Procurement's Role in Ensuring P&L Impact

finetune

MANAGED COSTS. MEASURABLE SAVINGS.

Introduction (Unattended Contracts)

Procurement instinctively seeks the presumed certainty and security that comes in the form of a contract. This conclusion is not a surprise to anyone in the profession. However, as Fine Tune CEO Richard Ham stressed in an April 2020 article on the Procurement Foundry blog, the emphasis on "contract confidence" potentially hinders an organization' s ability to realize "savings beyond the initial (contract) bump."

The problem, according to Ham—and confirmed by a recent Fine Tune survey distributed among the procurement community—is that "…for the vast majority of businesses, no one group is taking ownership of the effort to manage tail spend post-contract."

"If you don't have all the parts working in tandem with one another or dedicate the necessary resources to ensure P&L impact," concludes Ham, "you will not not successfully manage tail spend and your indirect suppliers will feast on your bottom line."

Section I
Understanding Tail Spend (A New Lens)

What is tail spend?

It is an academic question to which there is a familiar, universal answer.

Tail spend generally involves low-dollar, high-volume transactions in which the purchases are too small or infrequent to be effectively tracked and managed. These expenses often fall into complex spend categories such as uniform rental and facility services, waste and recycling, pest control, and security and guard services.

However—and as previously stated—the challenge with properly managing complex tail spend is not one of definition, but one of resource allocation and ongoing vigilance.

True savings?

When it comes to tail spend, what are "true" savings?

Answering this question seems pretty straightforward; true savings are measurable in a company's profit and loss "P&L" statement. True savings grow earnings before interest, taxes, depreciation, and amortization (EBITDA).

While this seems like an obvious statement on the surface, crucial pieces are missing in most organizations to ensure projected savings from contract negotiations actually hits the P&L. Almost no organizations are dedicating the time and resources needed to muster the sort of ongoing and vigilant management required to effectively manage tail spend categories, and similarly few are connecting the dots between departments to ensure continuity of management in tail spend. What results is frequently a failure for projected savings within these categories to actually grow EBITDA.

Based on experience, research, and "The Procurement Foundry & Fine Tune P&L Survey," when it comes to managing complex tail spend categories, projected savings steadily erodes over the life of a contract. The failure to recognize this savings decay—and manage spend accordingly to avoid it—turns good contracts into bad deals.

Unfortunately, most procurement professionals believe (or hope) that once contract negotiation is complete, the promised savings in the form of lower per-item costs is a "done deal." This mindset is one of the biggest challenges to optimizing P&L impact—but it is not the only obstacle procurement must overcome.

Savings obstacles

61% of respondents report a belief or reality that required resources are not in place to deliver expected results, suggesting a lack of resources—and not just mindset—is a major barrier to connecting procurement's efforts to the P&L.

Further frustrating procurement's strapped resources are shortcomings within the systems designed to track, monitor, and take corrective measures to ensure savings. In this regard, the survey results are telling—as there is a general belief among respondents that "both systems and reporting structures are not aligned to support" proper and effective tail spend monitoring.

This toxic combination of a lack of resources and systems as well as reporting misalignment manifests a real challenge for procurement professionals to be strategic, let alone take the lead in managing complex categories of tail spend. As one respondent put it, "We have 17 people to manage over $2B worth of overall spend."

The overwhelming conclusion at this point is that the resources for optimizing P&L impact are not in place, causing savings to decay over time and erode P&L impact.

As further evidence of this resource challenge, among the 39 percent of survey respondents who indicate they believe they are "adequately resourced" to deliver P&L impact, 57 percent indicate they "engage with outside partners to augment Procurement department resources." This fact—that a majority of the most resource-confident respondents are augmenting in-house resources with third-party help—is informative throughout the survey.

We will next take a deeper dive into the survey results and what they mean from the standpoint of stakeholder relationships and responsibilities—and why they matter.

Section II
P&L Relationships (A Deeper Dive)

The Procurement Foundry & Fine Tune P&L Survey

Sustainable savings requires constant validation.

Few would argue with this assertion. After all, it is impossible to say that saving has indeed "sustained" if it hasn't been validated. Unfortunately, however, the issue is not one of understanding this need for validation, but rather one of a commitment to proper resource allocation and ongoing vigilance—emphasis on "vigilance."

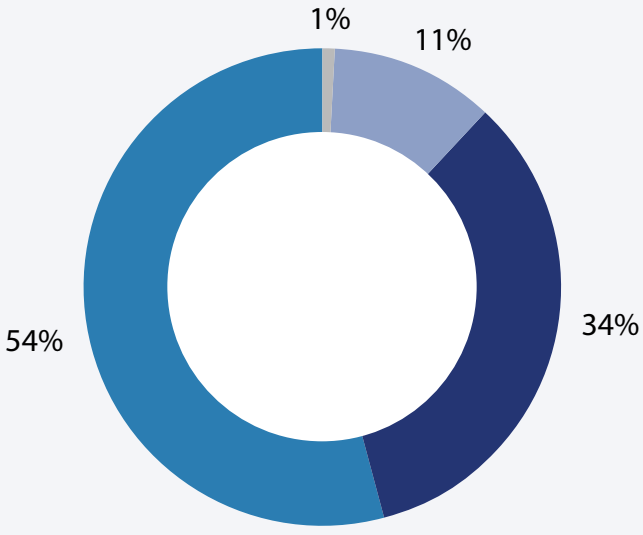
We know that actual cost savings requires a sustainable strategy for proactively shrinking the size of supplier payments. The only way to achieve this level of a continuous and diligent "nose to tail" category management approach is with dedicated, ongoing vigilance.

In other words, while effective sourcing and contract negotiations are essential, having a strategy that also focuses on continuous deal enforcement, assurance of competitiveness, and responsiveness to inevitable change in the market is critical for sustainable savings to materialize as planned.

The purpose of "The Procurement Foundry & Fine Tune P&L Survey" was to identify how savings are being defined, tracked and measured, including who is responsible for post-contract oversight and management of complex tail spend.

Alarmingly, we encountered disconnects right out of the gate, on seemingly straightforward matters. For example—when it comes to determining what qualifies as savings, 42 percent of survey respondents "don't know or don't believe their definition of savings is properly 'aligned' to deliver optimal P&L impact."

This disconnect extends beyond a savings definition to include who is responsible for what. According to most respondents, it is the finance department's role to measure and track the impact on the P&L on an ongoing basis.



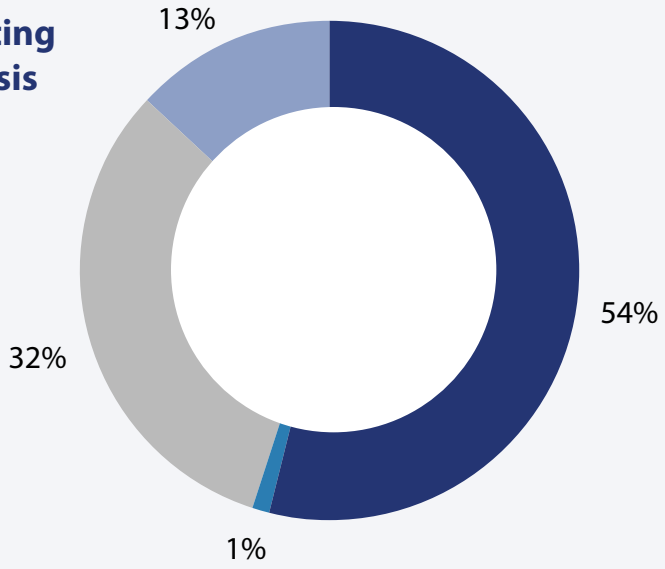
Which department is responsible for measuring and tracking the P&L impact of savings initiatives?

- Procurement
- Finance / Accounting
- Field / Operations
- Other (or combination)

However, most respondents believe that procurement should lead the overall program by interacting with the suppliers daily to determine "products and services used, quantities, inventories, frequencies, and programmatic changes."

After an agreement is signed, who is interacting with the supplier/vendor on a day-to-day basis to determine products and services used, quantities, inventories, frequencies, and programmatic changes?

- Procurement
- Finance / Accounting
- Field / Operations
- Other (or combination)



Given the above, it is clear that communication between procurement and finance is critical to address the challenges of effectively managing tail spend.

Unfortunately—and as a February 2021 Supply Chain Dive article points out—procurement and finance are "two historically adversarial functions" with a "traditional scoreboarding relationship built on distrust, poor communication, and a lack of understanding of supply chain and financial realities." As a result, rather than coming together "to create value for their company," what the article calls "misplaced tensions and missed opportunities" persists.

This internal communication breakdown—and resulting savings decay—manifests when finance approves a payment under the extended contract umbrella, assuming that the mere existence of a contract authorizes expenditures on the invoicing under this contract.

One typical example is a local office requesting additional mats that were not part of the original agreement. The supplier eagerly adds these off-contract items (at "book price"), and the cost for these mats becomes "embedded" in the monthly invoice. As a result, finance pays the vendor under the original contract (despite the off-contract items on the invoice) with no interaction with procurement…and savings gradually erodes.

In the final section, we will discuss how bridging the divide between procurement and finance will optimize P&L impact and return contracts to their intended savings arc.

Section III
The Way Forward (A Focus on Stakeholders)

Bridging the divide

"Complex procurement activities can benefit from the finance team's input and expertise, laying the building blocks for collaboration." – Supply Chain Dive (Feb. 2021)

Except for a small percentage of cases, the real takeaway from the survey is that no one group is stepping up to take ownership of the overall effort to ensure savings initiatives actually manifest in the P&L as intended, and stick over time. And even if they do, there are issues with savings measurement and a lack of resources to take on this ownership.

However, someone has to take the lead, and it seems only logical for procurement to be that "someone," primarily because it is the "author" of the initiatives at the heart of this matter. Procurement devises the contracting and cost savings strategies and uses the marketplace to achieve the desired contractual framework for success. To abandon involvement at this juncture—lobbing contracts over the wall to finance and operations, hoping the contracts will deliver the intended results—seems somehow like not quite finishing the job. And of course, finance can play a role in budgeting and tracking spend against established purchase orders, but the question of whether or not procurement's efforts have actually hit the P&L as designed is usually vastly more complex than "over or under budget" or "falling within the p/o parameters." It is unrealistic to expect finance or operations to grasp all of the intended effects of a procurement initiative, and thus the true owners of the "procurement to P&L" translation must surely be procurement itself.

Of course, procurement cannot go it alone in this realm, but the ownership must extend beyond execution of supplier agreements, or those agreements are doomed to fall short of their intended P&L impact.

In your opinion, is your procurement department adequately resourced to ensure procurement's efforts translate to lasting P&L impact?

Procurement is not alone

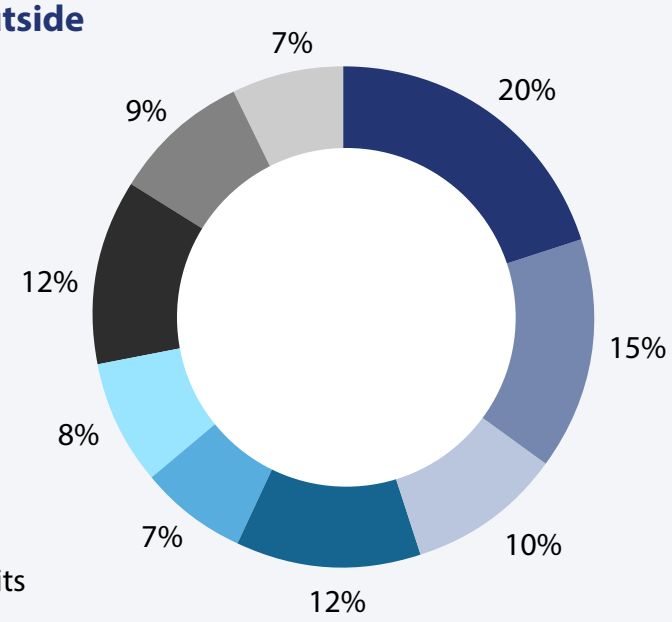
Suppose you don't have all the internal parts working together—including savings definitions/methodology and adequate resources for procurement to take true ownership of the categories they "own." In that case, you won't have a successful program, and procurement's efforts will likely fall short of their intended P&L impact.

In short, to have a complete and clear picture, all parts of the puzzle must be firmly in place, which is why it is important for procurement to take the lead in communicating and collaborating with finance and other stakeholders.

Beyond establishing a stronger working relationship with the finance department internally, procurement departments are—with increasing frequency—turning to outside partners to optimize savings with complex expenses—both in contracting and continuous management.

Which of the following activities do your outside partners engage in?

- Data collection
- Baseline category spend assessment
- Strategy setting
- Deal making / negotiations
- Implementation management
- Month to month invoice auditing
- Auditing past spend
- Resolving overcharges & ensuring a refund/credits
- Responsiveness to field issues



The reliance on outside partners does not preclude the need for procurement and finance to "work toward a shared design of analytics."

As stressed in the earlier referenced article, both procurement and finance must develop metrics and share data "freely." As a result of this "sharing," procurement and finance will have much greater confidence in each other's roles, thus laying a solid foundation for continued savings in tail spend.

Conclusion

Effective tail spend management programs are not unattainable, as evidenced by the 12 percent of survey respondents who believe they are "properly resourced" and their "definition of savings is aligned to ensure P&L impact."

12%

It is worth noting, however, that 88 percent of respondents could not answer in the affirmative to those two questions. For most organizations, the obstacles between their savings expectations and their realization of the same represent a daunting and unbridgeable divide. In other words, a steady decay of savings—when it is attained at all—is a daily reality with 80 percent of their overall transactions.

57%

To address this challenge, and in line with 57 percent of survey respondents, a growing number of organizations are looking outward to engage third-party providers with tail spend expertise.

Therefore, finding the right partner(s) to augment existing tail spend management capability and ultimately facilitate the internal collaboration process to ensure optimal P&L impact is the all-important first and best step.

About Fine Tune

At Fine Tune, we specialize in the continuous management of a small handful of particularly burdensome expenses, producing hard-dollar savings for our clients while enabling them to allocate their valuable resources more effectively. Established in 2002, Fine Tune has produced tens of millions of dollars in savings for hundreds of clients throughout the US and Canada.

To obtain your copy of the complete survey or learn more about our services, contact Fine Tune at contact@finetuneus.com.

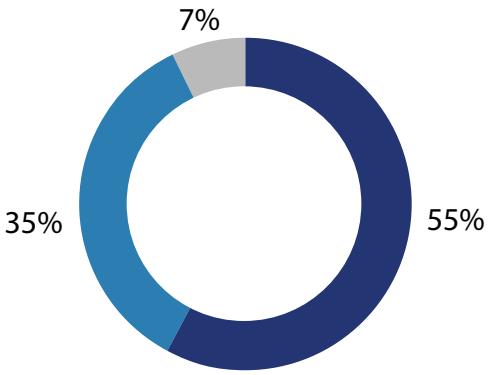
About the Survey

Commissioned by Fine Tune and conducted via an online survey tool, the survey polled 100 members of the Procurement Foundry community in May 2021.

Survey Results

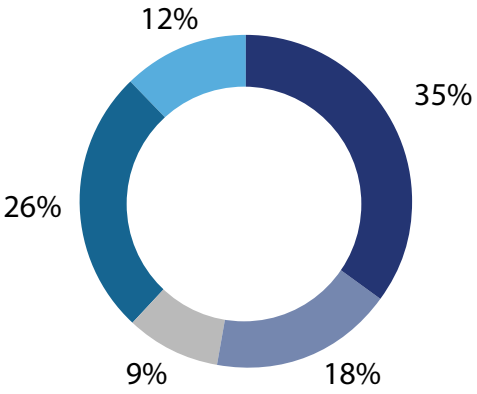
1. Do you believe your organization's definition of savings (and methodologies for measuring and rewarding savings) are aligned to ensure real and lasting P&L impact?

- Yes
- No
- I don't know



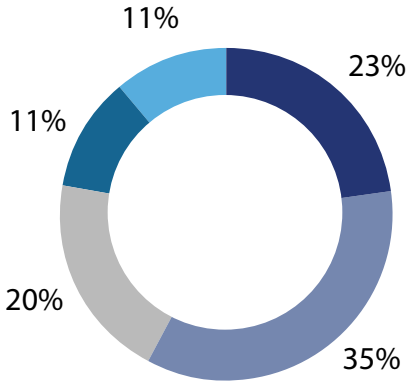
2. How is baseline spend calculated?

- LY total spend
- LY total spend normalized for material events
- LY by location
- LY by individual line item or SKU#
- Other



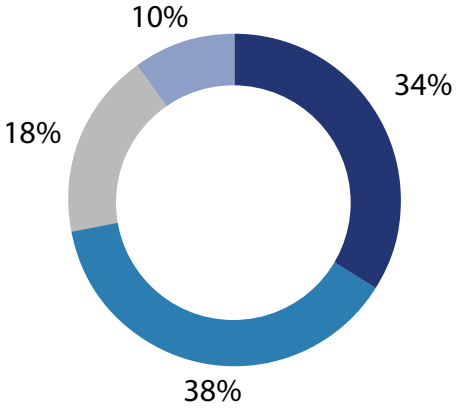
3. How are savings measured?

- Projected savings
- Actual monthly vs projected
- Total spend YOY
- Normalized YOY
- Other



4. When is savings credited/rewarded?

- Upon execution of savings initiative
- Month by month as P&L impact is realized
- At the end of the budget year
- Other



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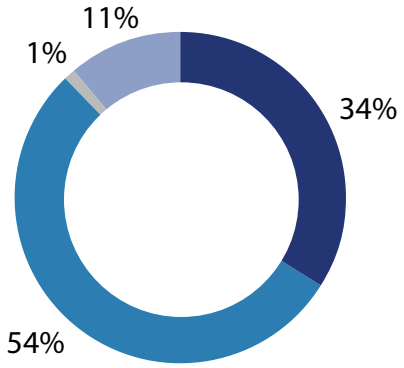
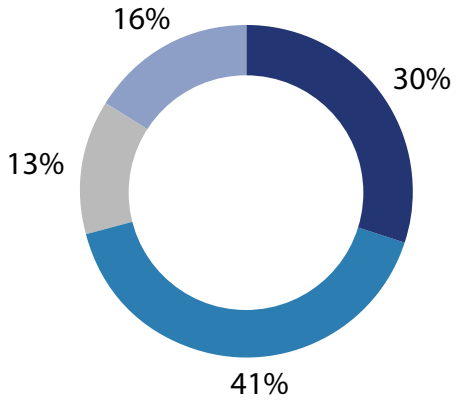


6. Who is responsible for ensuring P&L impact after a savings initiative has been implemented?

- Procurement
- Finance / Accounting
- Field / Operations
- Other (or combination)



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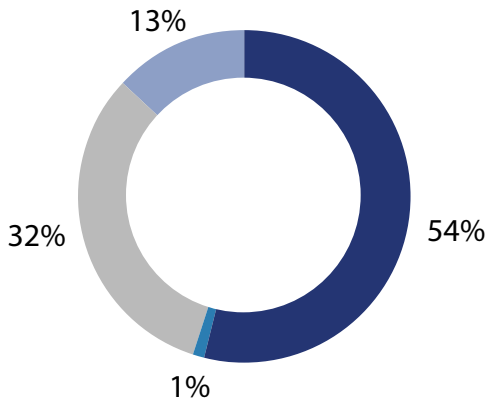
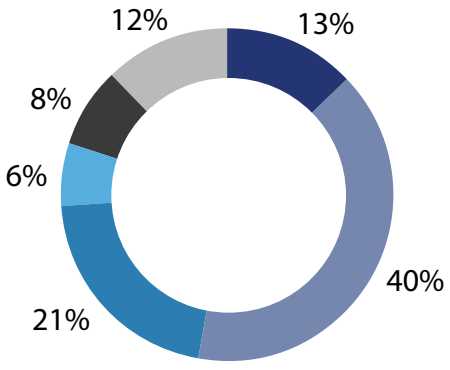


8. Who is responsible for approving weekly/monthly invoicing/payments?

- Procurement
- Finance / Accounting
- Field / Operations
- Accounting
- IT Systems (e.g. Ariba, Coupa, etc.)
- Other



9. In your opinion, is your procurement department adequately resourced to ensure procurement's efforts translate to lasting P&L impact?

- Yes
- No
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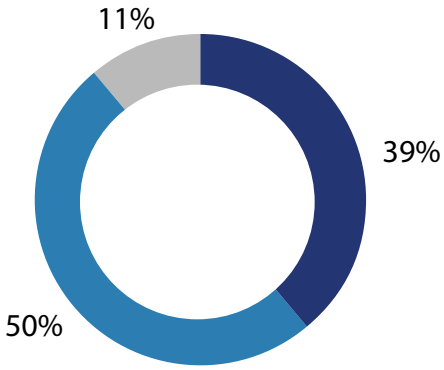
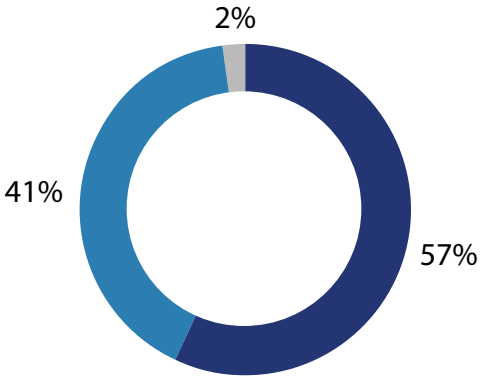


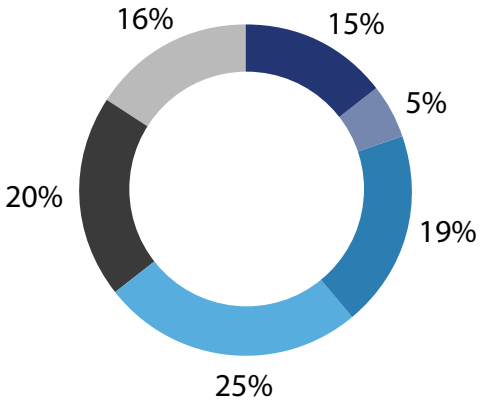
10. Does your company engage with outside partners to augment procurement department resources?

- Yes
- No
- I don't know



11. What type of outside partners do you employ?

- GPO
- Brokers (or other "cost-plus" enterprise)
- Auditing services
- Fee-based consultants
- Contingency-based consultants
- Other



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