



Driving Margin Improvement

# The Next Generation of Cost Savings

## A CHALLENGE, AND OPPORTUNITY, FOR LEADERS

The past eighteen months have been anything but easy. Lower demand levels, increasing global competition and higher raw material and energy costs have put extreme pressure on profits. Executives have had to focus heavily on taking costs out of the organization.

Moving now from the dire economic environment of 2008/2009 into the next phase – referred to by pundits as the “new normal” – executives face continuing pressure to not only sustain the savings they have already driven, but to also identify new ways to fund strategic initiatives, margin expansion and growth. Although economic conditions seem to have stabilized, operational efficiency and cost reduction are still of paramount importance. Leaders are looking for **the next generation of cost savings**.

“ORGANIZATIONS HAVE FAILED THE AGILITY TEST. NEW RESEARCH SHOWS THAT ORGANIZATIONS AT GLOBAL 1000 COMPANIES HAVE BEEN UNABLE TO KEEP COSTS IN LINE WITH DECLINING REVENUES.”

*The Hackett Group*

Even after the cost focused efforts of the last 1½ years, there remains an often overlooked and untapped area of opportunity for cost savings within Fortune 1000 companies – one which represents this next generation of savings. It is an area many executives believe they have already attacked, but where the anticipated returns have in fact not been fully realized – where the expected savings are neither hitting the bottom line, nor being reinvested into other growth-focused efforts. This opportunity area can yield hundreds of millions in savings – a figure which any corporate leader would acknowledge as materially significant. This paper details that opportunity.

## A HIDDEN AREA OF COST

In the drive for cost reductions to date, management has gone down the list of obvious cost cutting strategies – consolidating operations, employee layoffs, benefit reductions, product line rationalization, and so on. Many leaders would say they’ve exhausted the possibilities for significant savings, and are concerned that more of these traditional cost reductions would jeopardize the long-term success of the business. Yet, in many organizations, there remains an area of potential savings which, for a variety of reasons, has been overlooked.

## Under the Radar

This area of hidden cost is missed because much of it sits “under the radar”; a few layers down from the executive suite, and is highly fragmented across business units, geographies, plants, and other budget areas. Many organizations don’t look at these costs together **as a whole**, and therefore do not fully appreciate the magnitude. Finding this savings opportunity requires the attention and sponsorship of senior leadership, who are in a position to foster the right view, see the full magnitude, and drive to the necessary solution.

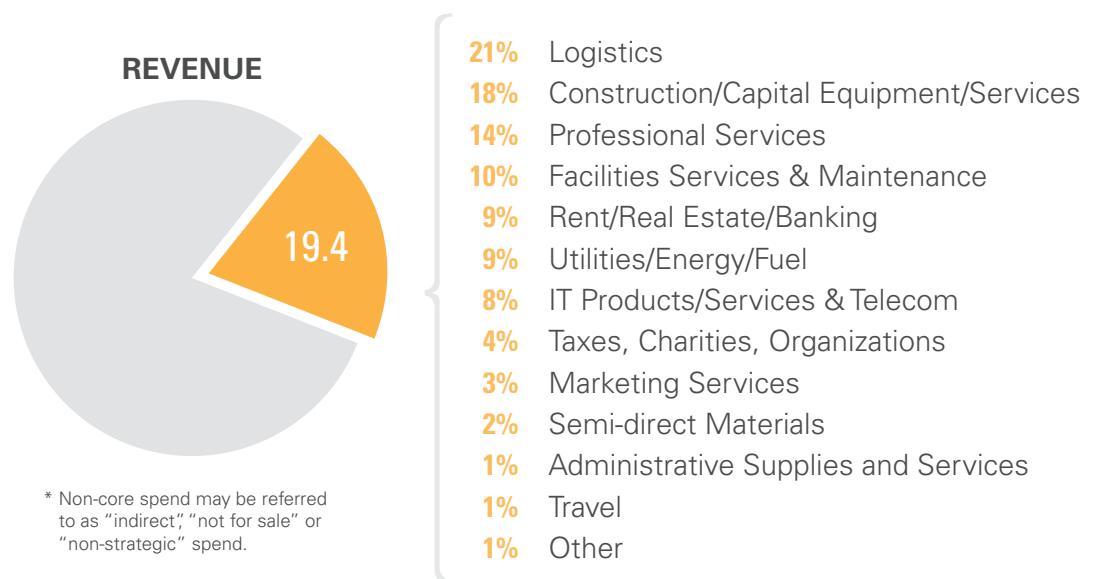
“WITH A MANDATE TO IMPROVE BUSINESS RESULTS, WE LOOKED TO NON-CORE SPEND AS AN AREA IN WHICH WE CAN ACHIEVE A MEASURABLE IMPACT.”

*John Miller,  
Senior Vice President,  
Whirlpool*

## What is this area of “hidden cost”?

**Non-core spend.** In most manufacturing organizations, non-core spend can represent up to **twenty percent of revenue**.<sup>\*</sup> Positively impacting just one percent of this spend can unlock millions of dollars in capital for reinvestment into the business, and the greater the level of spend addressed the greater the returns. Non-core spend includes all purchases that are not core to the finished product. A view to the major categories of non-core spend is provided below:

## 19.4% of company revenues go to non-core\* purchases



## Manufacturing Industry Benchmarks

## Major categories of Non-Core Spending are detailed below

Below is a sampling of the subcategories within each of the major categories of non-core spend. There are hundreds of subcategories in the aggregate, with savings opportunities hidden across the board in many companies.

Logistics	Marketing Services & Supplies	Professional & Corporate Services
Over the Road (Truckload/LTL)	Ad/PR Agency	Legal
Small Parcel	Direct/Web/Social Media	Tax/Audit
Air Freight/Forwarding	Market Research/Data	Consulting
Ocean/Vessel Charter	Trade Show/Exhibit Furnishings	Employee Benefits
3PL/Warehousing	Print/Fulfillment	Recruiting/Relocation
Freight Payment	Promotional Displays	Contingent Labor
		Corporate Travel/Meetings

IT/Telecom	Semi-strategic/ Direct Materials	Facilities/MRO
Hardware	Corrugated/Linerboard	Electrical/Electronic
Storage	Poly Films/Bags	General Industrial
Software	Folding Cartons	Cutting Tools/Tooling
IT Outsourcing	Chemicals and Gases	Safety
Help Desk	Metals	Pumps/Hydraulics/PVF
Data Center	Food Ingredients	Waste Management
Long Distance Voicedata		Janitorial
Wireless Services		HVAC/Elec./Mech.
Application Development		Catering/Cafeteria
		Construction

## WHY IT'S SO DIFFICULT

Finding and addressing non-core spend comprehensively across a large, complex organization is challenging because...

1. It is highly fragmented across the enterprise
2. It covers so many different and unique buying categories
3. Line of business owners for select categories and associated budgets often resist efforts to apply a standardized sourcing and procurement process to their areas – either based on past practice or because their internal procurement organizations don't have the specialized functional expertise required to satisfactorily support them.

Building the necessary levels of expertise – procurement expertise combined with specialization in all of the major categories/functional areas – is almost impossible to do internally. The resources required to properly support it amount to more than a company can rationalize for a non-core area of the business.

## Past Efforts Have Fallen Short

Many executives have recognized that these hidden costs exist, and have sponsored efforts - such as consulting or technology initiatives, or internal organizational restructuring - intended to drive efficiencies across procurement. They have approved business cases outlining the anticipated gains from such approaches, and followed the progress of the work, but many still find themselves wondering why the expected cost improvements are not materializing.

Savings from these efforts were quantified, identified and even applied to forecasts, but are not in fact being fully realized. Why? Because these types of efforts often only address one area or another but do not cover the full end-to-end procurement process completely. For example, technology solutions can enable an improved process, but without the right category expertise and broad supply market insight, sourcing results will fall short. Consulting solutions generally address the front-end of a program, but fall short on sustaining and expanding savings year over year. Without proper expertise, oversight and ongoing hands-on management, there is savings leakage throughout the process - the extent of which can significantly reduce actual realized savings.

**“DESPITE THEIR BEST INTENTIONS, TOO MANY COMPANIES SOON DISCOVER THAT, SOMEHOW, A LARGE PROPORTION OF THE SAVINGS THEIR PROCUREMENT EXECUTIVES PROMISED SEEMS TO LEAK AWAY. IN FACT OUR EXPERIENCE INDICATES THAT MOST COMPANIES REALIZE NO MORE THAN 50% OF THE PROCUREMENT SAVINGS THEY PLANNED FOR.”**

*Booz Allen Hamilton*

## THE DIFFERENCE BETWEEN AVERAGE AND WORLD-CLASS SPEND MANAGEMENT

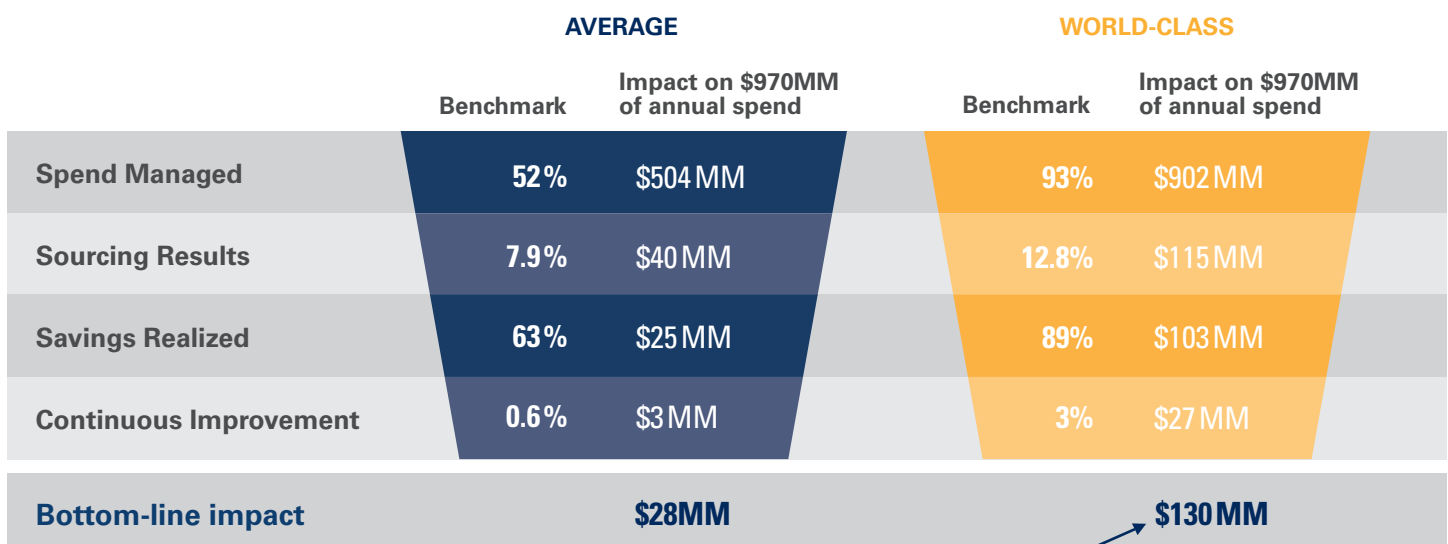
An analysis of non-core spend across top performing companies yielded the following comparison, showing that those excelling at managing non-core spend are achieving savings levels over four times greater than the average – or the equivalent of \$130MM for a \$5B manufacturing company.

The greatest disparities between average and world-class companies are in:

1. The level of **spend managed**, with companies on average managing 52% of non-core spend while world-class companies are managing over 90%.
2. The level of **savings realized** (actual savings at the point of invoice) – with companies on average realizing 63% of anticipated savings while world-class companies approach 90% realization of anticipated savings.

Two other areas – **optimizing sourcing results** and **driving continuous improvement** year over year – contribute additional savings in world-class environments as well.

### Hundreds of Millions of Savings



Over 4 times greater savings

## Four Key Levers to Maximizing Savings

Maximizing returns from non-core spend management revolves around the following key levers. Most companies are under-performing on two or more of these levers, and therefore achieving only a fraction of their potential for cost reduction.

### Spend Managed

Best Practice 93%  
Average 52%

Most companies have not amassed the full magnitude of non-core spend under central management – and **many are addressing only 50%** or less with the required combination of category expertise, supply market intelligence and sourcing rigor. They may focus on only a short list of categories, versus bringing together all non-core categories for maximum impact. Or they may exempt certain geographies or lines of business from a program, thereby missing significant savings. One other key reason for sub-optimized results is a **lack of sufficient resources and buying category expertise**. Companies are increasingly reallocating internal procurement resources to critical, strategic areas of their business, such as direct materials or their most strategic partner relationships. Resources against non-core are kept flat, or decreased. Hence, in-house teams focused on non-core are disadvantaged because they rely upon a small number of generalists working across hundreds of categories. It is difficult for these small teams to build the requisite category expertise and provide high service levels to varied stakeholders across the organization.

### Sourcing Results

Best Practice 12.8%  
Average 7.9%

On average, most companies are **only achieving 65% of the potential savings from their strategic sourcing efforts**, because their negotiating power is constrained. Many rely upon internal volume aggregation, and have sourcing resources that are not “in market” often enough to build the supply market intelligence needed to maximize negotiating power and develop innovative supplier solutions. Internal procurement departments generally source a particular buying category only once every 2-3 years, versus multiple times per year, so they may miss real-time market adjustments that could yield interim savings and lack the benefit of hundreds of innovative category solution examples.

### Savings Realized

Best Practice 89%  
Average 63%

One of the most significant areas of missed opportunity is that of realized savings – that is, savings that are actually achieved at the point of invoicing. Most companies are **only realizing 60% of the savings identified in the sourcing process, while 40% of these identified savings never hit the bottom-line**. This is because true “savings realization” requires compliance from thousands of end users as well as suppliers, along with a comprehensive, formalized tracking process to ensure that the savings are captured. Even after implementing new technology or consulting efforts, most companies find that there is still oversight and attention required to avoid savings leakage. Prices may not be adjusted correctly based on the terms agreed. A large portion of expenditures may never go to the preferred supplier. For non-core spend, most companies don’t have the resources to monitor compliance or to audit pricing, let alone work with suppliers to drive continuous cost improvements. Most categories are sourced and forgotten. The savings never materialize or quickly erode.

### Continuous Improvement

Best Practice 3%  
Average 0.6%

Maximizing sourcing results requires continually re-evaluating the procurement process and suppliers to identify opportunities for improved negotiation and leverage. Because most categories are sourced and forgotten, companies often forgo 2-3% of additional savings (on total spend managed) that comes from a rigorous and ongoing continuous improvement process.

## Achieving World-Class Non-Core Spend Management

Organizations looking to address the challenges outlined in this paper, and get to world-class management of non-core spend, have several options including:

**Build In-House:** companies choosing an internal solution for non-core procurement often hire 3rd party consultants to execute a sourcing program. Or they will implement a new technology solution expecting that the technology will solve the problem. Or a combination of the two. The internal procurement organization is typically not built out, but kept very lean. However, once the new suppliers have been selected, and technology installed, the company is still left with the same challenge – how to effectively manage thousands of buyers and suppliers and ensure savings make it to the bottom line, and identify continuous improvement areas all along the way. This requires a level of supply market intelligence and procurement specialization which is difficult to build internally, and usually cost prohibitive.

**In-house Combined With Some Outsourcing/Offshoring:** this option is similar to in-house build above, except that transactional aspects of the procurement process (such as purchase order and invoice processing) are turned over to less costly offshore resources. This solution largely serves to reduce procurement-related labor costs, which for manufacturing companies are typically less than .5%<sup>1</sup> of spend, but does not provide the fundamental expertise required to continuously manage individual spend categories.

**Procurement Business Process Outsourcing:** this option enables companies to put the needed focus and expertise on the problem, to drive maximum savings from non-core areas of the business, but without having to build and maintain the requisite knowledge and capabilities internally. A comprehensive solution can fully offset costs with savings in less than 12 months and yield substantive ROI as well. Companies selecting procurement outsourcing have recognized the challenges associated with in-house approaches and instead chosen to leverage a third party provider's infrastructure and operations to achieve world-class management of non-core spend. Procurement BPO providers have invested heavily in building and continually innovating solutions that would be difficult, if not impossible, to replicate internally. These solutions are designed to optimize each of the four key levers described on page 7.

“WHEN WE STARTED LOOKING AT NON-CORE SPEND, WE REACHED AN INFLECTION POINT WHERE WE RECOGNIZED THAT IF WE WERE TO GO BUILD THIS CAPABILITY, IT WOULD TAKE YEARS. WE DECIDED THAT OUTSOURCING WOULD PRODUCE A QUICKER PAYBACK AND A HIGHER PAYBACK.”

*Ron Brown,  
Senior Vice President,  
Global Sourcing and  
Supply Chain, Greif*

<sup>1</sup> CAPS Research, 2008

## Internal vs Outsourced Procurement

Value Levers	Key Drivers	Internal Approach	Outsourced Approach
<b>Spend Managed</b>	Specialized Expertise	<b>10-20</b> sourcing generalists	<b>250+</b> specialists
<b>Sourcing Results</b>	Negotiating Power	Categories sourced <b>once</b> every 2-3 years	Categories sourced <b>10-15</b> times a year across multiple companies and industries
<b>Savings Realized</b>	Integrated Process	<b>Disconnected</b> sourcing and buying Savings <b>claimed</b> before spending	<b>Integrated</b> source-to-pay operation Savings are <b>guaranteed</b> and calculated post spending
<b>Continuous Improvement</b>	Visibility and Ownership	No real-time visibility; little post sourcing attention	Dedicated specialists armed with spend, savings, and market intelligence.

### The First Step

In order to determine the best approach for your business, the first step is to complete a comprehensive spend assessment to estimate the potential savings opportunity. Critical in this assessment is access to and comparison of company-specific cost data against current and accurate supply market data. Obtaining accurate supply market data is the biggest challenge for any individual organization, but 3rd parties specializing in procurement will have extensive supply market data and offer spend assessment services.

As we move through the “new normal,” companies that have successfully tapped their non-core spend and captured the hidden savings will be better positioned to fund strategic initiatives, margin expansion and growth. Procurement Business Process Outsourcing offers companies a proven solution to drive the next generation of cost savings to fund and support these critical business initiatives.

To request a comprehensive spend assessment for your organization, or for additional information on how companies are improving non-core spend management through Procurement Outsourcing, please call **877-935-4242** or go to **[www.icgcommerce.com](http://www.icgcommerce.com)**



## ABOUT ICG COMMERCE

ICG Commerce, the procurement outsourcing specialist, is driving a fundamental change in the way today's businesses achieve financial agility and fund growth. ICG Commerce is the only procurement outsourcing specialist with superior market intelligence integrated into an operational approach, resulting in hundreds of millions of dollars in realized savings.

In its work to date with a growing list of leading companies, ICG Commerce has done extensive analysis of spending patterns and identified significant opportunities for savings - even within companies that have leveraged sourcing consultancies and implemented technology to address this area.

ICG Commerce is a privately held company and a member of Internet Capital Group's (Nasdaq: ICGE) network of partner companies. The company has earned recognition from Forbes, Fortune, The International Association of Outsourcing Professionals (IAOP) and numerous industry analysts for its leadership in procurement outsourcing.

## FOR MORE INFORMATION

To learn more about ICG Commerce's innovative Procurement Outsourcing offering, please call **877-935-4242** or visit us on the web at [www.icgcommerce.com](http://www.icgcommerce.com)

