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Five Biggest Areas of Corporate Spending Waste

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The Five Biggest Areas of Corporate Spending Waste

Indirect and related spend take a massive share of total enterprise costs, accounting for 15 percent to 30 percent of revenue. This spend spans everything from marketing services and IT to travel and capital equipment. Despite these large numbers, most companies fail to manage their indirect spend professionally. In fact, our benchmark data shows that the average company effectively manages less than 50 percent of spend, falling far short of best-in-class organizations at 90 percent or more of addressable spend managed. There is good reason to worry about this unaddressed spend as the savings potential through improved management of indirect spend is significant.

In the current environment of slower economic growth, companies need to do more with less, and deliver higher margins. Executives struggle to identify new areas of savings, failing to realize the great potential to reduce costs right away in the area of indirect spend.

There are three major barriers that prevent organizations from mastering their indirect spend:

Limited reach: Indirect spend areas are highly fragmented and require deep expertise to manage effectively, as well as effort to gain the trust of business stakeholders.

Information asymmetry: Your suppliers know far more than you do, creating a drastic information imbalance.

Lack of follow-through: Negotiated savings tend to disappear between the negotiation stage and the point of spending because of disconnected processes and poor tracking and visibility.

This paper explores major spend areas with significant potential for reducing wasteful spend. Understanding where and why waste is happening in your business is the first step toward preventing and eliminating it, and a step closer to reclaiming a margin point or more in bottom-line value.

1. Overspending on energy, especially in regulated markets

Utility costs represent one to two percent of indirect costs for most companies, or as much as four to five percent of costs for heavy-use manufacturers. Other than taking energy conservation initiatives and hedging costs of natural gas and fuel, most companies assume they can do little to manage energy costs that are influenced by volatile energy markets. This prevailing perception is the first example of needless corporate waste in action.

Consider the common misconception that in regulated markets (with no choice of energy providers as in deregulated markets) utility rates are nonnegotiable, leaving few opportunities to drive savings. This is not the reality. Within regulated markets, there are many rate tariffs and options available based on usage thresholds, keeping in mind that because usage is dynamic the rate environment is as well. A thorough analysis of a company's regulated utility usage and rates can yield substantial bottom-line benefit.

Given that roughly two-thirds of energy markets are regulated, potentially two-thirds of corporate energy spend is going unmanaged. Don't assume that your regulated rates are optimized just because you are using a utility bill payment service. Unless your provider has deep market intelligence, including rates paid by similar users in the same market, you are likely missing out on the best rates. With the right data, you can determine what rates you should be paying. You also may uncover incentives, rebates and applicability clauses available to you. Where new rate tariffs are applicable, savings of eight to 10 percent are not uncommon.

Incorrect bills create another source of waste in energy spend. Approximately one percent to two percent (and sometimes as high as five percent) of utility bills contain errors. Corporate consumers often end up overpaying for energy on incorrect bills. Utility bills may contain errors that fall into three major areas: meter reading and calculation errors, meter setup errors and rate misapplication errors (e.g., automatic rate tariffs that did not get updated, or a misapplication of an optional rate). Identifying and correcting errors can yield immediate savings in the form of lower ongoing utility costs (and applicable sales taxes). Depending on the jurisdiction, there may also be an opportunity to capture refunds on overpayments. In addition, audits can uncover other benefits being missed. For example, state tax incentives and credits being applied to one bill or location but not others.

Capture one percent to 10 percent savings or more in regulated energy markets and two percent to 15 percent savings in deregulated markets.

2. Wasting money on surgical benefits costs by failing to take advantage of medical specialization

At approximately US$700 billion, or 31 percent of the US$2.3 trillion in annual medical spend, surgical costs represent the largest component of U.S. health care spending, according to data from the U.S. Department of Health and Human Services. Not only are surgical costs a large cost driver but companies are wasting money by overlooking opportunities to take advantage of rapid specialization in the medical field. Specifically, some hospitals and medical facilities have focused on becoming specialist facilities or centers of excellence. These facilities are becoming destination sites for significant and/or high frequency procedures ranging from hip and knee replacements to to cancer surgeries based on their superior track records of efficiency, patient outcomes and cost. Companies can use these hospitals to stop wasting money on surgical expenses at facilities with higher costs and lower quality outcomes.

Imagine a scenario where an employer flies a patient and his or her family from Minnesota to Arizona for a hip replacement at one of the nation's top facilities. The employer can put the family up in first-class accommodations for the week (allowing the patient to have his or her family close by during the procedure and recovery while giving the family a mini vacation), all the while saving significant costs compared with spending more at the default local hospital. Our experience with clients reveals that this approach can introduce cost savings—including travel expenses—for many procedures of 30 to 50 percent.

30 percent to 50 percent potential savings on the largest bucket of HR benefits costs

Total savings, depending on employee populations and their specific medical needs, could represent millions of dollars toward the bottom line. But it is not just about cost savings—it is about better outcomes for patients, and better overall health of the employee population while eliminating another source of corporate waste.

3. Lack of benchmarking media performance and media spend

Marketing spend is a very large spend area for most companies, ranging from one percent of sales for manufacturers to six percent to seven percent of sales for consumer products and life sciences companies. Within the marketing category, media forms approximately 75 percent of marketing spend. Media is considered strategic because of its ability to drive brand awareness, recall and ultimately better sales performance. But marketers often fail to accurately measure and audit the performance of their media campaigns, losing opportunities to improve the returns on their investment.

The typical large brand advertiser has 40 media suppliers or partners. Marketers buy media impressions or exposure to target demographic and behavioral audiences and the media suppliers position the advertiser to deliver the impressions that the advertiser has paid for. But few advertisers have an accurate sense of whether they are getting what they pay for based on the available inventory and, therefore, little idea if their media dollars are yielding the expected impressions with their target audience.

Media performance can be measured not only in terms of whether actual viewership demographics matched expectations, but also where commercial messages are positioned within advertising pods for maximum impact on advertising recall and how this performance stacks up against the competition.

The need for media auditing and benchmarking is only increasing with the dramatic reshaping of the media consumption market. Increasingly, content is consumed on mobile devices, online or in time-shifted formats. In addition, as more advertising dollars move to online and digital channels, measuring performance of media spend across all channels becomes critical for justifying media strategy and prioritizing investments. Our media audit clients typically see a 10 percent improvement in their media investment, a massive return measured by increased impressions. This results not only in reduced waste in media investments, but also helps precious media dollars work much harder and deliver stronger results.

Use media audits and benchmarking to drive 10 percent or greater ROI from media spend

4. Not challenging fuel surcharges from transportation providers

Logistics costs can be one of the largest areas of spend for many companies, ranging from one percent to nine percent of sales depending on the industry. Within this large cost area, fuel costs are typically the largest single component at 30 percent to 40 percent of overall logistics costs. But shippers are wasting money because they do not actively manage their fuel costs—in part because fuel costs are viewed as a pass-through cost from the shipper and are based on unmanageable market variables. As with many spend areas, suppliers (in this case, the carriers) hold an informational advantage over buyers (the shippers), so shippers tend not to challenge the pricing assumptions used to determine fuel charges.

Typical fuel surcharges for truckload transportation are calculated based on a few basic components: distance of the haul or route, a fixed mile-per-gallon assumption for the truck and a trigger point for the assessed charges to start aggregating. Distance is fixed and unambiguous, but the other two assumptions can and should be examined.

Mileage assumptions: In assessing transportation for our clients, it is common to see mileage assumptions of five miles per gallon (mpg) used in fuel surcharge calculations, but is this realistic? Many carriers have made investments in fuel efficiencies and may be realizing six to eight mpg, but shippers often continue to pay fuel surcharges based on the five mpg assumption.

Actual fuel charges: Fuel charges are typically assessed based on a broad fuel table, which is based on generally accepted government averages. The prices may not reflect the actual fuel costs paid by carriers on the actual route, or may not reflect fuel rates that carriers have negotiated with their fuel suppliers. All of this means that a carrier may get as much as a 15 percent margin on fuel costs.

To stop wasting money by overpaying for fuel, shippers can flip the script by tapping real-time market intelligence to apply a "should-cost" approach to fuel cost estimates. With accurate mileage estimates based on actual truck/asset types, as well as accurate fuel prices along particular routes, shippers can calculate what fuel costs would be for a particular route. This analysis results in accurate and almost always lower fuel surcharges, and also levels the supplier playing field and centers negotiations squarely on the actual line-haul charges. The result is often a broader field of potential suppliers competing on a more apples-to-apples basis with transparency for the true cost of fuel, leading to year-over-year fuel cost savings in the range of one to five percent.

Drive one percent to five percent savings with a targeted fuel program

5. Poor management of real estate costs

Several trends are driving massive changes both in corporate demand for real estate, and how that real estate is being used and managed. As a result, companies are wasting money on bloated real estate portfolios and sub-optimal management of the space they own.

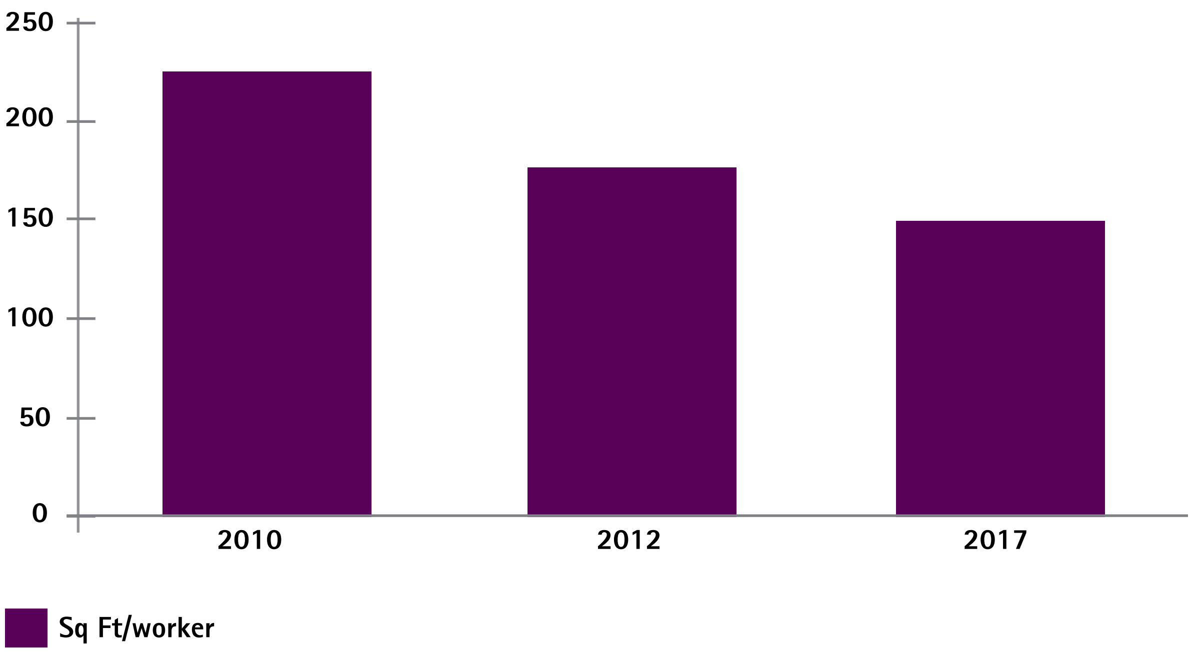
For example, mergers and acquisitions (M&A) activity, corporate restructuring and divestitures leave many large companies with a patchwork of real estate assets that may be redundant in some cases, or underutilized in others. With more employees working from the road and embracing mobility, and with new flexible workspaces designed to encourage collaboration, the average space allocation per employee has been trending down. The net result of corporate restructuring and these trends is that the average firm has 30 to 50 percent more real estate than it needs. For every $100 million of spend in real estate, ongoing operating costs frequently average $40 million annually. An oversized corporate real estate footprint, combined with poor management of existing assets, is a significant area of waste and a drag on corporate performance.

Few companies have performed a truly strategic analysis of the real estate portfolio, but the amount of waste is significant, and the pay-off from right-sizing a portfolio could be substantial. Shedding excess real estate is the first force multiplier, yielding cash flow benefits from the asset sale, and delivering ongoing benefits by eliminating the US$40 of ongoing annual operating costs for every US$100 of real estate.

The second opportunity is to optimize the operation of the remaining portfolio by centralizing overall asset management. Today most organizations manage real estate in a highly transactional, decentralized way, leaving local managers to manage properties individually with little overall portfolio visibility or benchmarking to understand if costs like security, maintenance, and janitorial services are optimal.

The first step to address this area of corporate waste and extract significant savings is to analyze and right-size the real estate portfolio to support corporate strategy and employee work styles. Next, take a comprehensive, strategic approach to optimizing ongoing real estate services ranging from lease administration to security to maintenance services.

Figure1: Space Allocation per Worker Trending Down



Conclusion

A significant amount of corporate waste can easily be curbed, particularly relating to indirect spend. Companies need to understand the three biggest obstacles to effectively managing indirect spend—limited reach, lack of information and lack of follow-through—and how these issues are causing waste. Procurement expertise, real-time market intelligence and integrated procurement processes can help overcome these obstacles and drive significant value for your organization.

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