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Purchasing

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Taking control of 'indirect' corporate spending

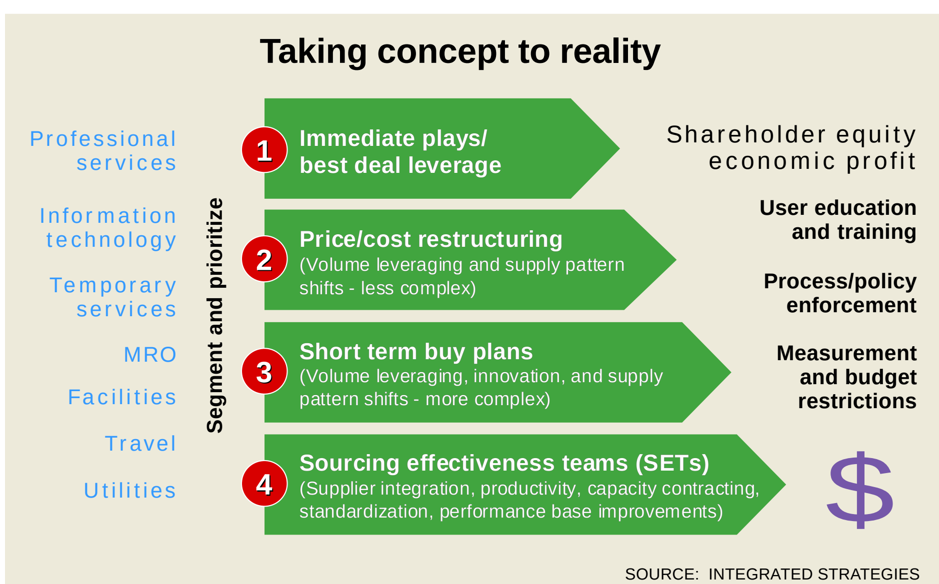
BY ANNE MILLEN PORTER

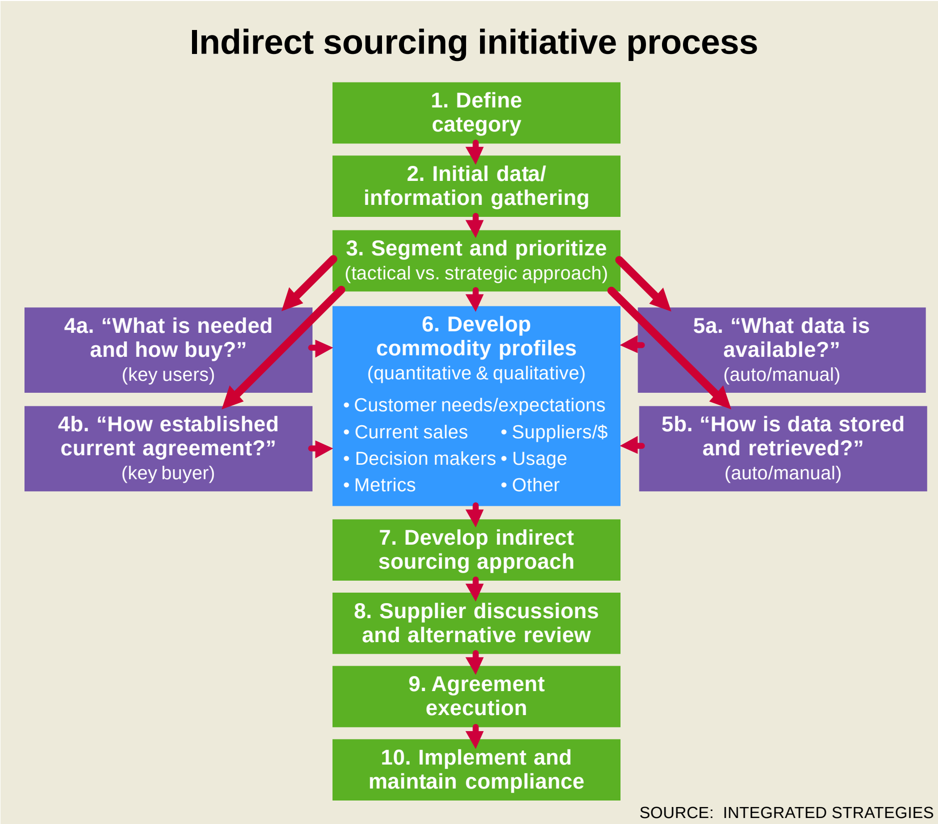
Over the last decade the purchasing function has begun to establish itself as a strategic contributor, often driving competitive advantage through improvements to cycle times, quality, service, price, and total cost. "Until recently, however, the primary corporate focus has been in direct purchasing-products and services that are direct components of finished products," says Dick Hottinger, strategic sourcing consultant and former chief procurement officer for Owens Corning. Now, companies are beginning to take control of the so-called indirect spend in addition to driving continuous improvements in spending for production. "Creating value in such spending areas as professional services, information technology, facilities, energy, and travel is becoming a 'must do' for purchasing departments," observes Steve Trecha, CEO of Integrated Strategies, located in East Lansing, Mich. "The price-cost reductions and service improvements are simply too great to ignore," Hottinger adds.

Last fall, IBM's Javier Urioste, director of policy, strategy, and international operations at IBM Global Procurement told PURCHASING Magazine that, "IBM procurement touches everything the company consumes. In addition to production materials, we buy advertising, health-care services, travel, legal services, and real estate. Half of what we buy might be considered non-traditional in other firms. Nothing is non-traditional as far as we're concerned."

But, in corporate America at large, this level of purchasing involvement in indirect corporate spending (spending not related to production) is certainly the exception rather than the rule. Indeed, Urioste had estimated that, on average, many companies capture only 40% of their total corporate spending under purchasing. "Many companies feel comfortable in the handling of their indirect spending simply because they employ purchasing cards or formal purchase orders," Hottinger observes. "In reality, however, the vast majority of indirect spends are not consolidated, leveraged, or integrated by purchasing."

In failing to control the commercial aspects of their indirect spends-leverage, total cost, terms and conditions, supplier performance specifications and measure-





ments-corporations may be leaving 8%-15% of their indirect dollars on the table, according to Trecha. They may also be missing opportunities for improving service quality and reducing their cycle times. "Typically, indirect spending is not linked to business-unit performance," Trecha says. "Without specialized purchasing processes in place, it's difficult to see how indirect buying decisions contribute to profitability or customer service. It's difficult to know if these dollars are being applied as effectively as possible."

Often, Trecha says, fragmented indirect buying decisions and processes can place too much emphasis on suppliers' perceived capabilities with too little understanding of total value delivery, resulting from inadequate emphasis on the total costs of products or services being purchased. A good example is the purchase of consulting services related to information technology (IT). "Traditionally, purchasing has had limited involvement and influence with major IT or MIS projects. Purchasing is perceived as bringing limited value into technology discussions," Trecha says. However, by focusing too heavily on technology service providers' perceived capabilities, the commercial relationship may be limited in the definition of objectives, deliverables, timing, tasks, roles, and performance expectations and measurements tied to costs. "Under these circumstances, it's not uncommon for IT service relationships to expand to 4-5 times their initial cost expectations," Trecha says.

What's more, Trecha notes that indirect spending tends to be budget-driven rather than cost or value-driven. This means people making indirect buying decisions may be spending to their budget (money they don't wish to lose) and not to the real market value or functionality of products or services they might be purchasing.

Business realities

While opportunities may be numerous for improving corporate approaches to indirect buys, Trecha remarks a number of common "business realities" serving as barriers. Some examples:

• Because they're not typically seen as contributing to competitiveness, indirect buys rarely capture the attention of top management

• It can be difficult to assemble teams and other resources needed to control indirect spending due to limited staffing or to the existence of other high-priority or high-visibility initiatives taking place in the company.

• Variability in fragmented "legacy" contracts can render too daunting the tasks of coordinated decision-making and establishing new policies and procedures for indirect procurement.

• Rivalries among disparate business units or managers can make it difficult to achieve cooperation or compliance with corporate initiatives.

• Limited availability of indirect purchase data and information

Despite these realities, Trecha argues that by taking a systematic approach, allocating the appropriate resources, integrating low-cost technology (for example, the Internet) to manage initiatives, and harnessing senior management interest in controlling indirect spending, companies can easily surmount these and other obstacles. In fact, based on his experience in helping firms to control indirect spending, he says big results can often be achieved in a matter of just weeks or months. For example, he says a multinational company launched an indirect sourcing initiative that included office furniture buys as a targeted category. The initiative team discovered one of the company's business units was in the process of salvaging and depreciating over two million dollars worth of 18-month-old furniture. The team broadcast the furniture availability to other business units. The result: avoided write down and avoided purchasing of new furniture for other business units. "From a corporate perspective, it affected profitability positively by avoiding both the write down and the new purchases, a bottom line impact of three million dollars," says Trecha.

Concept to practices

To take from concept into practice the idea of controlling indirect buys, Trecha says companies are most likely to succeed if they follow well-defined processes. Critical activities that need to be included in such processes-

• Establishing objectives for indirect buying initiatives. This involves understanding the general size and shape of indirect corporate spending and creating realistic expectations for improvements. It involves dedicating resources (people, money). It involves the discovery of best practices (ei-

Indirect purchase categories

Professional services

- Consulting services
- Management
- Information Technology
- Engineering/operations
- Architecture
- Scientific/product design
- Accounting/finance
- Staff augmentation (temporary)
- Administrative support
- Plant direct labor
- Professional service support
- Help desk support
- Marketing/advertising
- Creative services
- Media buying
- Telemarketing/lead tracking
- Databases/mailing lists
- Public relations
- Graphics illustration
- Education and training
- Computer systems training
- Professional/career development
- Facilities management
- Cleaning services
- Waste hauling
- Recycling
- Food services
- Conference planning
- Executive search/recruiting
- Legal services
- Real Estate

Information Technology

- Hardware
- Software

Utilities

- Telecommunications
- Voice communications
- Data communications
- Video conferencing
- Electric
- Gas
- Water
- Cable

Company Travel

- Airfare
- Internal aviation fleet
- Lodging
- Car rental
- Ground transportation
- Fleet purchasing/leasing
- Group travel/meeting planning
- Travel agency
- Corporate travel cards

Office Products

- Office supplies
- Copying expense
- Internal copy
- External copy
- Mail services
- In-house distribution
- Priority/express mail
- Courier service
- Office furniture
- Printing services
- Internal production
- External production
- Archiving/record storage
- Document disposal

Employee benefits

- Life, health, and disability insurance
- Employee relocation

Other indirect purchases

- Maintenance, repair and operating supplies (MRO)
- Capital equipment

SOURCE: INTEGRATED STRATEGIES

ther by looking within the company, at other companies, or by soliciting advice from external resources). It involves anticipation of obstacles. It involves creation of target objectives. “You can’t write a plan to an undefined target,” Trecha says. It also involves deciding how aggressively the company will pursue innovation. “Companies can choose completely tactical approaches,” Trecha says, “where they focus simply on developing dollar leverage, but don’t really alter the way business is transacted with the supply base in a particular spending category.” On the other hand, he notes, “they can try to come up with new ways for adding value to business transactions.” (See “Taking concept to reality graphic,” page 1)

• **Populating and training teams.** Indirect purchasing teams, according to Trecha, should comprise people who are knowledgeable about particular industries, suppliers or spending categories, user needs and expectations, and people who have the wherewithal to drive compliance with new purchasing policies and procedures. In all cases, the teams should be trained according to the tactical or strategic sourcing approach as well as the project management techniques that will be applied.

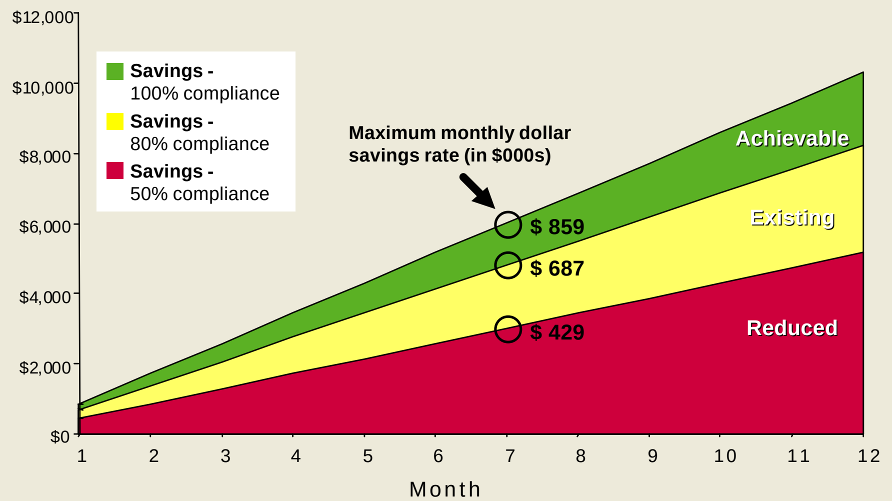
• **Targeting purchase categories.** This involves drawing up a master list of spending categories that will be covered by the indirect buying initiative, then prioritizing that list. (See sidebar above for examples of what might be included on such a list.) Prioritization is a two-step process. First, teams need to look at potential savings or value added that might be delivered in a particular spending area. Then they need to decide which projects might be most feasible given their corporate culture or other variables. Trecha recommends that firms begin with a combination of easy, rapid-but possibly small payback-projects (to quickly establish legitimacy for the initiative) and more difficult, longer-term categories with higher payback potential. For example, car rental and hotel agreements can be put in place relatively quickly and easily, whereas executive search and consulting agreements may require additional resources and time to ensure appropriate selection and effective lowest total cost arrangements.

• **Establishing initiative management processes.** Project management to a well-written plan is critical, Trecha says. However, he notes that “planning is an iterative process. It’s important to have realistic and well-defined goals, roles, responsibilities, and accountabilities across the corporation.” For example, business unit management must be on board with the expectation that operating budgets will be reduced commensurate with new supply agreements. “Additionally,” says Trecha, “there needs to be a system for tracking progress against goals, and for quickly ascertaining where the plan is falling down and how it needs to be fixed.” He noted that low-cost Internet technology is an excellent means for tracking and reporting performance to a project plan and for providing information to relevant personnel. Another key element in project management, Trecha says, is to stay focused on the future. “Too many projects waste time and resources documenting the past, instead of looking to the future,” he says. For example, where good historical data doesn’t exist, he says it’s very likely that estimates will suffice.

• **Creating a budget reduction process.** Senior managers, Trecha notes are rarely impressed by “soft” savings (that is, savings that don’t drop to the bottom line). In context of indirect purchasing initiatives, there needs to be processes whereby departmental budgets are actually reduced to reflect savings from new purchasing strategies. “Successful budget-reduction programs require finance-accounting, department management, and purchasing participation. Implicit in this process is a certain degree of resistance. Yet, as the benefits of new supply agreements are effectively communicated and demonstrated to department management, they will understand the opportunities and em-

Rate of savings and compliance curve

(Savings, $000s)



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Rate of savings and compliance reporting

Category	Company expenditures ($000s)				Compliance Progress[1]		
	BU-1	BU-2	BU-3	Company Total	Status	Max %	Savings
Professional Services							
Executive search	$2,041	$1,650	$2,966	$6,657	6	12%	$799
Staff augmentation	3,750	2,105	9,684	15,539	7	7%	1,088
IT consulting	5,682	4,150	9,792	19,624	6	10%	1,962
Total professional services	11,473	7,905	22,442	41,820			3,849
Travel							
Airfare	6,095	4,560	16,380	27,035	9	9%	2,433
Car rental	1,175	980	1,345	3,500	7	6%	210
Lodging	4,290	3,040	6,000	13,330	9	15%	2,000
Total travel	11,560	8,580	23,725	43,865			4,643
Office products							
Office supplies	2,120	1,976	2,820	6,916	8	15%	1,037
Furniture	1,336	950	953	3,239	9	11%	356
Express mail	1,650	862	2,734	5,246	9	8%	420
Total office products	5,106	3,788	6,507	15,401			1,813
Annual purchases	28,139	20,273	52,674	101,086			
Annual savings							**$10,305**

[1] Dollar and percentage savings estimates are for demonstration purposes only. typically achievable results average 8%-15% across all categories

brace new, lower cost ways of doing business," says Hottinger.

• Development of processes for new supplier introduction and development. A limited understanding of how to introduce new suppliers to different parts of an organization will stop indirect purchasing initiatives in their tracks, Trecha says. "The typical reaction from end users in that quality and service will be sacrificed to price."

(In some cases, Trecha concedes, teams may be insufficiently capable of applying total cost analysis to their buying decisions leading to price-over-quality-type decisions). Indirect buying teams also need ways to overcome the strong sense of ownership felt by people who have historically made indirect buying decisions for their locations or business units. Very often, these buying decisions may be based on personal relationships or they may reflect the limited influence that former decision-makers have had on the supply base or users.

• Measuring results and tracking compliance. "Results will vary widely based on the type of purchasing being done," Trecha notes. "Team members need to learn how to measure the value of supplier relationships in terms of total cost and other performance metrics." Integrated Strategies uses a "green-yellow-red zone" rate of savings and compliance reporting methodology. Once category-specific savings measures are agreed to, compliance to a new supply agreement proceeds. The methodology reports results. It also highlights where best-practice compliance is occurring as well as where additional focus is required, says Trecha (See green-yellow-red zone compliance reporting spreadsheet and rate of savings curve). The green zone identifies categories where compliance is achieving between 80%-100% of available cost savings. That is, new favorable supplier agreements are in place and are being used to their full extent. The yellow zone identifies where compliance is operating between 50%-79% of achievable results. The red zone identifies where compliance to a new agreement is operating at less than 50%. By color coding level of compliance, the organization can quickly determine where compliance improvement programs are required. They can also see the benefits achieved by more aggressively focusing in those areas.

Integrated Strategies has a 10-step Indirect Sourcing Initiative Process designed to help organizations take control of their indirect purchases to achieve and sustain price-cost reductions, customer service distinctions, and quality/process improvements. "Bottom line is improved profitability and that's what purchasing should be all about," Trecha says.

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Qualifications

- Consultants average more than 20 years experience
- Web-Based strategic sourcing tools
- “Concept to Reality” approach
- Hands-on implementation
- Worked with more than 200 firms across multiple industries
- Developed more than 250 supply chain and logistics strategies
- Integrate core supply chain with core business strategy

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Logistics

Materials Management

Order Fulfillment

Six-Sigma

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Integrated STRATEGIES INCORPORATED

Strategy Center
5000 Marsh Road, Suite 1
Okemos, Michigan 48864
517-381-4800 • (Fax) 517-381-4807

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