Market-Informed Sourcing: A game-changer for Procurement

How advanced sourcing tools can release significant benefits, but only if procurement reconsiders and adapts fundamental ‘category management’ thinking processes

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Spend Matters UK/Europe
October 2011
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Executive summary

Over the last few years, increased power of computing and advances in software have led to a range of improved sourcing platforms being made available by leading procurement solutions providers*. The most advanced of these can handle very complex tenders and perform complex analysis of the responses received.

Whilst some organisations have taken full advantage of these solutions, many have not, perhaps because of a lack of awareness of the power they offer, or a feeling that they are highly specialist and only applicable to limited category areas.

We also believe that another brake on their adoption has been solution providers using a range of different terms for the process and technology available. This contrasts with “Category Management”, a term and a process that spread relatively quickly through procurement (at least in terms of practitioners’ awareness of the technique). We therefore believe that it would be beneficial for both solution providers and practitioners to adopt a single term. In this paper, we propose to use the terminology “Market-Informed Sourcing” (MIS), which after some discussion with various key stakeholders does seem to sum up what makes this process different and valuable.

And valuable it is; we also suggest here that Market-Informed Sourcing is the most significant development in core procurement practice since category management. As such, it can fulfil some of the perceived gap that has been much discussed recently; that of the ‘next big thing’ in procurement.

Market-Informed Sourcing does not replace Category Management, but it changes the fundamental nature of the strategic sourcing process and requires a different approach process to be adopted by buyers. Market-Informed Sourcing allows the procuring organisation to open up options to the market, instead of narrowing down the defined requirement, which is the core of traditional Category Management. That enables the market to reflect back true economic factors in a manner that benefits the buyer. So the three key messages of this paper are:

• Market-Informed Sourcing does not replace Category Management, but it changes the fundamental nature of the CatMan / strategic sourcing process and requires a different process to be adopted by buyers

• MIS allows the procuring organisation to open up options to the market, instead of narrowing down options which is the core of traditional CatMan. That enables the market to reflect back true economic factors in a manner that can benefit the buyer.

• Market-Informed Sourcing is the most significant development in core procurement practice since Category Management

(*called optimisation, expressive bidding, or high-definition sourcing by various providers)
Procurement – looking for the ‘next big thing’

There has been much discussion this year around the future direction of procurement (or whatever we want to call it; sourcing, purchasing etc). It is not clear what has brought on this bout of introspection to the profession. Perhaps it is a feeling that procurement has been on a steadily upward curve for some 20 years now, but maybe that curve is flattening out now. While we still hear regularly about procurement success stories, with more senior executives heading the function, and making a major business contribution, there are other cases and organisations (less publicly noted in most cases) where procurement reputation seems to have fallen somewhat.

But in general, we would argue that procurement has been on a long upswing for the last 20 years or more. Why has this been the case? These have been the key factors.

• Organisations have developed a better understanding of just how much money they are spending externally.
• That proportion of external spend versus internal (staff) spend has grown for the vast majority of organisations, given greater specialisation and outsourcing, so the need for better procurement to manage the cost base has been emphasised.
• As well as cost-management, there has also been greater - though not uniform – understanding of what suppliers can bring strategically to the organisation in terms of top-line growth, innovation and so on.
• Supply chain risk, from supply interruption to corporate social responsibility issues, has also moved up the agenda over the last few years, and for many organisations has become an even bigger factor than cost savings in terms of the impact of the supply chain.
• Procurement has gained greater public exposure, from consultants, Institutes, press and media (e.g. the focus on public sector spend and savings in the UK).

But there are risks for procurement and procurement leaders. It would be complacent for professional leaders to think or expect that procurement must continue to grow in stature as a function. The biggest dangers include:

• Skills shortages – which could be technical or behavioural – meaning that procurement fails to meet their organisations’ needs.
• Greater focus on third party spend may expose poor performance and the lack of proper performance measures for procurement in some organisations.
• Technology that increasingly empowers users; enabling them to perform much that would have been the remit of specialists. External comparators also make users ask “why can’t acquiring the goods and services I need to do my job be as easy as buying from Amazon?”

So one key role for procurement leaders in every organisation is to keep abreast of the latest thinking and practice in the profession, to help ensure that procurement builds on its reputation and position. That outward facing approach enables the best organisations to stay ahead of the pack.

Market-Informed Sourcing: A game-changer for Procurement
The best get better...
Another trend observed over the last year or two is a divergence in procurement performance between the leaders and laggards. While there has always been a significant difference between the very best and worst organisations in terms of procurement, we would argue that this difference is increasing year by year, rather than performance converging, which might have seemed more likely.

Why is this happening? We believe it is a combination of three principle factors. Technology is one. As it gets better, more powerful, and more useful to procurement organisations (or indeed organisations who don’t have strong functions but still invest in technology), then those organisations that make full use of it will grow their lead over those that don’t. It wasn’t that long ago that a procurement leader could credibly say “I can do most of what the technology does manually, and what I can’t, doesn’t add much value anyway”.

This is simply not true now. State of the art spend analytics, advanced sourcing (as we will discuss later) or sophisticated purchase to pay capabilities are now way beyond what can be done without appropriate technology.

The second reason for the divergence in performance is people. The professionalism of the individuals who make up the procurement profession can drive greater benefits for the best organisations. But talented individuals are, we believe, less tolerant than previously of organisations who do not share their vision of where procurement could and should be. So, to be blunt, less good people will congregate in less good organisations, and good people tend to flock to the better places to work.

The third is around how procurement, as a function and group of professionals, work with key internal stakeholders; top management, budget holders, specifiers and users of goods and services bought. This topic deserves its own detailed examination, but it is clear that the top performing organisations have found ways in which procurement can work together with colleagues in a positive and results focused manner.

That’s not to say that procurement performance is set in stone. It is amazing how quickly a strong CPO, given access to reasonable resources, and with a positive and motivating approach, can turn an ‘also ran’ organisation into a very strong player. Some investment in tools and people, the ability to market to internal stakeholders what procurement can do; in months rather than years the situation can be turned round.

So, coming back to the next big thing, why is there such interest at the moment? Our suspicion is that it is actually a mix of weaker functions asking the question and looking for the magic solution that can transform their performance; and also high performing organisations looking to keep their edge and stay at the forefront.

We do not believe that there actually is a single ‘next big thing’ in all truth. However, as we’ll see in the rest of this paper, our view is that what we call Market-Informed Sourcing is as close as anything to fulfilling that role. But its fundamental effect on the design of core procurement processes has so far been poorly understood by most of the procurement profession; whether practitioners, consultants, academics or others.

But before we come onto explaining the change, we need to recap and briefly discuss the principles of strategic sourcing and category management.
Principles of Category Management

Category Management (‘CatMan’) has arguably been the most important development in the history of modern procurement. Although it was first applied by supermarkets and fmcg (fast moving consumer goods) manufacturers in terms of maximising profit from a sales category in stores, it soon spread to non-retail procurement situations, where its practical application is somewhat different from the way it was used in the retail environment. But once applied in general procurement, it took procurement into the pages of the business press and, by promoting a standard process that was clearly professional and could be linked to the organisation’s strategic objectives, gave procurement a credibility that has served the profession well over the last twenty years.

A.T. Kearney, the consulting firm, has some claim to be the founders of non-retail procurement category management.

But virtually every consulting firm introduced their own variant on a five, six or seven-step process, and most large organisations will now have their own version, often tailored to meet their own perceived needs and preferences. Fig. 1 below shows the high level 7-stage Category Management process that the author’s firm has used in consulting and is quoted in his co-authored book of 2010.

The core of this process is the development of the category strategy and plan. This approach requires the procurement professional to gain a good understanding of internal needs and the external market situation, then consider a range of approaches to the market, ultimately choosing the one that he believes will be the most beneficial to their organisation. In our view, as we’ll see later, Market-Informed Sourcing changes that process fundamentally.

Develop, implement and embed category management

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<td>Define scope &amp; category structure</td>
<td>Understand internal requirements &amp; stakeholders</td>
<td>Understand market &amp; suppliers</td>
<td>Develop category strategy &amp; plan</td>
<td>Select supplier(s)</td>
<td>Implement contracts</td>
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Iterative process

Fig.1 Typical Category Management process (Czerniawska, Smith, 2010)
Market-Informed Sourcing – what is it?
Over the last few years, increased power of computing and advances in software have led to a range of improved sourcing platforms being made available by leading procurement solutions and technology providers.

These automate and support with technology the process of engaging with the market and receiving proposals from potential suppliers, then choosing one or more suppliers to meet the buyer’s needs. This process can range from a basic ‘request for quotation’ through to complex tendering requirements with multi-attribute supplier selection models and dynamic pricing (such as reverse auctions).

At the most complex end of this range of options, what were initially called ‘optimisation’ processes became feasible with the growth in computing power at a reasonable price. This processing power enabled solution providers to develop software that could handle bids from multiple suppliers containing thousands (or more) of options and elements, and calculate the ‘optimal’ allocation of work between the suppliers.

The affordability of massive computer power now means that very complex tenders can now be managed in a manner that was not possible previously. So the technique was first used widely in transport tenders, where often there might be thousands of routes, load options, pick up points and destinations. Historically, buyers would break up the requirement into manageable pieces; or aggregate into a single ‘managed service’ Prime Contractor contract, without looking too hard at detailed prices. Now, a tender can ask for detailed responses across all the options, and the technology can analyse and identify the ‘best’ outcomes. As the technology has developed, it also enables suppliers to not merely respond to what is asked of them, but to propose their own variants on the requirement, or to suggest different commercial options. We’ll look further at the sort of responses that are possible in a later section.

In a mathematical sense, what the technology does is ‘optimise’ – choose the ‘best’ (which may or may not be lowest cost) solution, the optimal from the buyer’s perspective.

But different providers have used different terminology to describe their offerings; so we see optimisation, expressive bidding, high-definition sourcing and other terms used by various technology providers.

The purpose of this paper is not to give a detailed technical description of how Market-Informed Sourcing works. It is rather to suggest that it is more significant than most procurement professionals have realised. It is, if not the “next big thing”, certainly very important to the ongoing development of good procurement practice. In our view, it is already a key differentiator between the very best procurement performers and the rest; and it requires us to look again at category management (‘CatMan’) and what has become seen as the standard process.
How Market-Informed Sourcing changes Category Management

In this section, we’ll explain the three fundamental arguments of this paper. Here is the first.

Market-Informed Sourcing does not replace Category Management, but it changes the fundamental nature of the CatMan / strategic sourcing process and requires a different process to be adopted by buyers.

We are not claiming for a moment that Market-Informed Sourcing negates the value of the entire CatMan process. Indeed, it has no impact at either ‘end’ of the CatMan process. In the initial phases of the process, there is still a need to understand the organisation’s needs, and the market dynamics, and to understand broadly supplier capability. And at the downstream end of the process, contract and supplier management (often weaknesses incidentally in the overall implementation of CatMan) are just as important as ever; although, as we will see, optimisation does lead to some potential differences in how to best execute those phases of the cycle.

But the very heart of the category management process, as we have seen, is the development of the category strategy and plan. It is during this phase that the process takes all the inputs – the internal information around needs and requirements, and the external information about markets and suppliers, and works out the best way in which to engage with the market.

So this strategy development might typically involve the category manager considering issues such as these.

- Insourced/outsource options
- How to define the scope of the category or the tender
- Whether to consider a prime contractor solution, or multiple suppliers, and how to bundle the total category requirement
- How many suppliers are required (or commercially ideal)
- The geographic spread of the requirement and of the market solution
- The phasing and any seasonality aspects to the requirement
- The length of contract, including any options for termination or extension
- The core product or service specification
- Acceptable options for bundling, volume discounts, or conditionality

Of course, however well executed the process and diligent the people involved, the category manager is still working on imperfect information. She cannot be sure that all the economic factors that apply in that category have been assessed fully; in a sense, (s)he is trying to second guess the market and suppliers’ own preferences and cost structures in order to arrive at a strategy that is most beneficial for her organisation.

But historically, she has been forced to take a view on these matters, because the approach to the market must be clearly defined by procurement (or indeed another functional manager), covering the sort of points in our list above. Why was that the case?

Because the only way to make a sourcing exercise fair and manageable was to bring the requirement down to a common understanding. Evaluating multiple proposals that weren’t standardised was just too complicated and difficult; even calculating the lowest-cost overall solution could be beyond the capacity of the procurement executive if thousands of different options could be proposed by multiple suppliers. We just could not cope with suppliers offering alternative specifications, supply timing options, price / volume breaks, conditional incentives and so on.

Now the increase in computing power, and the sophistication of the new sourcing platforms we mentioned earlier, means that these old limitations can be blown away where it makes sense to do so.

And that is critical because the market – potential providers
within it to be precise – in most cases know better than the buyer which supply options will offer their customers best possible value for money and performance. So contracting in a manner that allows suppliers to express options and propose a range of alternative commercial solutions opens up the buyer to true market dynamics. With the technology and the analytical power that is now available, the buyer can now consider the different options; even if there are literally millions of potential ‘solutions’ to the requirement.

Our second key proposition is therefore this.

Market-Informed Sourcing allows the procuring organisation to open up options to the market, instead of narrowing down options, which is the core of traditional CatMan. That enables the market to reflect back true economic factors in a manner that benefits the customer.

So, the implementation of Market-Informed Sourcing changes quite fundamentally the way we need to address the core of the category management process. Instead of the category manager sitting in a (proverbial) darkened room, with a damp towel wrapped around his head as he thinks about the ‘best’ strategy, the market can in effect do much of that work. The task for the category manager before the initial contact with the market is to define the requirement, in the widest possible terms, and define the different attributes that the market is invited to address in their response.

There will of course still be constraints. Raw material X (let’s call it ‘carrots’) is still required at a number of factories across Europe perhaps, and the quantity of carrots per month in total may not be open to negotiation – although of course it might be if there is some flexibility in factory scheduling. The specification for carrots may be fixed; or again, there may be some flexibility (we won’t accept anything less than Grade B carrots, but we might be interested in seeing the price differential between Grade A and Grade B at different times during the year).

The enquiry to the market for carrots is therefore presented in a manner that enables potential suppliers to suggest options, to express interest in subsets of the total requirement, or suggest conditionality. This enables the buyer to understand far better than through conventional procurement methods exactly what the market dynamics are. The true cost of supplying to different locations; of seasonal issues; of different specifications; all of these can be made visible through a well constructed Market-Informed Sourcing enquiry.

In terms of the skill-set for category managers, instead of the current ability to, in effect, second-guess the market in developing the strategy, the skill needed now is in structuring enquiries to the market and then interpreting the results to gain maximum benefit.

Another way to look at the change is that we are reversing the funnel of category management. In the traditional process, the strategy development is all about narrowing down the requirement and the approach to the market so that all suppliers and offers are forced through the narrow part of the ‘funnel’ – mainly so we can make the fair comparison that procurement strives for and have a manageable amount of data coming back to analyse.

But now we can reverse the funnel. (A watering-can perhaps as the analogy?) The strategic thinking goes into considering how broad we can feasibly make the enquiry. The widest possible range of options can then be considered by the market, and their response should reflect the true market costs and preferences in a manner that allows the buyer to choose their most preferred solution; one that will reflect the true market situation.

We can see now what a fundamental change Market-Informed Sourcing actually is; from the customer organisation trying to predict the market through development of a constrained tender, to an enquiry that enables the market to respond reflecting true preferences, and that the customer can then analyse in order to choose their ‘best’ contracting outcomes.

That is a fundamental change; and leads to our third and final key proposition.

Market-Informed Sourcing is the most significant development in core procurement practice since Category Management.

Market-Informed Sourcing: A game-changer for Procurement
An example of Market-Informed Sourcing
Let’s consider a requirement to go to market for Facilities Management services for a large organisation with 5 subsidiary operating companies, occupying 30 sites in total across 7 European countries.

The category manager starts developing the strategy, and without consciously thinking about the ‘funnel’ effect, she considers how to narrow down the options. Do we want a Total Facilities Management (TFM) concept, with a Prime Contractor managing the whole supply chain? Or many specialist providers; or something in between (perhaps bundling all the maintenance type activities together, but keeping catering and cleaning separate)? Do we want one supplier for each country; or is it better to look at the operating company as the ‘unit’ for tendering. How many suppliers do we want for each site, or each sub-category?

How long should the contract be? Do we want to see different pricing options based on length of contract; and do we want fixed price, or open book plus margin; or pass through and management fee in the case of a TFM solution? Are there any major seasonal effects to consider e.g. long factory shutdowns? What about the requirements – is there any flexibility there or do we want to set a firm specification?

Now, a good category manager may make some effort to talk to the market about some of these factors; but many don’t, and in any case the final strategy development tends to be a set of internal judgments, which she hopes reflect market costs, dynamics and preferences tolerably well. The final tender then hits the market; and it stipulates (for example) a TFM approach, with scope for a different supplier per country, a 3 year contract with pass through costs and a management fee, and a well-defined specification. Then, she waits to see how the suppliers respond.

Now – we turn the funnel into our ‘watering can’.

We can use an Market-Informed Sourcing platform to ask potential providers to offer pricing for individual services, by site, plus offers for aggregating the elements in whatever way suits them (by country, by type of property, or operating company). We can invite other bundled offers (‘if you give me all the cleaning and security we’ll offer a further 3% rebate’). Offers might be invited for a 1, 3 or 5 year contract. We can actually see how the cost structures break down in terms of costs for individual services, management fees and so on. Alternative specifications can be tested; give me a price both for daily cleaning and a three times weekly regime.

And of course, most importantly, the platform can cope with this avalanche of data, and turn it into meaningful sourcing options. It can identify the lowest cost option, and then tell us what the impact of moving away from this option would be, or the effect of introducing certain constraints.

We may choose to go back to the market again to explore some further options; or we may take a solution directly. But in effect, we’ve seen the ‘funnel’ reversed; we’ve opened out to the market rather than closing them down.
What are the constraints of Market-Informed Sourcing?

Of course, Market-Informed Sourcing is not appropriate for every area of spend and every contract.

1. Very simple contract requirements or categories may not justify the time or effort needed to run a Market-Informed Sourcing process. If the requirement is very clear and there is no possible benefit in opening options up to the market, then clearly Market-Informed Sourcing is not justified.

2. Market-Informed Sourcing may not be suitable if there may be reasons above and beyond the normal commercial objectives that mean, for instance, an organisation wishes to develop a partnering relationship with a particular supplier. While there is no reason why Market-Informed Sourcing should be seen as indicative of an adversarial relationship (see later comments), a decision may be taken to put a chunk of business the way of a particular provider, even if a genuine approach to the market might lead to a different result.

3. Even where Market-Informed Sourcing is worth using, judgement still needs to be applied in terms of how many options are invited and considered. So (to take a ridiculous example) to make the point, based on our contract discussed above, you wouldn’t look to dis-aggregate your FM requirement to the level where you asked for pricing per floor of every building for the cleaning element of the contract.

4. There will need to be careful thought around how Market-Informed Sourcing can be used in the public sector, but we see no intrinsic reasons why that is not possible; for instance, within a Competitive Dialogue process. Indeed, it is immediately obvious how useful Market-informed Sourcing could be in public sector spend categories as varied as complex military construction projects or purchasing of social care resources and placements for local authorities.
Market-Informed Sourcing:
A game-changer for Procurement

Benefits
The benefits to the customer organisation are clear.

Cost reduction – evidence is emerging from users that engaging the market in determining the best solution to the buyer’s requirements can generate cost reductions and value improvements of 10, 20% or more. And that is even for organisations that have considered themselves as competent and experienced in terms of traditional category management practice.

Innovation – allowing suppliers to generate their own ideas in terms of how they meet the buyer’s needs can lead to new ideas and innovation in different areas. It may be innovative in the sense of how supply is organised and structured; or it may be innovative in terms of the actual product or service provided.

Speed and resources required – the automation of Market-Informed Sourcing and the speed at which complex sourcing events can be handled can reduce the cycle time for the end to end procurement process. Automation also reduces the effort and resource needed from procurement staff; useful in an era where pressure is constantly on internal cost structures.

But there are also benefits to the CPO personally and to the credibility of the procurement team. We go back to some of our early comments about the challenges facing the CPO, and the constant search for the ‘next big thing’, and we believe embracing Market-Informed Sourcing can help senior procurement leaders by;

• improving their internal credibility through delivery of significant value improvements;

• demonstrating their ownership of a leading-edge technology, which although user-friendly will require procurement to play the role of expert user and process owner;

• making visible the cost of constraints set by stakeholders e.g. the true cost of a particular specification or desire to use a certain supplier; and

• demonstrating that the organisation is at the leading-edge of procurement thinking and action, which builds stakeholder confidence and becomes a potential recruitment tool.

And there are even benefits to suppliers. Principally, Market-Informed Sourcing provides the supplier the ability to offer what they know is the best solution, based on their own economic situation and the market, rather than purely what the buyer has narrowly defined. The speed of the process also helps reduce the resource required for suppliers, and it is interesting to note that a number of Market-Informed Sourcing users have commented to us that the ability of suppliers to offer alternatives increases the ability to build a truly strategic, collaborative and mutually beneficial relationship. The process is, for instance, seen by suppliers as less of a blunt instrument than a simple reverse auction.
Conclusions

Market-Informed Sourcing, as we have seen, brings considerable opportunity, but requires a change of mind-set from many stakeholders within the procurement eco-system, and significant adaptation of the ‘traditional’ category management/strategic sourcing process.

We would suggest therefore that different groups of stakeholders need to look at the following.

Procurement leaders and senior managers generally need to get up to speed with this opportunity, if they are not already, or risk being left behind by competitors who are. The divergence we see between best and worst performers in the procurement sphere is at least in part down to successful adoption of these processes and tools.

Procurement practitioners need to get familiar with this approach. In some categories (not all) it will become the dominant sourcing methodology over the next 5 years. Experience and knowledge in this area will certainly be a differentiator for leading organisations looking to recruit their next generation of procurement leaders.

Procurement advisers; consultants have made Category Management a foundation for much of their work over the last ten years, whether it was transformational, introducing CatMan to organisations for the first time, or delivering savings through more hands-on operational programmes. We would suggest that consulting firms now need to ensure they understand how Market-Informed Sourcing changes the fundamentals of CatMan, and be able to include updated capability in their offerings to clients.

Procurement academics and educators; while changing syllabi takes time, we would suggest that CIPS, ISM and other bodies offering professional certification should start the process of incorporating this thinking into their material. Academics will we suspect find some interesting aspects of MIS to consider further and in a more rigorous manner than we have covered here. As a technique, it is intrinsically mathematical, and very data-driven, so there should be some worthwhile avenues for proper academic research to follow.

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Market-Informed Sourcing: A game-changer for Procurement

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Peter has 25 years experience in procurement and supply chain as a manager, procurement director, consultant, analyst and writer. He edits Spend Matters UK / Europe, and with Jason Busch, the founder of Spend Matters in the US, has developed it into a leading web-based resource for procurement and industry professionals. Peter is also Managing Director of Procurement Excellence Ltd, a leading specialist consulting firm, and is recognised as one of the UK’s leading experts in public and private sector procurement performance improvement. Peter has an MA in Mathematics from Cambridge University, is a Fellow and was 2003 President of the Chartered Institute of Purchasing and Supply, and his first (co-authored) book, “Buying Professional Services”, was published by the Economist Books in June 2010. Before moving into consultancy, he was Procurement Director for the NatWest Group, the Department of Social Security (the DSS), and the Dun & Bradstreet Corporation, and held senior positions in the Mars Group.

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Buying Professional Services (Czerniawska and Smith, Economist Books, 2010)
About BravoSolution
Supply management executives are now, more than ever, under pressure to deliver more savings, develop and manage strategic supplier relationships, accelerate procurement cycles, and maintain process excellence. Confronted with these diverse yet consistent challenges, CPOs and sourcing professionals must seek tailored solutions that deliver rapid ROI to their business.

BravoSolution offers leading software and services to fit the needs of today’s sophisticated supply management organisations. Our services organisation, one of the world’s largest teams of professionals dedicated exclusively to sourcing and procurement consulting, delivers lean, targeted services to support strategic sourcing and procurement initiatives.

Our industry leading software toolkit supports the full supply management lifecycle across myriad industries, geographies and business models.

As of today, over 40,000 procurement professionals in 60 different countries are benefiting from BravoSolution’s technology and service – unlocking tangible benefits such as increased process efficiency, decision support, cost reduction, improved process governance, greater quality relationships with vendors and the ability to share, understand and act upon the wealth of sourcing-related data held within their organisation. Locations in the United States, United Kingdom, Italy, France, Germany, Spain, Benelux, Mexico and China.

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