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A PUBLICATION OF USC CONSULTING GROUP

VOLUME 10, ISSUE 1

Spending Your Way to Profitability

An Interview with a Supply Chain Subject Matter Expert

Jerry Moody is a Senior Regional Manager and supply chain subject matter expert with USC Consulting Group. He also heads up the firm's Spend Management Practice. 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.
- 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 supplier database and a sourcing process that integrated cost, technology, and performance criteria into a global sourcing strategy for an automotive OEM.
- 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.

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.

Metrics: *What is your definition of spend management?*

JM: Spend management is the process of managing and controlling the way a business procures the products and services it needs to grow and sustain itself. It's a structured, data-driven, collaborative process that analyzes direct and indirect spend, defines strategy for each category, and identifies and validates potential suppliers.

Metrics: *Is spend management a new concept or just a new name for something that's been around for awhile?*

JM: There are elements of spend management that have existed for a long time. For example, strategic sourcing was very popular in the early '80s. It was a process to find lower-cost suppliers. As the Internet expanded, other tools, such as E-sourcing or online auctions, were developed that enabled more rapid deployment of the sourcing and procuring process. But spend management, as I define it, is a more holistic approach for driving out cost. It is an approach that helps us understand the business' true needs, align with the best suppliers, and then constantly measure and manage spend to identify other opportunities.

Metrics: *What are the overriding goals and objectives of spend management?*

JM: The overriding goal of any spend management program is to achieve continuous annual cost reductions in direct and indirect spend. But, there are other benefits as well. For instance, companies that embrace a spend management process have a much clearer understanding of the true market price for the materials and services they acquire. If you ask a purchasing manager how he knows he's getting the best price, he'll often admit that he doesn't know. By going through the spend management process, we help him understand very clearly what the true market price is.

It's also not uncommon for a spend management process to reduce negotiation time, shortening the development cycle, and resulting in a more nimble and agile

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product launch. And lastly, with the proper tools, purchasing executives have more visibility into what is actually being purchased. They can react to changes in the supply and the demand chains more quickly than they would be able to without that knowledge.

For example, in organizations that have been disrupted by mergers and acquisitions, there may be buyers at different locations dealing with the same supplier, but with different costs, terms, and warranties. The items being purchased may also have different part numbers and descriptions. With the proper monitoring tools, buyers and managers can have visibility into this situation and initiate corrective action.

Metrics: *Do you think there's been a shift among businesses to pay more attention to spend management now and, if so, why do you think that is?*

JM: C-level executives operate in a much different world today than they did ten years ago. Initiatives that were introduced to lean out their businesses have been successful, but now things are rapidly changing again. Competition is very fierce. Government regulation is looming. Customers are armed with better information. Owners are more impatient for financial returns. So spend management is more than just the flavor of the week, it's become a strategic imperative for C-level executives.

Metrics: *So where should responsibility for spend management reside in the management hierarchy?*

JM: The quick answer is that it is a supply chain or purchasing function, but the reality is that spend management is a holistic process that's designed to drive down not only the cost of purchasing the product, but also the cost of acquiring the product including the cost of design, logistics, and inventory. So, even though spend management may be a supply chain function, it must involve many areas of the business such as product design and engineering, finance, quality and sales, to name just a few.

> ***"…companies that embrace a spend management process have a much clearer understanding of the true market price for the materials and services they acquire."***

Metrics: *Can you cite an example to illustrate what you mean?*

JM: Specifications may evolve over the course of a product's lifecycle that look much different than the original design. These changes can have a large impact on costs and complexity. We had a client in the small appliance business that ended up with a couple dozen different power cords --- cords of different gauges, prong configurations, colors and lengths. When we examined the design, functionality, sales and customer requirements with our client, we found that, instead of two dozen different power cords, they only really had a need for about eight. By reducing the number of cords purchased, we were able to provide suppliers with a higher quantity on which to bid. This resulted in lower costs and fewer SKUs to manage.

Metrics: *Wouldn't the same apply to many of the components and supplies that a business purchases?*

JM: We see that a lot with component parts, for example commodities, such as fasteners, where there are screws of different threads and head types, lengths, packaging, and plating. When we analyze the volumes of each of those items, we often find that fewer SKUs are needed. Eliminating unneeded SKUs has a tremendous impact on reducing the complexity of a business.

Metrics: *So how big of an improvement opportunity does this represent as compared to labor for example?*

JM: Looking back over the last ten years, many companies have spent a great deal of time and resources improving the effectiveness of human capital and labor productivity. But the reality is that most businesses actually spend about five to seven times more in acquiring goods and services than they do for labor. So reducing the cost of those goods and services has a significant impact on the bottom line, both in profitability and in cash flow.

Metrics: *Can you quantify the significance to the bottom line for us?*

JM: Our spend management process enables us to categorize the items that are being purchased and develop strategies for achieving cost reductions for each of them. For those items that might be more commodity-like in nature, with a lot of suppliers in the marketplace and a lot of commonality to those parts, we've been able to achieve cost reductions in the 10-30% range. Categories such as corrugated or fasteners are ideal for those kinds of programs. For more complex items, those items that are highly engineered, we may find it beneficial to embark on a more collaborative approach with our suppliers. In some situations, a make/buy analysis results in an out-sourcing or in-sourcing strategy.

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Metrics: *So what is considered best in class when it comes to spend management?*

JM: There are two metrics we typically use to provide a quick assessment of a company's spend management strength. First, is the percent of total spend that's under a management program. The second is the annual percent of cost reductions relative to the total spend. The very best in class often have 80-85 percent of their spend under management and they're able to consistently achieve year-over-year cost reductions of 8% or more. Businesses that don't have a structured process in place typically are only looking at 25% or less of their total spend, and their cost reductions are significantly less, sometimes 3-4 percent, oftentimes less than that, on an annual basis.

Metrics: *What accounts for that extreme variation? Lack of C-level commitment, vision, manpower, technology?*

JM: The first is simply a lack of resources available to implement and manage a spend management process. Companies have leaned out their organizations to the point that those charged with purchasing are really busy with the day-to-day activities such as placing purchase orders, managing the paperwork, fielding calls from suppliers, fundamentally just keeping things running so they don't have time to be very strategic in their approach to procurement. I think another reason the gap is so wide is that companies have not invested in the tools to analyze or monitor spend. And lastly, there's a lack of high-level focus within the organization to engage all the appropriate stakeholders in the process.

Metrics: *You used the word procurement for the first time just a few minutes ago. Is there a difference between spend management and procurement, or are they one and the same?*

JM: Procurement is really an element, one of the nodes of spend management. I view procurement as the process of triggering a purchase, and then issuing a purchase order to a supplier. It's the transaction that takes place between a business and a supplier.

> ***"The very best in class often have 80-85 percent of their spend under management and they're able to consistently achieve year-over-year cost reductions of 8% or more."***

Metrics: *So is spend management all-encompassing or is it more relevant to high-dollar purchases or items that entail custom designs, long lead times, or something of that nature?*

JM: The spend management process can be applied to most products and services. Of course, a category strategy will vary depending upon the nature and size of the category or the business impact it has. It may also depend on the characteristics of the supply base. But spend management has application to virtually all direct and indirect spend of a business.

Metrics: *Only a limited number of manufacturers, General Electric and Pratt & Whitney, to name two, build engines for jet aircraft. Would they fall into the strategic category?*

JM: In our spend management process, we put a great deal of effort into understanding what we're buying, how those items impact the business, and the supply base characteristics. So, to take the jet engine example; they're very strategic. There are few suppliers; they're high dollar items; their quality and engineering requirements are stringent. How we deal with those manufacturers will be different than how we deal with suppliers of tray tables and seat backs. The process of spend management, and analyzing spend, takes that into account. From diligent and collaborative work with engineering, users, and often, customers, we're able to identify a strategy for that category that would take us in the right direction for reducing cost. On a very strategic item like a jet engine, we're going to be looking more at the supply chain, at the ordering practices, at the transportation and packaging, whereas if we're looking at a commodity-type item, we're going to be looking more at the unit cost.

Metrics: *Is spend management all about cost reduction or is there more to it?*

JM: It's always about the money. All of our work has to have a financial impact and material cost reduction is the largest. But there are many other benefits that are derived from a well executed spend management program. Those might include shorter cash-to-cash cycle times, lower inventory levels, a more collaborative effort with the supply base that drives a better designed or engineered product. In the long run, the more information we have about what we're spending our money on, the better partner we can be with our suppliers to drive out cost. So quality, durability, reliability, all of those things beyond pure cost reduction, are enhanced through the spend management process.

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Metrics: *Explain the concept of strategic sourcing and how it relates to spend management.*

JM: Strategic sourcing is an element of spend management. Once we have undergone a very deep, collaborative, data-driven analysis of what we're buying, whether it's direct or indirect, we go through a process of developing categories of spend and decide which items are strategic versus commodity-driven. Strategic sourcing is a more collaborative process that would be undertaken for those items that have a high business impact or high-dollar cost that are available from just a few suppliers, like the jet engines we just talked about.

M: *Is spend management broadly applicable across different industries or are there ones for which it is more appropriate?*

JM: I haven't seen any business where a spend management program would not be of benefit. It's applicable to every business, especially when you consider we're looking not only at direct material, those items that are being used in a product that we produce, but also at services and items we buy for resale or as part of a company's annual SG & A expenditure.

Metrics: *So, would contract labor be an example?*

JM: There are a lot of third party services that are often overlooked such as contract labor, general insurance, legal fees, building maintenance, uniforms, and marketing materials. These are items we spend a huge amount of money on that are generally not managed by purchasing. They're often managed by some other department within the organization and, so, are not subject to the same scrutiny they would be if they were a part of the purchasing effort. As we bring those direct spend items under the spend management umbrella, we're able to apply the same rigor to the process of analyzing that spend, aligning with the right strategy, and then searching out the best suppliers for the business.

> ***"The biggest misconception is that it's all about hammering the supplier for a better price."***

Metrics: *Recognizing that a lot of the indirect spend is really sourced independently, how difficult is it to get individuals accustomed to having wide latitude in purchasing to work collaboratively as part of a disciplined spend management program?*

JM: That's why we need C-level involvement. Oftentimes, we are examining spend that has been under someone's control for a very long time without a lot of scrutiny, so that can be an issue. The good thing about it is that, once that person accepts the spend management process, it begins to take away a burden they've carried with them unknowingly for a lot of years. It helps them answer questions such as "How do I drive the correct cost?" or, "How do I negotiate to get the lowest price, or most favorable delivery terms, when my real goal is to buy the highest quality?" So it can be very paradoxical and represents a paradigm that needs to be broken. It works best in those environments with high C-level support.

Metrics: *In your experience what do you think is the biggest misconception about spend management and how do you deal with it?*

JM: The biggest misconception is that it's all about hammering the supplier for a better price. The way we deal with it is by starting out with a sound analysis of what we're buying and what our true requirements are. We then examine the supply base to find suppliers most closely aligned with those requirements and, then, finally get around to the issue of price. Once we understand what we need, what our requirements are, and we're aligned with suppliers that can produce to those requirements, price falls into line.

Metrics: *What did you mean by 'true requirements' just then?*

JM: If we've had a long-term relationship with a supplier, over the years we've probably insisted on a lot of service and capability from that supplier, sometimes for good reason, sometimes not. Those things we've come to require have become the standard for our relationship. For example, we may require short lead time, or inventory being stocked at a third party warehouse, so we can draw upon it very quickly. We might require sales/marketing support for our customers; in other words, we ask our suppliers to send along one of their subject matter experts, or one of their engineers, to accompany us whenever we make sales calls. We may ask suppliers to ship a certain way, packaged or configured in a certain carton or pallet, and other things at various times that all cost money. Once we start to pull this "menu of services" apart, we can examine all those cost elements. Our objective is to identify, and begin to pare down, unneeded services that cost us money because they cost the supplier money. Reducing unneeded services can produce significant cost savings for the supplier and for us. Often, enlightenment

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comes when clients realize the true costs of this kind of service. The will frequently admit that, had they known this, they would've never asked for it. Suppliers are jumping through hoops to get us what they think we need, and we're wondering why we're paying so much. The lead times we give our suppliers, the quantities we order, all have significant impact on cost. If we can collaborate with them in a very detailed and yet open way, we can reduce their costs so they can pass the savings onto us.

Metrics: *What is your assessment of how broadly, or how well, American business employs spend management?*

JM: Everyone's always trying to reduce cost, and, depending on the economic environment and competitive situation, companies jump in and out of the cost reduction process from time to time. Many companies don't do that well at maintaining a structured spend management initiative.

Metrics: *So basically you feel it's underutilized?*

JM: Spend management is underutilized. Businesses don't tap into the power of their organization: their designers, engineers, sales/marketing people, in order to understand what it is that they really need to buy. Lacking that, they're often buying products that are either over-engineered or over-designed for what is required.

Metrics: *Spend management sounds like something that maybe an accounting department would think they could implement just because they understand the numbers. But is it something that requires special training or technology?*

JM: It's very challenging for a business to undertake a spend management initiative without the proper tools, organizational focus, and executive leadership. The perspective of an outside resource, empowered with those tools, can leverage the internal product knowledge and supplier relationships to achieve far better results in a shorter period of time than a business might on its own.

> ***"If we can collaborate with them (suppliers) in a very detailed and yet open way, we can reduce their costs so they can pass the savings onto us."***

Metrics: *What is technology's role in spend management?*

JM: It's a very critical role, especially in the ongoing management of the spend management initiative. Without the proper tools, businesses lose visibility to and knowledge of what's actually being purchased, why, and how it's being sourced. The visibility and knowledge that technology provides really enables any business to be a better partner to its suppliers.

Metrics: *One of the more challenging aspects of any spend management program is the massive amount of data that has to be reviewed in order to get a handle on everything that's being purchased. How does technology facilitate the data gathering, categorization and analysis process?*

JM: Technology enables us to understand what is being purchased. Today's enterprise systems, without exception, have not been structured to provide purchasing with the proper classification of parts necessary to begin a spend management initiative. It's not uncommon to walk into a purchasing department, take a look at the categories, and find there are only three or four of them and that 80% of what they purchase is called "parts." Well, that lack of knowledge really limits the ability to kick off a spend management program. It requires a very deep and diligent analysis of what they're buying, and that can be a very difficult and time-consuming task.

Metrics: *So would that be a barrier for a company that has yet to undertake a spend management initiative?*

JM: It's a major barrier for a company that has yet to undertake a spend management initiative. Furthermore, and perhaps more significantly, once a spend management initiative has been undertaken, without technology to monitor and manage the spend that visibility is lost and so is the ability to react to changes in the supply and demand chains.

Metrics: *Please describe the technology you are referring to.*

JM: Technology consists of several tools. One enables us to classify items around their functionality and supply markets to facilitate the development of category strategies. Another important spend monitoring tool is the capability to measure spend effectiveness and provide visibility into the spend. Other, more common, tools most businesses are probably familiar with include the E-sourcing and procurement platforms that provide the backbone for the sourcing process.

Metrics: *Can you cite a best and worst case scenario in the difference a solid spend management initiative can make?*

JM: The worst case scenario is that, without a disciplined spend management process,

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businesses will continue down the path of simply issuing purchase orders, managing paper, and struggling to understand why their costs continue to rise. There's no guiding process that will identify the supply base that most closely aligns with their needs. Each purchase order becomes its own initiative. That does not build a foundation for ongoing, continuous improvement. The best scenario is where we are achieving significant cost reductions over time, sometimes as much as 6-12% year-over-year, depending upon the category. We are aligned with suppliers that can help support and grow our business, and those suppliers provide critical services to us in addition to the products or services we buy: things such as engineering support, engineering design support, assistance with planning product needs, support for our inventory initiatives, and even our sales and marketing efforts.

Metrics: *If a company decides to undertake a spend management effort, what is the first thing it should look at or do?*

JM: The first thing it needs to do is make sure it has the right level in the organization as an executive sponsor. You want to make sure there's enough emphasis and visibility within the organization so that spend management will have a lasting impact. That's the first thing - make sure it's organized properly.

Metrics: *If you could give the readers one piece of advice about spend management, what would it be?*

JM: Spend management is not just a purchasing activity. It's not just the responsibility of the procurement or purchasing department. Spend management is an organizational process, that engages all the areas of the business in identifying potential cost reductions. C-level executives really need to be prepared to engage their entire organization in this process in order to drive the most benefit.

> ***"...without a disciplined spend management process, businesses will continue down the path of simply issuing purchase orders, managing paper, and struggling to understand why their costs continue to rise."***

Metrics: *And what would be your one caution?*

JM: Don't undertake the effort without detailed knowledge of what you're spending, supported by a very sound analysis. Don't undertake it without putting tools in place to sustain it. And don't give up on the commitment before you see it through. Implemented properly, spend management can pay enormous dividends.

Metrics: *Have you experienced a high rate of recidivism among clients that start down the spend management path? Is it easy to backslide without constant reinforcement or, if need be, remediation?*

JM: It's easy to backslide if you don't have the proper tools and visibility in place. And, in a business or economic climate where things are changing very rapidly, oftentimes the emphasis and priority of those acquiring goods or services, is on getting those goods in quickly rather than making sure that they're aligned with the right suppliers to ensure the right cost. Under those circumstances, it's easy to lose sight of the strategic objective.

Metrics: *What benefit does USC Consulting Group offer in the area of spend management?*

JM: We have experienced resources that can come in very quickly to supplement the resources of the client. We have the tools and can not only begin utilizing them very quickly ourselves, but can begin training client resources in their use so they can be left behind to sustain the process. The other thing we bring is the objectivity of an outside resource with a different perspective and focus that allows us to challenge the status quo. This helps us drive a new way of thinking about what's being purchased, from whom, and why -- frequently accelerating the gains a client might normally be able to achieve on its own.

Metrics: *Where does USC Consulting Group add value?*

JM: We launch the spend management initiative and provide the training and the tools to sustain it. And, ideally, we would stay engaged with the client long after the initial effort has been completed to review and monitor progress, say on a quarterly basis, and provide the objectivity necessary to optimize the bottom line benefits going forward.

New Addition Strengthens Midwest Sales Team

Kimberly D. Homa has been hired by USC Consulting Group (USCCG) as Director, Performance Improvement Solutions for its Midwestern U.S. sales region. Ms. Homa has more than 19 years' experience developing and delivering innovative business solutions to world class companies in the retail, consumer products, pharmaceutical, manufacturing, high-tech, medical technology, energy, and aerospace and defense sectors.

Most recently, Ms. Homa was an independent consultant helping clients with such things as market assessment, competitor analysis, operational process design and requirements definition, strategic business and operational planning, joint venture/partnership opportunities assessment, and financial modeling.

Before that, she was a Senior Manager in Quaker Tropicana Gatorade's (A division of PepsiCo) supply chain organization, where she was responsible for start-to-finish supply chain integration including forecasting, order management, shipment/delivery status, and strategic project identification and execution for the SUPERVALU and Target accounts.

Earlier in her career, Kim was a Manager in Accenture's Retail Supply Chain Practice, where she provided project management and subject matter expertise while leading the segmentation and flow path component of major network strategy projects for the world's largest retailer and the U.S.'s most profitable drug store chain.

Prior to that, as a Manager in Deloitte's Consumer Business Practice, Kim led numerous client engagements including the strategic visioning and store operations components of a supply chain project for a multi-division grocery retailer.

According to David Riggs, USCCG partner and senior regional manager for the Midwestern U.S., "Kim brings strong business acumen, proven ability, and recognized success, in achieving strategic and operational objectives across a diverse group of industries. Her process and analytical skills, coupled with her creativity in developing and deploying supply chain-based solutions, will add immense value to our business development team and clients."

Ms. Homa holds an MBA in Logistics, Operations and Marketing from the Georgia Institute of Technology, Atlanta, GA and earned a BS, in Industrial/Organizational Psychology at Ohio State University.

USCCG Tops in Client Satisfaction Ratings

USCCG clients continue to demonstrate solid satisfaction with the consulting firm's performance. Here are the latest survey results:

Overall Satisfaction 95.7%
95.7 percent of USCCG clients expressed overall satisfaction with the firm's work, while 79.7 percent said they were "extremely" or "very" satisfied.

Personnel 90.6%
90.6 percent rated USCCG personnel as "exceptional" or "very good."

Results 88.4%
88.4 percent of clients said the results the consulting firm achieved for them "met" or "exceeded" expectations.

Willingness to Rehire 90.6%
90.6 percent of its clients would consider hiring USCCG for other engagements, while 69.6 percent said they were "extremely" or "very likely" to do so.

Willingness to Recommend 87.7%
87.7 percent of the firm's clients said they were "very" or "somewhat" willing to recommend USCCG to a friend or professional colleague.

Learn more about what USCCG's clients have to say about the company's work by visiting their website at www.usccg.com.

USC Consulting Group

First we make it work. Then we make it last.®

For more information contact us at **800-888-8872** or www.usccg.com.

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Produced by Meta Marketing, Inc. Designed by Zelen Communications.