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Mastering Indirect Spend

Five keys to success

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Introduction

Over the last decade, we have seen a significant change in procurement's role. As companies and industries consolidate, significant focus is placed on the indirect expenditure. With the ability to dissect, segment and understand the expenditure with tools like spend analysis, categorization and contract management, companies have gained visibility into the indirect categories. It is no surprise that companies have realized that the global indirect expenditure can be as much as 50% of the total company's cash out flow to suppliers. Savvy companies have recognized that good-intentioned stakeholders–managing the suppliers on a part-time basis– lack the skills, tools and processes to effectively manage the expenditure. It is not untypical for key stakeholders to place their priorities solely on meeting the budget and crashing timelines. This practice is one where companies fail to optimize the cost and value improvement opportunity afforded by the appropriately managed indirect categories. World-class companies who have good indirect spend management process are achieving results in areas like marketing, engineering, capital, legal, laboratory, clinical trials, services, consulting and many others.

Difficulties in managing indirect expenditure

When managing the indirect expenditure, the large diversity of the number of items purchased and the number of internal customers can be overwhelming. That is where good category management segmentation and prioritization are useful when beginning an indirect category approach. In many cases, the materials are unclassified, random and very difficult to track. Often there is a lack of coding, sporadic buying and limited categorization. There are large number of individuals/stakeholders dispersed across the organization with no metrics, multiple computer systems and limited procurement rules. An expenditure analysis tool is a necessity since indirect items are often expensed, forcing category managers to dissect the general ledger to find the expenditures, which is both time-consuming and burdensome.

It is important to realize that category managers involved in direct materials tend to have ownership of both the process and the expenditure. The complete opposite is true with indirect as the stakeholders own the budget with the authority to spend it as they feel necessary. While the category managers do not own the expenditure nor the budget, they do own the procurement process. In order to be successful in the indirect expenditure area, category managers must have and use leadership and influencing skills to impact cost, value, timing, stakeholders, business management and demand. The lack of categorization and coordination through pre-negotiated catalogs can lead to a proliferation of items. For example, a company in the mining industry enabled every employee the ability to create item codes. Needless to say, the number of items ballooned out of control to 1900 new items per month. Item descriptions were not standardized and often the same item had multiple codes. One example was found in a requisition by a maintenance worker for "a grease gun like Joes". This became the description for an added code to the item master. Acquisitions and stakeholder's personal preference can also lead to a large base of suppliers where leverage and synergy are diluted.

Key to success 1

It is essential that the company use an expenditure tool to find all of the expenditure, identify all of the suppliers and categorize the expenditure.

Cost savings can vaporize causing procurement teams to lose creditability

It is not uncommon for category managers of indirect expenditure to claim savings only to find that the CFO cannot find savings hitting the profit and loss statement. If procurement saves $1,000,000 in the maintenance budget, the maintenance manager will do $1,000,000 in additional maintenance because the money is still in the budget. If procurement saves money in the travel area, stakeholders will do more traveling. Without predefining how savings will be dispositioned, all cost savings will vaporize.

Key to success 2

Prior to launching an indirect procurement initiative, the finance group, stakeholders and procurement should agree on what happens to the savings. In cases like travel, the management/ company may decide to keep the savings, but in marketing they may elect to do more marketing.

Why Stakeholders are reluctant to engage with procurement?

Stakeholders often view procurement as the policy police. They view compliance to the process, accepted procurement practice, ethical standards and supplier relationship management as tactics to delay projects with unnecessary red-tape, adding additional complexity. Stakeholders may fear that procurement could interrupt personal relationships developed with suppliers. They may not want to use well-defined competitive bidding or auction processes based on the timing and outcome. It is very convenient to use incumbent suppliers based on the learning curve and confidence in the supplier's capability. Stakeholders may believe that procurement will impact their freedom to make key decisions on their budget. By outlining the process, timelines and understanding of the stakeholder's business needs, objections can be easily diminished.

Stakeholders may fear that significant cost reductions or additional value will cause embarrassment and have a negative impact on their performance if discovered.

Key to success 3

It is essential that procurement build a good team process for indirect projects, inclusive of everyone, to minimize stakeholder fear and apprehension.

All Indirect programs require a governance structure to assure success

Before starting an indirect procurement program, it is recommended that you develop a steering group of company leaders. The steering group will validate the projects, give authorization to proceed and remove roadblocks. The steering group should also approve strategies, agree targets and decide what should be done with the savings. And without this overriding infrastructure, the projects can quickly lose priority, participation and, ultimately, the value the company is attempting to capture by managing indirect expenditure effectively. It is also wise to have a budget for the indirect projects for team member travel, supplier visits and any other expenses that may impact stakeholders. Stakeholders who are accountable to a senior management steering group have an incentive to make the project successful.

Key to success 4

Gaining top management and stakeholder leadership support will assure that projects are given the right priority by the organization.

Building and launching an effective cross-functional or cross-business team

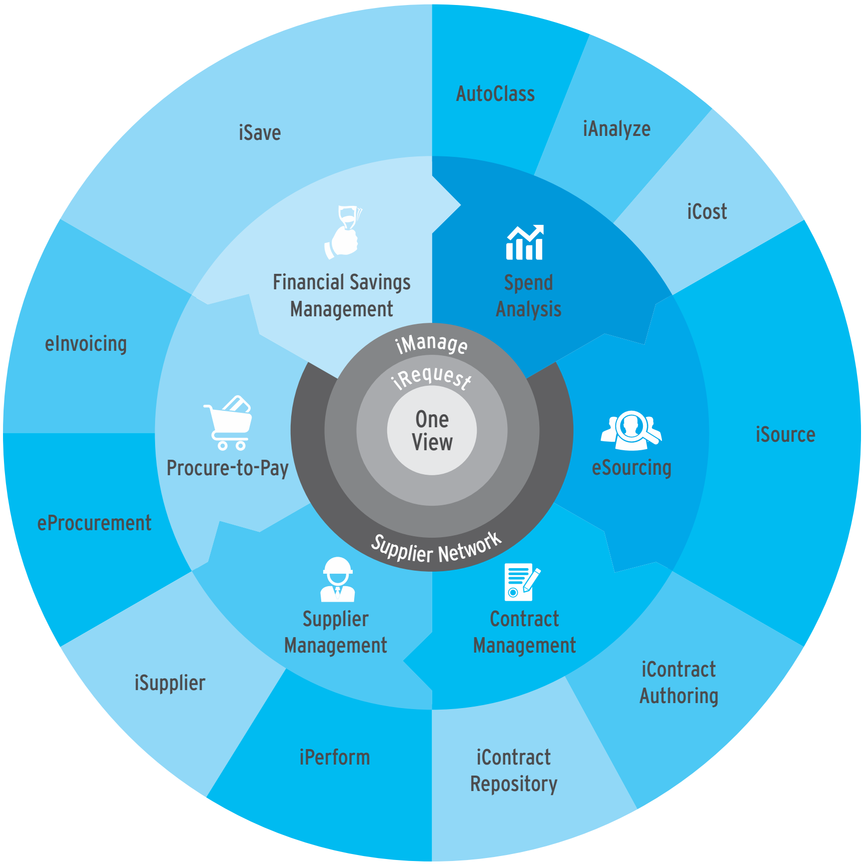
Cross-functional/cross-business teams are essential for successful management of indirect expenditures. Identifying all of the business needs, stakeholder requirements and gaining alignment can be done through a team. A team charter outlining the teams mission, vision, roles, responsibilities and accountabilities, is a great process for getting everybody on the team aligned and working together on a project. A well-defined project plan with milestones, timelines and a good category management process will assure a high performing team and capture the target opportunity. Time fence the project with 10 – 12 weeks for completion and a team report back to the steering group.

Key to success 5

Establish a team with a team charter, goals, roles, responsibilities, timelines and accountability for reporting results back to a management leadership group.

Conclusion

By using these 5 keys to success, companies can greatly enhance the opportunities for value improvement through indirect category management. Unfortunately, many companies entrust this buying to stakeholders whose priorities are to meet the budget and get it done. Stakeholders typically lack procurement skills, especially since buying is just part of their job and not their core competency. For successful indirect expenditure management, companies should create an environment where procurement can influence and engage stakeholders in the category management process to optimize cost and value improvement.



About Zycus

Zycus is a leading global provider of complete Source-to-Pay suite of procurement performance solutions. Our comprehensive product portfolio includes applications for both the strategic and the operational aspects of procurement - eProcurement, eInvoicing, Spend Analysis, eSourcing, Contract Management, Supplier Management and Financial Savings Management. Our spirit of innovation and our passion to help procurement create greater business impact are reflected among the hundreds of procurement solution deployments that we have undertaken over the years. We are proud to have as our clients, some of the best-of-breed companies across verticals like Manufacturing, Automotives, Banking and Finance, Oil and Gas, Food Processing, Electronics, Telecommunications, Chemicals, Health and Pharma, Education and more.

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