WHITE PAPER

Managing the Unmanaged
Unlocking benefits through Tactical Spend Management

– Vernon Kringas, Klas Hedstrom & Andrew Dougal

Introduction

As procurement organisations mature, their coverage of strategic and low value purchases improves and opportunities for delivering savings appear to become more difficult. The following paper briefly outlines opportunities to deliver savings in purchases that exist between strategic and low value spend. An approach that combines dedicated resources, simple processes and basic procurement technologies can deliver quick-win savings of more than 3-5% in this area.

Situation and Consequences

Procurement organisations in today's market prioritise their activities based on the spend profile within their organisations. This typically reflects a Pareto – 20% of transactions account for 60-80% of spend.

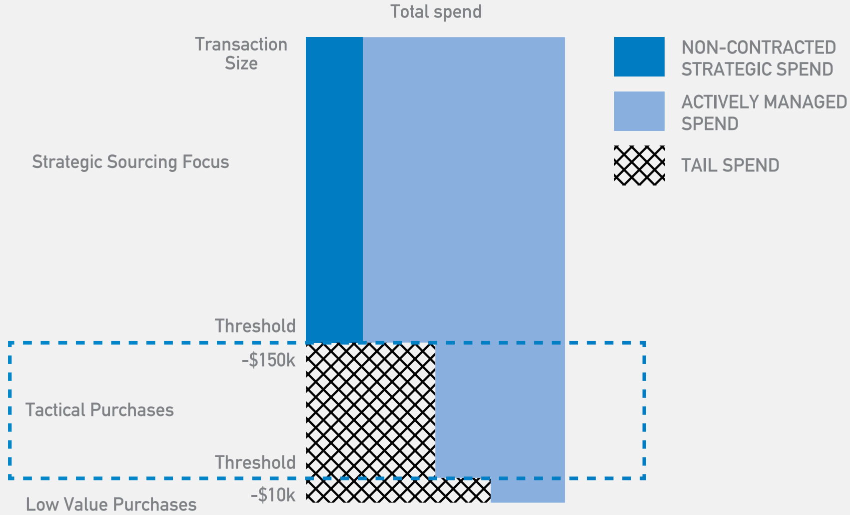
Given resource constraints, procurement teams direct their efforts towards establishing contracts and managing categories that cover as much of the high value or strategically important spend as possible. At the other end of the spectrum, corporate cards or simple e-catalogues are often used to give visibility over low value transactions (which often account for 50% of overall volume).

The remainder of transactions (e.g., those that sit between strategic and low value – referred to here as "tactical" transactions) are often not adequately addressed. Typically the value of these transactions ranges from about $10k to $150k. These may be with contracted suppliers or may sit outside of procurement responsibility because they are one-off purchases or lower value (but frequent) purchases. The consequence of failing to manage these transactions effectively is twofold; firstly, significant savings opportunities are missed and secondly organisations often expose themselves to unnecessary risk.

Our experience is that there are substantial and rapid savings to be made by systematically targeting this area of spend. Typical savings on non-contracted spend averages 20%; savings on contracted spend can also be made and average 5%.

Further business benefits include improved transparency, probity, accountability and reduced risk.

Typical Corporate Spend



Supply costs & risks are higher without an effective "tactical" transactions process

Typical Business Challenges

- Procurement resources focus on high value or strategically important spend areas - "tactical" purchases are often left unmanaged
- Panel supply models are often a 'set and forget' strategy - long term value from competitive tension across the panel is often lost
- Quoting processes are perceived as overly complicated, time consuming and unnecessary resulting in poor compliance as buyers 'avoid' the process
- Suppliers discourage buyers from competitively bidding
- Purchasing processes are typically manual and inefficient (e.g. limited use of simple eRFx technology, templates, standardisation, etc.)

Business Impacts

- Costs are higher than market - case studies show costs can range from 5-25% above market rates
- Purchases are made with non-contracted suppliers despite suitable contracted suppliers in place, increasing commercial and operational risk
- New sources of supply are often not investigated or developed
- Higher risk of probity issues arising from a lack of transparency and purchasers who site outside of procurement teams
- Tail spend continues to be highly fragmented
- Hidden process costs across the business (i.e. procurement and payment processes)

Recommended Approach

In most organisations, requisitions are routed based on simple rules via existing purchasing channels (e.g. managed panels, e-catalogues) or to the relevant strategic procurement teams for sourcing. The tactical spend optimisation process works by inserting a specialist team into the purchasing 'workflow' for transactions that meet certain criteria e.g. where transactional value falls within a specified value range (e.g. $10k to $150k) or for transactions where preferred suppliers have not been identified. These criterion are determined based upon a combination of policy and review of existing spend patterns.

Once established, the team reviews all "in-scope" requisitions and manages the purchasing directly in conjunction with the business requirement owner.

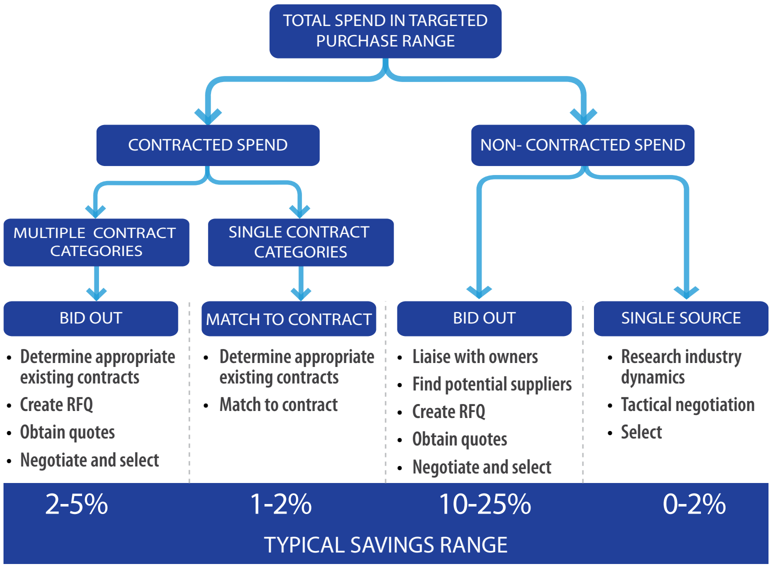
The main drivers of value from this approach, as highlighted in figure 3 include intelligent bidding of non-contracted transactions and appropriate matching of transactions to contracts – something many purchasing systems struggle to automate. Most of the savings stem from improved competitive bidding and compliance/enforcement to existing rates.

Indicative savings vary depending on the goods/services under review, on the industry and on the maturity of the current purchasing function.

Typical resource levels required to manage sourcing and requisitions via this process are 1 FTE per 1,000 purchases per year. This approach should have dedicated resources only if spend in the "tactical" space is greater than $10-15M/year.

A robust change management plan is critical to ensure that business units raise requisitions early, that resource is available to overcome process change obstacles and to build a leadership mandate that keeps the organisation aligned.

Value levers and typical savings ranges for "tactical" purchase improvement



Case Study

A "tactical" spend management programme typically pays for itself quickly and sustains high profitability. In the following live example, profitability at a large Australian industrials firm came within the first 6 months of operation and ramped up to a substantial ongoing ROI run rate of >5x. Further, the program delivered better visibility across contract management and PO approval processes as well as flagging opportunities for improved strategic sourcing.

The creation of a dedicated team led to 3-4% savings on all tactical spend

Key Objectives and Outcomes

Situation

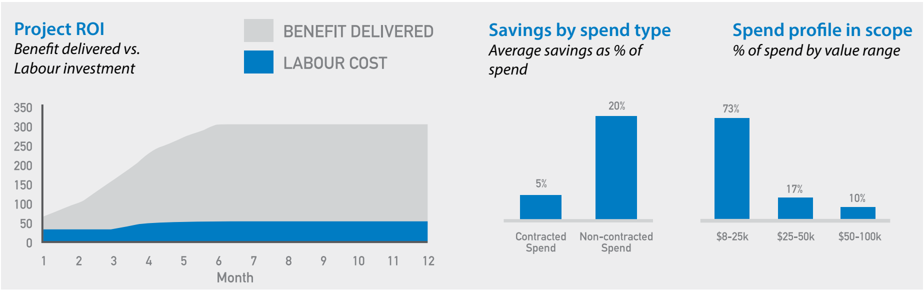
- 50% of $8-100k spend is on contract - the remainder is not on contract
- Over 70% of spend is below 25k, indicating importance of process efficiency
- Scope covers more than 10 categories ranging from IT to plant and production

Actions Taken

- Developed change programme for the business around the move to a PO-based process and managed roll-out
- Process rolled out to deal with all transactions in the targeted spend range
- Dedicated resource brought in by Portland Group to speed up recruitment, support and train local staff, provide flexibility/scalability and ensure consistent quality of outputs ranging from IT to plant and production

Result Achieved

- Profitability within first 6 months
- Run rate ROI of >5x achieved within one year
- Average 20% savings achieved on non-contracted spend
- Average 5% savings achieved on contracted spend



Conclusion

Mature organisations with a developed strategic sourcing program and a system to manage low value spend often leave "tactical" spend unmanaged – this represents an area of significant opportunity. Implementation of a targeted programme in this space can be completed with almost immediate payback and an ROI run rate of greater than 5x within the first year. Further benefits of improved transparency, probity, accountability and reduced risk make this an opportunity too good to miss.

About the Authors

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Vernon Kringas is an Associate Director in Portland Group's Sydney office and leads Portland's Procurement Operations practice. Vernon has more than 20 years of experience in designing, implementing and managing financial processes and systems with deep expertise in the procurement process and shared services.

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Klas Hedstrom is a Category Manager in Portland Group's Sydney office. Klas has over 7 years of experience leading procurement teams and projects across a wide variety of categories. Klas has deep knowledge of how to establish robust P2P processes and has built & run several Tactical buying teams across a number of ANZ based organisations.

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