

## **Spend Analysis: The First Step in Strategic Sourcing**

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**Abstract.** Spend Analysis: The First Step in Strategic Sourcing details the baseline process that an organization should follow to establish a functional strategic sourcing program grounded on accurate expenditure information. Austin-Tetra will discuss the framework for evaluating current spend thus ensuring the potential of strategic sourcing initiatives is fully realized.

**The Opportunity.** Three key best practices of spend management are:

- Baseline spend to establish visibility to current purchasing and identify initial sourcing opportunities
- Support compliance initiatives to meet internal savings targets including Federal government regulations and socioeconomic initiatives
- Implement process improvement to meet the dual goals of sourcing savings and best practices in compliance

**Objective.** The objective is to present practical information for procurement professionals on why spend analysis and enterprise-wide spend visibility is a critical enabler to strategic sourcing.

“Few companies have employed standard procedures or systems to control spending from sourcing through purchasing compliance and quality assurance” according to Aberdeen Group, *The Category Spend Management Report Series 2004*.

In order to have a successful strategic sourcing program, it is essential to follow three steps. First, you must baseline your current spend to achieve complete enterprise-wide visibility. In order to know exactly who you are spending your money with, an adequate analysis must be done of your supply chain to provide detailed vendor visibility, leverage spend to negotiate enterprise-wide cost savings, and increase communication between procurement and accounts payable.

“Spend management requires data management and performance management”, says Pierre Mitchell formerly of AMR Research. “Master data management deals with how to clean up and classify master data for suppliers, commodities, contracts and parts (for manufacturers).”

Gaining spend visibility can be time consuming and resource intensive; however, when complete, it opens vast opportunities for cost savings. You must review your suppliers to ensure the intelligence is accurate and up-to-date. Intelligence is defined as ensuring information such as business demographics (name, address, phone, etc.), commodity and service categorization, corporate ownership and socioeconomic status are complete and

current. If this is correct, you will know exactly who you spend your money with, what you are buying, enabling buying leverage and potential cost reductions.

Example: A supplier database contains five companies labeled IBM at five different addresses and in two different countries. After cleansing and enhancing your supplier master data, you now know that four of the five IBM records, are owned by IBM Corporation. In knowing you spend \$2.5 million with IBM Corporation, you are able to negotiate additional savings across your enterprise.

The quickest way to achieve complete visibility is through a spend analysis center of excellence, comprised of resources with deep subject matter expertise, an accessible repository of critical information, workflow to support efforts such as exception handling and applications to support data management and decision making capabilities. The spend analysis center of excellence should provide you with a repeatable process and a centralized decision making capability of ever improving information.

Many companies have multiple systems capturing expenditures in multiple formats making it challenging to understand how many vendors you have. A centralized repository allows for faster, more complete data in understanding your spend.

For example, your vendor, "ABC International", relocated its' headquarters in May 2004 but your information is only updated annually. Your accounts payable department has added this company as a new record versus changing the address of an existing record. Your information now contains a duplicate supplier and can cause an inaccurate assessment of savings opportunity with "ABC International".

Your spend repository should be continually refreshed and managed. Updating your information at least once a quarter is critical to having complete spend visibility. If your information is readily available or on-demand, the change in information will be seen in real-time.

### **Spend Management: Key Process Steps**

- 1. Extract, Cleansing and Validation:** Identify where spend takes place and how to ensure complete visibility.
- 2. Code for Insight:** Standardize purchased products and services into common commodity structure.
- 3. Supplier Enrichment:** Identify ownership, risk, socio-economic and denied parties indicators for both strategic suppliers and the overall supply base.
- 4. Implement Process Improvement:** Standardize on a consistent process framework in order to ensure improved visibility going forward.
- 5. Analyze and Execute:** Using standard reporting and analytical tools on a continuous basis to support decisions on strategic sourcing and procurement such as cost cutting, streamlining operations, and category and supplier rationalization.

Another key consideration in spend analysis and strategic sourcing is ensuring that spending meets organizational goals. Examples include:

- **Sarbanes-Oxley:** Spend and supplier enrichment assists in addressing Sarbanes-Oxley (SOX) compliance demonstrating appropriate controls in purchasing.
- **Risk:** It is important to consider supplier risk in making critical strategic sourcing decisions.
- **Denied/Debarred Parties:** Organizations which have been identified by the U.S. Federal Government as denied parties.
- **Socioeconomic:** Many firms have internal and external requirements to track and report spending with small businesses as well as minority and woman-owned firms.

Finally, by implementing process improvement you standardize on consistent process framework and categorize spend to a common supplier master and harmonized spend categorizes across the organization. Additionally intelligence is captured closer to the transaction for higher compliance.

According to Aberdeen Research, inadequate spend management capabilities are costing businesses \$260 billion in missed opportunities annually. Implementing a comprehensive spend management framework has become necessary to fully realize the promise of strategic sourcing.

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