By Ashok Santhanam

# Uncover Savings Opportunities

**Spend analysis and optimization are more than one-time events to cut costs; they provide a framework that must be executed on an ongoing basis.**

Many businesses are losing millions through the corporate procurement process because they fail to have clear insights into what they are buying, for how much and from whom. According to leading analysts such as Aberdeen Group and AMR Research, most organizations can save about 2 percent to 6 percent (or even more) of their total spend by identifying low-hanging cost savings opportunities such as rationalizing the supplier base, eliminating purchase price variance between facilities or improving contract compliance by providing clear visibility into their spend. For a typical manufacturer to show a similar increase in gross margin to what it might see by analyzing its spend, it would need to show a 15 percent increase in revenue.

However, in order to identify where to focus and what the opportunity for cost reduction might be, one first needs to have visibility into current spend across various dimensions — by division, by category, by business unit and by suppliers. Only then can you identify and prioritize such cost-reduction initiatives. Without it, you are shooting in the dark in terms of where to find the low-hanging opportunities.

It is challenging, however, for organizations to get a complete picture of their direct and indirect spend without deploying spend-analysis technology. One approach is to run reports on top of ERP, but that does not always offer the broad visibility you need. Alternatively, a supply management organization might consider manual work using spreadsheets. Unfortunately, such an analysis only provides an approximate view, and because it is manual, it is prone to errors. In addition, if you need such visibility on an ongoing basis, that analysis cannot be reused and you would have to start the complete process over again.

Today, spend analysis technology enables organizations to have detailed and ongoing visibility into spend. It shows you how much is being spent, for what, with whom and where. Spend analysis entails taking the existing information already being tracked in the form of invoices, purchase orders and receipts, then "cleansing, normalizing, categorizing and enriching the data," as marketing research firm Forrester Research defines the process. After doing so, companies will have better insight into their spend and use it to deploy cost saving initiatives discussed here.

It is important to first understand why organizations fail to get clear visibility into their spend in the first place, when they are running reports on top of their ERP system. I believe that running such reports is likely to give partial answers and may even point you in the wrong direction.

First, the data required for spend analysis exists in multiple systems: for example, ERP, T&E (travel and entertainment) data from the credit card company and P-card data from a bank, and so on. One may also get some procurement data from their subcontracting partner(s). Because many organizations store this critical data in various systems, everything you need is likely not stored in your ERP system; therefore, an organization has to be able to aggregate data from multiple sources.

Second, the data in ERP may be incomplete or dirty. The same supplier may be coded differently in one system — such as "HP" in one system and as "Hewlett-Packard" in the same or other systems — while the same supplier's name may also be misspelled, making it hard to roll that information up into one line item. Item categorization may be nonexistent, so that one cannot roll up spend on two items that belong to the same category. You may also not know that you are buying from the subsidiary of another supplier — information that would increase your negotiation leverage.

Finally, you may need IT to help you translate the complex ERP database structure to help you see the data in your reports.

All these issues make it hard to do spend analysis on top of an ERP system. This issue has led top supply management executives to initiate spend analysis technology to get clear insights into their spend.

Whether you do it yourself or work with a service provider, there are three key phases organizations need to undertake in order to implement a successful spend analysis campaign.

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### Gather and Combine Information

In the first phase of the spend analysis process, consider the following:

- Combine spend data currently stored in multiple systems. This data often exists as individual transactions in ERP systems, e-procurement applications and external travel and expense systems. This data must be extracted from multiple systems and stored in a common location, such as a separate database.
- Cleanse data and normalize supplier information so that misspelled supplier names, where the same supplier name is written differently in different records (such as the HP/Hewlett-Packard example mentioned earlier), can be unified. A combination of technology and methodology can quickly address cleansing and normalization.
- Map each product to popular standards-based classification taxonomies using the Universal Standard Products and Services Classification (UNSPSC). Mapping allows users to aggregate spend information by commodity type — such as five of the similar horsepower Hewlett-Packard motors coming from two different suppliers, despite the fact that these motors were labeled with different item codes in the ERP system. As a result, their spend data can be aggregated after classification codes have been added. Spend analysis technology can help accelerate this process.
- Enrich the supplier data with useful information such as supplier's parent company name, their revenues, credit rating and diversity status, and so on. This data gives supply management professionals the ability to get better insights into their supply base to make the best sourcing decisions.

### Analyze Spend, Look for Savings

Once your data has been cleansed, normalized and enriched in phase one, it is analyzed in phase two to identify low-hanging opportunities for cost savings. Analysis in phase two gives you clear visibility into spend, such as how much you are spending by category, how many suppliers you have for a category and how much you are spending across various suppliers for a category. You can develop a pareto distribution chart across suppliers for a category and have visibility into the degree of supplier overlap by category. Alternatively, you can take a product perspective and evaluate product proliferation by seeing how many items you have in a category, the number of suppliers for each item and price variance of each item across locations, business units and suppliers. You can perform detailed analysis for various dimensions such as categories, suppliers, items and employees, and so on.

With this level of visibility, you now can identify opportunities such as rationalizing the supply base or eliminating purchase price variance between locations. Once all the opportunities are identified, they are prioritized based on criteria such as the magnitude of savings, relative ease of implementation and cultural changes needed to achieve the results. This allows organizations to zero in on those opportunities that offer the highest business impact for the lowest barriers for implementation.

### Implementation of Initiatives

Once you have completed the prioritization, you continue to phase three. This phase involves implementing the priorities that have emerged from phase two. Such priorities can include implementation of best practices, strategic sourcing initiatives or compliance initiatives, and can lead to deployment of various technologies such as supplier relationship management, supplier collaboration and more. Key performance indicators can also be established and used as a way to rationalize the organization's suppliers.

If spend analysis shows that one department pays a lot more for contract services than another one does, for example, your organization can move to consolidate contract purchases from the lower-cost provider. It can also implement the processes needed to ensure that all departments comply with new contract rules regarding purchasing the less expensive services.

Through adopting the three phases of spend analysis, a large aerospace company we worked with recently was able to reduce its overall supply management spend by about 5 percent. In this initiative, the company analyzed procurement data within 16 systems, including SAP. The company extracted and consolidated a total of 22 million records and standardized more than 3 million item/service records. It also created a five-level classification scheme for items and services. After finishing the spend analysis initiative, the company was able to reduce its rate of purchase of similar commodities from multiple suppliers at varying contractual prices. The insights also enabled the organization to identify maverick buying as a cause of waste and to implement processes that would eliminate this problem. For example, after clearing up price variance issues — a prevalent problem throughout the company — the organization reported a $42,000 annual procurement savings on one item alone.

In order for spend analysis and optimization efforts to pay off in the long term and see continuing gains, it's important to repeat the phases on a regular basis. While organizations may see a large spike in savings from going through the entire process just one time, this does not set things up for sustained results. Over time, practices such as maverick buying, lack of contract compliance and buying the same commodity from multiple suppliers at varying prices will invariably creep back in. Rather than approaching spend analysis and optimization as a one-off project, we believe it is critical to execute this framework on an ongoing basis to achieve sustainable benefits. This allows you to build upon the work done in the past without having to repeatedly initiate brand-new data improvement and enrichment processes.

Under a long-term program that combines spend analysis initiatives with a managed services program, supply management professionals can continue to enjoy sustained cost savings. **ISM**

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