



THE LONG AND SHORT OF MANAGING TAIL SPEND

Abstract

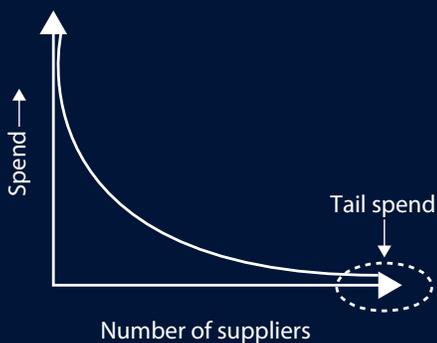
This POV explores and articulates the (usually) least focused but significantly important area of any organisation's spend management – known as tail spend/low-value spend management. Various factors exist behind this paradoxical situation, from defining what is tail spend to why a firm should pay attention and make the right investment on it while still focusing on high-spend/core areas.

What is tail spend?

Tail spend is that spend for any firm, which is not actively managed in all the spend categories and may have an impact on the firm's financial performance due to its impact on SG&A and COGS.* It contains a small portion of the spend (10–20% under each spend category) but large number of suppliers accounting for it and generally refers to purchases below the radar of strategic sourcing.

Tail spend can be classified in a number of ways, depending on the firm's as-is definitions, focus areas, procurement performance, and to-be procurement maturity and performance goals. Many organisations have defined and scoped tail spend for assessment as per the usual one, out of many definitions listed as under:

- Off-contracted spend
- Fragmented spend
- Low-value spend
- Low-value transactions
- Non-PO spend
- Commercial/one-time vendor
- Unclassified/misclassified spend
- Maverick spend



A thorough spend analysis and tail spend assessment needs to be done to arrive at the optimum definition(s). The section titled 'Taking charge of tail spend' details the way in which the right definition could be arrived at.





Why is tail spend management needed?

Increasing pressure on cost reduction and sustained savings through purchasing is making organisations sit up and take notice of their tail spend. The following objectives have usually been the drivers behind such initiatives taken up by organisations:

Spend coverage and savings

- Increase coverage of spend managed by sourcing firms
- Improve visibility of low-value spend
- Identify and implement opportunities for sourcing savings

- Eliminate/reduce transactions and transaction costs

Process improvement and optimisation

- Identify opportunities and include them in the existing category strategies
- Reduce business risks by increasing contract coverage and compliance
- Eliminate trivial suppliers as and when an opportunity is presented
- Enable self-service channels thereby increasing no-touch/low-touch transactions

Effective spend management

- Provide end-to-end execution support to manage tail spend
- Increase diversity of the supply base quickly (MWVDBE)
- Manage maverick spending and prevent frauds
- Increase compliance to internal policies and external laws (e.g., SOX)

Challenges faced in arriving at tail spend

The most common challenge faced by organisations while trying to segregate tail spend is 'poor data quality'. Typically, spend data consists of incorrect suppliers and material names. Incorrect or absence of data linkages, duplication of data, and presence of junk characters in the data are a few examples.

- In some organisations, lack of adequate integration between two systems, such as the procurement system and the contract management system, makes it difficult to arrive at the non-contracted or off-contracted data.
- Tail spend is known for its high number of sub-categories, huge item costs, and a substantially high number of suppliers. The sheer volume of ordered line items and a long list of suppliers can complicate spend analysis despite low value of spend.
- There are possibilities that business groups of the same firm are working in silos with decentralised policies and processes. In such cases, to consolidate data from various operating systems requires time and substantial manual efforts.

There is already a growing awareness that data cleansing and classification leads to greater spend visibility and informed decision-making. However, significant analytical capabilities are needed both in the extraction and cleansing of data and in performing the spend analytics. Not only is there a need for technology to automate significant amount of work, but there is also a compelling need to be able to understand what the technology does, how it is used, how it can be best applied by the sourcing team to cater to the requirements, and how to verify and extend the results.



Taking charge of tail spend

Typically, various organisations start with a Tail Spend Assessment Project (spanning across 3–6 months) where the scope is to define the tail spend, evaluate scope for opportunities, and then provide business case comprising of savings, investments, and operating models to outsource tail spend management. The outsourcing service provider then starts transitioning and implements the operations. Effective tail spend management would usually require the following tasks to be conducted during the analyse-to-pay cycle.

Analyse → Source → Contract → Procure → Pay

In addition to the above, various inefficient, non-value-added steps (like PO–invoice mismatch error resolution, blocked invoices resolution) must be re-engineered. The application of total quality management techniques such as RCA (Root Cause Analysis), PFMEA (Process Failure Modes and Effects Analysis), and value stream mapping combined with procure-to-pay tools' (e.g., Ariba Buyer) exception-driven workflow capabilities lead into identifying preventive controls (e.g., e-Invoicing/ERS, automated returns management process). Such preventive controls can be tested and processes can be modified to become error-proof. Breakthrough spend visibility procurement applications might be considered to have spend dashboards available on demand.

Analyse

- Repeated cleansing and classification of transaction data leads to more spend visibility.
- A monthly refresh of data helps in getting accurate data for further analysis.
- Tail spend data should be classified/filtered into opportunity areas such as price variance, spend fragmentation, spot buying, off contract, etc.

Sourcing (source-to-contract)

- Usual as well as category-commodity specific sourcing levers should be used.
- Some of such sourcing levers that deployed are contracts, rapid RFx, spend aggregation, vendor rationalisation/consolidation, e-market place, and consortium buying.

Procurement (procure-to-pay – PTP)

- Procurement methods such as catalogues, punch-outs, P-cards, and e-invoicing/ERS, fully automated 3- or 4-way match (contract-PO-invoice-payment).
- These increase the compliance and efficiency of the PTP processes as well as reduce the transaction cost.



Tail spend management process



It is imperative to have a mechanism so as to prioritise sourcing plans and identify sourcing strategies as there are many tail spend categories, sub-categories, and commodities to be managed.

Recommended sourcing strategy framework for tail spend management

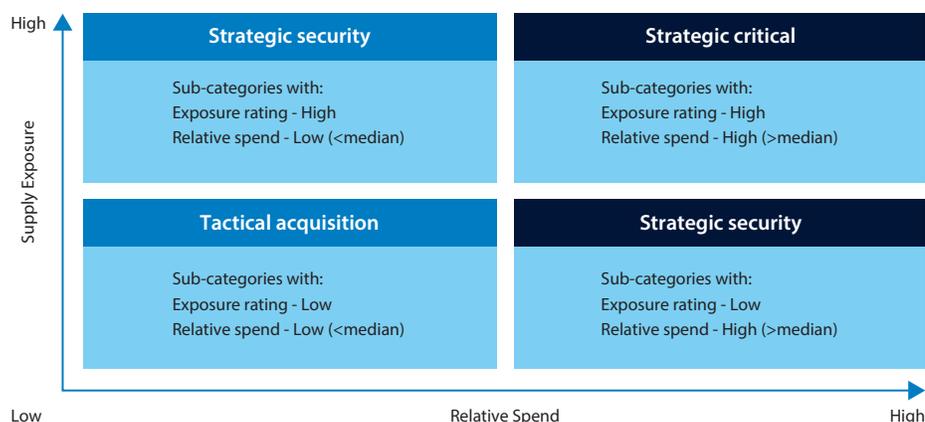
The framework follows a step-by-step approach detailed as follows:



The recommended framework follows the approach of mapping all commodities on two parameters – spend and 'supply exposure' or 'business risk,' defined across four quadrants – strategic security, strategic critical, tactical acquisition, and tactical profit.

(Adapted from – The Kraljic Matrix by Peter Kraljic)

Note: Infosys BPM builds client-specific statistical models to compute supply exposure ratings for sub-categories and along multiple parameters



Using this framework, sourcing strategies can be drawn across a large number of commodities. A decision can be taken as to which quadrant commodities have to be managed first and which ones later. Additionally, what execution plans and strategies will suit what commodities is also defined by the matrix. For the same reason, it is a complete framework for sourcing plans and execution strategy.



The benefits of tail spend management

Various research reports show that the potential to reduce transactions up to 60% and transaction costs up to 40% is usually achievable in the procure-to-pay side. Additional sourcing savings of up to 8% is

possible by deploying various usual and breakthrough levers as detailed above. Increase in customer/user satisfaction up to 20% over 2–3 years is an added benefit that can be easily obtained post

implementation of the program. Listed below are multiple benefits experienced by our clients:

- Positive ROI
- Reduction in maverick spend
- Increase in the percentage of contracted spend
- Standardisation of processes across business units
- Increase efficiency and compliance to the procure-to-pay process

- Increase in customer satisfaction score
- Improvement in supplier relationship management score
- Increase in SOX compliance
- Increase in MWVDBE compliance
- Reduced cost of procurement function

- Reduction of transactions
- Reduction of transaction costs
- High contract compliance
- Detection of funds
- Strengthening of procurement controls

Conclusion

Over the years, as the emphasis on cost reduction and savings is increasing, bringing the tail spend under better management should be the top priority of organisations. Outsourcing tail spend management process to a capable service provider can be a better approach for organisations for whom internal expertise, investment, or approach to effective tail spend management is unclear. Outsourcing of tail spend is being increasingly used by organisations as an option for cost-effective management and also to direct their internal resources' time from tactical tasks to more strategic activities.

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Deepa is responsible for program managing Source-to-Pay client operations including sourcing, procurement, accounts payable, master data, and transformation workstreams. She is based out of Dallas, Texas, and has been instrumental in carrying out tail spend management projects for clients across various industries. Her prior experience includes working in the manufacturing and pharmaceutical sectors managing raw materials and R&D equipment sourcing. Deepa has completed her engineering in Material Sciences and her post-graduation in Supply Chain Management. She is IPSCM certified from ITC, Geneva, and has completed an Executive Leadership Program from Stanford University.

*For organisations on the digital transformation journey, agility is key in responding to a rapidly changing technology and business landscape. Now more than ever, it is crucial to deliver and exceed organisational expectations with a robust digital mindset backed by innovation. Enabling organisations to sense, learn, respond, and evolve like a living organism will be imperative for business excellence going forward. A comprehensive yet modular suite of services is doing exactly that. Equipping organisations with intuitive decision-making automatically at scale, actionable insights based on real-time solutions, anytime/anywhere experience, and in-depth data visibility across functions leading to hyper-productivity, Live Enterprise is building connected organisations that are innovating collaboratively for the future.

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