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Smart spending: a new approach that can help you optimize your procurement spend

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Gaining more value from your procurement spend

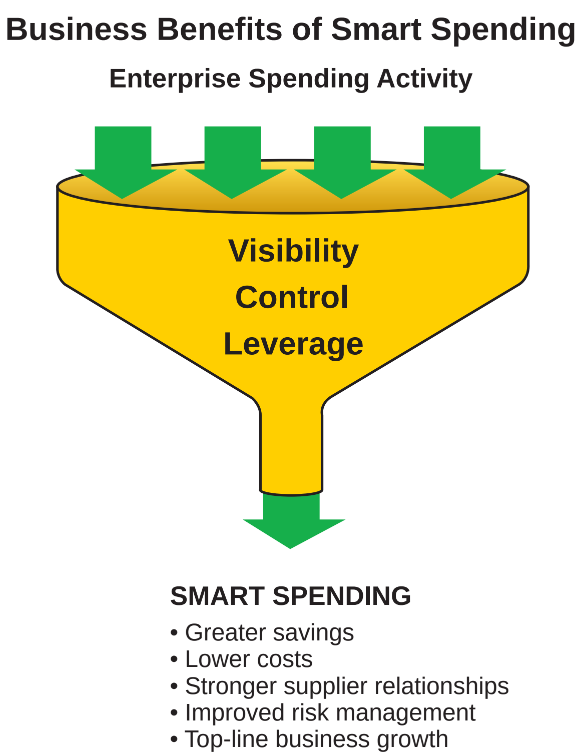
Challenging economic times and intense global competition have placed increased pressure on company balance sheets. More than ever before, businesses are refocusing on core activities and carefully managing cash. By natural extension, this has led to detailed scrutiny of procurement spending with suppliers—which can equal as much as half of a company's annual revenue. As pressures continue to mount, businesses must ensure that they are realizing the optimum value from their procurement spend or they may find themselves at a competitive disadvantage.

Many companies are adopting a new approach that is taking sourcing and procurement to greater levels of value. *Smart spending is a broad, multi-faceted way to manage procurement spend; it combines sound, fundamental procurement and financial practices with innovative techniques and greater leverage of spend and infrastructure.*

Smart spending represents the next phase in the evolution of the procurement function by moving beyond the traditional in-house buying and sourcing activities that have served global commerce for many decades. Smart spending gains additional value for businesses by strategically leveraging external capabilities to complement and enhance internal procurement functions.

Smart spending is helping transform the way companies manage their procurement spend, resulting in improved financial performance and more competitive businesses.

This comprehensive approach calls upon a variety of ways to capture critical data from numerous sources, integrates that data across multiple systems and uses it to synthesize actionable real-time insights. Smart spending comprises three fundamental principles: **visibility**, **control** and **leverage**.



Smart spending uses innovative procurement techniques, sound financial practices and technology while strategically leveraging third-party capabilities to achieve greater value from a company's procurement spending than it could obtain on its own.

1. Visibility: understanding buying opportunities

In order to effectively manage their spend, companies must identify what they are spending—and with whom. Sounds pretty basic, yet many companies have incomplete information about their spend profiles. This gap often is particularly prevalent for "indirect" spend (non-core goods and services such as office supplies and travel). Indirect spend typically amounts to 10 percent to 20 percent of a company's annual revenue and is often purchased through a large number of local suppliers.

But visibility extends beyond merely identifying the sources and uses of procurement spend. Also important is an in-depth knowledge of the suppliers and the attributes of the category marketplaces from which the goods and services are obtained.

Additionally, with the advent of a global, interconnected marketplace, the scope and tasks of this type of supplier/market intelligence have grown increasingly more demanding. For example, today's procurement officers must be acutely aware of supplier risks and social responsibilities that might affect their buying organizations. It is no longer sufficient—or responsible—for companies to simply buy goods and services locally. The mandate to identify and manage global sources has increased the complexity and expertise of the procurement function. And, once initial savings have been realized, supplier market intelligence becomes even more critical to drive year-to-year savings and improvements.

Visibility extends beyond gaining insight into total spend; it enables insight-driven business decisions, especially when companies team with providers that have strong analytics capabilities in addition to relationships with global suppliers.

Together these visibility concerns represent a significant investment of expertise and capability for any business. Better visibility through smart spending techniques can help ease these complex and costly buying issues with actionable insight, often gained through the capabilities of a third-party procurement and finance and administration (F&A) partner.

Using solid data to take corrective action

Businesses often invest in sophisticated tools and processes for customer relationship management (CRM) to do in-depth analyses of customer needs, wants and buying patterns. Innovative procurement and finance providers should apply a "CRM-like" approach to internal users of procurement processes through advanced analytics. These tools and processes identify, monitor and continuously improve savings programs by detecting discrepancies, repetitions, redundancies, errors, omissions—and opportunities.

Similarly, teaming with a provider that has a sophisticated view of the purchasing activities of your organization—as well as those of many others—can help you spot common themes and patterns. It can also help you monitor the full scope of purchases and supplier performance, with alerts for off-catalog purchases and direction on how to improve performance. This level of visibility enables you to identify, for example, other areas that can be folded into procurement services to achieve greater cost savings.

Companies often can gain better control of indirect spend with the help of third-party providers that have access to far more data than they can capture on their own.

Your organization can reap added value from a provider's investments in these reporting and analytic tools.
IBM Business Process Services for procurement, for example, works with its renowned research arm to delve deeper into procurement analytics and transactional spend data—including spending patterns, scope and trends—on a vast scale, not just for individual companies, but across industries and organizations. And not just as a one-time project, but regularly, as a part of an ongoing, structured, end-to-end spend management system.

More important, you can use such data to predict outcomes—and potentially prevent negative consequences. Visibility on this scale allows you to put market intelligence and corrections into place quickly, rather than weeks or months post-sourcing, placing power in your hands to reap maximum benefit from your provider. Yet this is only one part of a comprehensive smart spending strategy.

Smart spending for year-to-year savings

A large American financial institution lacked an overall corporate telecom strategy. Multiple networks operated in isolation with multiple supply contracts. The lack of a strategy, integrated operation or centralized procurement process limited the client's visibility to its spend, restricting the ability to track and reduce expenses. IBM's solution included developing a consolidated, centralized platform for performing moves, adds and changes, enabling greater visibility of spending activity. Specialists performed a spend analysis and implemented an overall corporate telecom sourcing strategy and supporting IT processes to leverage spending power and supplier relationship and to provide a structured supplier selection process for immediate cost savings. The team also created a call center to support all telecom and IT requirements and established standard procedures/processes to strengthen change and control issues, and streamline operations. The multifaceted approach led to 15 percent savings on a year-to-year basis.

2. Control: improving compliance and spend management across the enterprise

The second principle of smart spending—control—begins with the comprehensive identification of appropriate purchase and payment channels for all categories of spend. For example, many companies have suitable controls over purchase order (PO) processes but experience significant "leakage" of uncontrolled spend through non-PO processes, such as credit cards and check requests. Once companies have identified all their spending channels, they must implement enforceable policies and practices to manage procurement spend.

Of course, one of the best ways for businesses to save money is to *not* spend it in the first place. Implementing effective policies for demand management can change spending patterns (including avoiding spending) and result in real cash savings. For example, IBM's changes to its own travel policies (scaling back the allowable class of airline seats and rental cars) quickly resulted in tens of millions of dollars in annual savings—savings that were instead spent on core competencies, like research and global market expansion.

Savings on individual employee purchases may be relatively small, but they can add up to tidy sums (money in the bank) over the course of a year.

But even with spend channels identified and demand management policies implemented, companies will not realize the full value of potential savings without a strong compliance management program (the extent to which participants in the procurement process use the policies, contracts and suppliers that companies put in place). Companies striving to gain full value from their procurement spending should be achieving compliance levels in excess of 90 percent. But for many companies, compliance performance (particularly for indirect goods and services) can be dismal—with nearly half of spending being non-compliant. This results in significant lost savings opportunities for the average firm and an unnecessary drain on cash flow. For example, IBM's global solution for travel expenditures has enabled IBM—as well as our clients—to maintain visibility and control over spending in order to realize the full benefits of travel policies and sourcing strategies.

Finding cash in accounts payable leakage

Another area of compliance performance that's coming under increased scrutiny as a source of "hidden" cash reserves is accounts payable. Leakages may be found in such areas as overpayments, early payments, duplicate payments, lack of controls over new vendor additions, billing errors, manual processes with multiple human touch points, errors in purchasers' and vendors' IT systems, and more.

In fact, despite IT investments in powerful, leading-edge systems for transaction processing, companies still see gaps in tracking, accessing and updating data necessary for improved invoice processing efficiency. Adding to the complexity are government mandates for many industries to create additional internal compliance and certification processes. As a result, already-overtaxed employees become bogged down with (or completely ignore) company policies—creating even greater inefficiencies, increased legal exposure and cash leakages.

The financial settlement cycle encompasses related activities of delivering POs to suppliers, processing PO and non-PO invoices, and paying business-to-business transactions. By automating these often manual, error-prone processes, many organizations are achieving new levels of efficiency, improved use of payables-related working capital and increased compliance.

Other leakages can be identified and recovered through standardized and automated audit recovery processes, which can return benefits in the range of 0.05 percent to 0.1 percent of the company's total spend. With greater visibility to procurement and payables data, controls such as these can lead to real-time recovery for current losses, as well as for revenue leakages in the past. And they can help identify control weaknesses in order to implement long-term corrective actions to reduce probabilities of revenue leakage recurring in the future.

Managing and gaining control of the end-to-end payables cycle, especially with the help of a third-party provider with integrated processes and specialized tools, is often a source of a relatively swift recovery that can just as quickly infuse cash into more productive areas. Among other benefits, third-party partners can also use their leverage to help bring electronic payables opportunities to clients, when suppliers have not been able to achieve this on their own.

Procurement area	Typical starting position	How smart spending can help
Spend under management by procurement	Low performers have less than 50% of spend managed by the procurement function	Up to 90% or more of spend managed by the procurement function to ensure best value obtained
Compliance with procurement process and authorized suppliers	Less than 50% compliance, resulting in lost savings opportunity	80% to 90% compliance, ensuring most of the negotiated savings goes to the bottom line
Ratio of procurement spend savings (reduction and avoidance) to cost of procurement	On average, companies report a 469%[1] return of total savings, versus the cost of procurement; low performers may see less than 100%[1] return	Increase the average savings-to-cost ratio to more than 700%; individual company ratios may range from less than 300% to more than 1,000% return, depending on industry and specific spend profile
Vendor payment recoveries	Limited controls and recoveries	From 0.05% to 0.10% of total spend recoveries from vendors due to errors and other payables leakage
Demand management	Ad hoc demand management programs	From 5% to 10% demand management savings at a category level

Samples of the financial benefits possible through smart spending.

Strategic sourcing helps reduce total annual spend

Each division and location of a major international financial services firm maintained its own supply programs/contracts, with few standard policies and enforcement practices. Expense reporting capabilities and visibility were limited. Working with the client, the IBM solutions team implemented a strategic sourcing process for travel agency, airline, hotel, car rental, and travel and entertainment card. They also implemented a global delivery system; a standard corporate travel policy; and a centralized online booking tool that enables visibility to total spend by business unit, supplier and major geography, with enhanced control of spending activity. In addition, the unified procurement team instituted strategic sourcing processes and demand management techniques in the management of the supply base. All of these activities—including a comprehensive travel policy that mandated the use of preferred suppliers—resulted in a 17 percent total cost reduction on an annual spend base of approximately US$30 million.

3. Leverage: building value from the strengths of others

The third principle of smart spending involves gaining strategic leverage of procurement spend, resources and infrastructure, both within the enterprise and with the judicious use of third-party providers. Leveraging the experience and reach of third-party providers is helping companies transform procurement—historically a business function of constant cash outlay—into a key source of cash and working capital for improved margins, growth and innovation. An organization's one-time purchase could well be available on a provider's strategically sourced contract with the same vendor for the same item at a far superior set of pricing, terms and conditions.

Even large global companies with sophisticated purchasing organizations can gain additional value by tapping the purchasing, resource and infrastructure power of an experienced third-party provider.

Progressive companies also are leveraging third-party providers' capabilities to realize superior returns on investment (ROI), which can be eye-opening at the very least. For example, IBM Managed Business Process Services for procurement typically drives a 300 percent to 1,000 percent savings return on the cost of procurement, depending on the scope of services.

High-stakes savings through high-volume purchasing

Once a company has proper visibility to spend, it must successfully aggregate spending across its enterprise and direct it to a consolidated set of suppliers in order to obtain the most value (including price, quality and service). While most companies have already aggregated their own spend, smart spenders look beyond the walls of their own businesses and selectively use the additional volume leverage of third-party providers to increase their value. After all, small- to medium-size companies purchase the same categories of indirect spend that large global enterprises do, only on a smaller scale. Tapping into a third-party's buying power helps level the playing field by giving companies volume rates and boosting their competitive advantage. A market-leading procurement services provider like IBM, with more than US$50 billion of managed spend, can bring additional spend scale and deeper supplier relationships than a company can achieve on its own.

Skilled resources at your service

In a similar way, businesses must put in place internal efficiencies and economies of scale by consolidating and centralizing shared services buying and payables operations. These internal shared services operations often can be further leveraged by using a third-party's operations hub that provides services to multiple clients.

For example, while many companies rely on general purchasing experts for a majority of their spend, large providers are able to invest in specialists in scores of categories, from rental cars and food services to telecommunications and marketing expenses. Sharing the skills of such professionals expands your sourcing team, often from a handful to hundreds of highly specialized experts. With global networks of suppliers, they can zero in on your company's precise needs using suppliers your company has not had access to in the past.

Optimized sourcing and supplier management

Tapping the resources of a third-party global provider also can help secure improved service from your suppliers through the accumulated expertise of its sourcing professionals and its larger total managed spend. But such smart spending partnerships can offer even greater value. For example, by synchronizing sourcing events (such as invitations to bid) at the category level, providers can pool multiple clients' requirements. Your company benefits from the provider's negotiating strength for better terms, multiplying the effectiveness and savings across the sourcing process.

Providers that manage an expansive, multi-client supplier base also can help you detect risky behavior or questionable issues specific to your enterprise. Better yet, they can resolve them with the highest level of decision makers, rather than on a local or regional sales level.

Supplier consolidation helps save on facilities services

A consumer products company with 10 branches in the U.S. had a $20M annual spend in facilities services and more than 500 suppliers. In an attempt to improve facilities services management, the client turned to IBM to help streamline its supply base, standardize processes and practices across locations, and improve the performance and efficiencies of the business—all while cutting down on energy demands and reducing procurement costs.
IBM developed an aggregation model that consolidated all the facilities services—including building maintenance, janitorial, security, grounds and some environmental services. The team developed key performance indicators (KPIs) that focused on increasing preventative maintenance while decreasing critical and corrective work orders, reducing unplanned production and equipment down time, ensuring safety at the sites, and improving customer satisfaction. IBM implemented the model in each location within eight weeks. The client consolidated its supply base from 500-plus suppliers down to a single supplier. With the supplier now effectively managing the facilities, the client has been able to shift essential resources to core activities. Increasing equipment efficiency also produced a dramatic reduction in energy demand. KPIs were deployed for all categories and are measured on a quarterly basis. Within a year, the client realized cost reductions of 15 percent ($3M).

Leading-edge infrastructure you can afford

True value isn't achieved by volume buying and shared resources alone. In addition, integrated technologies that reveal new insights are especially important enablers of procurement efficiency and effectiveness. To achieve optimal results, companies must either invest in a fully functional solution in-house or partner with a third-party provider to augment their own solution or provide one tailored to their needs. Companies that remain committed to purchasing/developing, supporting and maintaining their own data centers, IT groups, and (often redundant) processes and services face ongoing capital and support expenses. They also face costs associated with ramping up and down with demand.

Global provider partners can remove such costly distractions by using their own sophisticated procurement systems, processes, tools, personnel and innovative delivery models like cloud computing. And they are able to rapidly respond to market changes. Today's providers' consolidated transaction processing centers, for instance, offer low-cost, efficient and flexible operations activities, including purchase-order processing, hands-free transaction monitoring, vender master file updates and systems administration. Better yet, companies can tap into these state-of-the-art solutions, as needed, with software licenses and implementation fees amortized over the engagement period.

Smart spending reaps new working capital

Vendors of a global manufacturing company were critical of perceived delayed payments. But an IBM data analysis demonstrated that vendors were actually being paid *earlier* than their contracts required. The IBM solution team also found that the company's vendor master file—the central, comprehensive database that holds required information about vendors and determines how they should be paid—was improperly interfaced with the payables application, which led to the incorrect payments. The team replaced the vendor master file and synchronized it with contracted vendor terms, leading to more consistent and compliant payments. The approach resulted in a reliable vendor payment schedule with amended payment terms—and far fewer vendor complaints. And once on-time payment performance improved, the solution delivered working capital savings close to 1 percent of the company's annual spend.

More than savings—top-line growth

Smart spending also can serve to help companies' top-line revenue growth—not just save money. Highly competent, experienced sourcing strategists understand their markets well and can secure the best arrangements to support a growth strategy. But such strategies are not restricted to price alone—there are many other facets to a supply agreement, any one of which may be the key to competitive advantage, market access or favored relationships. In addition, the appropriate direction of buying power can lead to enhanced service levels at competitive costs. These can be integrated into improved customer service experiences for your clients (such as call center satisfaction). Smart sourcing strategies can even leverage vendor investments in a direction that enhances differentiation.

As procurement organizations adopt smart spending, they are better able to measurably improve cash flow and direct it into core competencies.

Smart spending (through smart sourcing) can also help enhance revenue growth by nurturing stronger supplier relations. As experienced procurement officers know, some of the best competitive market intelligence—and innovation—comes through friendly suppliers, including some who may have been treated unfairly by your competitors. A procurement partner with multiple supplier relationships within and outside your business sector has access to information and innovative ideas from unrelated suppliers that can be leveraged for growth in *your* company. Further, co-marketing dollars may be available from suppliers whose brand is strongly aligned with your own. Robust relationships such as these can bring new clients, but they need to be handled carefully by experienced professionals with appropriate business controls to ensure fair value in sourcing events.

Conclusion

Companies that move beyond traditional sourcing and procurement and embrace smart spending practices have an opportunity to increase the year-over-year returns they are already receiving from their own procurement spend practices and policies, introduce innovation and improve their overall competitiveness. Such techniques are part of the relentless move toward a smarter planet—a more connected, results-driven, data-rich world with systems that are creating elegant real-world solutions: less traffic, environmentally efficient data centers, healthier food, cleaner water, safer cities, and wiser use of company resources.

Executed in partnership with a comprehensive third-party provider, smart spending can help position your procurement organization where it belongs—as a tightly integrated link between your firm's growth and the vendors that are helping drive that growth.

For more information

To learn more about IBM Business Process Services for procurement, as well as opportunities to align your payments with benefits attained, please contact your IBM marketing representative or IBM Business Partner, or visit the following Web site: **ibm.com**/services/process

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[1] Based on data in Cross-Industry Benchmarking: Cross-Industry Metric Report, Center for Advanced Purchasing Studies, November 2009.

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