



## Indirect Spend: the Next Frontier in Supply Chain Optimization for Manufacturing

*By Steve Griffiths and David Austin*

Over the years, manufacturers have invested billions of dollars in supply chain optimization tools, processes and technologies. This focus on optimization has completely changed the face of manufacturing. What began as a commitment to streamline basic processes has now evolved to include the use of advanced artificial intelligence and simulation to drive industry-changing improvements in sourcing, forecasting and production. From the production line to delivering goods online, innovations across the supply chain get the right products to the right place at the right time to effectively align supply and demand; all while significantly reducing the costs required to make it all happen.





Despite large-scale improvements on the production side of the business, many manufacturers have neglected a critical piece of their supply chain and cost structure—indirect spend. Having settled the frontier of direct cost of goods and production, pioneers are setting out to apply what they've learned around controlling direct costs, gaining visibility, and implementing controls to the indirect and MRO side of the business. However, the same set of ERP and MRP tools don't work effectively in the considerably more complex and fragmented Wild West of indirect. But there's good news: recent advancements in technology are now providing manufacturers the power to optimize the costs associated with indirect spend and at long last, explore the next frontier in supply chain optimization.

## Wrangling the Complexity of Indirect Procurement

It's no mystery why indirect spend is often ignored. By its sheer nature, optimization has proven to be incredibly challenging. Unlike direct materials which are often highly engineered, associated with a specific set of approved suppliers, and controlled precisely through ERP and MRP technologies, indirect spend is comprised of a highly fragmented group of suppliers that vary by business unit and plant. These suppliers represent 1000s of sub-categories of goods and services and are often easier to substitute than their direct counterparts. From a manufacturing viewpoint, this can mean anything from machinery spares to consumables, from repair services to facilities maintenance, and from IT to basic office supplies. Compared to direct materials, the number of suppliers is both huge and decentralized, with major inconsistencies in size; from small mom-and-pop shops with limited technology know-how, to large, multi-national suppliers with significant selling power. And there is little to no standardization on which to base procurement methods whether through catalogs, P-Cards, paper-based POs, phone, fax – you name it.

Not only does the sheer number of suppliers create complexity, but the lack of control in the way organizations purchase these materials and services compounds the problem. Repair services, office supplies, and specialty MRO materials are all part of the spend profile of a manufacturer, but they are

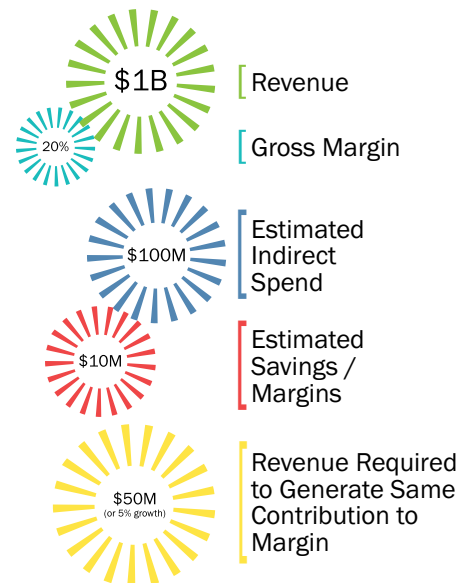




infrequently controlled in the same way direct materials and services are controlled. So it's not uncommon to go to the head of corporate purchasing for a large multi-plant company and find they have no idea how much is spent in the area of indirect and MRO. And if they do have a high-level estimate, none of them can provide a granular view of that spend by BU, plant, geography, supplier, or commodity. The result? Little if any indirect spend is optimized.

Many companies have left control of indirect and MRO to their plant managers and GMs, and on occasion, national contracts in obvious categories such as office suppliers, travel, industrial gases and technology. And it's no wonder. Clunky ERP systems were designed to manage direct, not indirect spend, so they've been largely incapable of addressing the indirect supply chain in the right way. So legions of plant controllers, buyers and administrative staff walk around with spreadsheets tracking spend, have huge paper catalogs sitting on their desk from the local distributor, or even worse, have ceded control of their indirect to third-party consolidators and distributors who promise savings and control, but surely at some cost and without transparency.

Another challenge is that many executives have treated indirect spend as non-strategic. Why? Because they have been rewarded for focusing on the largest chunk of spend, namely direct materials and services. Plus, indirect is just plain tough or thought to be too small in volume. But with the direct side under reasonable control, executives and progressive managers are turning their heads to the largely unaddressed indirect, which represents between 8% and 20% of a manufacturer's revenue. And since there's no aggregate visibility into that amount of spend, many CFOs and CPOs are left wondering what to do about that 8 to 20 cents of every dollar.



Let's put it in different terms, if a \$1B manufacturer with 20% gross margins can reduce their indirect cost by 10% then that's \$10M to the bottom-line





which is the equivalent of having to increase revenue by \$50M to generate the same amount of profit. Which is easier 5% growth or 10% cost take out on a neglected segment of the business?

It's time to tackle indirect spend head-on by mobilizing intelligent procurement software that moves beyond automation; that facilitates smarter, real-time change; and that drives an immediate and significant impact on the bottom-line by effectively addressing the complex challenges of indirect spend.

## From Amazon to Big Data: Technologies for a New Frontier

Technology innovations – especially those driven by advancements in consumer buying, social technology and big data management – can now be applied to pull together the complex web of suppliers, intangible deliverables, and inconsistent pricing and processes. These readily available technologies can meaningfully simplify the buying experience while optimizing other aspects of indirect spend cost such as supplier fees, terms and conditions, performance specifications and performance management. If executed correctly, optimizing indirect spend adds significant improvement to the bottom line through cost reductions, productivity gains, and control – often 6% to 13% of overall indirect costs.

### Cost Reduction Levers

Benefits Levers	Spend Influence	Savings Range
Budget-driven Demand Management	100%	1% to 2%
Catalog-Driven Procurement	60%	2% to 5%
Spot Buy Process Improvements	20%	5% to 11%
Invoicing 3-way Match & Overpayment Elimination	100%	0.6% to 1.2%
End-to-End Procure-to-Pay Automation	100%	0.5% to 1.5%
Strategic Sourcing Impacts	60%	3% to 5%
	<b>Total</b>	<b>6.1% to 12.9%</b>



### ***Consumer-like ease with enterprise control over the indirect supply chain***

Consumer procurement that takes place today has taken over two decades to mature. Amazon was founded in 1994 and back then, the user experience, let's say, left more than a little bit to be desired. But the extensive knowledge, technology, and expertise developed over that time improved the customer experience and those learnings and innovations are now being transferred to the B2B world. Simply put, with any target audience – employees, customers, partners, and more – the use of Cloud-based technology offers an immense opportunity for business optimization while solving some of the greatest client service challenges. Where an “Amazon-like” experience has now become cliché, it's taking that baseline of ease of doing business and wrapping it into an enterprise experience where controls remain in place that is the goal for eProcurement technologies.

The lessons from consumer retail sites like Amazon, Zappos and a myriad of others don't stop with just ease of use. For example, technology's ability to support real-time chat communication simplifies processes on both sides of the business transaction. In the manufacturing world where a cutting tool from an incumbent supplier is out of stock, emergency orders from alternative suppliers may be a phone call away – however that phone call is messy, creates significant back-end headaches and most often results in significantly higher costs. Imagine real-time communications like chat in this manufacturer example, where you can conduct expedited transactions through an entirely digital experience – where emergency POs can be placed, orders expedited and collaboration can occur between requestor, buyer and seller – without negatively impacting the plant. This collaboration also reduces errors and saves time, which translates into dollars saved and in the case of a production line, less down time. From connecting people to improving processes, the opportunity for applying new (consumer-tested) technologies to the indirect supply chain is tremendous.



### ***Transforming big data into procurement efficiency***

Technologies being used to manage big data have also evolved at lightning speed. These innovations have become capable of managing greater amounts of data and, as a result, for organizations that are able to conduct indirect transactions through a single platform, they can now have rich analytics come into play to deliver previously unobtainable analytics capabilities. Applying sophisticated algorithms to look for and act on repeatable data patterns helps these systems create sense out of chaos. All of this activity is completed with a singular goal in mind: *to drive better business decisions*, for example:

- Real-time data analysis to understand and reveal insights which are embedded within complex data
- Predictive analytics that leverage user behavior to predict future trends
- The ability to proactively respond to real-time data for customer service purposes

For the indirect supply chain, this brings additional major advantages. Procurement data that until now has been held hostage in existing ERP and myriad finance systems, can be leveraged to gain direct visibility across the enterprise to determine the real cost of indirect spend and identify opportunities for optimization.

Of course, leveraging analytics advancements requires the one thing that most manufacturer's indirect organizations lack: clean, usable data. So for manufacturers looking to lasso their data, the short term solution is to gather information from their disparate systems, normalize it, enrich it, categorize it at a granular level; and begin to look for opportunities to consolidate, take out cost and exert greater control. This data work is no small task and often requires the use of experts and their tools to help accelerate the time consuming process. Medium and longer term, chief procurement officers must move their indirect transactions to systems that can manage the entire closed loop indirect process (outside of the ERP) and provide that real-time visibility businesses seek to drive greater value to the enterprise.



## Reaping the Rewards



So why aren't manufacturers leaping at the opportunity to transform indirect spend and explore this last frontier? The answer is as complex as indirect spend itself. Many manufacturers actually are – either investing in procurement technologies for upstream sourcing or downstream purchasing, others still have outsourced the problem to distributors and consolidators. But the majority of medium to large size enterprises are still slow to adopt new approaches. Budgets are often narrowly focused and depleted from expansive (and expensive) ERP systems fixated on what has traditionally been viewed as the low-hanging fruit of the supply chain: direct spend. IT resources are many times engaged in endless cycles of upgrades and integrations. Decision-making in manufacturing is often decentralized and trying to find that one champion or leader to start is a challenge. And management is fatigued by the cost of point solutions that promise long-term value but end up solving short-term problems.

### *It's time for a change*

Senior management's top priority remains the same – drive value for the business. And while procurement manager's feet are held to the fire to achieve cost reduction targets and improve productivity, many struggle because they are still using outdated tools and technology. Alternatively, for end users, their focus is simply to get their job done right, as quickly and easily as possible. By applying new technology, insight, and thinking to the challenge of indirect spend, manufacturers can corral indirect and MRO spend and—finally—meet everyone's needs:

- **Senior management** can have access to informative, standardized dashboards and reports that provide a clear view of indirect expenditures, and consistent processes that help reduce indirect expenses and improve the bottom-line.
- **Procurement managers** can create a closed-loop, real-time indirect procurement process that applies discipline across all requests and purchases, helps ensure the right data is captured in the right way at the right time, and provides valuable performance measurements at every level - by supplier, user, plant and enterprise.



- **End users** can use tools that help them make more effective procurement decisions (including smart forms, online coaching, and real-time feedback loops), and communicate easily and more effectively with every supplier.



## Conclusion:

Wrangling the complexity of indirect spend is no easy task. It's a distinct challenge that requires skill, insight, and the right tools to do the job. Yet it's clear that for those willing to take the next step, there's a gold mine. The time has come. By taking advantage of the convergence of supply chain innovation and the ever-growing power of consumer, social, and big data technologies, manufacturers now have the opportunity to harness the data, processes, and significant costs of indirect procurement, and settle the "next frontier" of supply chain optimization.

### Authors

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### **About Xeeva, Inc.**

Xeeva is driving the development and delivery of the next generation of intelligent cloud procurement and financial solutions for indirect spend. The company's software suite includes Sourcing, Procure to Pay, Supplier Collaboration, Financial Collaboration and Extended Enterprise solutions and is used in over 40 countries and available in 18 languages. You can learn more about Xeeva's focus on driving immediate and sustainable results for its customers by visiting [www.xeeva.com](http://www.xeeva.com).

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