

Best Practices in Utility Procurement 2020

PART ONE: Value Creation



Introduction

The utility industry is in the midst of a sea-change. In years past, excellence in procurement was seen as a mere feather in a corporation's cap. Increasing customer demands together with added cost and regulatory pressures, however, have driven this principle into the forefront of business strategy. Excellence in procurement has become a requisite within the industry and a driver of how leading companies can create value for customers. With a thorough understanding of dollar outflow and how organizations manage enterprise cost, it's increasingly more straightforward for companies to identify opportunities for improvement in procurement operations and to implement strategies to realize cost savings.

In this three-part whitepaper series, ProcureAbility will showcase findings from our recently conducted Utility Procurement Best-Practice Study, capturing the pulse of this dynamic industry in terms of 1) Value Creation, 2) Operational Excellence, and 3) Strategies for Growth. The findings from across the electric and gas utility industry provide a compelling snapshot of industry procurement practices, collective challenges, and future trends.

About the Study

The 2014 Utility Procurement Best Practice Study was conducted by ProcureAbility as a means to identify industry-specific best practices and organizational trends within procurement. The study elicited responses from procurement executives across leading electric and gas utility companies in North America.

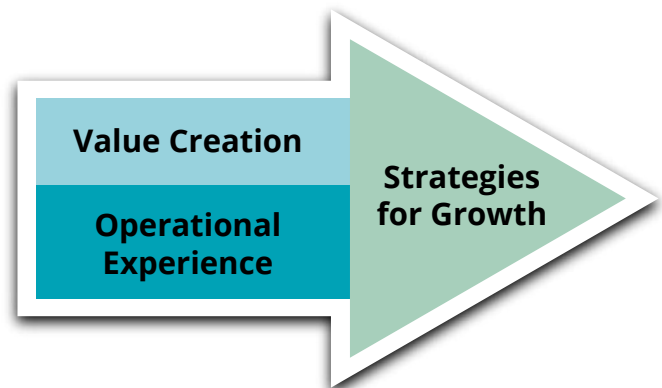
In conducting this study, ProcureAbility gathered and evaluated 53 quantitative benchmarks and qualitative practice points. The initial 20 participating organizations, with average revenues of nearly \$6.7 billion in 2013, formed the benchmarking study group. 85 percent of participants owned and/or operated systems relative to generation, 70 percent relative to gas, 85 percent to transmission, and 80 percent to distribution. Of the study group, two participants were transmission-only organizations, while one participant was generation only.

Participants completed a detailed survey with metrics and practices organized along three primary themes:

Value Creation—Practices and metrics relating to procurement's ability to generate value to the organization.

Operational Excellence—Practices and metrics relating to procurement's ability to operate efficiently and cost-effectively.

Strategies for Growth—Trends and anticipated changes in the procurement landscape over the next three to five years.



Prelude: An Industry Perspective

Below are statistics* that provide an overview of the electric and gas utility services industry.

- In 2014, shareholder-owned electric utilities are estimated to make record CAPEX of \$103B, up 14.4 percent from 2013.
- As of August 2014, U.S. utilities employed 560,000 people, an increase of 0.3 percent annually and 1.6 percent monthly.
- In the U.S., shares of natural gas in the electricity-generation mix expanded from 10.1 percent to 20 percent last year (2013).
- The Transmission and Distribution (T&D) future investment is estimated at \$819B from 2014–2035, the breakdown of which is 31 percent Transmission and 69 percent Distribution. This will go toward building infrastructure, refurbishment, replacement, and renewable integration.

Research also helps define current industry trends:

- Improved energy-efficiency efforts are resulting in a stagnant electricity demand in the U.S.
- Tightening regulations on coal plants, with continued transition in generation-fuel mix to shale gas and renewables.
- Regulatory, technological, and competitive forces are pushing the industry toward a potentially disruptive

phase, requiring innovation and new business models to meet challenges.

- Mergers and acquisition activity are likely to continue in order to gain synergies and take advantage of regulated rate-base growth opportunities.

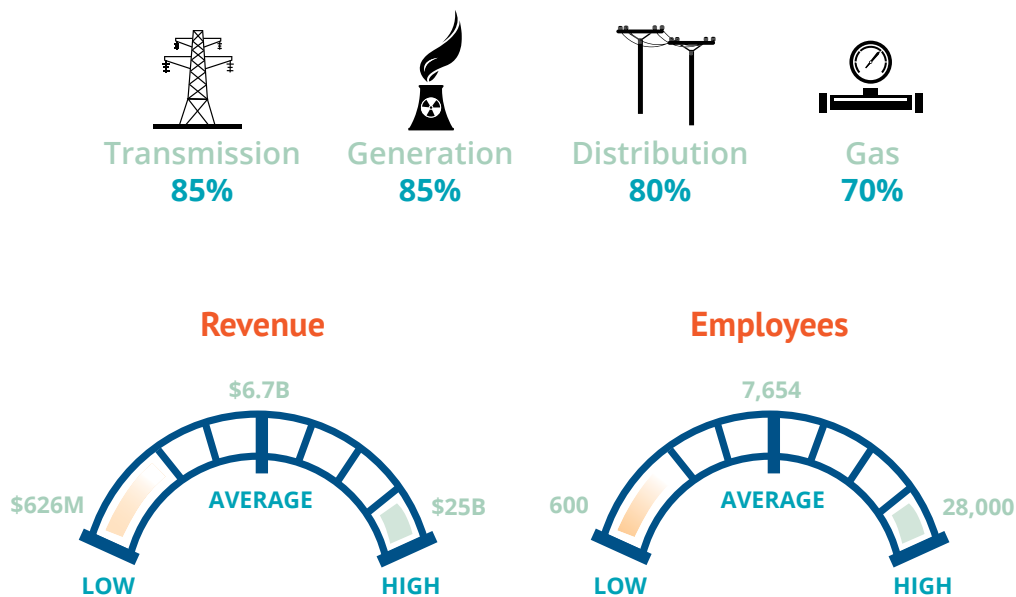
**Source Data: SNL Financial, EEI, EIA, BLS, IHS, MarketLine*

Value Creation

High-performing procurement organizations demand that value creation is a driving philosophy, both internally and among their supplier base. In order to do that, utility procurement organizations must first capture key data across all information systems and key suppliers, gaining visibility and control over enterprise spend. Key benchmarks must be quantified across cost, quality and service – along with capturing qualitative processes for comparison to best practice.

The participating companies were queried on various aspects of how value is created by the procurement organization and how much was generated given the workforce they had; data points were then captured and summarized. First a quick snapshot of the participating companies:

20 Participants



Around value creation, we have grouped responses by subtopic:

- External spending trends
- Savings and value generation
- Managing suppliers

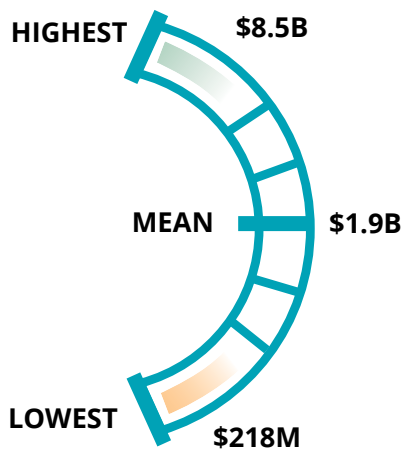
External Spending Trends

A prerequisite to delivering excellence across the procurement function is a spend analysis, which must be performed and validated prior to doing other strategic activity like sourcing, budgeting, or planning. As the saying goes, if you can't measure it, you can't improve it—and access to timely, accurate, and complete spend data offers invaluable intelligence in terms of identifying hard-dollar savings opportunities and determining spend-category strategies.

It is becoming more common for utility procurement organizations to routinely assess their dollar outflow: collecting, cleansing, categorizing, analyzing, and validating spend data over a fixed period of time is a must.

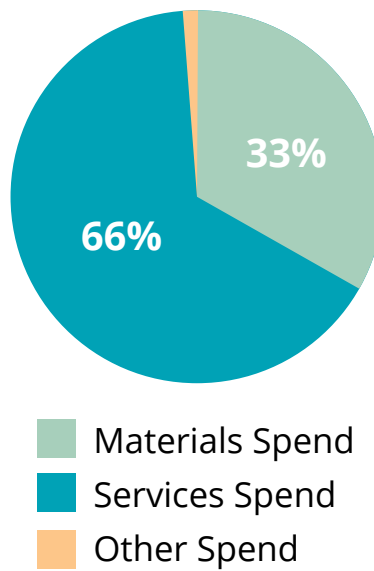
As part of the 2014 Utility Procurement Best Practice Study, ProcureAbility benchmarked participants across a variety of spend metrics.

Spending Ranges of Participants

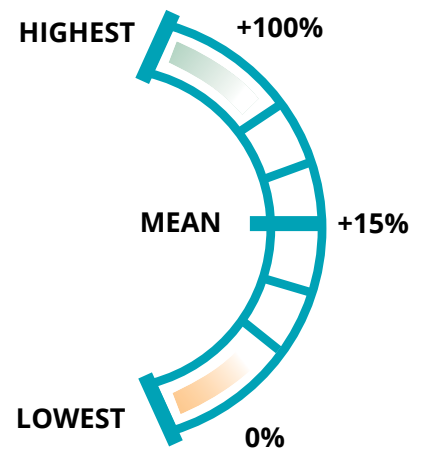


Total Spend

Spend Distribution



Expected Change in Spending Over the Next 2 Years

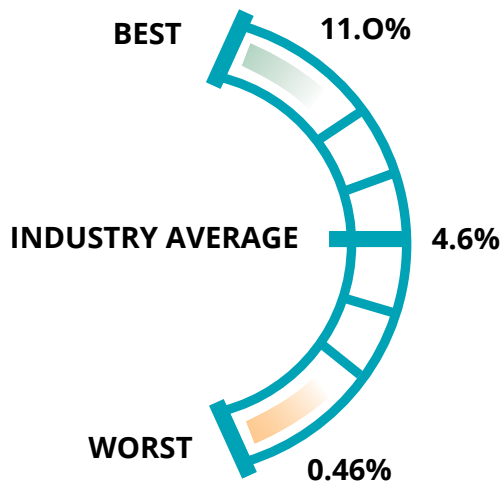


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The participant group reported average total revenues of \$6.7 billion and total external spend of \$1.9 billion. The breakdown of spend was 66 percent services and 33 percent materials, and they expected an average increase in spending of 15 percent over the next two years. In terms of supplier diversity, on average nearly 18.2 percent of spend was directed toward minority and women-owned business enterprises (MWBE).

Savings and Value Generation

Total Savings as a Percentage of Total External Spend



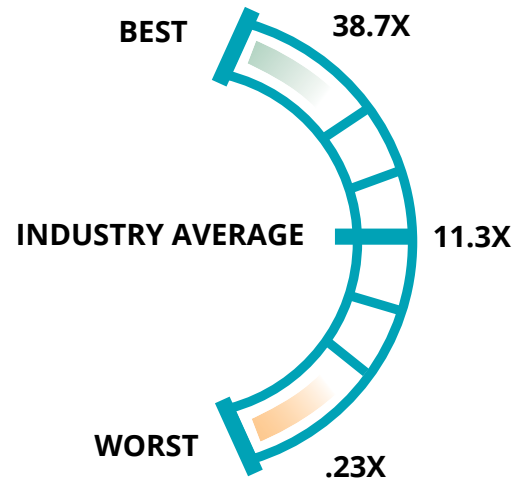
Complimentary to the work performed understanding the spend that procurements groups must manage, the real indicator of performance is how well spend is managed in terms of cost. Key Performance Indicators (KPIs) around savings generation play a valuable role in providing precise, measurable, and actionable metrics that often determine the success or failure of a procurement organization.

While total savings as a percentage of spend may vary year over year due to a variety of factors, it is often the metric most visible to company executives.

The 2014 Utility Procurement Best Practice Study found that nearly all respondents (95 percent) attempt to measure cost-reduction savings from procurement activities. In aggregate, respondents on average said that they were able to tie 4.6 percent of total savings directly to the efforts of the procurement organization. The value generated by utility procurement groups is significant though wide ranging, with just 0.46 percent savings on the low end to about 11 percent on the high end. Sustaining nearly 5 percent savings or more year after year is the real challenge, requiring dedication and innovation.

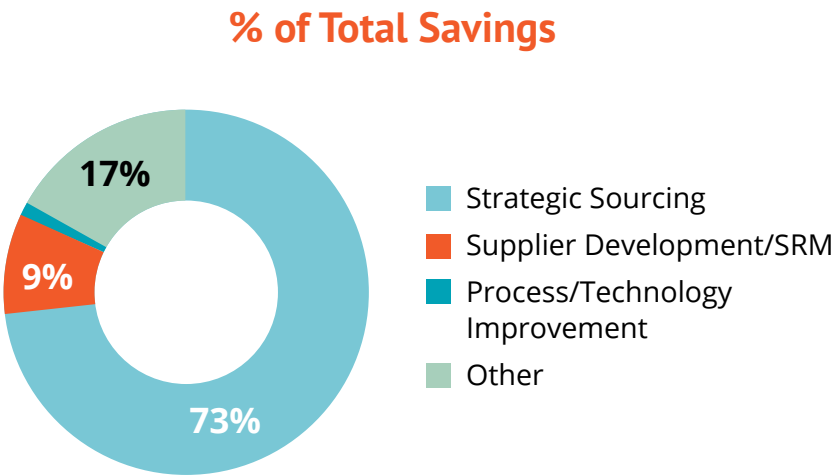
In procurement, another KPI is return on investment (ROI). This metric looks at the cost of operating a procurement department—considering salaries, benefits, and other overhead—and compares it to the amount of savings that the procurement department generates. While the industry average ROI was reported at 11.3x, the range varied from 0.23x to upwards of 39.7x.

Return on Procurement Investment



In determining your organizations return on procurement investment and targets for 2015, it's important to remain wary of targets exceeding the average, especially when claimed year after year. Simply put, progressive procurement organizations cannot maintain astronomically high ROIs, as their supply-chain maturity and cost-management practices inhibit the production of continuous and large-scale cost savings. Some companies may be able to generate only an ROI of 3x, while others may simply break even. The key takeaway, however, will be the business benefits achieved, such as process improvements, innovations, reduced lead times, and improved customer service.

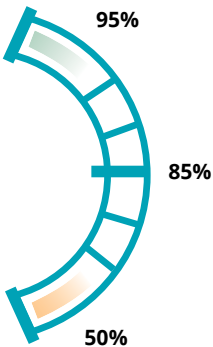
In terms of which procurement-related activities actually generate the value, it was clear that strategic sourcing is the primary contributor, with supplier development/supplier relationship management and process/technology improvement also as key contributors. The following graphic shows the breakdown of contribution.



Participants realize 65% of savings, on average as “hard spend” reduction savings (vs. cost avoidance)

Expecting that strategic sourcing would be a primary contributor to savings, ProcureAbility asked participants how many sourcing events they run annually, how much of the total spend is under procurement management, and what are some of the top categories that are not managed by procurement. Here is what we found.

Managing 85% of total corporate spend on average



% of Spend Under Management

Initiating 815 sourcing events each year



0% Change

95% of participants had categories that were not managed by Procurement. The top categories not managed were:

Fuel	Travel
HR Activities/Benefits & Insurance	Real Estate
Purchased Power	Rail Transport
Legal	

The study found that 40 percent of the participating utility companies strategically sourced products and services but were unable to systematically report on the number of annual sourcing events. Respondents of the metric reported an average of 815 sourcing events per year, equating to approximately \$77,497 in cost savings per event. We were also pleasantly surprised that, on average, 85 percent of total corporate spend is under management by procurement.

Finally, regarding the types of things being done to create value, respondents said the top procurement-led initiatives were as follows (with the percentage of respondents using this tactic noted on the left):

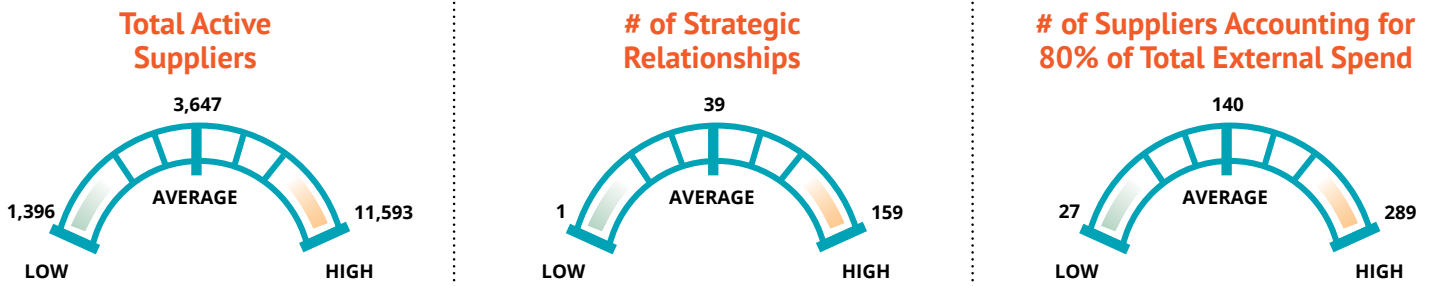
Top Initiatives That Created Value



Managing Suppliers

A final note on value creation: active supplier management is a vital component of procurement excellence. Before companies can cultivate approaches to developing, managing, and controlling their supply base, they must first define and classify that base. In the end, it is the strategic partners who are encouraged to bring innovation and improvement to the supply chain. Procurement works with those suppliers to optimize design, cost, quality, service, and cycle time.

In addition to managing the strength of your supplier community, it is important to manage the number of suppliers you are using. Below are some key data points from the participating companies.



Looking Ahead

Working with your organization's finance and/or business analytics team to extract and implement such metrics will help any procurement organization gain valuable insight into its effectiveness. Not only will this provide a thorough understanding of dollar outflow, but it can also identify opportunities for improvement in procurement operations and assist in developing new strategies to achieve cost savings.

To remain competitive, procurement organizations need to both evaluate value creation and critique its operational excellence.

We invite you to join us soon in Part 2 of this whitepaper series to discuss survey findings in operational excellence among the utility procurement organizations. Part 2 will include insights, practices, and metrics relating to procurement's ability to operate efficiently and cost-effectively while maximizing value creation.

About ProcureAbility

ProcureAbility™ transforms traditional, outdated consulting and staffing models by offering our clients advisory and resource support on their terms.

Our delivery model is unique. We give clients access to unbundled resources, plus the ability to selectively add value through leading-edge methodologies, the latest best practices, and specialized insight and advice—an approach unheard of in traditional consulting and staffing firms.

ProcureAbility's customer-focused delivery model allows for a wide range of flexibility:

- **Working with strategic or tactical experts** who can deliver a wide range of solutions, from consulting to staffing
- **Scaling a team your way**, from individual resources to complete project teams
- **Adding value as needed** from a deep and broad library of procurement insights
- **Choosing remote or on-site support options** — or both

Since 1996 we've focused only on procurement's success. **It's all we do.**

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