

Spend Management: Key Elements for Realising Cost Savings in Procurement



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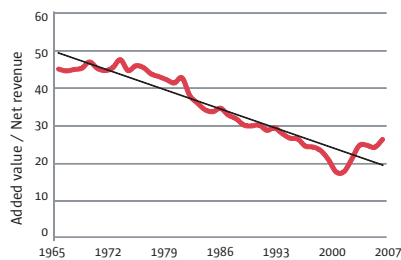
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Focus on sourcing typically yields significant profits: a euro in increased sales is ten cents in profit while a euro saved in costs is a euro increase in profit.

Introduction

Figure 1. Increased outsourcing and specialisation leads to lower value added. (Source: Teknikföretagen 2008.)



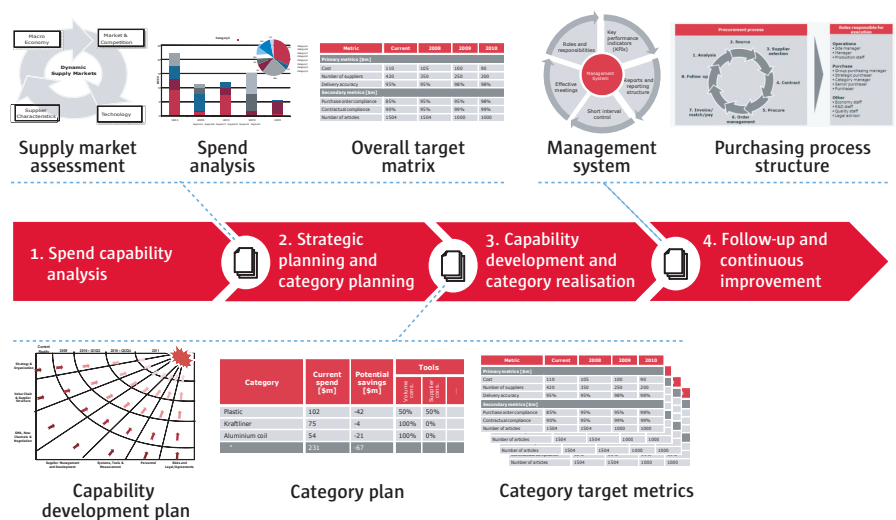
Spend analysis forms a solid foundation for sourcing initiatives. It creates an understanding of the organisation's spend structure and enables actions to be based on facts rather than intuition. However, spend analysis does not create a return on investment itself: it just provides the necessary insight for focusing management's attention on the procurement projects that appear to promise the highest return on investment.

In this white paper we discuss spend management and the actions that enable realising the saving potential revealed by spend analysis. We describe leading practices in use today, and present a path for achieving measurable cost savings in procurement.

During the past decades the value added within organisations has decreased (See Figure 1). In practice this means that a larger part of the end product's or service's value is purchased from outside the organisation. This has increased importance of the procurement function. More recently, the economic downturn has also increased the weight being put on procurement. According to an Aberdeen study (Aberdeen Group 2009) 75 percent of European Chief Procurement Officers believe that their role within the organisation has gained importance due to the global recession.

The procurement methodology of BearingPoint is presented in Figure 2. After each phase, there are concrete deliverables that articulate the analysis and findings. In the methodology, spend analysis is conducted in the first phase. It aims to answer three basic questions: what do we buy, who do we buy from, and how do we buy? Figure 2 includes examples of these deliverables between the phases. In this white paper, we discuss issues related to all four phases.

Figure 2. BearingPoint Procurement Methodology



1. What is Spend Management?

Spend management presents a holistic view of the activities involved in the “procure-to-pay” process. This process includes, for example, sourcing, purchasing, goods receiving, payment settlement, and management of accounts payable and general ledger accounts. In short, spend management is the way in which organisations control their spending. Whether the money is spent on goods or services for direct inputs (for example raw materials used in the manufacturing of products), indirect material (for example office supplies), or services (for example temporary and contract labour), organisations need a mechanism by which they are able to control and reduce costs related to procurement.

Successful spend management initiatives need to be aligned with the business strategy and have full commitment from the top management. Thus procurement should be recognised as a bottom-line driven activity contributing through reductions in end products’ costs and finding suppliers with new innovations.

To be able to identify any sourcing opportunities, visibility to the current and past spending is needed. This enables the buying organisation to enjoy a comprehensive view on the metrics that drive improved cost and process efficiency as well as supply chain performance through analysis of bottlenecks. Monitoring how well the suppliers are currently performing enables to see the need for development activities and thus the targets for the future.

2. How are Organisations Managing Spend?

Unfortunately most organisations do not have an end-to-end view on their spending. The need for spend visibility is rather evident as it is noticed in a study by AMR Research: “From recent interviews with 70 supply management executives, we find that those that don’t utilize spend analytics have 55% on average of untapped spend, miss 10 % to 15 % in savings in categories that have never been examined, and miss at least 6 % in savings per category currently managed” (Spend Visibility: Do You Have the Correct Lenses?, M. N. Rizza, AMR Research Inc., December 2009). The same study reveals that spend under management varies considerably between different organisations: “AMR Research finds that leading organisations have 65 %, while laggards have only 3 %” (ibid).

This year the procurement department’s and CPO’s roles have been elevated as more pressure has been put on delivering cost reductions (See Figure 3). With the current economic downturn, organisations should take a “back-to-basics” approach to uncover the potential cost saving opportunities in their purchases. This requires structured and disciplined analysis of their spending. These opportunities stay mostly hidden because most organisations still do not have any formal spend management programs.

If the organisation’s systems and processes do not provide timely and accurate spend data, it can result in sourcing decisions being based on intuition rather than facts. In addition many organisations fail to realise the cost saving potential because they do not link the spend analysis output to their strategic sourcing decisions. Considering the top four pressures for procurement officers shown in Figure 3, it is logical that an increase in sourcing activity is the most planned action for European Chief Purchasing Officers (CPOs) (See Figure 4).

The foundation for efficient procurement is systematic analysis of spend data. It helps organisations to uncover the potential and required sourcing development activities. These activities may vary from renegotiating current contracts for better payment terms to insights on internal compliance with contracts, spending patterns, supplier commitments, and supplier performance.

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Figure 3. Top four challenges identified by EMEA-based Chief Procurement Officers (Source: Aberdeen Group October 2009)

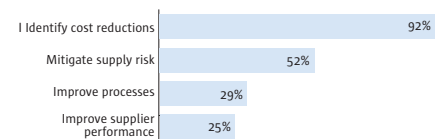
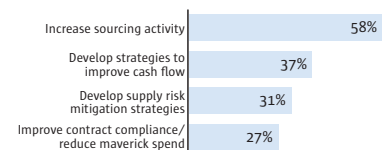


Figure 4. Top strategic actions for European Chief Procurement Officers . (Source: Aberdeen Group October 2009)



3. Key Elements of Spend Analysis

Spend analysis should be the foundation on which sourcing initiatives are based on. It creates an understanding of the spend structure. The analysis is conducted by coupling spend data with analytical methods and tools.

The focus should be in total consolidated spend, the suppliers, and purchased items. An implication of spend analysis could, for example, be the forming of commodity groups that focus on selected spending areas and developing distinctive commodity strategies. At BearingPoint we consider spend analysis a five staged process where each step has its own goals and methods (See Figure 5).

Figure 6. Data used for spend pattern and performance analysis

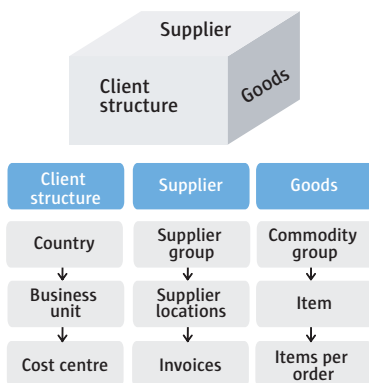


Figure 5. Spend analysis process used at BearingPoint



In the first phase spend data is gathered and processed in order **to create a functional spend database**. The needed data consists of three dimensions with varying levels of detail: supplier, client structure, and goods (See Figure 6). Gathering the data often poses challenges because it must be collected from multiple information systems and other sources such as accounts payable, general ledger, and enterprise resource planning (ERP) systems. The data quality and structure is also usually highly uneven.

Pulling the data together is often referred as *extracting, transforming and loading (ETL)*. The spend data is then combined with needed master data of the organisation and imported to a data warehouse from where it can be used for analysis and reporting purposes (See Figure 7).

Figure 7. Spend analysis architecture

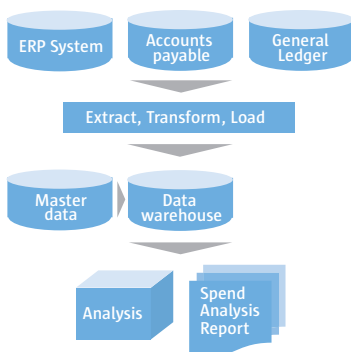
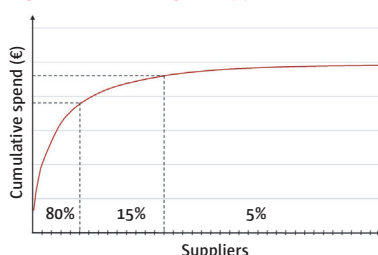


Figure 8. Cumulative spend can reveal that purchases made from smaller suppliers should often be merged together with larger suppliers



After collecting the data, it must be processed in order to assure its quality. The cleansing process means taking out irrelevant and false information (for example duplicate entries or rows with typing errors) and unifying the data from different sources. To provide a one-time spend analysis, it is possible to use simple spreadsheet models. However, for continuous spend analysis automatic and properly scalable systems are required. In practice this means implementing professional spend management software that is integrated to the organisation's other information systems.

The purpose of the second phase is to **analyse the overall sourcing performance and the detailed spend patterns** of the organisation. The sourcing performance can be measured by the capabilities related to sourcing strategy implementation, spend control, spend reduction, centralisation of buying, and supplier and contract management. The performance analysis requires selection of relevant key performance indicators, which can be compared to industry benchmarks.

Spend pattern analysis provides detailed analysis of the organisation's spend and thus is the core of a spend analysis project. In practice, this means crunching the data (either automatically with a suitable software or manually by using spreadsheets) in order to find issues and pain points for the purchasing process. Deliverables can be, for example, spend distribution and number of suppliers of commodity categories, cumulative spend, and rate of common suppliers (See Figure 8). The information related to item spend and suppliers of those items can be used for creating purchasing strategies for different items (See Figure 9).

The third phase, **commodity prioritisation and opportunity analysis**, relies on the performance and spend pattern analysis performed in the previous phase. In this phase rough cut saving potential and commodity groups are identified. The results are

benchmarked against internal and external information. At BearingPoint, we use established market research company databases as well as our own internal experts to evaluate the saving potential. The identified cost saving opportunities are analysed in workshops where they are prioritised and assigned for further *deep dive analysis*.

The fourth phase, **deep dive analysis**, focuses on digging deeper into selected commodity groups with the purpose of creating a better understanding the spend pattern. The target is to provide hypotheses on where and what to save from a total cost perspective. Completing the deep dive analysis phase should result in a report per commodity group including a savings estimate and action points for implementation.

The **business case and roadmap development** phase is the last phase in spend analysis. The target is to identify, quantify and present credible business cases and a roadmap for a strategic sourcing program. This means evaluating the return on investment of the development initiatives and then making decisions on whether to launch or reject a project.

4. Realising Spend Analysis Business Cases

Spend analysis plays a crucial role throughout the entire supplier relationship life cycle, from cost cutting opportunity identification to contract compliance. Opportunities identified through spend analysis are, however, not leveraged in most organisations. Next we will elaborate on the key activities required to realise spend analysis business cases.

Create a roadmap and assign responsibilities

Spend analysis is followed by a detailed implementation roadmap that involves all critical stakeholders. The roadmap includes, for example, prioritisation of the identified sourcing opportunities and an initial schedule for needed development activities to realise these opportunities. The outcome of spend analysis should be reviewed across business functions in order to together determine the proper actions that are needed. A cross-functional review can also help in increasing spend under management as information and views are shared between organisational units.

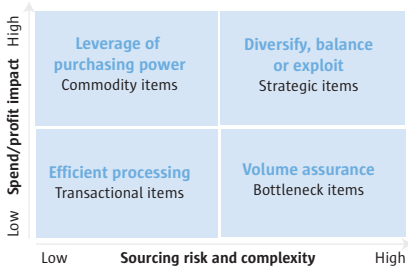
Organisational roles and responsibilities need to be assigned to start realising and tracking the targeted savings. Thus, in some cases the outcome of spend analysis can impact the overall structure of the procurement organisation. As item categories are identified, each category should have a manager assigned to coordinate the organisation-wide procurement of the (category's) items in question (See Figure 10). Each unit, on the other hand, should have a purchasing team responsible for the operational purchasing activities.

Leverage spend analysis to rationalise supplier base and to move towards more strategic partnerships

Analysing spend will help organisations to rationalise and categorise their supplier base and focus on those suppliers that offer the best value. Supplier rationalisation might include actions, for example, to consolidate spending if purchased volume is too much spread to multiple suppliers in order to make better one-off deals.

In some cases it can also be recommendable to agree strategic partnerships with the suppliers of critical items. This usually means that there are also other important variables than just price, such as cooperation in research and development.

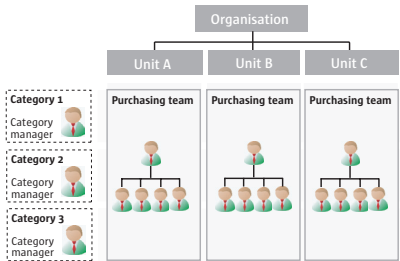
Figure 9. The sourcing category matrix developed by Peter Kraljic segregates categories by their risk and complexity and spend/profit impact. It can be used for developing different purchasing strategies. (Source: Kraljic 1983)



When realising cost saving potential revealed by spend analysis, organisations should follow these four basic guidelines:

1. Create a development roadmap
2. Decide on key item categories
3. Design and implement category strategy
4. Track and measure results

Figure 10. Assign organisation-wide category management responsibilities to category managers. Each unit should have a purchasing team to manage operational purchasing.



Building key metrics for all spend categories helps to monitor progress and thus ensure success in realising the cost saving targets and sourcing opportunities.

Gather facts to enable effective contract negotiations

To be prepared for contract negotiations, organisations should estimate their bargaining position and saving opportunities. Spend analysis is used to gather information of items' purchasing volumes throughout the organisation as well as prices demanded by different suppliers. The overall spend volume per supplier should be identified across all business units. Revealing the complete spend volume and value helps to strengthen the organisation's position in the contract negotiations.

Getting the best price in the market requires also analysis on the supplier's pricing policy. In some cases the ordering policy might incur additional costs. For example, transaction costs of ordering can be relatively higher if orders are made either too often or in too small amounts. The organisation might also be bearing costs due to poor delivery accuracy or, on the other hand, overly high reliability that is really not required.

Tightening credit access across industries due to the financial crisis is showing the importance of cash availability. Therefore new and current contracts should be renegotiated to gain better payment terms. In general, market knowledge is essential in creating the right benchmark onto which the current contracts can be compared to.

Link spend analysis tightly with contract compliance and contract lifecycle management

Strategic sourcing can be viewed as a process that begins with spend analysis and continues through contract execution to tracking of contract compliance. History has repeatedly shown that even the best purchasing contracts deliver no savings if the organisation and suppliers do not comply with them. Spend analysis and performance management can help the procurement organisation to track compliance, identify spending irregularities, and take needed corrective actions. Contract compliance tracking can also help to identify potential product or service related issues that need to be addressed by the supplier or through internal training.

Create metrics across all spend categories and utilise reports and dashboards to track change

Building key metrics for all spend categories helps to monitor progress and thus ensure success in realising the cost saving targets and sourcing opportunities. The measures range from understanding the current performance of a category to detailed specific supplier performance metrics. It is also critical for procurement professionals to maintain trustworthiness by tracking actual savings. Management often complains that savings are identified but never realised or same savings are claimed for several projects.

Enhance the internal category, supply market, and sourcing process expertise

Leveraging spend data to enable more informed sourcing decisions requires commodity expertise within entire procurement organisation. Understanding the historical buying patterns, accurate demand information, and clear purchasing requirements can enable sourcing professionals to develop requests for proposals and negotiate better contracts. This can lead to price discoveries and hence cost savings.

5. Examples of our Experiences in Spend Management in the Nordics

Major food producer

BearingPoint conducted a one-time spend analysis in order to find saving possibilities in the company's buying methods. The analysis included direct purchasing, indirect purchasing and trading goods purchasing. The analysis revealed possibilities in volume and supplier consolidation as well as more competitive bidding. Category strategies were also clarified. The analysis revealed a saving potential of over 3 million euro. In order to realise these savings detailed recommendations for improvement were made.

Leading suppliers of lifting solutions

BearingPoint delivered an assessment of the procurement performance of the company against best practices in order to create recommendations for improvement. Due to the company's rapidly growing business volume, world class procurement was required to handle rising procurement costs. In the starting point, the company's procurement was decentralised and did not support spend analysis or strategic global sourcing. BearingPoint developed a procurement roadmap, which included a redesigned procurement organisation, a plan to integrate procurement operations with the whole supply chain, global sourcing pilots, and best practices for conducting spend analysis.

Wholesaler of industrial and electrical products

BearingPoint helped to implement a consolidated sourcing approach to realise savings. This project involved a spend analysis indicating a major savings potential by aggregating spend across seven countries. BearingPoint also supported the client in negotiations with existing and potential suppliers based on a new sourcing methodology in four commodity groups.

Leading supplier of spirits and liquors

BearingPoint assisted the client with a variety of sourcing improvements. We conducted a spend analysis as part of a larger assessment of the clients procurement operations, and helped to redesign the procurement model. This included process redesign, organisation transition, improved IT set-up and negotiations with existing and potential suppliers. The client is now working actively with group-wide sourcing efforts based on BearingPoint's methodology.



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To get there. Together.

Contact persons

Riku Santala
Partner, BearingPoint
+358 40 532 2135
riku.santala@bearingpointconsulting.com

Samuli Syrjänen
Senior Consultant, BearingPoint
+358 40 708 8613
samuli.syrjanen@bearingpointconsulting.com

BearingPoint Finland Oy
Porkkalankatu 20
00180 Helsinki

www.bearingpoint.fi

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