

# SPEND ANALYSIS and SUPPLY BASE RATIONALIZATION

*Presented By:*



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## INTRODUCTION

The Institute for Supply Management™ (ISM) in conjunction with Staples, conducted an online survey of supply management executives in December 2005. The survey was conducted to determine the extent to which organizations have adopted spend analysis and supply base rationalization techniques in their operations.

For the purposes of this study, spend analysis was defined as the process of identifying current spend to determine what is being spent, with whom, and for what. Supply base rationalization was defined as a conscientious effort to determine the right number of suppliers to do business with. The results of the survey are reported here along with analysis and commentary.

## SURVEY METHODOLOGY

The online survey form was developed collaboratively between the staff of ISM and Staples. The objective of the survey was to determine the extent to which supply management organizations are utilizing spend analysis and supply base rationalization techniques in their operations.

An e-mail message was sent out to 4,000 randomly selected supply management professionals in ISM's customer database with an invitation to respond to the survey. The invitation included a link to the online survey tool. Responses were collected over a three-week period. In all, 222 completed responses were received – a response rate of 5.4 percent. The resulting data were tabulated and analyzed by ISM staff. All percentages reported here have been rounded to the nearest whole number.

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## DEMOGRAPHICS OF RESPONDENTS

The survey included a number of questions that were asked to determine the demographic makeup of the respondents and their organizations. The majority of respondents (73 percent) held upper-level positions of manager or above that included responsibility for purchasing/supply management/sourcing in their organizations. The breakdown of respondents by job title is reported below.

Chief	2%
Vice President	7%
Director	19%
Manager	45%
Agent, Buyer, Sr. Buyer, Planner, Purchaser	23%
Consultant	2%
Other	1%

Of all respondents, 60 percent were employed in a manufacturing industry and 40 percent were employed in a non-manufacturing industry. The detailed breakdown by industry is as follows.

Manufacturing	60%
Automotive/aircraft/transportation equip.	9%
Chemicals, plastic and rubber products	3%
Computer and electronic products	4%
Electrical equip., appliances, and components	7%
Fabricated metal products	2%
Food/beverage/tobacco	2%
Furniture and related products	1%
Machinery	3%
Nonmetallic mineral products	1%
Other	19%
Petroleum and coal products	2%
Primary metal products	3%
Textile/textile products/apparel/leather	1%
Wood products/paper/printing	3%
Non-manufacturing	40%
Business/consulting services	3%
Distributors/wholesale trade	2%
Other	19%
Other business or educational services	7%
Professional, scientific and technical services	3%
Retail trade	1%
Transportation/logistics services	5%

The size of the organization was reported in revenue for the most recent fiscal year and in number of employees. The breakdowns for organization size are reported below.

Revenue	
Less than \$10 million	4%
\$10 million - \$99.9 million	18%
\$100 million - \$499.9 million	18%
\$500 million - \$999.9 million	10%
\$1 billion - \$10 billion	31%
\$10 billion or more	20%
Number of Employees	
Less than 1,000	24%
1,000-4,999	28%
5,000-9,999	11%
10,000-49,999	19%
50,000-99,999	9%
Over 100,000	8%

## SURVEY RESULTS

### Spend Analysis

The first section of the survey asked respondents about spend analysis initiatives in their organizations. For the purpose of this survey, spend analysis was defined as the process of identifying current spend to determine what is being spent, with whom, and for what. Of all respondents, 90 percent are involved in some sort of formal spend analysis initiative and 10 percent are not pursuing a spend analysis initiative. Of those involved in a formal spend analysis initiative, 68 percent have been involved in the process for two or more years with slightly less than half (42 percent) indicating that they have been involved in spend analysis for more than five years. A small percentage (13 percent) have been involved in the initiative for less than a year.

In terms of effort, 47 percent of respondents indicate that their companies have expended “significant effort” in pursuing its spend analysis initiative with 40 percent indicating that they have expended “some effort,” and 13 percent indicating that they have expended “minimal effort.”

The majority of respondents (60 percent) indicated that their companies spend analysis initiatives have been “somewhat effective.” Nearly a third of respondents (31 percent) indicated that their company has been “highly effective” in pursuing its spend analysis initiative. A small number of respondents (9 percent) indicated that their company has been “not effective” in pursuing its spend analysis initiative.

Cost savings was the primary objective of the spend analysis initiative for 61 percent of the respondents while 20 percent cited channeling spend to fewer suppliers for increased leverage as the primary objective. Supply base rationalization was the primary objective for 11 percent of the respondents

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while increased centralization of purchasing operations was the primary objective for 6 percent of the respondents.

With regard to spend analysis targets, slightly less than half of the respondents (47 percent) hope to account for 80 percent or more of the company's total spend. The breakdown for the percentage of total spend that is hoped to be accounted for in the spend analysis efforts is reported below.

Up to 50% of total spend	18%
51-70% of total spend	15%
71-80% of total spend	20%
80-90% of total spend	27%
91-99% of total spend	14%
100% of total spend	5%

A list of potential barriers that could prevent or hinder the achievement of spend analysis goals was presented. Respondents were asked to indicate the barriers that were threatening to keep their company from achieving its goals. Of these potential barriers, the lack of time to devote to the effort was cited most frequently – by more than half of the respondents to this question (54 percent). The percent of respondents to this question who selected each barrier is listed below.

Lack of time to devote to the effort	54%
Lack of needed tools and resources (e.g., systems)	44%
Lack of support from staff in other functional areas	43%
Resistance to change	39%
High levels of spend outside of purchasing	37%
Lack of useful data	33%
Lack of top management support	17%
Lack of support from purchasing staff	9%
Other	9%

It is of little surprise that the lack of time and tools are the most frequently cited barriers. It is interesting to note that the next three barriers in order of frequency reported are largely external to the supply management function. This would indicate that many respondents are struggling to get other functions to assist in the effort as needed. While resistance to change is high on the list, the low number for lack of support from purchasing staff (9 percent) would seem to indicate that the bulk of the change resistance is coming from other functional areas. Perhaps more concerted effort to overcome these barriers will help to increase the effectiveness of spend analysis efforts.

The next question on spend analysis asked respondents to indicate the effectiveness of a number of different tools in helping to analyze spend. Respondents could answer using a three-point scale with 1 indicating “not effective,” 2 indicating “somewhat effective,” and 3 indicating “very effective.” An additional option of “not using” was offered. The average

score for each tool was calculated and all of the tools received an average score that was greater than 2. The tool with the highest rating for effectiveness was also the tool used by the largest number of respondents. Internal reviews of spend data were reported as being used by 95 percent of respondents. The next most frequently used tool, centralization of purchasing operations, received the same average score as internal reviews of spend data but was used by 81 percent of the respondents. The average score for each of the tools is reported below along with the percentage of respondents who indicated “not using.” The factors are listed in descending order based on the average score.

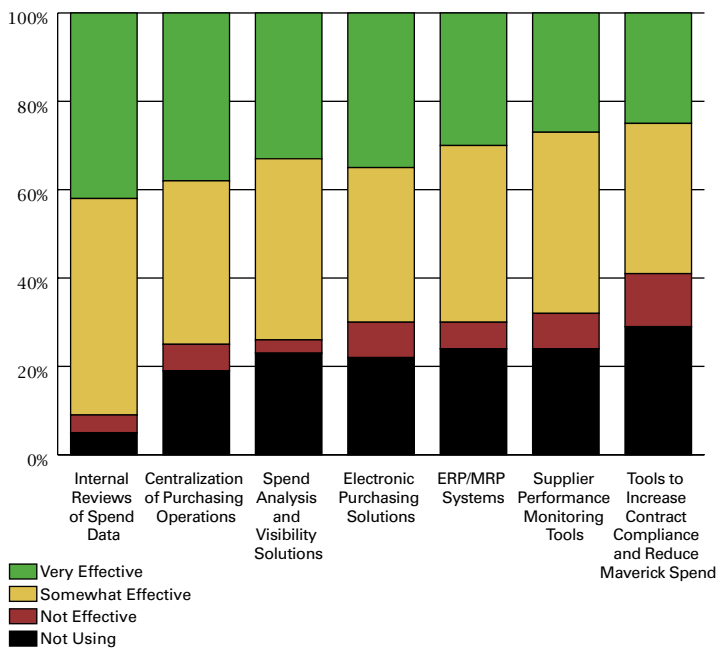
	Average	Percent indicating “Not Using”
Internal reviews of spend data	2.40%	5%
Centralization of purchasing operations	2.40%	19%
Spend analysis and visibility solutions	2.39%	23%
Electronic purchasing solutions	2.36%	22%
ERP/MRP systems	2.33%	24%
Supplier performance monitoring tools	2.25%	24%
Tools to increase contract compliance and reduce maverick spend	2.19%	29%

A graphical representation of the results for this question is presented in Chart 1. Each of the tools in the list has been adopted to some degree or another by 70 percent or more of the respondents. This indicates that the overall acceptance and use of these tools is high. However, as shown above, 44 percent of respondents indicated that the lack of needed tools and resources is threatening to keep the company from achieving its spend analysis goals. This might indicate that more effective tools and resources still need to be developed and adopted to increase overall effectiveness.

Several open-ended questions were asked at the end of the section on spend analysis to gather additional information from respondents. The first question asked respondents to indicate what would help them be more effective in their spend analysis efforts. Nearly three-fourths (70 percent) of respondents provided some sort of answer to this question. Over half of the respondents (52 percent) indicated that improvements to internal systems and tools would help the spend analysis

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Chart 1: Effectiveness of Various Tools in the Spend Analysis Effort



initiative be more successful. Nearly one-fourth of responses (24 percent) indicated that support from others in the organization – particularly from top management and information technology staff – would help the initiative. Other items mentioned for helping the spend analysis initiative include additional time, staff, or other resources; increased centralization of purchasing operations; benchmarking data; and assistance from suppliers.

The next two questions asked about how suppliers can help the spend analysis effort. Two-thirds of the respondents (66 percent) to a question that asked how strategic suppliers have helped the spend analysis initiative indicated that their suppliers have provided detailed reports of what was purchased from them. Additional respondents reported that suppliers have negotiated price reductions and other terms, and have suggested various other cost cutting measures. The second question asked what assistance strategic suppliers could offer to help make the spend analysis efforts more effective. Over half of the respondents (54 percent) indicated that they would like to see more spend data from suppliers. Additional responses included more cooperation from suppliers; cost reductions; market information; benchmarking information; and business intelligence.

The last question on spend analysis asked respondents to indicate what they felt were the three most important attributes

of a successful spend analysis program. The answers to this open-ended question covered a wide range of topics but more than half of the respondents (56 percent) mentioned something pertaining to the accuracy of the data involved. More than one-fifth of respondents mentioned cost savings (22 percent) or top management buy-in (21 percent) as important attributes. Helpful tools to aid in the spend analysis effort were mentioned by 18 percent of respondents while an organized plan of execution was mentioned by 12 percent. Other responses that were mentioned by more than 10 percent of respondents include a reduced or rationalized supply base (11 percent) and increased leverage with suppliers (11 percent). Additional responses included the support of suppliers; the support of other functional areas in the organization; purchasing compliance throughout the organization; an adequate number of spend categories; centralized purchasing operations; consistency throughout the organization; automated procedures; time to devote to the effort; and an adequate set of skills to analyze the information and make decisions.

## Supply Base Rationalization

The next section of the survey asked questions relative to supply base rationalization efforts. For purposes of this survey, supply base rationalization was defined as a conscientious effort to determine the right number of suppliers to do business with. Of all respondents, 86 percent are pursuing a supply base rationalization initiative and 14 percent are not. Among those who are pursuing a spend analysis initiative, more than two-thirds (68 percent) have been involved in the initiative for 2 years or more. The breakdown for the length of time respondents have been involved in supply base rationalization is reported below.

Less than a year	12%
1-2 years	21%
2-5 years	33%
5 years or more	34%

The supply base has been reduced in 70 percent of the companies since the rationalization efforts began with 76 percent of respondents expecting to reduce the supply base further in the next 12-24 months. The supply base actually increased in size since the rationalization efforts began for 11 percent of the respondents while 19 percent reported that the size of the supply base did not change. For the next 12-24 months, 3 percent of respondents indicated that their company has set a goal to increase the size of the supply base and 21 percent have set a goal to maintain the current size of the supply base. Chart 2 shows the actual breakdown for how the supply base has changed since rationalization efforts began side by side with the supply base rationalization goals for the next 12-24 months.

The next question asked about the barriers that might be keeping the organization from achieving its supply base rationalization goals. Respondents were allowed to select all answers that

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applied. As was the case with the similar question for spend analysis, the lack of time to devote to the effort was at the top along with the lack of support from staff in other functional areas. The actual breakdown for each option is reported below.

Lack of support from staff in other functional areas	52%
Lack of time to devote to the effort	52%
Resistance to change	48%
Lack of data to compare suppliers	37%
Lack of needed tools and resources	36%
High levels of spend outside of purchasing	32%
Concerns about risk	28%
Lack of top management support	24%
Lack of support from purchasing staff	12%
Other	11%

Supply base rationalization is not applied equally to all categories of spend. Of all respondents, 76 percent say that rationalization has not been pursued in all categories of spend. Of these, 23 percent have pursued rationalization in direct spend only, 8 percent have pursued rationalization in indirect spend only, and 45 percent have pursued rationalization in both direct and indirect spend but not in all categories. Slightly less than one fourth of the respondents (24 percent) have pursued supply base rationalization in all categories of spend.

The next question asked respondents to indicate the actual commodity areas in which they have pursued supply base rationalization. Multiple answers were allowed. Of all of the commodity areas listed, supply base rationalization is most likely to have taken place in office supplies. It was cited by 74 percent of the respondents to this question. Other commodity areas that were cited by more than half of the respondents include direct materials (64 percent), MRO/indirect materials (64 percent), and copy services/printing (55 percent). The complete breakdown by commodity area is reported below.

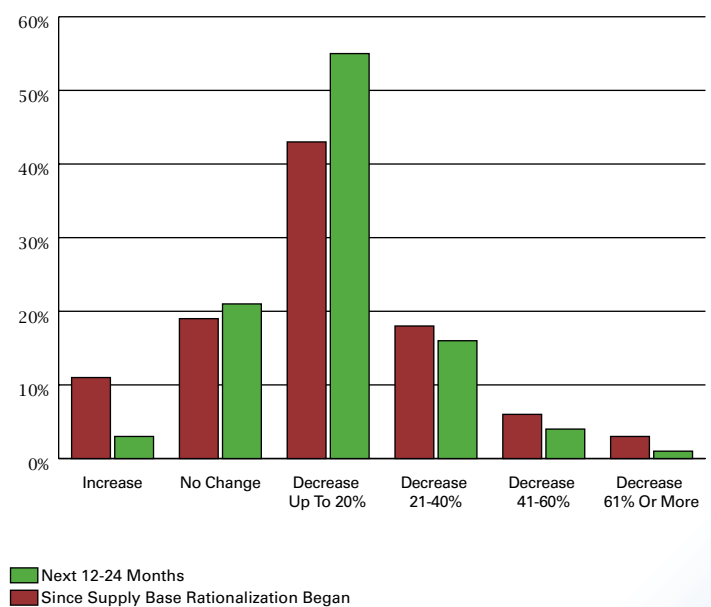
Office supplies	74%
Direct materials	64%
MRO/indirect materials	64%
Copy services/printing	55%
Travel	48%
Technology	45%
Telecommunications	43%
Transportation/logistics	43%
Janitorial services/sanitation	42%
Temporary labor	39%
Furniture	38%
Packaging materials	38%
Promotional and miscellaneous items	22%
Energy	21%
Marketing/advertising services	21%
Legal services	8%
Other	8%

The interaction between spend analysis and supply base rationalization was the focus of the next question. It asked respondents to indicate the extent with which the spend analysis efforts have been a factor in the supply base rationalization efforts. Of all respondents to this question, nearly half of respondents (49 percent) indicated that it was either an important factor or a highly important factor. Just 12 percent of respondents indicated that it was not a factor. The actual breakdown for this question is reported below.

Not a factor	12%
Somewhat of a factor	39%
Important factor	37%
Highly important factor	12%

Respondents were asked to indicate the importance of a number of factors for each supplier when considering rationalizing the supply base for a particular commodity group. Respondents could answer using a four-point scale with 1 indicating “not important” and 4 indicating “very important.” The average score for each factor was calculated and six factors received an average score that was greater than 3 (“important” to “very important”). The six factors were quality, overall costs, delivery performance, customer service capabilities, price and

**Chart 2: Change In Supply Base**





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supplier flexibility. The average score for each of the factors is reported below along with the percentage of respondents who indicated “important” or “very important.” The factors are listed in descending order based on the average score.

	Average	Percent indicating Important or Very Important
Quality	3.74%	98%
Overall costs	3.64%	95%
Delivery performance	3.57%	98%
Customer service capabilities	3.22%	86%
Price	3.11%	83%
Supplier flexibility	3.06%	83%
Supply chain management capabilities	2.73%	64%
Implementation time	2.73%	63%
Staff assigned to your account	2.70%	61%
Switching costs	2.66%	59%
Financial and operational metrics	2.65%	56%
Account management capabilities	2.61%	55%
Variety of goods/services offered	2.61%	52%
Switching risk	2.60%	55%
E-commerce/e-procurement capabilities	2.56%	52%
Demand management capabilities	2.52%	50%
Environmental initiatives	2.39%	37%
Diversity initiatives	2.24%	34%
Social responsibility initiatives	2.20%	34%
Demographics of ownership (i.e., minority owned)	2.20%	34%
Personal relationships	2.18%	38%
Global distribution capabilities	2.12%	34%
Presence of local outlets/ fulfillment centers	2.10%	33%
Proximity to your facilities	2.01%	27%

Chart 3 shows the breakdown of responses for each of the 24 factors in the survey.

The last two questions in the survey were open-ended questions that dealt with ways that suppliers have set themselves apart by going above and beyond what was expected and by assisting in the supply base rationalization effort. The first of these questions asked respondents to indicate how strategic suppliers have helped in the supply base rationalization efforts. Of all respondents given, 27 percent indicated that suppliers

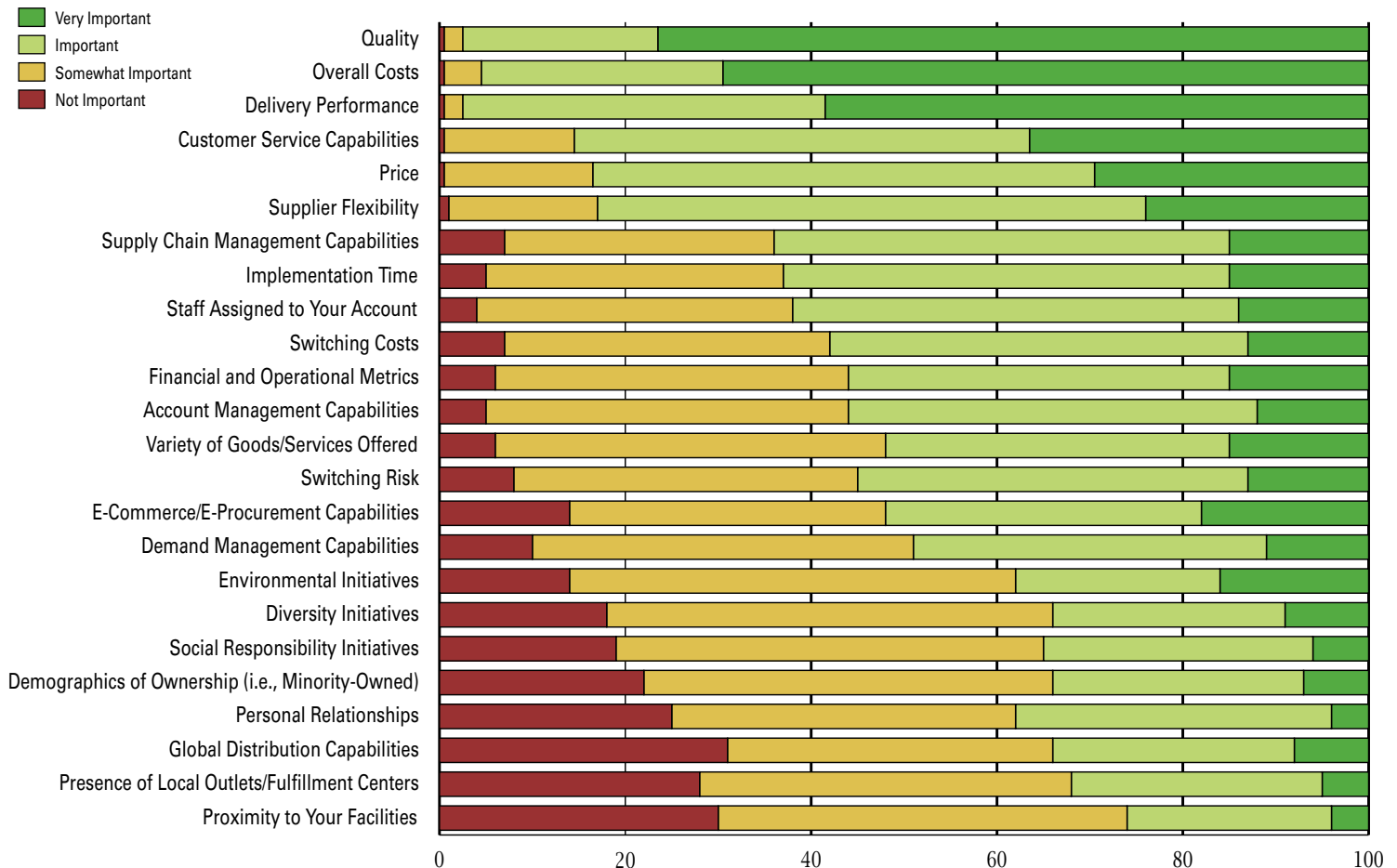
have assisted by providing data, 21 percent indicated that suppliers have improved performance in some way, and 18 percent indicated that suppliers have simply cooperated in various ways. An additional 16 percent indicated that suppliers have expanded their product or service offerings, 13 percent indicated that their suppliers have taken on more tasks, and 9 percent indicated that suppliers have offered some sort of price concession. One respondent indicated that strategic suppliers are the result of supply base rationalization rather than helpers in the effort.

The other open-ended question asked respondents to share an example of how one of their top suppliers has provided service that went above and beyond what was expected to earn the distinction as a top supplier. Of all responses, 24 percent indicated that the supplier has provided knowledge and skills that helped improve quality, reduce costs and/or improve efficiency; 20 percent indicated that suppliers have helped in cost/price areas by offering price concessions or expertise that has helped to cut costs or remove inefficiencies from processes; and 12 percent indicated that suppliers have taken on additional tasks or roles to reduce the work performed by the buying organization. An additional 12 percent of respondents indicated that suppliers have gone above and beyond by expediting orders when time was of the essence. Some of the actual responses to this question are listed below.

- During recent supply problems, the supplier found other products to keep us running.
- Recommended alternative supplier.
- Maintained competitive costs, broader product line, multiple distribution locations. Provided credible industry forecast and intelligence.
- Offering opportunities to support our diversity initiatives.
- After reviewing a particular commodity and the associated applications, they made a recommendation that reduced the number of items being carried by 10 percent.
- Immediate support during unplanned interruptions.
- Following recent hurricanes, a supplier offered generators to us at their cost which we provided to team members without power.
- When one of our divisions shut down its internal machine shop, a strategic partner hired the employees who were let go to maintain the job knowledge and support for the offloading of that product.
- Taking on vendor managed inventory or consignment.
- Identifying material discrepancies in a particular part that was undetectable in the end product. They were open and honest with us and were an integral part of the solution.
- Invested in capital equipment to serve special product need.
- Reconcile packing slips with receiving on a weekly basis.
- The supplier took us to another manufacturer where we benchmarked best practices, systems and process improvements.

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**Chart 3: Importance of Various Factors in Rationalization Decisions**



## IMPLICATIONS FOR MANAGEMENT

### Supply Management

Several respondents to the question that asked how suppliers have helped in the supply base rationalization or spend analysis efforts indicated that some suppliers were strongly opposed to the ideas and refused to assist in any way. Some even responded that suppliers became offended and defensive when they learned that supply base rationalization was taking place. While this is not unexpected, it is probably due to a lack of understanding about what the end result could be. In cases like this, the supply management community needs to do a better job of communicating the purposes behind supply base rationalization and spend analysis efforts and to educate suppliers on how they can benefit from it. As some of the

examples above demonstrate, those suppliers who recognize the long-term value of the closer relationships that are often the end result of spend analysis and supply base rationalization efforts can truly make significant contributions to the success of your organization. It can be well worth the extra effort it may take to get your suppliers on board.

When a decision is made to drop a supplier from your current supplier list, an effort should be made to communicate the reasons to the supplier. Don't mislead the supplier into assuming that they can win back your business by correcting a few deficiencies. Rather, you want to let the supplier know the reasons why you have decided to go in another direction. This effort will help the supplier identify areas that might need improvement so that they can take the necessary steps to improve their operations.

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It is also evident from the results of the survey that supply management needs to exert more time and effort to sell internal staff on the long-term benefits of spend analysis and supply base rationalization. Lack of support from staff in other functional areas was cited as a major barrier to achieving spend analysis and supply base rationalization goals. Resistance from staff in other functional areas could be diminished if more time and effort is spent educating these people on the long-term value of these initiatives. Efforts that are aimed at increasing the buy-in and support of top management can go a long way to removing barriers that are put up by other functional areas. Also, increased support from top management can lead to an increased level of investment in the tools and resources that may be needed to make these projects more successful.

### **Upper Management**

The results of this survey indicate that one of the most common barriers to success in the spend analysis and supply base rationalization efforts is the lack of support from staff outside of the supply management function. While supply managers can and should do more to sell the benefits of these programs to other staff members, upper management can assist them by endorsing the programs and making it clear to all staff that these programs are for the long-term good of the organization. Also, time and resources are required to carry out these initiatives. These resources should be made available to assist the supply management team as needed and as prudent.

### **Suppliers**

Many suppliers fear the results of spend analysis and supply base rationalization. They envision a day when they will lose hard-earned business to another supplier in the name of cost cutting. The results of this survey show that that is not usually the case. While price is very important, it is usually not the main reason buyers go with one supplier over another. A low price will frequently get you onto the short list but will usually not push you to the top of the list. Many other factors are given careful consideration when the final decision is made. The most frequently cited consideration is the quality of the goods or services to be purchased. Suppliers can truly set themselves apart by offering goods and services of superior quality for the right price.

The next most frequently cited consideration that buyers use to determine the right suppliers to work with is the overall costs of doing business with you. Buyers are looking for the lowest total delivered cost and the price of the goods or services in question is just one component of this equation. Other components include the cost of ordering, transportation and handling costs, inventory carrying costs, the cost of credit, accounts payable costs and more. Suppliers can set themselves

apart by taking steps that minimize the costs of doing business. Such steps could include e-commerce capabilities that reduce ordering and payment costs and working proactively with customers to reduce costs.

Other factors that can set your organization apart from other potential competitors include on-time delivery performance, exceptional customer service, flexibility and variety in your offerings, supply chain management capabilities, account management capabilities, and active environmental and social responsibility initiatives to name a few. The presence of these programs and capabilities can make the difference when buyers must decide among different suppliers when other factors like price are equal.

## **CONCLUSION**

Supply management professionals are putting large amounts of effort into spend analysis and supply base rationalization programs. While the initial results have shown various levels of effectiveness, efforts are likely to continue into the future. It is likely that spend analysis efforts will attempt to account for an ever greater percentage of total spend and that supply base rationalization will be applied to a greater number of spend categories. New tools and techniques are likely to be created and adopted to address the barriers that are preventing organizations from achieving their objectives in these areas.

### **STAPLES CONTRACT DIVISION**

Staples Contract Division is Staples' fastest growing business with industry-leading double-digit growth for the past seven years. The business serves mid-sized companies through Staples Business Advantage and Fortune 1000 companies through Staples National Advantage. Contract works collaboratively with its customers to efficiently manage procurement programs with lowest total delivered cost. Staples Contract is a division of Staples, Inc., which today is the world's largest office products retailer. With 69,000 associates, the company is committed to making it easy to buy office products, including supplies, technology, furniture and business services. With 2005 sales of \$16.1 billion, Staples serves consumers and businesses in 21 countries throughout North and South America, Europe and Asia. Headquartered outside of Boston, Staples operates approximately 1,780 office superstores, mail order catalog and e-commerce.

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