

Indirect Procurement Optimisation

Unlocking areas of savings
and value creation



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Are there still opportunities to cut costs?

According to a recent survey EY took part in, of the 267 Chief Procurement Officers and other procurement executives contacted, 65% cite finding more savings as their top pressure¹. With persistent high inflation in many emerging markets, finding new ways to contain costs is a constant challenge. The financial sector provides a pertinent example. Compensation costs have declined as a proportion of revenue for the top 50 global banks in 2013 (from 33% in 2009 to 30% in 2013), however, non-staff costs have continued to rise faster than revenues².

South African banks have struggled to contain cost growth in line with much slower revenue flows since the global financial crisis. Both compensation and non-staff costs for the banking sector have consistently outpaced inflation during the past five years. As a result, efficiency ratios rose considerably, from 52.8% in 2008 to 56.3% in 2012. This is not unique to the banking sector. 75% of Consumer Products executives EY surveyed globally believe it has been harder to sustain their operating margins over the past three years³. Non-compensation or indirect costs are all other costs (such as utilities, logistics and IT spending) that an organisation incurs before they pay salaries and bonuses.

The global economic scenario is now forcing companies to reduce costs on a sustained basis to improve bottom-line profits. Although indirect procurement costs are sometimes considered as “fixed” and much more inflexible than salaries and bonuses to manage, they are one of the few areas in an organisation that still provides ample opportunities to reduce costs and improve bottom-line profits.

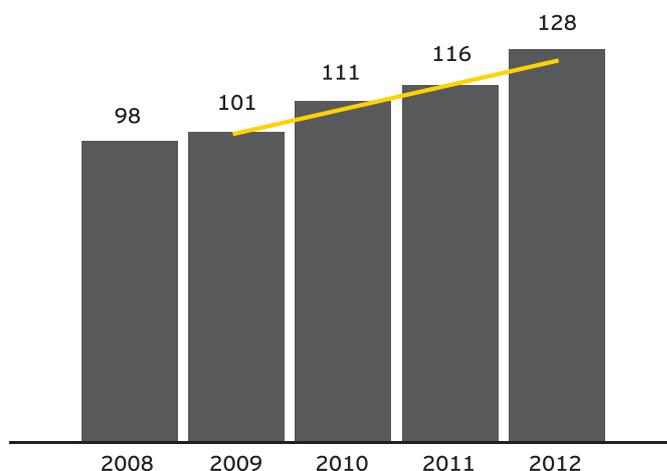
The key to a sustainable reduction in indirect spend is to strike the right balance of focus between supply and demand activities in an organisation. Considering the opportunity levers below for both demand and supply will assist organisations in identifying significant savings in a structured way.

¹Ardent Partners, CPO Rising 2012: Keeping Score, 7 Dec 2012

²Global Banking Outlook 2014-15

³EY, Margin Unlocked: Integrated margin management to deliver breakthrough performance

Bank Expenses ZAR bn



Opportunity levers for both demand and supply will help organisations identify significant savings in a structured way

Indirect procurement costs are often considered as insignificant. Organisations therefore underestimate the influence on the bottom line that the failure to control indirect spend cost, terms and conditions, supplier performance specifications and performance management have on the bottom line.

Estimates are that even a five percent reduction in indirect spend can translate to a one to three percent impact on the bottom line.

Management should be aware of and address the factors which could result in them overlooking a golden opportunity to optimise indirect spend to cut costs. These factors can be summarised in the three categories below:

Number of stakeholders and a highly complex area to manage:

The diversity of materials and services that fall within the indirect procurement category, the multiple channels through which they are procured, and the number of stakeholders involved often results in indirect procurement being a highly complicated area to manage. This complexity is frequently seen as a barrier for companies that want to achieve quick-wins in cost saving opportunities.

Sporadic buying, lack of a centralised supply chain and meaningful data:

Generally, organisations do not have a procurement area dedicated to indirect spend. This results in sporadic buying patterns, lack of preferred suppliers and a number of challenges such as a lack of meaningful data, fragmented supply chains, and embedded local personal relationships with suppliers.

Indirect spend is therefore seen as a low-value and low-risk area to manage, and the potential cost savings are overlooked by management.

Lack of measured Savings:

Companies usually have key suppliers for direct spend with whom they have powerful relationships and leverage volume buying to negotiate discounts and cost savings. If procurement negotiate discounts and cost savings in the area of direct spend the impact on profit and loss is clear.

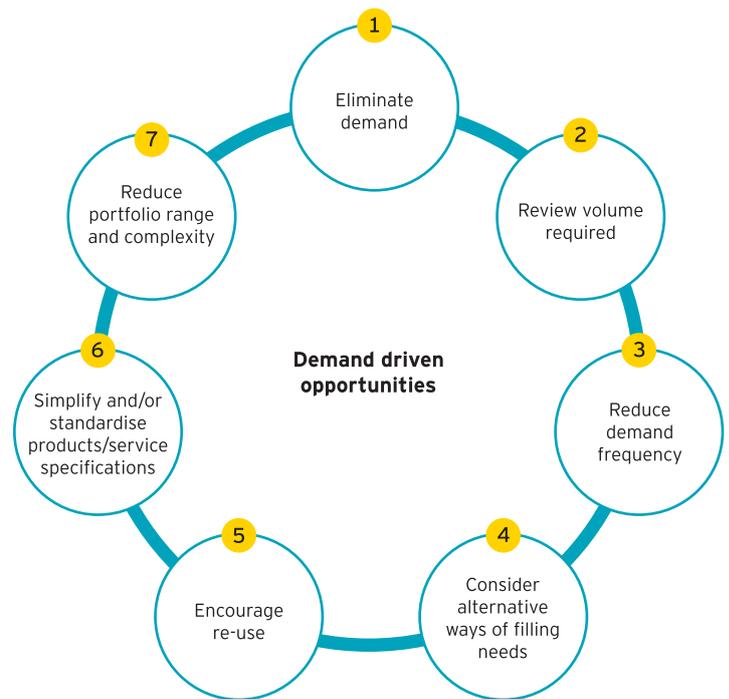
Indirect suppliers are not restricted as to which industries they can supply. It is therefore only on rare occasions that a company can use its volume buying power to attain a dominant position over an indirect supplier. Companies have to look for more innovative ways to improve their indirect spend portfolio by consolidating, standardizing and outsourcing indirect items of spend to reduce costs and raise service levels.

The fact that cost savings for indirect procurement are not linked to a specific bill of materials as with direct procurement results in the impact of cost savings in indirect procurement being underestimated by management.

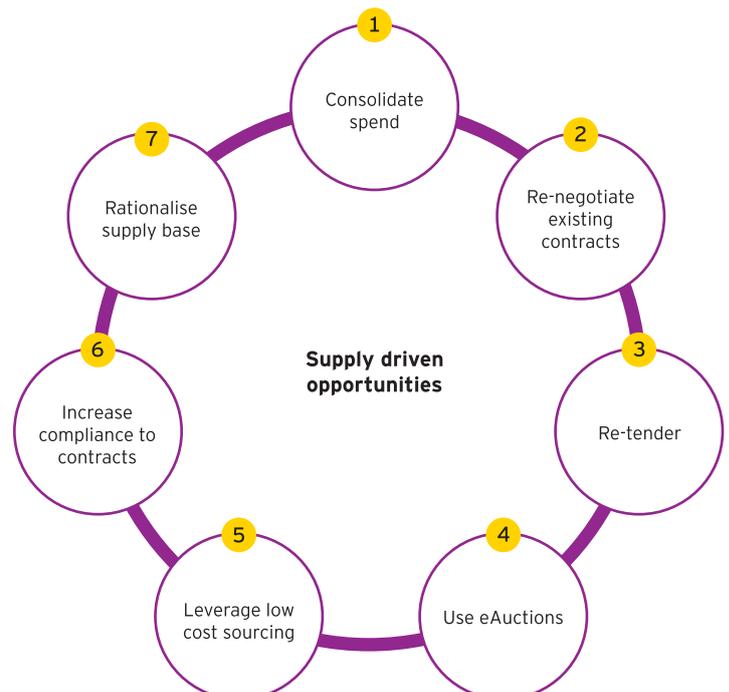
“Sometimes when I consider what tremendous consequences come from little things, I am tempted to think there are no little things.”

Bruce Fairchild Barton, American author

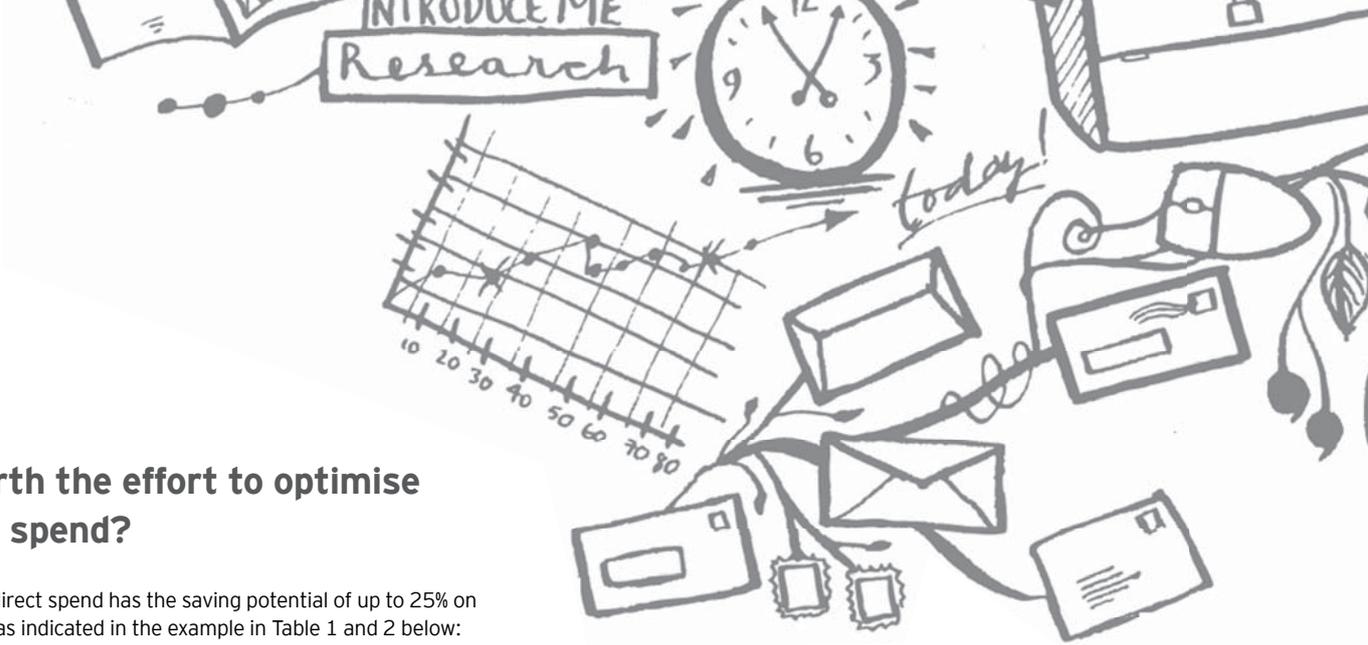
Opportunities to alter the way in which business is transacted in a specific spending category



Value for money opportunities in a specific spending category



¹http://www.procurian.com/docs/research-papers/procurian_everest_optimizing_indirect_spending_2011.pdf



Is it worth the effort to optimise indirect spend?

Optimising indirect spend has the saving potential of up to 25% on current costs as indicated in the example in Table 1 and 2 below:

Demand driven indirect procurement cost saving matrix

Source: EY experience. Illustrative (not exhaustive)

Cost Categories	Example of indirect procurement categories	Opportunity Lever and examples of saving areas that can be addressed with indirect procurement optimisation	Typical Savings Range
IT and depreciation: 17% of total cost	Hardware: Computer equipment	1. Eliminate demand: <ul style="list-style-type: none"> ▶ Rationalisation to one laptop and desktop ▶ Challenge organisation on what add-ons and option packages are really needed 5. Encourage re-use <ul style="list-style-type: none"> ▶ Re-use laptops for new employees 7. Reduce portfolio range and complexity <ul style="list-style-type: none"> ▶ Reduce specifications (no DVD player, etc.) 	5-25%
	Software: Software licensing and maintenance	2. Review volume required: <ul style="list-style-type: none"> ▶ Per user versus software licensing ▶ Analyse the usage of organisation's software 	
Other: 15% of total costs	Office Management: <ul style="list-style-type: none"> ▶ Courier services ▶ Business printing services ▶ Archiving/record management ▶ Office furniture ▶ Promotional products ▶ Mail products and services 	4. Consider alternative ways of filling needs: <ul style="list-style-type: none"> ▶ Restrict utilisation of an overnight courier and express services to urgent matters 5. Encourage re-use <ul style="list-style-type: none"> ▶ Encourage reuse of furniture 6. Simplify and /or standardise products/service specifications <ul style="list-style-type: none"> ▶ Products rationalisation (50 items catalogue) 	15 - 20%
	Travel: <ul style="list-style-type: none"> ▶ Car rental ▶ Travel agency ▶ Corporate travel cards ▶ Airfare ▶ Lodging 	4. Consider alternative ways of filling needs: <ul style="list-style-type: none"> ▶ Economy class for flights <6 hours ▶ Consider lower cost options like video, web and telephone conferences instead of face to face meetings 	
Premises: 11% of total costs	Utilities: <ul style="list-style-type: none"> ▶ Electricity 	4. Consider alternative ways of filling needs <ul style="list-style-type: none"> ▶ Issue laptops and notebooks which use up to 90% less energy than a desktop PC. ▶ Energy saving measures: It is estimated that organisations can save as much as 75% of energy costs by making the switch from traditional incandescent light bulbs to energy-efficient Compact Fluorescent Light (CFL) bulbs. 	9 - 16%



Supply driven indirect procurement cost saving matrix

Source: EY experience. Illustrative (not exhaustive)

Cost Categories	Example of indirect procurement categories	Opportunity Lever and examples of saving areas that can be addressed with indirect procurement optimisation	Typical Savings Range
IT and depreciation: 17% of total cost	Hardware: Computer equipment	7. Rationalise supply base: <ul style="list-style-type: none"> Optimise hardware by taking licence requirements into consideration when buying hardware. 	5-25%
	Software: Software licensing and maintenance	1. Consolidate spend: <ul style="list-style-type: none"> Eliminate duplicate licensing through identifying the software that is included in the licences the organisation has paid for. 2. Renegotiate existing contracts: <ul style="list-style-type: none"> Identify whether the organisation actually uses all features that are paid for. Renegotiate the contract to receive and pay only for software editions that are utilised. 	
Other: 15% of total costs	Office Management: <ul style="list-style-type: none"> Courier services Business printing services Office furniture Promotional products Mail products and services 	7. Rationalise supply base: <ul style="list-style-type: none"> Control purchasing processes by utilising preferred vendors and leverage supplier relationships where possible to ensure the organisation gets the best price. 	15 - 20%
	Professional services: <ul style="list-style-type: none"> Marketing services Advertising Employee training 	6. Increase compliance to contracts: <ul style="list-style-type: none"> Improved contract management to ensure: <ul style="list-style-type: none"> Costs claimed by advertising agent match actual costs incurred Commissions/service charges for employee training are not passed through after period allowable per contract 7. Rationalise supply base: <ul style="list-style-type: none"> Reduce multiple contracts in place across different locations for similar services to avoid a lack of consistency. 	
	Travel: <ul style="list-style-type: none"> Car rental Travel agency Corporate travel cards Airfare Lodging 	5. Leverage low cost sourcing <ul style="list-style-type: none"> Utilise cost savings for advanced flight booking 6. Increase compliance to contracts: <ul style="list-style-type: none"> Compliance to preferred contracts (air, hotel) 	
Premises: 11% of total costs	Services: <ul style="list-style-type: none"> Cleaning services Security Facilities management Food services 	7. Rationalise supply base: <ul style="list-style-type: none"> Cost versus performance analysis of HVAC (heating, ventilation, air conditioning and cooling) installations. Measurement of the service requests to contracts and SLAs. Cancellation of contracts where suppliers does not meet the contract. 	9 - 16%

What steps should be taken to optimise indirect procurement?

Number of stakeholders and a highly complex area to manage:

A structured approach should be taken to identify the areas that can deliver significant savings and change the way in which enterprises manage their indirect procurement.

The following four key areas should be considered to transform current indirect procurement practices into those that will yield the envisaged cost saving benefits:

Classification of spend data

Spend data should be analysed to create a spend portfolio. The spend portfolio should identify the amount, category and suppliers where the spend occurred.

A master list of spending categories which will be addressed in the cost saving initiative should be developed.

Identifying saving opportunities

The opportunity levers for both demand and supply should be examined to identify and prioritise significant savings in a structured way. The biggest and most sustainable opportunities are usually demand driven.

Each opportunity should be prioritised for ease of implementation and financial benefit. This will allow opportunities to be pursued in waves.

The prioritisation should consist of two phases. The first phase is the identification of potential savings in a particular spending area. This includes identifying savings that can be implemented immediately as well as the longer term initiatives.

The second phase entails the identification of opportunities which will assist to rapidly establish the legitimacy of the initiatives. These are less complex and possibly small pay back projects such as car rental and hotel

agreements. The more difficult and potentially higher payback potential projects should be implemented in the longer term.

Designing of a short and long term implementation plan

A critical element in the implementation of the indirect procurement cost saving initiative is a robust implementation plan.

The plan should include agreed goals, roles and responsibilities across the organisation. It is important to keep in mind that the plan should involve both the procurement function as well as the departmental budget owners.

The procurement function can influence the supply driven opportunities. However, the most significant opportunities are influenced by the way business is transacted in a specific spending category. It is therefore imperative that departments alter the way in which they spend their budgets.

Control measures should be implemented to ensure that the cost saving initiatives are adhered to. These include, amongst others:

- ▶ A process whereby departmental budgets are reduced to reflect savings from the revised indirect procurement strategy.
- ▶ Technological control measures which:
 - ▶ Prevent certain categories of purchasing
 - ▶ Invoke penalties for these categories of purchases
 - ▶ Enable an approval or check and balance system.

Implementation of a monitoring system (continuous cycle)

The value of the savings and compliance to the revised procurement process should be measured and reported on.

A reporting methodology should be implemented which tracks the savings made and assists business in identifying areas where improvement is required.



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