are nice to try. Most auctions are not expected to fulfil the conditions for success, namely an extensive community of buyers and sellers. What is more, auctions stimulate traditional price-based shopping, as opposed to professional sourcing.

The following represent high-risk initiatives:

- any e-procurement strategy that is – wrongly –based on the presumption that it can encompass all spend areas. Most e-procurement solutions depend heavily on content (articles, conditions, suppliers). Content management, however, is a major burden. Even large conglomerates can only handle the amount of content required for a small number of spend areas.
- starting a marketplace of your own, with or without other parties. This is definitely a high-risk option. Marketplaces in open, highly competitive markets enjoy the best chances of success. The more a vertical market disturbs the existing market balance, the greater the risks.
- creating horizontal markets. Delivering generic, NPR products to the market, still offers as reliable a prospect of success as Russian roulette. The investments are enormous and – what is more – are in fact still incalculable. Besides, no-one knows yet how much time (years?) it will take before business people have enough trust in and feel comfortable with Internet buying.

Apart from the above-mentioned opportunities, it seems wise to suspend any major investments in e-procurements until:

- the expiry of the incubation period that people need before they feel comfortable doing business on the Internet;
- the next generation of Web technology. Microsoft has started to develop more intelligent browsers.
- the arrival of new-economy suppliers to whom you can outsource parts of your NPR-procurement, and:
  ◊ who will be here to stay;
  ◊ offering hosted e-procurement solutions;
  ◊ offering content management;
  ◊ offering procurement professionalism.

And last, but not least, the very best thing you can do is to make effective use of e-procurement's infancy by professionalising your (NPR) spend areas: make your businesses, processes and spend areas e-procurable

before investing in a system. The old-economy rule, organisation before automation, also applies to the new economy.

Your response to this report is very welcome at rietveld@compendium.com.