

## **E-PROCUREMENT OF DIRECT MATERIALS**

In today's competitive business world, the corporations are continuously looking for IT solutions to improve the efficiency of their business processes and there by cut cost of operation to improve their margins. The businesses are under constant pressure to improve their bottom line irrespective of the growth in top line. They have no choice but to adopt the new [e-procurement solutions](#), to improve time-to-market, reduce operations cost, avoid costly mistakes to stay on top of competition and avoid risk of extinction

In order to improve the procurement efficiency and realize maximum potential savings, it is necessary that the entire supply chain must be very efficient. The suppliers and the trading partners, such as shipping agents, clearing and forwarding agents and finance agents must be as efficient in order to provide the right materials at the right time at the right place at the right price at the right quality. This is only possible by a collaborative solution between buyers, suppliers and trading partners. It is important that the e-procurement solution must focus on collaborative supply chain practices in order to realize the fullest savings.

There are various types of procurement activities in an organization based on direct and indirect materials. The direct materials are items that are purchased for the production and the indirect materials (MRO items) are purchased for support of production activities. The features and the specifications of the e-procurement solutions vary for direct and indirect materials, depending on the procurement process of different vertical industries. Due to these varied requirements of e-procurement, different e-procurement providers focus on either different vertical industries or horizontal processes based on their domain knowledge and expertise.

[e-procurement solutions](#) come in different flavors and colors to cater to variety of industry requirements.

Vertical and Horizontal Exchanges  
Public exchanges for various vertical markets  
Private exchanges sponsored by corporations  
ASP solutions

The above technologies can provide efficient e-procurement solutions, but have limited scope in their effectiveness. Vertical exchanges focus on transacting goods in a single industry, product or material. They typically exist in industries where buyers and sellers are fragmented and inefficient. Horizontal exchanges focus on leveraging expertise in a particular business process across number of industries. Service industries lend themselves well to a horizontal exchange. The most active horizontal exchanges today are competing in the realm of e-procurement.

There are different market making mechanisms employed in vertical and horizontal exchanges. They are:

Auctions	One Seller, Many buyers
Reverse auctions	One buyer, Many sellers
Bid/Ask exchange	Buyers and Sellers interact

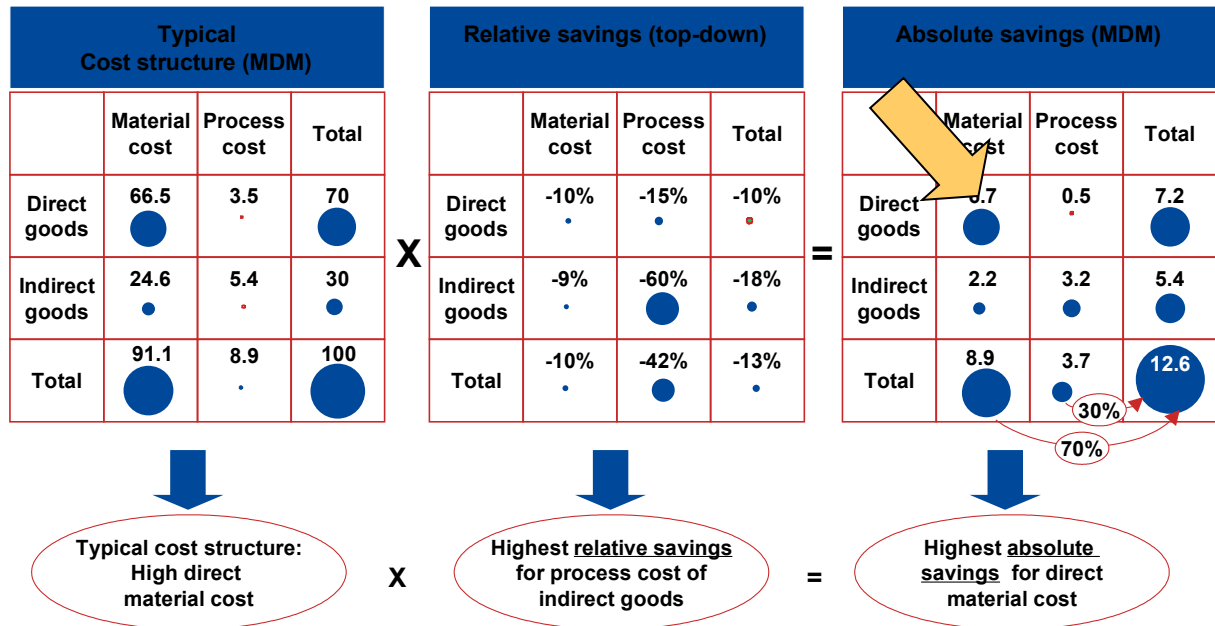
However, none of the above market place solutions completely satisfy the requirements e-procurement of direct materials. Following concerns of the businesses must be addressed in the procurement solution of direct materials:

1. Custom and unique procurement and approval processes of direct materials, which have been developed over years of experience
2. Protecting the intellectual property and secrecy of design, drawings, purchase and contract pricing and supplier details
3. Collaboratively perform procurement functions such as RFQ, Purchase Orders, Shipping and Payments between buyers, suppliers, and trading partners

4. Adopt best procurement practices

**Why focus on direct materials:**

Research has shown that direct materials present the maximum savings potential in a manufacturing setup. Following table shows the average savings potential for direct and indirect material in a typical manufacturing organization.



Source: BCG B2B study, August 2000

Businesses can derive variety of savings by implementing e-procurement solutions.

**The direct cost savings are as follows:**

- a. Lower communication costs      Fax and telephone costs
- b. Lower procurement operating costs      By reducing cycle time and improving efficiency of RFQ/PO processes
- c. Lower follow-up costs      By auto reminders and tracking RFQ/PO status
- d. Lower inventory costs      By lower supply chain time
- e. Lower Product costs      By improving supplier and trading partner's efficiency

**The indirect cost savings are:**

- a. Improved procurement efficiency      By higher levels of collaboration and no-paper transactions
- b. Avoid cost mistakes      By checks and balances in e-procurement application
- c. Lower obsolescence cost

## **e-procurement of direct materials:**

Manufacturing companies can automate their procurement of direct materials by collaborating with their existing suppliers and trading partners, such as shipping agents, clearing agents and finance agents to improve the operating efficiency and increase the margins. The direct materials that go into the Bill of materials, account for 70 to 80% of the purchases of companies. Most of the B2B exchanges and procurement solutions address only the MRO purchase, which account for only remaining 20% to 30% of purchases. In order to improve the bottom line of any manufacturing company significantly, it is imperative to improve the procurement efficiency of direct materials.

For direct materials, the companies would already have their approved suppliers and have their business relationship established over the years. Moreover, the prices of direct materials are already pre-negotiated to the wire and only scope of further reduction in prices is possible by improving operating efficiencies. Changing suppliers of direct materials is a long drawn expensive process as it involves extensive part/ vendor qualification and often requires elaborate reliability and product testing. The companies are not willing to break-up long standing relationship with existing suppliers and risk with unknown new suppliers, unless it is absolutely essential. E-procurement solution must automate the procurement of direct materials with existing suppliers and trading partners with out having to change the existing business/ procurement processes with suppliers and trading partners, there by reducing the operating costs and improves time-to-market.

e-procurement solution for direct materials must be based on the Collaborative Private Market Place model. The procurement of direct materials is a very complex collaborative process involving the many departments within the buyer organization (such as R&D, Purchase, Quality, Materials, Accounts, Finance, Legal, Manufacturing etc.), the suppliers and trading partners such as shipping agents, clearing agents, Banks and finance agents. Right information should be available to the right people at the right time to make the right decision in the procurement process. This custom procurement process is evolved in a company over the years of experience. The design specifications and drawings that are being exchanged in the design/ RFQ/ PO processes are very proprietary and the Intellectual property of the company. The Public Market Place have limited scope for providing customized business processes and may not cater to the security requirements. On the other hand, Private Market Places can lend itself for customization easily due to its limited private membership and security is less of an issue as it is being sponsored and managed by the buyer organization.

To summarize, following are the key advantages of Collaborative Private Market Place solutions for e-procurement of direct materials:

1. Realize the maximum savings potential of direct materials
2. Allows collaboration between buyers, suppliers and trading partners by hosting in corporate intranet/ Virtual Private Network (VPN)
3. Protect the intellectual property and secrecy of design and drawings by the very nature of being a private market place
4. Allows custom procurement and approval processes to be implemented by easy customization to meet the dynamic business needs
5. Helps to improve the efficiency of suppliers and trading partners by means of better vendor tracking and vendor management system

For more details or free trail about E-procurement, Please contact us at [www.xtenzasolutions.com](http://www.xtenzasolutions.com)

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