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# Controlling as a Support Tool for Generating Savings in Procurement

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## Abstract

*Procurement controlling process increases efficiency and reduces costs associated with improperly submitted orders. Most large organizations already appreciate the advantage to be advised by effectively controlling purchasing activities. Procurement controlling and procurement performance management are two synonyms for the same functional area. Through procurement controlling purchases received information that is relevant for their purchasing decision. Improving supplier performance is a challenge faced by many organizations, accordingly this, procurement controlling offers the right tools such as developing balanced scorecard. By developing a set of a leading performance measures, managers have the information necessary to identify opportunities for performance improvement.*

**Key words:** *procurement controlling, supplier performance, supplier scorecard, effectiveness*

## 1. WHAT IS MEANT BY THE TERM PROCUREMENT CONTROLLING

The purchasing process is a highly specialized service. A high level of professionalism and maximum objectivity must be applied to all facets related to a contract award decision.

For the procurement process, orders to suppliers should be handled on the basis of already negotiated terms and conditions. The performance of suppliers is incorporated in the list of improvement measures for purchasing and in the purchasing strategy in the form of a supplier assessment. The procurement process is only completed upon payment of the invoice, and in this regard, it is important to integrate the specific features of invoice auditing [9].

Controlling is the final link in the functional chain of a management's activities and brings the functions of a management cycles full circle. „*the goal of controlling is to recognize and solve problems or to propose measures in order to avoid similar problems in the future*” [7]. The purpose is to achieve as much as possible within available resources. For that purpose, we need rules of conduct and the game rules for the moderation process by means of which win-win solutions can be found „*Continuous application of operational and strategic controlling instruments will assure the improvement of the market position, as well as the realization of set goals and will successfully support the process of making decisions*” [8].

Unfortunately the procurement controlling isn't very well developed in most of the companies and in comparison with other controlling departments not very well stuffed. Especially when we consider the relation of controlled

spend and personal capacity in all of the different controlling departments procurement controlling is by far very tiny. One reason for this contradiction is the long lasting and difficult process that is necessary to implement the right IT-system and also to develop the right people with the needed experience and fitting skills [10].

Most large organizations already appreciate the advantage to be fired by effectively controlling purchasing activities, but many medium and small organizations have yet to reap the full rewards because insufficient recognition has been given to this function.

Procurement controlling and procurement performance management are two synonyms for the same functional area. The terms describe the tasks of supporting both strategic purchasing and operative purchasing with methods, processes, data, key figures, analyses and software. The objective is to efficiently manage the functional area of purchasing as a whole and to coordinate it with the predefined corporate goals. For this reason, procurement controlling usually linked very closely to financial controlling. In some companies, procurement controlling is subordinate to financial controlling, or even part of the finance department, so that no separate procurement controlling exists.

The key figures used in procurement controlling are specifically orientated toward the functional area of procurement, and within that, are positioned in particular toward strategic purchasing. They are mainly comprised of key figures concerning purchasing successes or savings (e.g. the so-called changes in material prices or negotiation successes), as well as key figures in regard to reporting areas such as compliance, automation and processes, procurement

volumes/ spend, conditions, working capital, quality, supplier reliability, supplier evaluations and many more. The responsible employee working in procurement performance management is referred to as the performance manager or manager of performance management (in purchasing). This position is equivalent to that of the purchasing controller. The performance manager reports directly to the chief procurement officer (CPO) in most cases. The purchasing controller provides services for both the individual purchasers and the finance department.

Data that has been recorded within procurement processing must be processed with suitable reporting to achieve the goals of procurement controlling.

Production and retail enterprises, but also public administrations, must increasingly ensure to reduce the costs for the production of goods or the purchase of consumption goods.

This is closely linked to procurement processes, which must sustainably and continuously be improved. In theory and practice, there are different controlling instruments you can provide to the respective decision makers within procurement controlling or purchasing controlling.

Procurement controlling is a part of operational controlling. It is used to enable the planning, control and supply of information for the provision of production factors for the operational production process.

Procurement controlling enables you to make the following decisions and definitions:

- In-house production or external procurement
- Determination of lower and upper price limits
- Optimal order quantity
- ABC analyses [3].

Through procurement controlling purchasers receive information that is relevant for their purchasing decision. The controller must ensure that purchasers are provided with the corresponding cost and business volume magnitudes from operational Financial Accounting. Based on this information you can, for example, determine the upper price limit of goods to be procured, and make decisions with regard to in-house or external production.

From an organizational perspective, procurement controlling can be implemented both by a central unit (e.g. central procurement department) and decentralized departments with appropriate "procurement competencies" and authority to make decisions.

In both application scenarios, procurement controlling must be integrated into the enterprise's organization in such a way that access to the relevant information is ensured at all times. Only then can effective and controller reporting be ensured. This enterprise-internal information is supplemented by data from external enterprises (vendors) that is relevant for the procurement process. This lets you take advantage of

the improvement potential both on the vendor and enterprise side.

In procurement controlling, you should consider all procurement processes of an enterprise that contain raw materials, commodities, services and assets. The goal is to achieve more efficient procurement processes, which can have monetary effects (cost savings) and nonmonetary effects (reduction of lead times).

An essential prerequisite to achieving these objectives is to ensure smooth communication and cooperation with vendors.

Another task of procurement controlling is to provide information about the enterprise's internal and external processes.

Moreover, evaluation criteria (e.g. procurement cost and quality standards) must be defined for objectives evaluations.

Information must be provided in suitable reports. The following sections describe possible report types in general, and explain the requirements of reporting – including the required report components.

## 2. REPORT TYPES

In general, we distinguish among the following types of reports:

- Standard or planned reports
- Triggered or variance reports (exception reporting)
- Individually requested or requirements reports (ad-hoc reports) [3].

The information submitted must be true, objectively verifiable, and up-to-date as much as possible, so that the user doesn't lose confidence in the reporting system or make decisions based on outdated data. Reports should be provided to the recipient at regular intervals, and indicate the objectives achieved in the past as well as the future prospects of the enterprise.

The information content can be increased considerably by delivering comparison objects. Individual information and totals should be clearly separated from each other, and exceptional situations will be quickly recognizable.

The profitability analysis should determine whether the potential for reducing process and procurement costs justifies the high investment and high operating costs. Therefore, you must carry out requirements and vendor analyses.

The goal of the vendor analysis is to analyze it to analyze the ability of individual vendors to enable internet-based procurement of goods that are categorized as catalog-capable.

Reporting is supposed to enable efficient procurement controlling by providing suitable real time reports with an appropriate level of detail. On the other hand, you must meet the requirements of revision-proof documentation of business processes.

### 3. PURCHASING ANALYSIS

Purchasing is generally the main cost pool in a company. Therefore, controlling and optimization of operating and strategic processes in purchase controlling, via planning and control mechanisms, is of crucial importance

The main objective is creating complete transparency in the entire purchasing process. Market or supplier price developments need to be measured. Supplier performance and delivery potential in the market requires a qualified consideration in order to achieve a comprehensive picture of the purchasing market. The task is to deal with the flood of information in the procurement sector and to condense this into meaningful figures in order to identify key messages and draw the correct conclusions.

Purchasing controlling not only determines and evaluates historical values. Future impact on cash flow is also determined, for example due to changes in payment terms. The control and steering of the purchasing budget is an important task of controlling.

Strategic purchasers require information about the supplier structure and need to be able to include opportunity and risk factors in their considerations and decisions. On the one hand, this helps to reduce dependencies and to strengthen the negotiation position for unplanned increases in volumes, and on the other hand, to safeguard the standard delivery extent against supply risks.

Purchasing controlling and supplier management generally aim to follow a standardized methodology for the analysis and evaluation of existing and potential suppliers. This standardization and validation logic allows for informed decisions in terms of procurement strategies.

Objectives of strategic purchasing and supplier controlling:

- Safeguarding and optimization of the competitive situation and maximization of competitiveness
- Increase of delivery quality
- Reducing procurement costs
- Minimization of procurement risks.

In the sector of operative purchasing control, the standardization of supplier evaluation also opens up possibilities for the comparison of performances and therefore the uncovering of potential for optimization and reduction of procurement costs.

Potential (cost reduction) as a result of bundling of subcontractors, needs to be made comparable with the necessary risk minimization of supply bottlenecks by diversification of the supplier structure.

Within the framework of the operative purchasing and supplier control, measures should focus on the following objectives:

- Improving the negotiation positions of buyers
- Uncovering of potential for optimization (cost and processes)

- Optimal ratio of diversification and bundling of purchase volumes
- Creating objectivity and transparency in supplier evaluation
- Identification of valid and reliable suppliers (quality, adherence to delivery dates, volume guarantee)
- Optimization of supply performance [8].

### 4. IMPROVING PURCHASING PRACTICES

Purchasing decisions largely control the type and amount of raw material that enter a company's manufacturing stream. Thus, efficient and waste – sensitive purchasing practices are critical to controlling inventory and ensuring that too many materials do not end up as waste. Efficient purchasing practices can reduce both the toxicity of waste and the amount of a product or package that is destined to become waste. Clearly, such practices can minimize the waste that results from over-purchasing materials which are the allowed to expire on the shelf. In addition, when creating purchasing standards, a company can go further by specifying the purchase of less toxic or more easily reusable products. Moreover, as part of its purchasing program, the firm can negotiate with suppliers to reduce the amount of packaging used in connection with the goods they provide.

The benefits of improved inventory control and purchasing practices include reduced costs for raw materials, decreased disposal costs for wasted materials, a lower risk of spills resulting from reduced handling and storage requirements, and a decreased need for storage space [6].

#### 4.1 Scorecard in Procurement

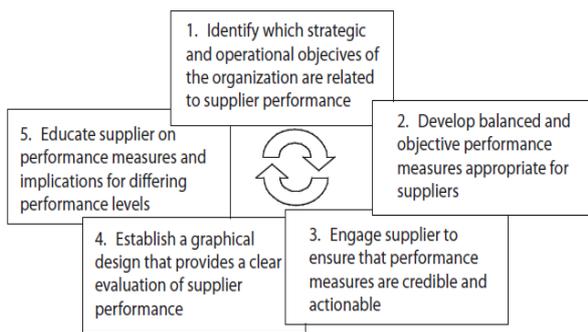
Improving supplier performance is a challenge faced by many organizations. Kaplan and Norton (1996) documented the potential for the balanced scorecard to serve as a strategic management system. By using scorecard to define organizational objectives in clear and operational terms, by providing feedback, and by enabling strategic review, a balanced scorecard provides a mechanism for strategic planning in an organization.

Similarly, scorecards developed for the purpose of supplier evaluation can and should also be tightly linked to the objectives of the organization. Doolen, Traxler and McBride describe one mechanism, the suppliers score card, for supplier performance improvement.

The performance measures contained in a scorecard are critical to the design and implementation of a successful supplier measurement process. Performance measures included in the scorecard must be objective, credible, timely and encompass the key aspects of a business.

Five steps were identified to assist in the development of performance measures and the creation of a successful supplier measurement process. The steps are summarized in Table 1.

**Table 1.** Design and implementation steps for supplier scorecard development [2].



Choosing appropriate performance measures is essential to developing an effective supplier scorecard. The set of balanced measures should be few in number and must focus on real, value-added results [1].

There is no standard template for a supplier scorecard, but a review of the literature identified three simple guidelines for creating a scorecard [5]. First, simple graphics can be used to compare monthly and year-to-date performances against established targets. Bar charts and /or tables are examples of display mechanisms that serve this purpose. Second, a simple color scheme can be used to aid in the interpretation of results. For example, a three color scheme can be very effective. Third, the scorecard should be limited to a few pages. An effective supplier scorecard can be created in one or two pages. Overall, the scorecard should be concise, accessible, and understandable to managers and leaders in both the supplier and customer organizations.

## 5. CONCLUSION

Introduction of controlling in the entire procurement process imposes itself as an important precondition for the development and survival of the company.

Procurement controlling involves the introduction, monitoring of a number of financial and non-financial indicators that are linked together in a cause – consequences relations. Procurement controlling must be integrated into the enterprise's organization in such a way that access to the relevant information is ensured at all times. Only then can effective and controller reporting be ensured. This enterprise-internal information is supplemented by data from external enterprises (vendors) that is relevant for the procurement process. This lets you take advantage of the improvement potential both on the vendor and enterprise side.

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# Kontroling kao alat za podršku generisanja ušteda u nabavci

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## Rezime

*Proces kontrolinga nabavke povećava efikasnost i smanjuje troškove povezane saneppravilno podnetim porudžbinama. Većina velikih organizacija već uveliko ceni prednost da budu savetovane od strane efikasnih aktivnosti kontrolinga u nabavci. Kontroling u nabavci i upravljanje učinkom u nabavci su dva sinonima za iste funkcionalne oblasti. Kroz nabavni kontroling, nabavka dobija informacije koje su relevantne za njihovo donošenje odluka o kupovini. Poboljšanje performansi dobavljača predstavlja izazov sa kojim se suočavaju mnoge organizacije, u skladu sa ovim, kontroling u nabavci nudi prave alatke kao što su razvoj uravnoteženih pokazatelja. Razvojem skupa vodećih mera performansi, menadžeri imaju informacije neophodne da identifikuju mogućnost za njihovo poboljšanje.*

**Ključne reči:** kontroling u nabavci, performanse dobavljača, uravnoteženi pokazatelji dobavljača, efikasnost.