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Getting a Grip on Tail Spend

by Ralf Mägerle, Kyle Rosenthal, Christian Meyer

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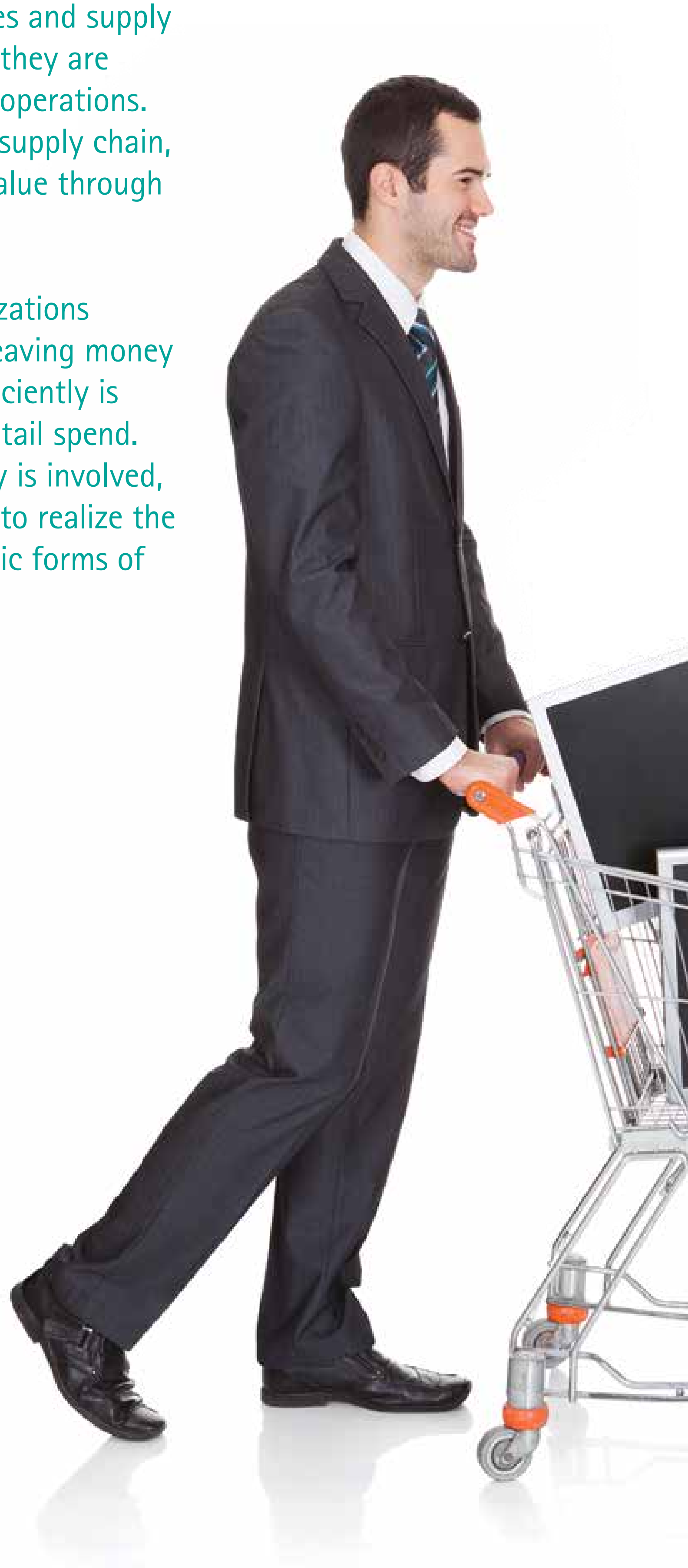
Sourcing and procurement organizations are under pressure like never before. Not only are they responsible for purchasing at a time of volatile commodity prices and supply market risks but, like other corporate functions, they are expected to do more with less funding for their operations. At the same time, along with other parts of the supply chain, they are being tasked with delivering business value through innovative, agile, and flexible operations.

Amid these pressures, most procurement organizations understand that one place where they may be leaving money on the table and deploying their resources inefficiently is in the low-value purchasing generally known as tail spend. Few understand, however, just how much money is involved, much less how to manage their tail spend so as to realize the potential savings and deliver other, more strategic forms of business value to the larger organization.




Getting a Grip on Tail Spend

Understanding Tail Spend

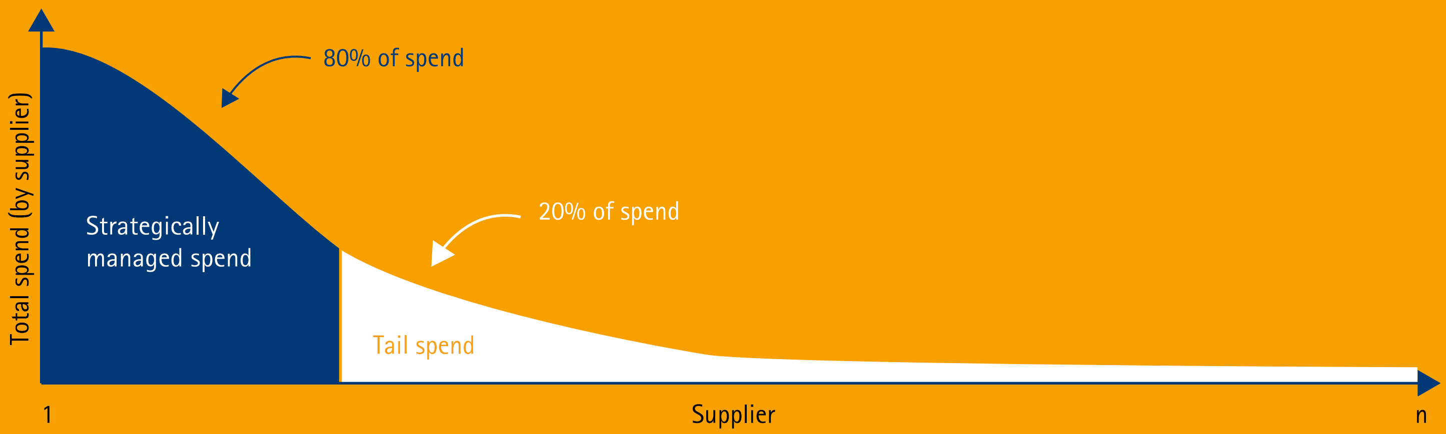
Every year, companies make millions of purchases that are too small to be handled by procurement or too infrequent to be included in catalog systems. While most companies believe they have their most important purchasing categories under control, they tend to neglect this tail spend—the considerable portion of their total spend made in purchases of, say, less than 200K USD (though the upward limit will vary, of course, from one company to another).

Frequently, this "tail" falls outside the purview of procurement personnel with a mandate to strategically manage it and the ability to leverage the full buying power of the organization. Indeed another way of defining tail spend is as all spend that is not strategically managed. As a result, it is often not accounted for in a company's procurement policy. Moreover, because these small purchases are not addressed by procurement, they are made by employees who may not have the time or the appropriate purchasing expertise to research the best options. This can lead to mounting waste, every day, across the enterprise. Indeed, neglecting to manage tail spend can potentially drain tens of millions of dollars annually from a company's coffers.

Tail spend management is a complex challenge. In a single company the tail spend may include tens of thousands of low-value, transaction-intensive purchases across a daunting range of categories—everything from painting a local office to purchasing sophisticated measurement devices. These purchases are fragmented and can involve hundreds of different suppliers. With many resources busy with the large number of transactions that are part of tail spend, the result can be low value per transaction and an inefficient procurement operation. Yet because many companies understand little about their tail spend, they may not know where the inefficiencies arise—let alone how much they are costing the enterprise.

Figure 1 illustrates the simplest and most common approach to analyzing a company's tail spend, which is to calculate the ratios of spend to suppliers at various points along the purchasing spectrum. In the figure, the Y-Axis represents spend per supplier while the X-Axis represents the total supplier base, with suppliers ranked in descending order of size from left to right. The whole figure, we should note, represents a hypothetical case for purposes of illustration. In actual fact, any company that has 80 percent of its total spend strategically managed and concentrated among the largest 20 percent of its suppliers already has its tail spend pretty well under control; procurement organizations that we call procurement masters have 86 percent of their total spend strategically managed.

Figure 1: Strategically managed spend vs. tail spend.



How do you know when your company has a problem with tail spend? If two or more of the following statements apply to your procurement organization, you need to get a grip on your tail spend:

- Number of suppliers > number of employees;
- 2/3 or more of suppliers supply only 5 percent of spend;
- < 70 percent of orders negotiated by procurement;
- > 10 percent new suppliers added each quarter;
- < 50 percent of transactions with preferred suppliers;
- < 50 percent of purchases automated—e.g., through catalogues.

Even when you understand, or suspect, that you have a problem with tail spend, why is it so difficult to come to grips with it? Chances are that you are familiar with some of the typical explanations:

- The sheer numbers of suppliers in the tail make it difficult to manage it effectively.
- Lack of visibility into purchases in the tail can make it difficult to manage it effectively.
- You may suffer from "tail spend fatigue," with procurement managers too busy handling small purchases and putting out fires to be able to analyze and address the root causes of tail spend.
- Your procurement professionals may be too expensive to involve in low-value spend.
- Different stakeholders are affected in different ways by tail spend issues.
- Change means aligning consumption policies and P2P processes and having the IT to support them.

While the complex details behind any given company's problems with tail spend will vary greatly from one organization to the next, we have found that the most powerful method for dealing with a procurement organization's tail spend challenges is to segment the tail and then address the unique issues posed by each segment.

Segmenting the Tail

As we have noted, the most common approach to analyzing tail spend involves calculating ratios of spend to suppliers—many companies, indeed, simply classify as "tail spend" all purchasing with vendors other than the 20 percent with whom they have the highest spend.

At Accenture we go one step further and describe four segments of tail spend that we call the Hidden Tail, Head of the Tail, Middle of the Tail, and Tail of the Tail:

Hidden Tail

As we have noted, a company's biggest suppliers are generally dealt with as part of "strategically managed spend," meaning that for these suppliers there are professionally negotiated contracts in place. As we have often observed in our client work, however, some spend with big suppliers is not covered by contracts—e.g., because existing contracts do not cover the specific materials/service being purchased, or simply because of "non-compliant" purchasing. We call spend of this kind the Hidden Tail.

Head of the Tail

This segment contains spend that is not strategically managed, even though spend per supplier may be in the range of $50,000 to $1M per annum.

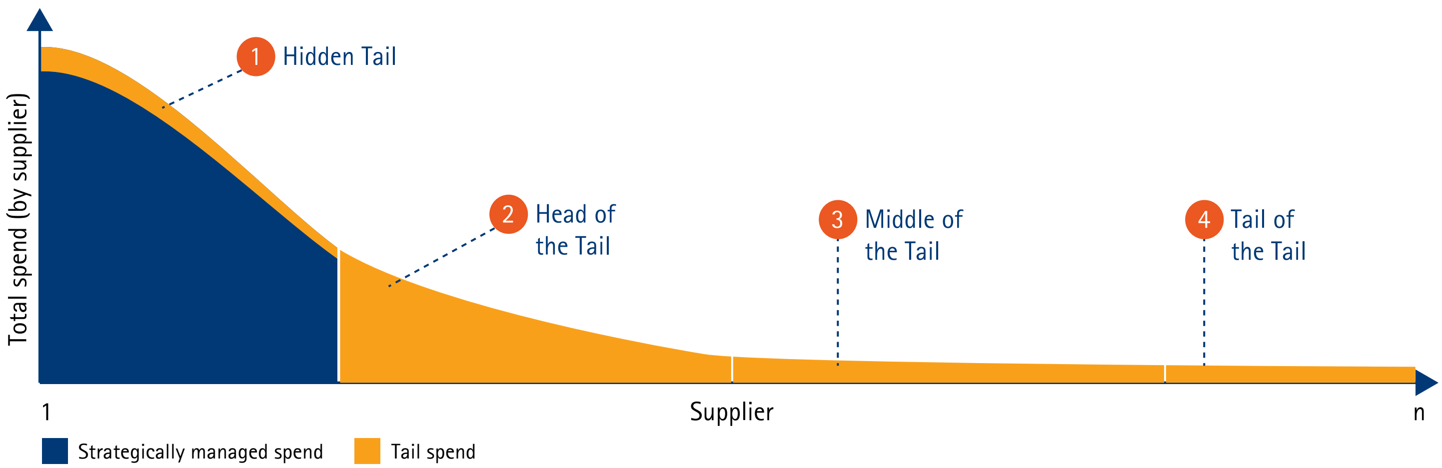
Middle of the Tail

Purchases in this segment of the tail, which includes a large number of suppliers, may be in the range of $2,000—$200,000 per supplier. The Middle of the Tail is not strategically managed because the spend per supplier is just too small.

Tail of the Tail

This segment of the tail contains suppliers with less than $2,000 spend. This spend is highly transactional and fragmented, involving many one-off purchases with a large number of suppliers.

Figure 2: Tail segments overview.



As shown in Figure 2, both the Hidden Tail and Head of the Tail can contain sizeable portions of total spend. However, since this spend is not covered by professionally negotiated contracts, or is conducted without use of existing contracts, there is a high potential for savings in these segments. Still, most companies lack visibility into this spend and therefore fail to understand the total volume of business they do, or could do, with known and approved vendors, thus missing out on opportunities for bundling demand and achieving discounts. Or else—to take another example—they may not know that they are using several suppliers for the same items, thus missing out on chances for supplier consolidation. The key to realizing the high potential savings in the Hidden Tail and Head of the Tail is to drive as much as possible of the purchasing here into strategically managed spend—the goal, indeed, should be to have a minimum of 86 percent of total spend strategically managed.

The Middle of the Tail and Tail of the Tail do not present the same savings opportunities in absolute terms, for the obvious reason that they contain a smaller percentage of total spend. In the Middle of the Tail, however, companies can achieve significant spending reductions in percentage terms along with significant operational efficiencies.

The Tail of the Tail, meanwhile, offers opportunities to simplify purchasing for business users without involving procurement at all.

Solutions and Segment-specific Considerations

The tail spend management (TSM) journey begins with a dedicated project team conducting a tail spend assessment. This is followed by a 3–6 month "spot buy reduction" program for all four segments of the tail, focused on: 1) moving tail spend into strategically managed spend; and 2) channeling more spend—strategically managed or not—into catalogues or other automated and efficient buying channels.

In parallel with a spot buy reduction program, companies should consider establishing a spot buy desk. A spot buy desk consists of a dedicated team of professional buyers utilizing processes for rationalizing spot buying and supported by appropriate technology.

The spot buy desk needs buyers who can speak the local languages of requesters and vendors. It tenders free text requisitions, managing one-off purchases by creating a "buying channel" for spend that cannot yet or never can be moved to strategically managed spend or into automated buying channels. A spot buy desk should be able to perform tasks such as soliciting bids, conducting professional negotiations, and selecting the best offers for spot buy purchases that would otherwise be made purely locally, without bidding processes. Experience with hundreds of thousands of spot buys shows that—provided local knowledge and language capabilities are available—spot buying can be done very effectively and efficiently from near-shore locations. (See Figure 3 for examples of the savings from using a spot buy desk.)

In addition to these strategies applying to all four segments of the tail, we have developed segment-specific solutions:

Hidden Tail

To help capture the savings in the Hidden Tail, a dedicated task force should be formed to find and eliminate spend in this segment for which there are no existing contracts. The task force should negotiate new contracts or extend existing ones in order to reduce the Hidden Tail. In cases where spend has occurred without reference to existing, professionally negotiated contracts, the team can look into the root causes and devise mitigation measures (such as more transparency) to make existing contracts easier to find, establish new policies to force demand to existing contracts, and create automated buying channels that can prevent non-compliant buying.

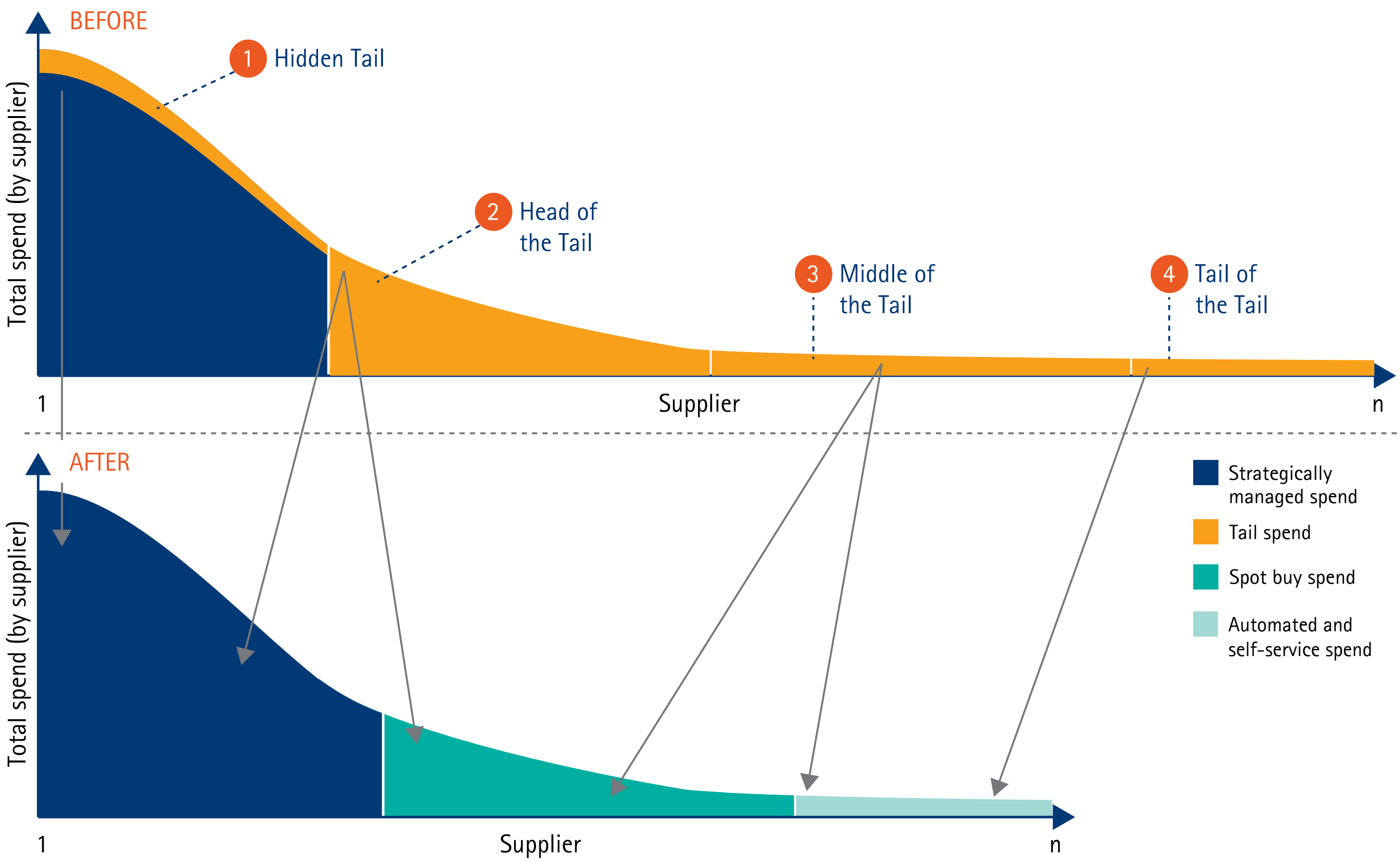
Head of the Tail

For the Head of the Tail we also recommend the use of a task force. Besides undertaking the actions recommended for the Hidden Tail, this task force should look for quick supplier consolidation opportunities. The purpose of this quick consolidation is not to create immediate savings but to move this consolidated spend into strategically managed spend.

Figure 3: Before and after using a spot buy desk.

	Initial specification from requester	Final specification after involvement of Spot Buy Desk
Example 1	• Continuous sealer, semi-automatic • Sealer should be able to seal aluminium • Speed: 6.2 meter/min • Price: €2,885	• Impulse sealer "Seal-Boy", manual • Seals aluminium bags of approx. 20cm • Sufficient for low volumes • Price: €355 **Savings: €2,529**
Example 2	• Purchase set of drum form according to the drawing • Unique approved supplier specified by Engineering • Payment terms: 21 ddl • Price: $47,900	• Purchase set of drum form according to the drawing • Development of new supplier by spot buyer with approval from Engineering • Payment terms: 30 ddl • Price: $22,400 **Savings: $25,500**

Figure 4: Before and after applying TSM solutions—an illustration.



Middle of the Tail

The Middle of the Tail typically also contains spend that can be moved into strategically managed spend or be automated by selecting an appropriate buying channel. However, within this segment—where spend per supplier is relatively low but companies have large numbers of suppliers—most of the savings will often come from establishing a spot buy desk and having it tender smaller spend.

Tail of the Tail

In the Tail of the Tail, the savings potential is usually too small for purchases to be strategically managed or even handled through a spot buying desk. Since this segment consists of a huge number of transactions of low value, a key to finding savings is to rationalize buying channels. This means establishing alternative channels that allow low-value buying without the involvement of procurement—for example, user-friendly, self-service systems that maximize use of e-catalogues for repetitive demands, or purchasing cards (P-cards) for ad hoc or one-off demands.

Figure 4 illustrates how tail spend is transformed by means of the solutions we have described:

With a greater percentage of total spend now strategically managed, and purchasing that once constituted the Head, Middle, and Tail of the Tail now handled through spot buy desks or automated and self-service methods, tail spend itself has disappeared! To ensure that spot buy spend and automated and self-service spend will decrease over time and that no new Hidden Tail or Head of the Tail pops up, the spot buy desk should:

- engage in continuous monitoring of transactions and spend patterns to identify spend that should be moved to strategically managed spend and automated spend;
- identify transactions that come in as free text requisitions where there are contracts and preferred vendors but the requester does not find the contract and/or preferred vendor, and channel this demand to the existing contracts and preferred vendors.

Reaping the Benefits of Tail Spend Management

The first, most visible and easily appreciated benefit of actively managing your tail spend is the price reductions that can be achieved from moving tail spend into strategically managed spend and improving processes for spot buying so that it, too, effectively becomes strategically managed spend.

Companies that transform their tail spend management in the ways we recommend typically can realize savings of anywhere from 10 to 20 percent from spot buying.

A second benefit, as we have seen, comes from the increase in strategically managed spend that can be achieved with effective TSM. Since this spend is managed by procurement professionals, companies typically can achieve a one-time savings of 10 to 15 percent when addressing this spend the first time, and 2 to 5 percent per year in savings thereafter. Companies should ultimately aim, as we have already noted, to have a minimum of 86 percent of total spend strategically managed.

A third benefit comes in the form of increased efficiency. Consolidating the supplier base, for example, not only reduces the number of suppliers to be dealt with (while reducing costs) but also enables procurement personnel to focus on larger contracts that add more value. Increasing catalogue coverage and self-service procurement are other ways of enabling procurement professionals to spend more of their time on value-adding activities. The improved visibility into the procurement process gained through improved TSM can also help identify opportunities for continuous improvement. In all, such factors can result in productivity increases for the procurement function of up to 20 percent.

A fourth benefit from TSM is increased compliance by business users with policies and contract terms, and by vendors with contract terms. Reducing the supplier base to eliminate unreliable suppliers also helps reduce risk, while a more transparent procurement process helps with fraud prevention and detection. Having a spot buy desk checking to see whether demand can be satisfied by existing contracts also drives compliance with these contracts. Another compliance benefit from TSM programs results from increased control of the transactional process. TSM programs are designed to control, monitor and track transactions as they occur, and exceptions can be acted upon before they are submitted to suppliers. TSM programs are particularly effective at preventing "rogue" spend and providing a detailed view of spend behavior. In all, by implementing TSM companies can help ensure up to 95 percent of purchases can be compliant with policies and contracts.

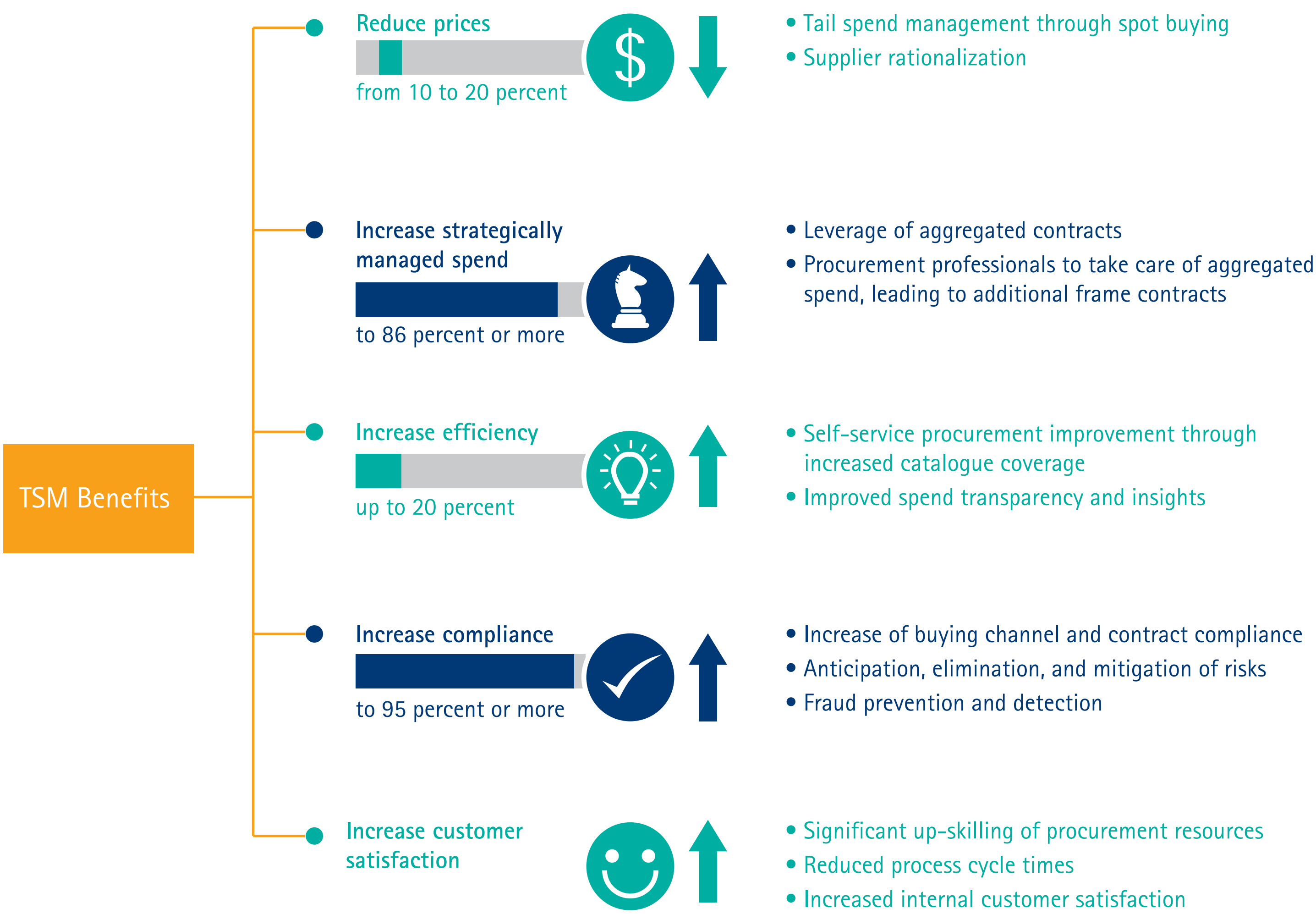
Finally, a fifth benefit of better TSM can be increased internal customer satisfaction from easy-to-use systems, clarity around responsibilities and go-to persons, reduced process cycle times, and significant up-skilling of procurement resources. (See Figure 5 for a summary of TSM benefits.)

Tail Spend Management in Action

In 2013 a global consumer goods company launched a tail spend management program focused on improving spend quality controls, identifying value savings opportunities, and increasing user satisfaction. To accomplish these goals they established a buying desk within their buying channel to process orders and maximize value on a per-order basis. The spend was expected to achieve a 4 to 6 percent savings with high per-order addressability. Initially the addressability was low due to user to supplier relationships, orders were too late in the process, and spend was classified as rush to bypass the procurement department. However, as TSM programs are designed to adjust 'real-time' with the spend, changes were implemented that established effective TSM quality controls. Today the resulting savings are more than 20 percent, exceeding initial expectations.

Considering these benefits, and the available methods for getting a grip on your tail spend to boost the bottom line and improve your procurement organization's strategic capabilities, there is no longer any excuse for letting tail spend fatigue cause your procurement function to fall behind. By carefully segmenting your tail spend, pursuing spot buy reduction to increase strategically managed spend and use of automated channels, and following segment-specific strategies for your entire tail, you can learn to manage your tail spend in ways that not only save significant amounts of money but also open up new and unexpected ways for procurement to deliver value to your business.

Figure 5: Benefits from Tail Spend Management – Illustrative.



About the Authors

Ralf Mägerle is the managing director of Accenture's Sourcing & Procurement Services practice in Austria, Switzerland, and Germany. During his more than 20 years with Accenture he has helped clients from a variety of industries to change and improve their procurement and supply chain through strategy, processes, organization, and systems. He is focusing his client work on increasing the value procurement brings to the business over and above cost savings, particularly with regard to risk management, innovation, sustainability, and contribution to top-line growth. Ralf holds a degree in computer science, a post-graduate degree in economics, and an MBA.

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