Capturing Sourcing Savings

Catalogs and spend analysis can maximize returns on supplier contracts

The power of strategic sourcing cannot be denied. For some companies, reducing costs by 10 percent on goods and services purchased is equivalent to a 25 percent increase in revenue and overall profits. But as powerful a tool as sourcing is, many of its anticipated benefits don't reach the bottom line because employees and suppliers fail to comply with pricing and terms laid out in corporate contracts. Companies that want to capture all their sourcing savings can do so by making it easier for employees to buy and procurement teams to track suppliers' adherence to contracts. It's time to get this last mile right.

Every year, companies leave millions of dollars on the table because their employees and suppliers do not adhere to contracts that the procurement organization so painstakingly negotiated. In fact, when performing spend analyses for our clients, we often find that less than half of contracted sourcing savings reach the company's bottom line. Most of these savings are lost due to gaps between the terms of purchasing contracts and the ways in which employees make their purchases.

Employees are not always to blame, however. Indeed, failure to comply with master contracts is not a behavioral issue so much as a procedural challenge. Most employees make every effort to buy from corporate contracts. But in many cases, people simply do not have a clear understanding of the terms and how to implement them. Thus, for urgent requests—and in today's just-in-time business environment, all requests are urgent—people typically prefer to work directly with suppliers.

Instead, the root causes of noncompliance are often due to delays in the corporate procurement process. Case in point is the situation at a major telecom company where buying even straightforward items required a requisition to go through nine approvals and three different IT systems before procurement processed the order. In fact, the average order took 60 days to deliver.

Also, in many cases, a company's ordering process assumes that the same process suffices for the ordering of all products and services, which results in a complex, confusing and time-consuming "one size fits none" system. When this happens, employees seek any avenue to speed things up, which usually means steering clear of corporate altogether.

Increasingly, the separation between day-to-day buying responsibility and strategic sourcing means

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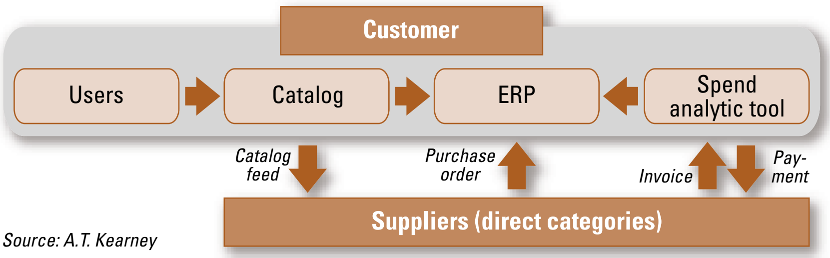
FIGURE 1: Manage compliance with catalogs and spend analysis



Source: A.T. Kearney

many functions—such as HR, marketing and construction—are responsible for buying goods and services from corporate contracts. These functions have to be in tune with how contracts work, so purchases through a corporate contract won't result in more frustration than compliance. A good way to increase compliance and thereby maximize the percentage of spend that meets the terms of corporate contracts is to offer more user-friendly tools and techniques. We recommend two: *catalogs* to improve purchasing abilities of others within the organization, and *spend-analytic tools* to monitor rogue purchasing activity *(see figure 1)*.

Catalogs and Spend Analytic Tools

Most companies put enormous effort into clinching the sourcing deal with a supplier but less effort into teaching employees outside the procurement organization how to buy under the new contract terms. Our answer to the compliance problem is to simplify the buying process with catalogs.

Catalogs allow employees to requisition products and services under terms from the master contract. These catalogs can be reinforced with spend-analytic tools that monitor and quickly address rogue spending.

Most companies today put their online catalogs on the corporate intranet or a secure external website. The catalogs offer a finite number of items per category (to reduce complexity); each item requires in-place supplier agreements and continual updating as contract terms evolve. Catalogs accelerate downstream processes, adding fluidity to the approval process and reducing errors as price checks against the corporate contracts are already reflected in the catalog.

For example, one outsourcing firm reduced its purchase order processing time from 30 days to less than one day after implementing a catalog system *(see figure 2)*. The catalog simplified the requisition and approval processes and linked the budget system with procurement. Now, only a small percentage of the company's orders are made outside of the catalog system, which also means there are fewer manual interventions. In fact, purchase orders requiring manual intervention dropped from 90 percent to less than 5 percent.

In addition, some companies create sales catalogs that link with buy-side catalogs, thus making it simpler for their own customers to place orders. In such a system, once a sales order is placed, the order is triggered automatically to suppliers if the items are not already in stock. This will improve customer satisfaction, as customers can seamlessly place orders, track them and receive items quickly.

The other side of compliance is to ensure that suppliers are adhering to the contracts. Spend-analytic tools confirm that suppliers are in compliance with agreed-to terms and specifications, and they help identify rogue spending. Of course, not all spend can flow through a catalog, so companies must continue to confirm they are getting maximum value from suppliers on items that are not part of the catalog. There are a number of ways to do this. For example, a spend-analytic tool for software will focus on managing software licenses to

FIGURE 2: The benefits of online catalogs

Client example

Measure	Pre-catalog	Post-catalog
Compliance	40% to 50%	90% to 95%
Customer satisfaction	40%	75%
Back-end systems	Multiple systems that are not linked	Integrated ERP system with spend visibility
Electronic catalogs	0	~500
Electronic purchases (requisition to invoice)	0%	95%
P.O. processing time	30 days	<1 day

Source: A.T. Kearney

FIGURE 3: Spend analytic tools ensure suppliers are in compliance

Category	Challenge	Tool	Approach
Hardware	• Make sure users comply with price and item	Flat catalog	• Develop standard configurations for catalog • Define exception process • Consolidate supplier base
Software	• Manage software licenses, entitlements and deployments	License management tool	• Establish link to supplier catalogs • Develop link to inventory auto-discovery tools • Consolidate supplier base
Telecom	• Make sure suppliers comply with contract	Telecom expense management	• Outsource audit and invoice management • Develop demand management process
Contract labor	• Ensure user and supplier compliance • Manage multiple configurations	Integrated sourcing solution	• Develop standard procurement process • Consolidate supplier base
Administrative services	• Defragment spend • Create standard user interface	Punch-out solution	• Link to supplier punch-out sites • Develop easy user interface • Consolidate supplier base

Source: A.T. Kearney

ensure the company is not buying excess licenses. For telecommunications, the tool verifies that suppliers are billing per contract terms *(see figure 3)*.

Tailoring the Catalog Solution

While catalogs might sound simple, the effort should be approached strategically to avoid addressing spend categories that are relatively insignificant. After all, why develop a catalog for office supplies when more substantial direct categories continue to demonstrate spend leakage? Making the best use of catalogs begins with answering the following questions:

Which items should be cataloged? Items and services that are standardized and have agreed-upon prices are ideal for catalogs. Nonstandard items that are either custom-made or made-to-order do not belong in catalogs and instead should be handled through an exception process, as should items or services for which there are no negotiated pricing mechanisms. These exception buys will involve manual processing and a lengthier ordering process, so they should be used selectively.

Should the company or its suppliers host the catalogs? While there are a number of catalog solutions available today, there is no clear consensus on whether the company should manage catalogs in-house or the supplier should manage it. Internally hosted catalogs provide better data control, but they also add cost and effort. Conversely, relying on a supplier-maintained site reduces costs and effort but also limits control over the data. The answer lies somewhere in the middle. For example, companies that perform trade-off analyses often find that controlling the data is key when they want to standardize items and minimize confusion. In our view, a company should host the catalog for all direct and high-spend categories to obtain maximum benefits from compliance.

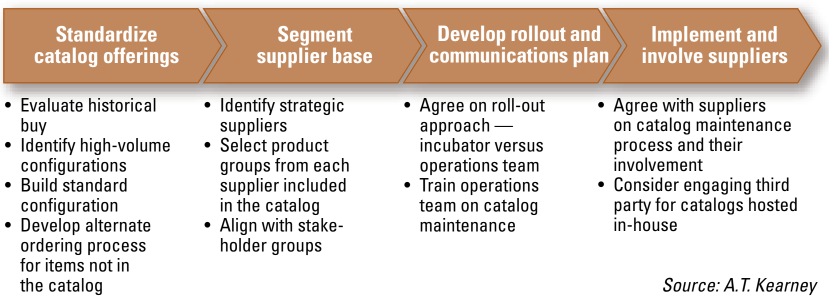
Who should manage the catalogs? Populating a catalog is a major undertaking, and keeping it updated requires dedicated resources. It typically makes sense for a company to own the review process (determining prices and items) and to outsource the process of data population and maintenance. This decision depends largely on the company's ability to get suppliers to comply with its catalog requirements. If suppliers are willing to support catalog requirements, then the outsourcing requirements will be minimal. Overall, the cost of managing catalogs is negligible compared to the benefits they bring; management costs often represent less than 2 percent of the total benefits of compliance.

Four Steps to Compliance

Bringing a catalog to life requires reducing complexity, deciding which suppliers to include in the catalog, developing a rollout approach, and engaging suppliers in the effort. The following four-step approach to catalog development—outlined in figure 4 on the next page and detailed below—will deliver powerful results.

Step 1: Standardize catalog offerings. Because most suppliers offer numerous product options, a company must decide which options will minimize complexity. For example, we recently conducted an analysis of network equipment at an outsourcing services provider, finding that it

FIGURE 4: Four steps to developing a catalog



Source: A.T. Kearney

purchased some 6,000 different routers over a one-year period. On the surface, this proliferation appeared to be legitimate, due to the company's wide range of customers. However, a deeper examination revealed that approximately 90 percent of the spend was on less than 5 percent of the total router makes and models. The company had not defined standard configurations, so employees were ordering a variety of models. Each make and model in the system adds complexity along various dimensions, including inventory tracking, maintenance and network management. Once a product is reduced to a manageable number of variants, it can be included in a catalog—and the newly pooled spend used to negotiate better terms.

Step 2: Segment the supplier base. Catalogs can provide a powerful incentive to rationalize the supplier base, but, generally, only strategic and long-term suppliers should be included in a catalog. Companies make a significant investment entering, linking to and maintaining each supplier's data, so unless a supplier is strategic the effort will not pay off. Most suppliers recognize the significance of catalogs and typically offer competitive pricing to ensure their place in them. In cases where key suppliers are not yet identified, a segmentation exercise can help segment the supply base into strategic, preferred and tactical suppliers.

Step 3: Develop rollout and communications plan. Catalogs can be rolled out through operational teams or an incubator team. The decision involves making a choice between disrupting some day-to-day business to get operational teams fully trained on catalogs, or taking an incubator approach that poses less risk to daily business. The incubator approach involves significant training time at a later date and requires forming a temporary catalog start-up team.

Step 4: Implement and involve suppliers. Suppliers play a critical role in making catalogs work by providing data at regular intervals, validating pricing agreements and automating links to ensure data transfer with customers. Supplier cooperation is key to catalog implementation. When a supplier is not ready to support catalog requirements, some companies hire a third-party service provider to enable and maintain their catalogs.

Capturing the Savings

Catalogs require substantial upfront work in gathering and cleansing supplier data, validating prices, and synchronizing supplier ordering systems with the company's procurement system. Additionally, ongoing maintenance will ensure that the data remains current. Catalogs give procurement an opportunity to leverage the corporate contracts that it so painstakingly negotiated. Given the money lost to noncompliance, the return on investment from cataloging is well worth the effort.

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