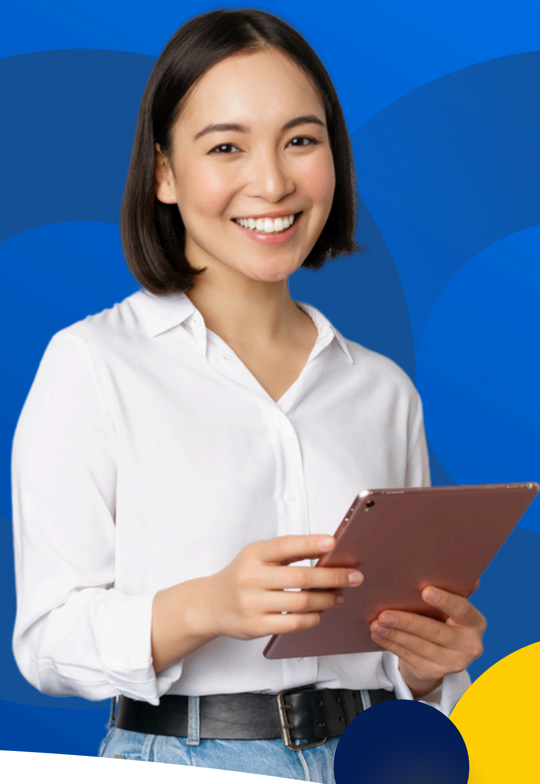
10 Key Performance Indicators (KPIs) to Effectively Evaluate Your Procurement Process

E-BOOK



Procurement key performance indicators (KPIs) are a hot topic. But while tracking core metrics may seem a worthy goal, many companies struggle with what to monitor—and what to do with the procurement data produced.

The need for actionable procurement metrics has become increasingly vital in recent months. High inflation has businesses scrambling to find cost savings in the procurement function. Cost optimization depends on accurate data, and procurement metrics are the best way to target and measure the impact of cost-cutting strategies.

As Amazon's Business 2024 State of Procurement Report shows, 53% of procurement decision-makers expect increased budgets in the next year, and 98% plan further investments in analytics tools, procurement automation, and artificial intelligence solutions. Procurement KPIs will play an essential role in assessing the impact of these technology strategies, just as investment in technology will help businesses measure KPIs more accurately.

To help you start on the right foot, we've pulled together ten procurement KPIs to give you a holistic understanding of your procurement process's performance. While this list is far from comprehensive, it's a good starting point for understanding the health of your spend, supplier relationships, and process management capabilities.

Spend Management & Cost Savings

Spend management is the foundation of an efficient and strategic procurement strategy. The following five procurement KPIs represent a solid starting point for understanding the health of your procure-to-pay cycle.

1.

Total cost savings

Measure the financial impact of procurement strategies.

Ultimately, procurement aims to acquire necessary goods and services in as cost-effective a way as possible. So naturally, one of the first procurement KPIs you'll want to track is the total savings achieved by your procurement operation.

The cost savings KPI measures the reduction in overall expenditure achieved through cost-saving initiatives and strategies. It allows the business's procurement team to track the impact of contract negotiations, process optimizations, and technology implementations.

Cost savings is a holistic KPI that focuses on both hard savings and soft savings. **Hard savings**, such as unit cost reductions and volume discounts, immediately impact the bottom line. **Soft savings**, alternatively, are usually reductions in process costs, such as reduced time expenditure due to procurement automation efforts.

While total savings can stand on its own as a procurement KPI, you can also supplement it with additional metrics:

- **Total cost reduction** measures the amount you save by reducing the cost of your goods and services through procurement best practices.
- **Total cost avoidance** measures the amount saved by avoiding purchases or price increases.
- **Price competitiveness** measures how the prices paid by an organization for goods and services compare to the market standard or to the prices paid by competitors. Understanding price competitiveness can help procurement leaders uncover new opportunities to reduce spending. Even if market benchmarks prove difficult to track for an accurate price comparison, a similar technique can be applied internally to find price discrepancies within a business—a process made feasible by modern spend visibility software.

Spend under management

Track the proportion of spend controlled by procurement.

2.

In a perfect world, all of your company's spending would be managed by procurement and funneled through preferred supplier contracts. That's often easier said than done, so it's important to monitor the proportion of managed spend and the proportion that escapes management and oversight.

Managed spend is subject to procurement policies, procedures, and negotiated contracts. The more spend under management, the better procurement teams can optimize spending and implement procurement cost avoidance strategies. Increasing spend under management can also improve your leverage with suppliers and help you to fully realize the value of contract negotiations.

Additionally, tracking spend under management is key to identifying **rogue spending**. Transactions outside your procurement workflows are called rogue spending (or maverick spending). Monitoring this metric—and taking steps to bring rogue spending back under management—supports contract compliance and helps your organization benefit from the best available pricing.

Spend visibility

Ensure comprehensive tracking and analysis of spending.

3.

The spend visibility KPI monitors the extent to which an organization can track, analyze, and predict its spending. The goal of spend management is a clear, comprehensive understanding of all organizational spending. That requires the collection, classification, and analysis of spend data to gain insights into where money is spent, whether buyers are likely to stick to budgets, and opportunities for cost savings.

Spend that the organization can't see is at risk of being mismanaged, leading to financial inefficiencies, unoptimized procurement practices, and missed opportunities for strategic supplier negotiations.

Modern SpendTech solutions provide a range of data collection and analytics tools that enhance spend visibility.

Contribution to total spend

4.

Balance supplier consolidation with flexibility.

Contribution to total spend breaks down the proportion of spending on individual suppliers and product categories within your overall spending.

Before the COVID-19 pandemic, procurement teams often aimed to consolidate spending to a small group of suppliers. Consolidation increases order value and volume with each supplier, giving buyers more leverage to negotiate favorable terms and lower prices.

The pandemic made it apparent that excessive consolidation leads to reduced agility and flexibility. If a supplier can't deliver, where does a company turn? They're forced to make emergency purchases outside of negotiated contracts or, at worst, to suspend production altogether.

Today, procurement professionals aim to balance leverage and flexibility. Consolidation remains a useful cost-reduction strategy, but it must be balanced by supplier diversity.

Contribution to total spend helps businesses to keep an eye on the health of their supplier base, **ensuring there is sufficient supplier diversity to manage risk** without ignoring price reduction opportunities.

Contract compliance

5.

Ensure spending aligns with negotiated agreements.

Contract compliance measures the proportion of total spend that aligns with existing contracts. High contract compliance indicates that a significant portion of the organization's expenditures are made through suppliers with whom it has formal agreements.

This is important because contracts are negotiated to secure favorable terms, prices, and conditions. Contract compliance ensures cost-effectiveness and predictability in spending.

A related metric identifies spend that is supposed to be directed at a specific contract but which is, in fact, spent outside of that contract, often with different suppliers. Low adherence indicates the prevalence of rogue spending, oftentimes increasing costs.

Supplier Management & Procurement Process

Buttoning up your spend management by establishing proper procurement KPIs can produce significant procurement performance improvements and cost savings, but they're not the only metrics that deserve your attention. Improving your supplier relationship management and procurement processes can also surface opportunities to cut costs, improve efficiency, and drive stakeholder satisfaction.

Percentage of digital suppliers

6.

Gauge supplier integration with digital systems.

This KPI measures the proportion of an organization's suppliers capable of integrating with the buyer's digital systems. It reveals the extent to which suppliers can engage in electronic transactions, such as receiving electronic purchase orders, submitting digital invoices, or providing punch-out catalog integration for seamless purchasing within an e-procurement system.

Digital procure-to-pay systems significantly reduce procurement process costs by eliminating manual work, improving accuracy, and enabling improved spend visibility. They also accelerate the procurement cycle through enhanced automation and communication. However, many of these benefits can only be realized to their fullest extent when suppliers are willing and able to transact electronically.

Supplier performance management

7.

Assess supplier reliability and quality.

Supplier performance management depends on a cluster of KPIs that provide valuable insights into supplier performance and quality. Return rates are a vital supplier performance KPI, measuring the rate at which goods or materials are returned to the supplier after being assessed as inadequate for various reasons, including:

- Incorrect quantities
- Incorrect items
- Damaged items
- Quality assurance failures
- Late delivery

Return rates can be helpful for tracking supplier performance over time—an increase in a supplier's return rate might be cause for concern—and benchmarking vendors against each other when negotiating contracts or making purchase decisions.

Other metrics relevant to supplier performance management include:

- **Supplier availability**: A measure of supplier's ability to meet demand.
- **Delivery lead times**: The time it takes for the supplier to deliver the goods or services after an order has been placed.
- **Pricing competitiveness**: How competitive the supplier's pricing is compared to other suppliers.

Procurement Department Process Management

Finally, beyond monitoring your spending and supplier relationships, it's crucial to track metrics that provide insights into the management of your procurement process, as this will enable you to further optimize your procurement operations.

8.

Purchase order (PO) cycle time

Identify and eliminate order process bottlenecks.

The PO cycle involves every step taken between making a purchase request and releasing the PO to the chosen supplier. The length of your organization's PO cycle time is affected by the efficiency and speed of order creation, approval, dispatch, delivery, and receipt.

Measuring the time it takes to complete this cycle—or even individual stages within this cycle—can reveal internal bottlenecks that are slowing down purchasing. For example, manual purchase request approvals can significantly slow PO cycle times while requisitions await approval before a PO can be sent to the supplier.

In contrast, PO cycle times can be accelerated with an integrated procurement platform that automatically delivers purchase requests to the relevant manager and provides an intuitive approval management interface.

9.

Orders per full-time employee (FTE)

Evaluate procurement team efficiency and productivity.

Orders per FTE represents the number of orders processed by one full-time equivalent employee over a specific period. It's used to measure a procurement team's efficiency and productivity, often to provide a benchmark to assess the impact of procurement process optimizations.

For example, when a company digitizes its procurement process with integrated supplier catalogs, PO automation, and invoice automation, it should expect to see orders per FTE increase in line with a reduction in time-consuming manual processing.

Procurement ROI

10.

Measure the financial effectiveness of procurement activities.

No list of procurement KPIs would be complete without including ROI or return on investment. Procurement ROI is the return on the money invested in procurement activities. It's a ratio that compares the gains (or benefits) achieved from procurement to the costs involved in procurement operations.

It's typically expressed with the following formula:

Procurement ROI = Annual Cost Savings ÷ Annual Procurement Costs

The importance and purpose of Procurement ROI lie in its ability to provide a quantifiable measure of the financial effectiveness of an organization's procurement activities. It serves as a crucial indicator of how well the procurement function contributes to the company's overall financial health.

Factors that impact procurement ROI include:

- **Strategic Sourcing**: Implementing strategic sourcing to ensure the best value in procurement.
- **Process Optimization**: Streamlining procurement processes to reduce costs and increase efficiency.
- **Supplier Management**: Developing strong relationships with suppliers to negotiate better terms and prices.
- **Investing in Technology**: Utilizing procurement technologies to automate procurement processes and provide better spending visibility.

Getting Started with Procurement KPIs

Identifying the right procurement KPIs can seem overwhelming, given the number of options available. However, procurement teams don't need to implement these and other metrics simultaneously to make a substantive difference in your procurement processes. Begin by assessing your current procurement strategy and tracked KPIs, and then add the 1-3 new metrics likely to have the biggest impact on your operations.

Over time, as your organizational sophistication around tracking procurement KPIs improves, you can always add new metrics to further improve your data-driven decision-making capabilities.

Transform Your Procurement with Vroozi's Best-in-Class SpendTech

Ready to elevate your procurement and AP processes to the next level? Discover how Vroozi's AI-powered P2P solution can drive cost savings, improve spend visibility, and enhance supplier management. Schedule a Vroozi demo today and see how our innovative technology can help your teams achieve their KPIs and streamline your procurement operations.

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