CoVest
Sourcing Network

YOUR GUIDE TO CONQUERING SPEND CATEGORIZATION

Having item level data and knowing from whom you buy isn't enough. Few organizations have high quality data that can identify actual items purchased or warrants the creation of a category strategy.

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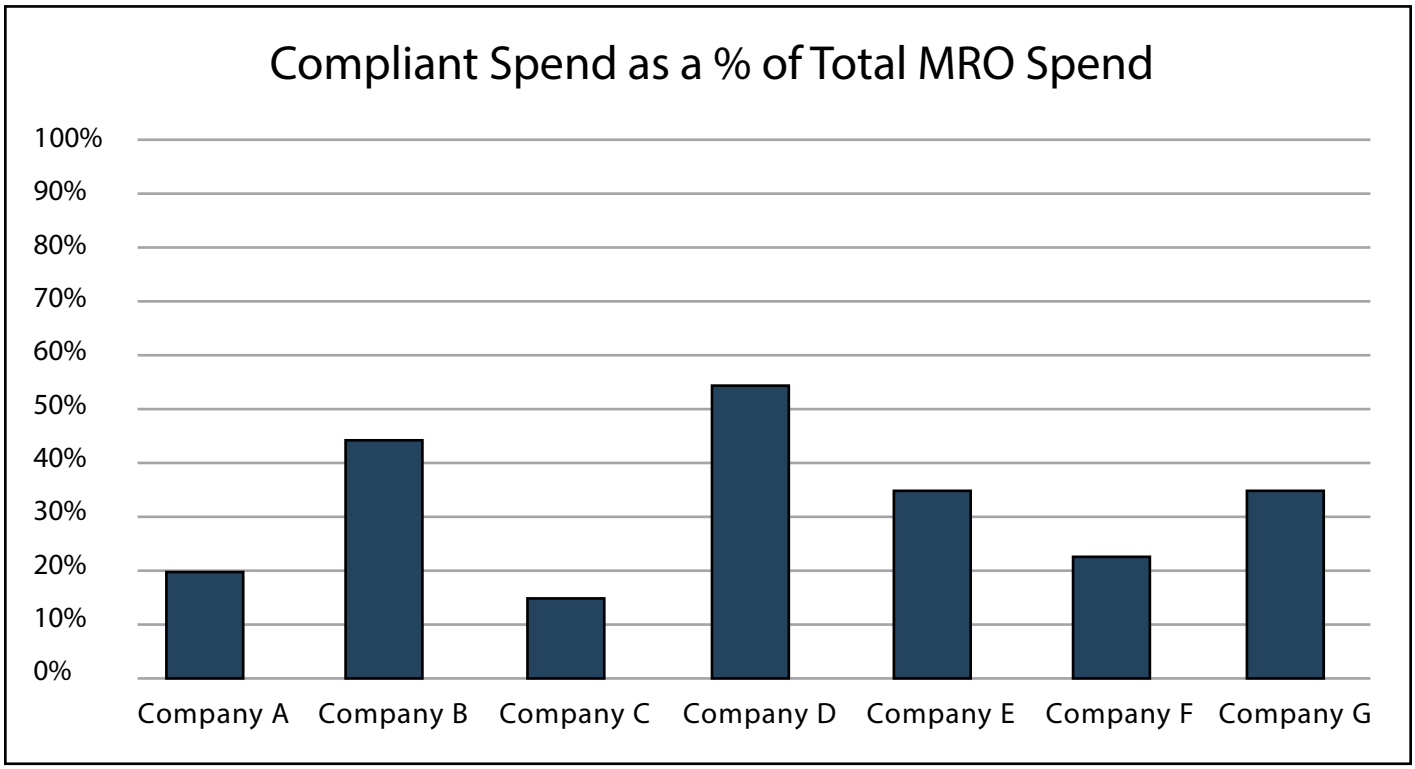
The Struggle to Establish Usable Information

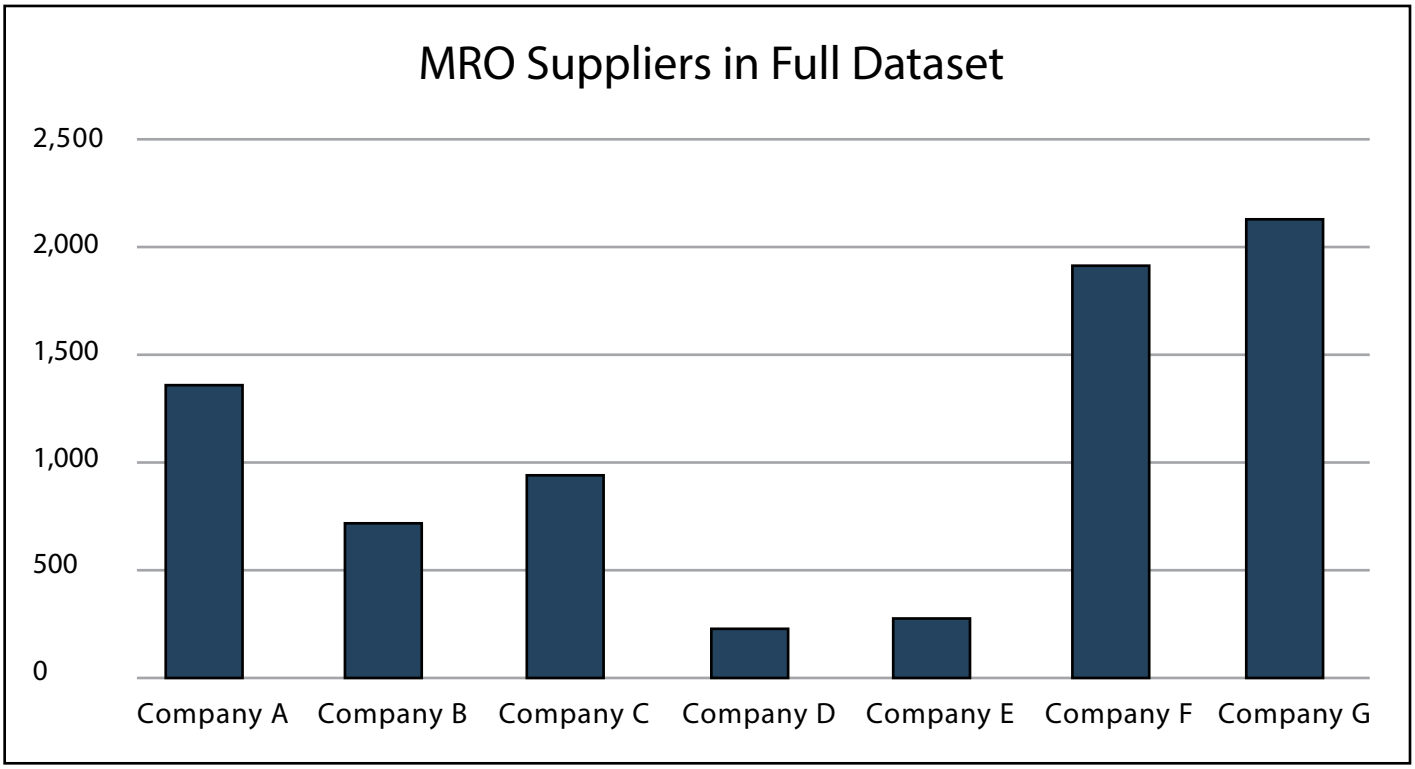
In a world where data abounds it has paradoxically become harder, not easier, to create usable information. This is incredibly apparent in the indirect procurement world. All of the systems, piled on top of one another, have gotten us no closer to the real goal – creating programs that easily manage all of our company's purchasing needs.

The procurement world has been grappling with enabling data to manage our businesses for well over two decades, and yet procurement teams from Fortune 1000 companies nearly always say the same thing… "our data is not great." We may know from whom we buy and perhaps have item level data, but rarely is that data high enough quality to approach the creation of a category strategy and nearly never good enough to identify actual items purchased. This is never more apparent than in MRO and Facilities items, where high SKU count and very low item repurchase frequency become significant barriers to creating solid programs with high compliance.

ERP and purchasing systems have aided in managing transactions and recording at least a basic understanding of what has been purchased. However, this basic data is not enough to present to new suppliers to aid them in identifying what value they can bring to our organization. When we examine the full breadth of a company's indirect spend profile, even if they have well established, strong national supply partnerships, the typical supplier count is not in the hundreds. Instead, these companies will utilize thousands of suppliers to help their business continue to operate. In this environment, we see companies churning through RFP after RFP for the same sets of goods year after year. In the end, complete success of these RFPs would only mean the creation of a program that satisfies only 20-40% of their organization's needs.

The following charts detail a few data points from actual spend categorizations performed by CoVest. This data is not exhaustive, but examples have been taken to demonstrate the breadth of a couple of variables, namely the percentage of spend in compliant programs, and the overall number of suppliers used prior to CoVest program adoption.


Compliant Spend as a % of Total MRO Spend
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Company A
Company B
Company C
Company D
Company E
Company F
Company G


MRO Suppliers in Full Dataset
2,500
2,000
1,500
1,000
500
0
Company A
Company B
Company C
Company D
Company E
Company F
Company G

The solution to these issues is much more easily articulated than executed. Quite simply, we must locate data that is detailed enough to identify what is being purchased. Upon this location, we must then organize that data into a format that allows us to identify buckets of spend that have defined market solutions available to fulfill those needs. Easy, right? The problem with this approach is that few solutions exist to aid in this process. In the absence of a magic wand, we will explore a couple of ways to tackle this difficult problem.

The Ideal Spend Categorization

Before we talk about solutions, however, let's take a moment to talk about what a finished spend categorization should look like. Often we have data organized in a way that it makes sense to all of our internal stakeholders. That could mean how it is managed today, where it originated, how it is purchased, or even why it is purchased. This internal organization makes perfect sense to track spend in that fashion for budgeting purposes and to aid in internal forecasting needs as well. However, this internal classification fails to grasp the aforementioned buckets of spend that can easily defined by a preexisting market solution. We need to organize spend along the lines of the potential, and perhaps the ideal, solutions that exist in the marketplace. Knowing that an item is a safety supply or a mill supply isn't enough. Is it a glove, a gate, a tag, a tool, or a bearing? Even when a company does implement a line item spend classification system, it's often found that their new data gets them no closer to building opportunities, due to this lack of information. Although it may seem like a simple solution, manual entry does not solve this issue as individuals entering the data are busy and not often aware of how accurate descriptions will make their job easier.

In CoVest's case, suppliers with whom we have strong relationships should be able to provide the right data, and they often do so. Since that is the only data that we have to work with then they are rewarded with RFP after RFP to retain their relationship, and our non-compliant suppliers are left alone because we do not have data to use to source that spend in the first place. We find petty savings and move on to the next RFP leaving the big savings behind because it is too hard to find the data. Honestly, that is a pretty rotten way to reward a partner and is frequently why working with suppliers in the indirect space feels more like a never-ending war than a business transaction. The key to unlocking this cycle of negativity is to create a concerted effort to craft programs that manage all of the needs of an organization. Undoubtedly some of these needs can be met by existing suppliers, and for others new partners will need to be found.

Spend Categorization Solutions

There are several potential solutions to this issue. The expensive and time intensive path is to implement a spend categorization system. This, on the surface, seems to be the ideal path, but the costs and resource drains do not end when you pay the software provider. The benefits of this approach can be substantial if the project is accompanied by a commitment to dedicate resources to implementing solutions that will manage the spend uncovered through the data stream. If the only output is better data with no follow-through, then the benefits will be minimal.

Another approach is to bring in a third party, such as a consulting firm, to aid in a more rapid categorization process. This can be more cost effective, but you will lose some of the benefits of the repeated observation of changes in needs over time. Keep in mind that within a stable organization, needs in many categories of spend do not change that rapidly. The amount of needs in a given area can change significantly from year to year, but the need itself is likely to persist regardless of market conditions. Many providers in this space use the term "spend cube" to reflect this exercise, but the term spend slice is more appropriate. This is a one-time look at what your organization needs to perform their daily tasks. This time-suspended look at company finances can still provide valuable insight into the needs that sites fulfilled by suppliers outside of your approved programs.

However, the key lies in the ability to execute. Unless you have people in your organization that can free up time to tackle these newly uncovered needs, the exercise is once again futile. If the third party aiding in this process happens to have capabilities to aid in project execution, that can be an avenue to driving results without adding permanent costs to your payroll. These consulting firms will bring results, because they have enough resources to look at all possible revenues. However, these short term consulting engagements are not built to tackle tough to manage categories. Improvement plans can be created, but companies often find themselves back where they began - needing to rally their organization again, look at another "slice" and then determine the best solution for the continuing unmet needs.

A GPO's Route to Spend Categorization Success

The indirect space is truly unique. It is easy to find several partners in the right space, but so hard to truly craft solutions that handle a large majority of your organization's needs. Group Purchasing Organizations (GPOs), like CoVest, are uniquely positioned to help in this arena, especially with projects requiring strong analytical capabilities. CoVest has long-term relationships with supply partners that can survive the rigor and patience needed to build compliance. These relationships are built stronger through a series of data-driven projects used to pull in the disparate needs of a diverse organization. CoVest's approach to spend categorization can not be mimicked, and we feel that it is a strong, practical approach to identifying compliance-creation projects.

First, we start with the best data that a company can provide across all indirect purchases. Occasionally this is item level data, but more frequently this is supplier level data (supplier, location, amount, maybe even a breakdown of their purchasing team's description of the type of goods). In either case, we utilize our spend categorization engine (that we built, not a third party) to organize the spend into defined buckets that align with market solutions. Some market solutions exist within our network, but many lie outside of the GPO world.

Step two takes the output from the spend categorization and prioritizes potential projects. There are a number of factors to consider:

- Is the category large enough to be impactful?
- How much of the spend is unmanaged?
- How many suppliers can be consolidated in this area?
- Are the suppliers easy to engage and craft a solution?
- What is the savings potential?
- When was the last time this category was sourced?

Ultimately, three metrics can be used to prioritize: savings potential, supplier consolidation potential, and project difficulty.

Undoubtedly, several high potential spend and savings categories will emerge with a high degree of fragmentation and unmanaged spend. Spend can, and should be, folded into existing solutions as well. The key to both fragmentation and unmanaged spend is persistence. There is a reason that spend is unmanaged, and while we have rarely found issues that cannot be overcome, they nearly always require a concerted effort over a long period of time.

Data Gathering

Before crafting a solution, more data must be gathered. Assuming that you did not start with pristine item level data, the next step is to dive into the projects that have been selected and gather as much information about those specific needs/suppliers as possible. This data could come from an ERP system, combing through p-card data, working with company sites to gather data from invoices and POs, or having discussions with sites regarding what they buy and how. Additionally, the one source of the best data available are your current suppliers. Although suppliers may be unwilling to share data, especially if they are unable to craft a larger solution to your company's problems, it is always worth reaching out.

Once we have this information, we work with our solution providers to create an analysis of the impact of moving to a new program. Without the help of CoVest, this could mean working with an existing supplier to bring on new spend or creating a new sourcing engagement. Because the reviewed spend is unmanaged, the goal of creating compliance and driving savings are generally not difficult at this point.

On average, our spend categorizations show 30% - 50% of spend is managed in a contracted program. Even for mature procurement organizations, most spend is unmanaged and they churn through the same sourcing events over and over. There are two reasons for this. Programs are built to degrade over time, generating higher prices for those in contracted programs. Along with program degradation, savings can be found several years after an agreement has been signed, as the pricing has gotten progressively worse. More on squashing that phenomenon HERE.

Once you have fixed that problem, it is time to build compliance. We generally find three to four projects that will drive an additional 10-20% of spend toward a compliant contracted program. Here are a couple of examples:

A large chemical manufacturer had several approved MRO programs, including a well-implemented integrator. Despite that fact, they were utilizing 50+ vendors in the area of facility safety before CoVest's help (including lock and tag, safety gates, signage). CoVest was able to identify one vendor for all of these needs and implemented the solution in less than three months.

Another spend categorization identified significant non-compliant spend in janitorial and cleaning supplies, totaling in the hundreds of thousand of dollars. Some quick data gathering revealed a savings opportunity, and working with the sites to connect them with the existing supplier was simple and took about a month.

Conclusion

If companies are willing to take the risk, there are plenty of opportunities outside of our category comfort zones. The benefits, both to our careers and to our companies, can be rapid and significant. Companies are consistently increasing savings targets and these targets cannot be achieved by simply altering categories that are already managed. CoVest has continually proven to double the savings in non-compliant categories compared to those savings in compliant areas. As a team, CoVest is more than confident.

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