

UNCOVER INDIRECT SPEND: CONTROL COST WITH STRATEGIC SOURCING

Indirect Spend has a material impact on a company's profitability. In addition to the cost of the item or service, price negotiations, bulk ordering, delivery expense and supply chain risk add complexity to what seems like simple purchasing. You can imagine how multiple locations, business acquisitions and changing technologies cause the old way of managing Indirect Spend to be out of date.





Why Does Indirect Spend Matter?



Cost

Up to **40%** or more of a company's expenses might be Indirect Spend.



Savings

Optimizing procurement can save up to **25%** of Indirect Spend.



Profit

Improving Indirect Spend procurement can deliver up to **10%** to the bottom line.

Management of Indirect Spend is challenging, but the transformative effect on the business justifies the effort. Lower costs are not the only benefit. Rigorous specification, supplier qualification and procurement processes can improve the products and services used by the company in ways that significantly improve the business and give you a competitive advantage.

Gain Control & Harvest Savings

To reap savings from your Indirect Spend, companies must strategically manage the processes and people involved. Typically, a business must commit to:

- Executive sponsorship of a comprehensive review and analysis of Indirect Spend
- Business processes that identify, categorize and aggregate items for competitive bid
- Systems, such as Purchase Order (PO) processing, that best fit the business need and handle all the company locations
- Support processes that help departments select qualified suppliers and negotiate sound contracts
- Collaboration between those who know how to use an item and those who can get the best deal for the company
- Economic, government and industry monitoring for pricing, risk assessment and changing market conditions
- Measurements and visibility that keep savings on track and garner incremental, long-term improvements

Focus on The Future State

Indirect Spend can consume up to 40% of total expenses. Transportation Insight Director of Sourcing Solutions Gene Smith recommends steps to reduce Indirect Spend by double digits and win over employees to help.

- Identify and categorize spend to establish priorities.
- Aggregate spend to negotiate multi-year supplier contracts with low-cost delivery.
- Understand the total cost of ownership versus piece price.
- Realize savings through the power of a Group Purchasing Organization (GPO).
- Implement visibility tools to track spending compliance, rein in maverick spend and measure savings.
- Celebrate the wins that are sure to come.



Gene Smith
Director of Sourcing Solutions
*30+ years experience as a
procurement professional.*



An organization with a heavy industrial machining operation changed to better-suited safety gloves, reduced consumption 40% and realized an overall cost savings on MRO supplies.

Update Procurement Processes to Improve Performance

Historically, companies put more focus on Direct Spend which are the costs that go into finished products. Indirect Spend categories can be more complex, fragmented, numerous and diverse. Traditionally, the authority to purchase items of Indirect Spend is assigned to remote locations, business units, departments or internal stakeholders in a group, such as maintenance, operations, legal, HR or marketing. For these managers, priority is often on relationships, proximity or speed rather than cost savings. Besides, these buyers inadvertently may buy an item that is not best for the specific application, missing an opportunity to take advantages of advances in utility, technology or materials.

Also, we have seen examples where remote offices or departments execute contracts on their own that may not be in the best interest of the organization as a whole.

When departments step away from procurement experts for supplier selection and contracting, the company misses opportunities, starting with qualification-based selection (QBS) that guides firms to genuinely qualified suppliers that meet documented requirements. By including procurement professionals, you obtain competitive bids, periodically review pricing and monitor contract compliance, renewal and termination.

A periodic, detailed review of spend, categories and suppliers can help identify strong supplier relationships and provide larger bid packages that might realize lower prices in new rounds of bidding.

What Is Indirect Spend?

Indirect Spend items are purchases of goods and services not directly incorporated into the final product or service offering of a company. They are not within the cost of goods sold (COGS).

What Categories of Expenses Are in Indirect Spend?

Category optimization can result in savings of 20-40% from aggregating item quantities across locations, creating larger bid packages and rigorous contracting.

Indirect Spend categories include:

- Accounting, insurance and financial services
- Advertising, media buying and creative agencies
- Marketing, websites, writing, agencies and the marketing technology stack
- Consultants, industry analysts and advisers
- Travel Management services, travel desk services
- IT-related services: hardware, software, cloud computing, printers, network management and Information Security
- Telecommunications, internet services and video (cable or satellite)
- HR-related services, such as recruitment, training and benefits administration
- Facilities Management services: physical security and cleaning
- Utilities: gas, electricity, water and wastewater/sewer
- MRO (maintenance repair and operations)
- Capital Goods (plant and equipment, such as machinery)
- Fleets and Fleet Management
- Warehouse, material handling and packaging equipment
- Laboratory, Office supplies and Furniture
- Safety equipment, such as safety goggles
- Food services, such as catering
- Commodity packaging supplies

Consider how necessary these expenses are to the success of your company. Then, think about how drastically technology has improved the solutions. Is your company able to keep up and make the best use of the best solutions?

Purchases justify a procurement group that can lower costs in the short-term and understands how supplier relationships can generate value for the company. The proper procurement group helps your company recognize new technologies and opportunity.

Turning Categories into Procurement Classifications

As a company assesses the items and quantities it may purchase each year, seek to logically group the pieces into procurement classifications as you create a more efficient procurement process. Move some things into categories ripe for strategic sourcing.

Transportation Insight offers free information and discussion about how to analyze your spend, put together a plan, assess the current situation, establish cost-saving processes, conduct strategic sourcing and save money.



TACTICS

for Controlling Costs

Identify Items, Quantities and Suppliers

These steps can start bringing indirect expenditures under control:

- Identify items and suppliers, often by a review of Accounts Payable (AP).
- Assign items to categories, aggregate quantities across the company.
- Review specifications and the use of products or services versus newer technologies, materials or offerings.
- Investigate the category, amount and supplier for each Indirect Spend item. This can help identify savings opportunities even before you put a new process in place.
- Aggregate Indirect Spend item quantities into fewer, larger orders with preferred suppliers.
- Implement company-wide contracts that reap volume discounts, favorable terms and responsive suppliers.



A large company with \$1.3M in MRO supply expenses realized 15% savings by aggregating spend quantities and consolidating suppliers. A lot of “nickel and dime costs” accumulated into \$150,000 in annual savings.



TACTICS

Group Items, Review Prices and Reduce Suppliers

Focus areas

These actions are Indirect Spend opportunities:

- Decrease purchase quantity and frequency by identifying and avoiding any non-crucial spending.
- Reduce per-unit costs. An item cost review can be done starting with a specification review. Adjust the specification to make sure that items purchased conform to the requirement and is not unnecessarily sophisticated.
- Rationalize (reduce) suppliers and stock-keeping units (SKU). Giving high quantities to fewer suppliers should get better leverage for your company and a volume discount. Centralize purchasing and seek out competitive bids. Strive for fair prices and stronger relationships.
- Simplify and improve processes. Fully implement controls built into your ERP system or current expense and purchasing systems to avoid inefficient and ineffective Indirect Spend purchases.





Decrease purchase quantity and frequency

List all the items your company purchased: the volumes (and trend up or down), suppliers, buyers (who authorized purchases), delivery fees, expediting charges, size of POs, timing (regular, erratic, or all at year-end) and required stock.

Reduce per-unit cost

Minimize maverick spend by aggregating quantities and similar items to negotiate contracts in top expenditure areas. Pool smaller spends to be supplied by fewer suppliers with more leverage on pricing for lower costs.

Build a Leaner Network of Suppliers

Rationalize the number of suppliers, favoring suppliers on price, quality and performance.

Fewer items, fewer suppliers and larger bid packages can streamline purchasing. Immediate gains can be realized by aggregating item quantities into more substantial bids.

Simplify the Process, Get Better Solutions

- Long-term benefits can come from evolving with technological and materials updates that make operations smoother.
- Specify the right item or service (conformance to requirements).
- Right suppliers will be identified to meet the specification or standard.
- Enter into sourcing contracts with selected suppliers.
- Monitor suppliers and improve the process.

Find Strategic Supply Partners

At first, place suppliers into different groups. Ideally, clustered on the value and importance of the category in consideration.

A strategic relationship with a supplier can boost business growth, offer supply chain resiliency and add value.

Reap Cost Savings & Benefits

Identify areas with significant saving opportunities and create action to reap savings. You can start to optimize specific categories of Indirect Spend or put your entire indirect procurement up for review.

Transportation Insight can help you analyze your Indirect Spend and the existing procurement processes. This analysis can create transparency about categories and methods that offer insight into item demand by location, unit price and total spend. This information provides glimpses into the potential for improvement.

We are happy to discuss solutions to bring your indirect procurement up to best practice.

Additional Tactics

- Invest in Automation and Technology.
- Partner, hire or train Procurement Professionals.
- Involve departments in creating processes.
- Get an optimal supplier portfolio.
- Move toward long-term savings and value creation.

Get outside consulting help if you need it to select technology, develop strategy, implement new procurement processes, pick qualified suppliers, or negotiate better, longer-term contracts. Aim for contracts with suppliers that realize savings, maintain quality, reduce total cost and optimize your company's use of the products and services.

TACTICS

Measure Cost Savings and Supplier Performance

Technology can provide real-time visibility into purchase transactions to the line-item level, which helps to stay on track with ongoing spend management. Evaluating all Indirect Spend and managing it well should be the goal. A comprehensive item list, visibility and analytical capabilities help decision-making for all stakeholders.

Set KPIs for Suppliers

Sometimes, suppliers offer metrics that do not reflect your needs. Your KPIs can be used across suppliers, measuring contract compliance, customer satisfaction, cost competitiveness, service, support and continuous improvement.

Review Budgets Based On New Costs

Look at cost reductions that let you reduce budgets, justified by the line-item saving. Keep department managers responsible for budgets and for purchasing within the new process.

Periodically review for savings opportunities under the revised procurement process. Ongoing cost review is part of a continuous improvement effort. Also, look for ways to improve your new procurement process.

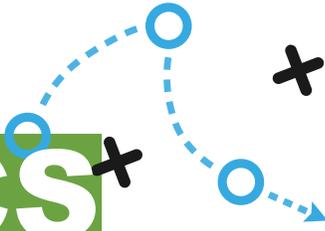
Create Lasting Value and Competitive Advantage

Ultimately, your procurement strategy should shift from the initial cost reduction phase to a value creation phase for the company.

The sourcing and purchasing function needs the ability to capture new trends, technologies and innovations to make informed decisions.

Long-term, your procurement group in concert with the department can acquire complex systems in partnership with certain suppliers that boost utility and add real value to the company.





TACTICS

Start Tactical, Move Towards Strategic Sourcing

Procurement operations handle day-to-day tactical transactions, such as issuing a Purchase Order to a supplier. A best practice is to move beyond the tactical toward a more strategic process. Pursuing a strategic sourcing mindset looks across all activity to address planning, supplier qualification, item specifications, technology advances, training, support, outsourcing, contract negotiation and periodic contract review.

Strategic Total Sourcing

Strategic Sourcing identifies the lowest total cost - not just the lowest purchase price. It embraces the procurement life cycle, from specification to payment.

Strategic sourcing is a procurement process that offers continual improvement of the purchasing activities of a company. Strategic sourcing often creates a close, partner-like relationship with a supplier to meet that customer's needs better.

With direct procurement in production environments, this is a common feature of supplier relations for vendor-managed inventory when there is a supplier mandate to deliver Just-in-Time raw materials or sub-assemblies to an assembly line.

A best practice is to move beyond the tactical toward a more strategic process.



Outsourcing

A 12-Step Process Path to Strategic Sourcing

- 1 Collect data on items and suppliers.
- 2 Analyze current spending.
- 3 Aggregate items to find the unit price, who needs it and where it is shipped.
- 4 Total cost analyses: How much does it cost to provide each good or service?
- 5 Assess the suppliers, then research to uncover better suppliers, changing technologies, new materials and machinery, supply trends and risks that may influence price or availability.
- 6 Determine how to narrow down potential suppliers based upon market demand, delivered cost and supply risk.
- 7 Choose potential suppliers for a bid list.
- 8 Send out the Request for Information (RFI), Request for Proposal (RFP), Request for Quote (RFQ), or Request for Bid (RFB).
- 9 Negotiate with suppliers on price, delivery, payment terms, service level, response time and geographical coverage.
- 10 Sign contracts.
- 11 Implement a new purchasing process and procurement group support and oversight.
- 12 Track results and periodically assess supplier performance.

Educate Staff on Indirect Spend

- Your procurement group (purchasing group) and budget owners from each department should become acquainted with the goals of our Indirect Spend cost-saving initiative.

Add and monitor performance metrics so managers can measure contract compliance, customer satisfaction and cost competitiveness, as well as promote continuous improvement.

Strategic Sourcing Success: Optimizing Indirect Spend Transforms Companies



By combining tactical procurement processes and strategic sourcing, companies realize up to 10% savings in Indirect Spend that goes to the bottom line. As companies improve buying processes and view supplier relationships over a longer term, the value of these relationships goes up along with the benefit to the company.

In the Uncover Indirect Spend and Record Lost Profit webinar, we learned how implementing new technology changed one organization's approach to shrink-wrapping pallets on the loading dock. Better materials meant less use of plastic resin. There is a ripple effect from new materials: lower weights and volumes of resin; lower costs from using less of the better materials; less storage space required and more effective packaging.

Imagine capturing the benefits of new technologies and new offerings from suppliers and the ripple effects it could have on your company. Strategic sourcing goes beyond buying for today based on price. It extends to researching and securing alternative products and services with higher, long-term value to the company.

Beyond our plastic resin example, businesses know that changes in technology, regulation and markets alter the playing field for the company and that its ability to adapt to lower-cost and better-performing solutions is critical to success.

