

# Spend Management: Five Keys to Greater Profitability

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In today's economic climate, businesses face many challenges including rising materials costs, poor supplier quality and delivery performance, and over-extended organizations, all of which are compounded by stagnant and sometimes declining revenues. USC Consulting Group's (USCCG) spend management process provides the structure and tools to help overcome these adverse circumstances and achieve significant improvement in operating performance.

In a recent survey, 80% of C-level executives stated that reducing costs was one of their top three initiatives. Yet only 30% had *any* program in place to manage the cost of direct and indirect materials and services. For those who had a program in place, there is a belief that most of the cost savings have already been achieved. To be successful, the next round of cost reductions will require a more holistic approach and organizational focus. The key attributes of this process include:

1. C-level sponsorship of cross-functional and divisional teams to leverage category spend and improve processes;
2. A disciplined process to develop, communicate, and execute project plans and planned key events;
3. Standardized metrics and summary scorecards that are meaningful and timely;
4. Robust tools to automate, aggregate, classify, and analyze spend data; and
5. Engaged suppliers working toward joint improvement goals.

This paper defines the five key elements of a holistic spend management initiative that can deliver the cost savings desired in today's challenging business climate.

## C-level Sponsorship

In most organizations it is not uncommon to find organizational silos or individuals charged with the responsibility for reducing cost.



Further, Lean initiatives are well entrenched and often producing results. Yet, both of these activities may be sub-optimizing potential performance gains by not leveraging the power of cross-functional teams to examine *all* options for achieving cost reductions. For these teams to be effective, they must be sponsored by someone with the authority to involve the engineering, finance, operations, logistics and procurement functions, and hold the team accountable for results.

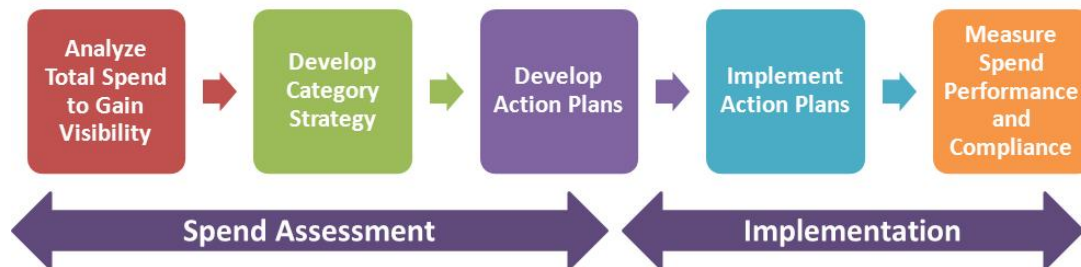
For example, procurement may identify outsourcing opportunities that on the surface appear to reduce cost. But as the products are outsourced, the ability to utilize the capital already invested in existing plant and equipment is reduced, resulting in a net increase in cost. Conversely, applying engineering changes that utilize new components can add additional SKUs, vendors, and back office work to existing business processes.

**Value Assessment**  
*A power tool manufacturer found that, over time, it had more than 21 different power cords. A value assessment determined that there was need for only six cords – a reduction of 15 SKUs. This reduced the number of purchase orders, planning activity, inventory, invoices, and storage locations. Savings were far above what a re-sourcing effort alone would have likely achieved.*

Without C-level sponsorship and mandate, activities to reduce cost will never reach their full potential.

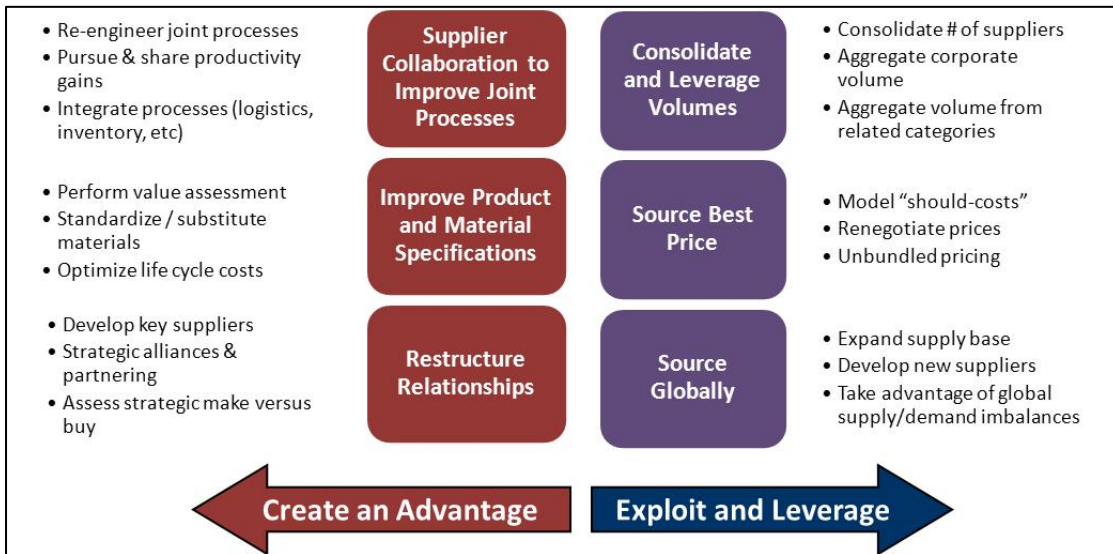
### A Disciplined Approach

A disciplined approach that involves the entire organization in reducing costs will have an advantage in identifying and implementing opportunities. This approach should include a thorough analysis of historical spending as the basis for developing strategies for optimizing *future* direct and indirect spend.



This approach is the roadmap for engaging the internal and external organizations necessary for developing category strategies that will provide the blueprint for achieving significant cost reductions. One strategy might simply be to re-source and find a better

price. But for most categories, other strategies will emerge that have the potential to produce better cost reductions. For example, *value assessment* of the specifications and functions of various components may uncover opportunities to tighten specifications to reduce the number of SKUs, thereby leveraging volumes and reducing administrative expense.



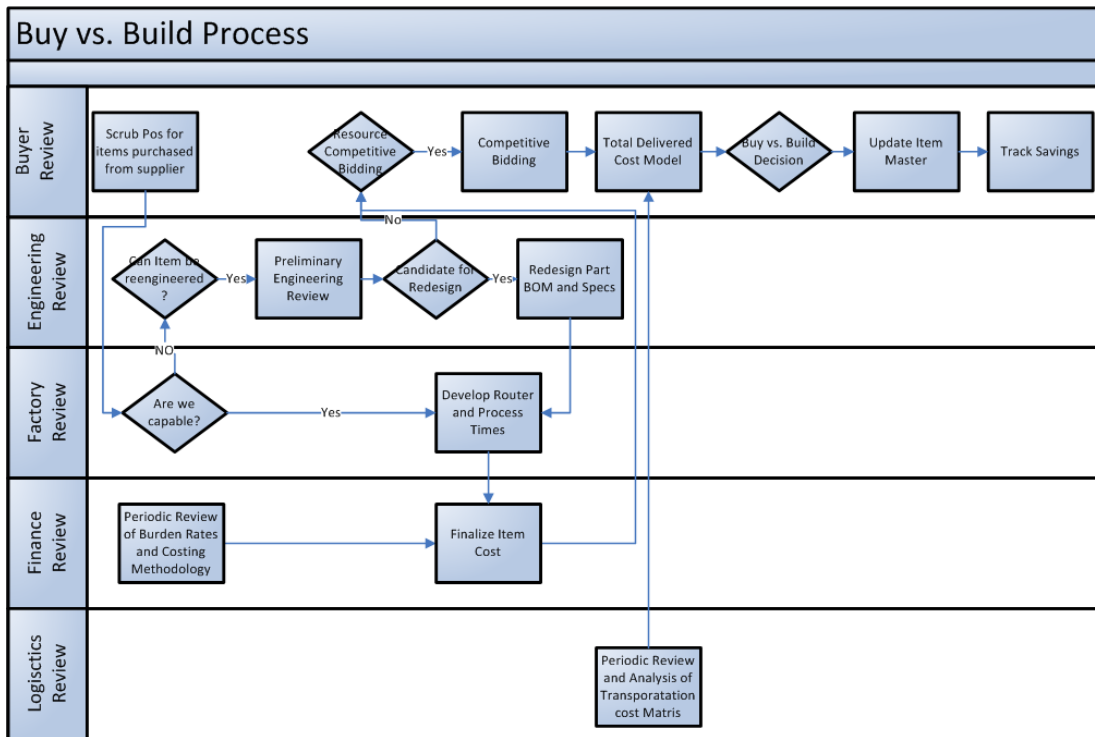
Implementation of these strategies requires a view of the total cost structure of the business from procurement to manufacturing. The process can be tedious, but produces benefits that far exceed what Lean and sourcing programs can produce as separate initiatives.

In one recent case, a company engaged USCCG to help improve its forecast accuracy to overcome chronic material shortages it was experiencing. When the consulting team delved into the issue, they learned that the company had switched its component sourcing from a nearby three-state area to Asia a year earlier. Although this change proved more cost effective, the company had failed to recognize how it would impact its ability to turn around finished goods for their customers. As demand increased, it no longer took only a few days to receive materials, but 60 days, which took the company's management by surprise.

USCCG's examination of the entire operation led it to recommend that the company reassess its procurement processes, including its MRP and ERP systems, which would allow them to build a common informational database for use by everyone from

suppliers to delivery schedulers. In addition, the company revised its plans for procuring components to include sub-assemblies to shorten manufacturing lead times. Highly visible contingency planning and communication across the entire organization ultimately provided the kind of flexibility and adaptability this company needed to meet customer demands.

Another manufacturer of custom-engineered capital equipment experienced a severe downturn in new orders. The spend management process uncovered an opportunity to conduct a Buy vs. Build Analysis of the purchased products to determine if there were any opportunities to bring some items back in house in order to utilize existing equipment and retain its skilled workforce. The category strategy that was developed included a thorough review of the total delivered cost of items compared to the cost of manufacturing the items in house.



## Standardized Metrics

The adage that you can't manage what you can't measure has great applicability to the area of spend management, a frequently overlooked opportunity to improve EBITDA in even the best performing companies. The reality is that most companies don't have their total spend completely, or even mostly, under management.

A recent survey<sup>1</sup> estimated that best-in-class companies averaged 88% of all non-payroll, tax, tariff, and fee-related expense under management while average performers had slightly less than two thirds of these same expenditures under control. Of even greater significance was the fact that the former companies were enjoying an average 8.5% cost savings vs. 5.2% cost savings of total spend for the latter while laggards, with just 23% of spend under management, were saving a mere 3.7% cost of total spend. The same research has shown that “enterprises have been able to achieve a 5 - 20% cost savings for each new dollar of spend brought under management.” More and more, spend management is increasingly viewed as a strategic imperative. With so much at stake, you can ill afford to leave it unattended.

On a global level, the metrics must measure broad performance indicators. First, the spend management *process* itself is a critical metric. Once a spend management initiative has been embraced, its process effectiveness must be tracked and measured. Concurrently, the net costs to acquire and produce the goods and services required by the business must be measured against a baseline involving EBITDA. These costs must include the external spend, the internal spend, and the overhead required to produce and acquire the products.

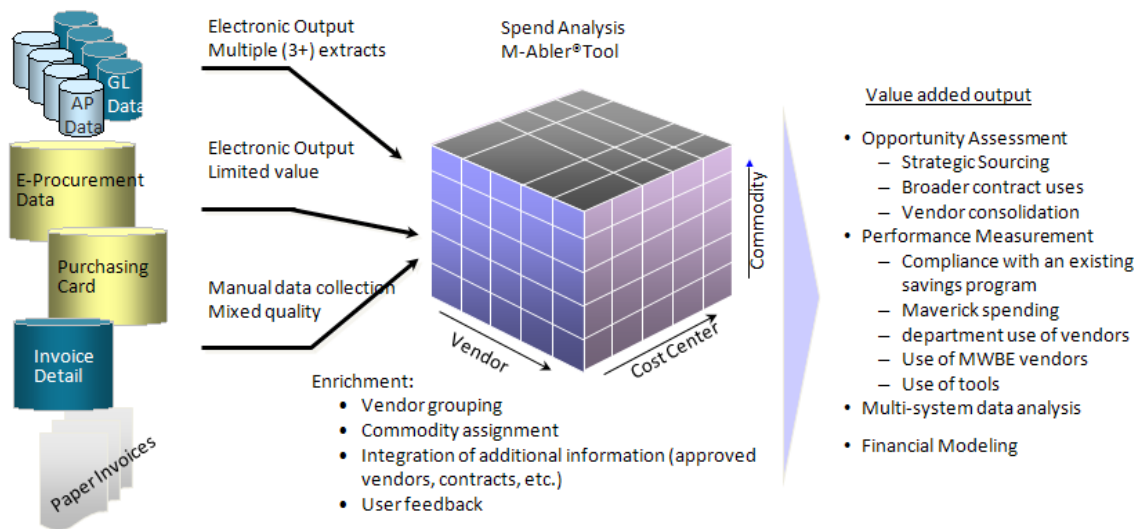
## **The Right Tools**

Other challenges facing businesses today are SKU proliferation, organizational inertia and resistance, and fragmented spend, all of which are exacerbated by an inability to obtain and interpret company-wide information. Tools must provide timely and meaningful interpretation of enterprise-wide costs including direct and indirect purchases and manufacturing conversion costs.

With the right analysis and compliance tools, buyers (and managers) are able to accurately determine true market pricing and availability for the goods and services they want or need to purchase. They’re able to identify potential new sources, reduce negotiation cycle time, and consolidate procurement among fewer, more strategic suppliers.

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<sup>1</sup> Aberdeen Group © 2009



## Engaged Suppliers

Developing category strategies will highlight suppliers that have a strategic role to play in the success of a spend management initiative. These suppliers can provide opportunities to reduce both purchase cost and administrative costs if fully engaged in a collaborative process.

A North America-based distributor of over 80,000 types of paper, printing, imaging, graphic arts, packaging, and maintenance supplies and equipment, operating out of 19 locations with over 1,700,000 square feet of warehouse space, wanted to reduce its annual direct spend on the materials it sells. The goal was to lower the cost of planning, purchasing, moving, and storing inventory and pass these savings on to its customers.

It quickly realized that eliminating nonvalue-adding activities and the cost of supplier services it didn't need would require undertaking a massive collaborative effort with its vendor pool for which it was ill equipped. Accordingly, it decided to seek outside assistance and, so, engaged with USCCG to provide the needed expertise and horsepower.

From the very beginning this initiative had broad multi-functional, support from the highest levels of the company. It was organized and chartered by senior leadership to

achieve ongoing, results-driven success. It began with a comprehensive diagnostic, conducted by USCCG, to uncover cost savings opportunities within central purchasing, receiving, and payables, while developing a roadmap for subsequent supplier collaboration.

The company devised a process for engaging suppliers to drive value in the areas of

#### Supplier Collaboration

- Select suppliers with the will, skill and scale
- Engage at the highest level possible
- Assess menu of services and collaborate on process improvements to reduce waste and redundancies
- Develop actionable events
- Routinely track and share progress

freight rates, freight allowance, EDI credits, full pallet discounts, full truckload discounts, and joint stocking and network opportunities, most of which represented new areas of savings for its expanding service offering.

The collaborative process began with supplier identification, vetting, and notification. It included a site visit and presentation of the initiative's objectives; gathering and analyzing supplier data; strategy development; vendor selection, negotiation, and retention; and finally, tracking outcomes against a performance scorecard. Technology was used to automate transaction-intensive activities (e.g., EDI, ASN, and pay on receipt).

Various tools and templates were used to facilitate the process. These included, but were not limited to, a supplier collaboration scorecard, a collaboration cost model, a supplier data request template, and a negotiation template plus internal data downloads of sales, inventory and purchasing transactions.

By the end of the engagement over \$3 million in savings had been identified and \$1.5 million implemented. The company's CEO, speaking on behalf of the senior leadership team summed up by saying, "Without USCCG's capable assistance we could've never undertaken this initiative. With it, we not only met but surpassed expectations."

## Summary

When existing initiatives to control and reduce spend can't produce the level of savings required/desired, it may be time to step back and re-engage with a fresh, holistic approach. With the proper executive-level sponsorship, process, teams and tools,

additional opportunities can be identified and harvested and performance improvement and cost savings achieved.

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#### About the Author

Jerry Moody is a Senior Regional Manager and supply chain subject matter expert with USC Consulting Group (USCCG). Highlights of his 30-year career include:

- Sourced and managed a supply chain optimization initiative for a \$1.2 B distributor with 18 service centers. Developed the supplier collaboration model and interfaced with suppliers to reduce delivered costs and improve cycle times.
- Managed a competitive sourcing project that identified a 12% reduction in procurement costs for a provider of business forms and products.
- Directed a global sourcing effort to identify producers of specialty printing papers.
- Developed a global sourcing supplier database for an automotive OEM and a sourcing process that integrated cost, technology, and performance criteria into a global sourcing strategy.
- Benchmarked Fortune 1000 companies to identify leadership practices in sourcing and purchasing.
- Developed the distribution strategy for a global manufacturer of data processing systems. Evaluated existing distribution network and recommended strategic improvements.
- Served as president/general manager for a \$60 MM manufacturing and distribution business. Responsible for new products, sales, and operations of three manufacturing plants and a network of company-owned and independent distributors. Acquired a Canadian manufacturing business to ensure North American marketing programs.

Jerry holds a Bachelor of Science degree in Industrial Engineering from Purdue University and a Masters of Science in Industrial Administration from Krannert Graduate School.