AN INTRODUCTION TO

TAIL SPEND

AND WHY YOU NEED A TECHNOLOGY-BASED SOLUTION

Sourcing Innovation
Next Generation Supply Management Defined

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Introduction

How do you achieve Procurement success? If you take the traditional viewpoint promoted by the big consultancies, you follow the 80/20 rule and identify the categories, suppliers, and organizational units that represent the 80% of your spend and source those categories, manage those suppliers, and work with those organizational units to control demand. Done right, this will work great, at least initially, as a properly applied spend analysis followed by an appropriate sourcing project that uses advanced sourcing techniques on each sourced category will identify an average savings of 11%[1] on each category sourced the next time it is sourced. This means that, if the organization is an average organization able to strategically source $^1/_3$ of this spend each year, it will save 11% on 26% of spend, or approximately 3% against the bottom line. That's quite good, especially in an industry where margins are only a few percentage points, but what these consultancies don't tell you is that the big savings only materialize once.

As the author has pointed out repeatedly on Sourcing Innovation (and in Strategic Spend Visibility, a free e-book co-authored with Bernard Gunther), most spend analysis initiatives fail to generate ongoing returns after the initial analysis is made and each strategic category sourced. Why? There are a host of reasons which include, but are not limited to lack of flexibility, lack of platform support, and lack of breadth. This last one is key. Focusing on the 80% of the spend that the organization deems strategic ignores the 20% of spend in the tail that might also provide a significant savings opportunity. The argument for ignoring this spend is that there is no volume leverage, little opportunity for demand control, and few opportunities for savings and that the organization is giving up considerably less than one fifth of its savings potential by doing so, but this argument is wrong.

[1] AT Kearney, Indirect Procurement Study, 2010
Aberdeen, The Advanced Sourcing and Negotiation Benchmark Report, 2007
Grosvenor, Advanced Spend Levers Identified 11% Savings, 2015 & Grosvenor, CPO Study, 2015

Tail spend not only represents a significant savings opportunity but, unlike strategic spend, also represents a significant on-going savings opportunity. Why? First of all, as no one ever shines a light on this spend, overspend is typically in the 15%+ range, with many products and services being bought at 30% over real cost. Second, most of this spend is on commodity products and services, and we all know that after introduction, most commodities get cheaper over time until they reach a price point that represents minimal production cost with current technology plus a fair markup. Similarly, as professionals become more experienced and best practices get refined, the best service professionals and firms will get more efficient over time and while the price per hour might increase, the price per project will also decrease over time. Third, over time, certain categories in the tail spend will increase or will shift to suppliers supplying strategic products and services and while these categories may not be candidates for deep strategic sourcing projects, there will be opportunities to include them on master contracts or negotiate reduced prices or better service based on overall supplier spend. In other words, whereas the savings in many strategic categories often drops from 10%+ to 3%- in subsequent events, year-over year savings in tail-spend stays high.

Not only will an organization that appropriately manages it's tail spend see as big a contribution to the bottom line from tail-spend management (3%, calculated as a 15% savings over the 20% of tail spend) as it does from regular spend management, but as it reaches the baseline on its strategic categories, the organization might even see more savings from tail spend in years where inflation is high and supply is restricted.

This savings potential is very real. Accenture[2] recently published a piece on *Getting a Grip on Tail Spend* where they found that companies that transform their tail spend with spot buying management practices realize a one-time savings of at least 10% to 15% and an ongoing savings of 2% to 5%. Furthermore, Everest Group[3] found that tail-end spend management can drive 50% savings over and above the 5 to 10% level achieved by more traditional spend management.

Moreover, addressing tail spend is not as expensive as the providers of traditional sourcing suites (designed for strategic spend) would have had you believe as recently as a few years ago. Research as far back as 2008 found that (external) tail spend management could generate a return of up to $8 for every $1 invested.[4] Considering that 80% to 90% of procurement transactions occur in the tail, this should not be surprising. In other words, if you want to take your Procurement to the next level, you have to understand, and get a handle on, your tail spend.

2 Accenture, Getting a Grip on Tail Spend, 2014
3 Everest Group, Betting on Tail Spend to Save Coin, 2014
4 Cummings, How to Move Procurement to the Next Level, 2008

What is tail spend?

While the definition of "*tail spend*" varies between services and solution providers, a proper definition is any spend that is not strategically sourced and strategically managed. For traditionalists, it is the "tactical" (or "nuisance") spend in the lower-left quadrant of the famous Krajlic 2x2 matrix, which describes a strategy of "purchasing management" to manage non-critical, abundant supply that can be sourced locally in a de-centralized manner for maximum efficiency. And while the method is efficient, it has proven to not be very effective, as we will discuss later in this paper.

What typically constitutes tail spend?

Tail spend is composed primarily of low volume and low dollar spend, much of which is made on an irregular basis. (Although "low" can be misleading, as major Procurement consultancies like Accenture indicate that any transaction less than $200,000 is too small to be strategically sourced. For a mid-size company, $200,000 is a lot of money, especially if transactions of this size are made on a regular basis.) Tail spend will contain a disproportionately high percentage of spend from (far-flung) subsidiaries, a large percentage of non-compliant and maverick spend, and suppliers that no one in Procurement has heard of.

In particular, tail spend contains a lot of:

- one-time purchases
  e.g. office furniture, promotional items, etc.
- deadline-driven (emergency) spend where processes are put aside
  e.g. new office location to support a new contract, etc.
- unique requirements that cannot be met by contracted suppliers
  e.g. new equipment requirements for new custom-manufactured products
- small, semi-regular purchases for daily (office) operations, etc.
  e.g. paper, printers, laptops, etc.
- below-threshold (maverick) spend that a buyer wants to go off-contract for
  e.g. airline and hotel reservations (for points), cell phones, etc.

When a buyer tries to categorize the tail spend, the buyer might come up with the following buckets:

- low price, low volume buys
- low price, high volume over time buys
- one-time buys
- misclassified purchases
- intentionally maverick spend

But needs to keep in mind that key categories of tail spend include:

- print / packaging
- signage & display
- travel & expense
- events and promotional items
- Maintenance, Repair, & Operations (MRO)
- consumables and office products
- marketing services
- uniforms & apparel
- temporary labour
- facilities

Why is tail spend important?

In an average organization, tail spend constitutes 20% or more of spend which is completely unmanaged. There is low, if any, visibility into the expenditures, which are often made using manual processes (online search, e-mail and fax, and spreadsheets), without controls, and with no way of ensuring compliance to policies. Purchasing is often delegated to junior buyers, and, as a result, a lot of the purchases are made in a sub-optimal manner that results in either degraded quality, significant overspend (in the 10% to 30% range, with average overspend being 15% or more), or a considerable increase in organizational workload to manage the spend.

In addition, tail spend hides a considerable amount of risk, which includes, but is not limited to:

- rebate and discount loss
  when contracted volumes are not met as a result of off-contract spend
- high process cost
  as tail spend invoices are numerous, often submitted through fax and e-mail, and typically do not have an accompanying or referenced purchase order for m-way matching
- liability risk
  when services vendors without appropriate insurance are contracted
- reputational risk
  if a junior buyer buys from a supplier with a poor Corporate Social Responsibility (CSR) record
- supply risk
  if a junior buyer buys from a supplier not financially stable
- organizational non-compliance risk
  if a junior buyer bypasses mandated MWBE vendors or fair-trade vendors
- (personnel) fraud risk
  as buyers can put charges on p-Cards with very little documentation,
  or submit the same receipt 3 times over 6 months

What are the common approaches for dealing with tail spend?

Organizations are currently taking a number of approaches in dealing with their tail spend, which include, but are not limited to:

- ignoring it to focus more on the top 80%
  which can often yield more one-time savings when an organization migrates to an advanced sourcing solution that is optimization-backed, analytic driven, and market-informed
- p-Carding it
  and getting it all on one statement in one system
- tacking it on to managed spend
  by giving as much as possible to suppliers under contract for strategic categories
- Group Purchasing Organization (GPO)
  where it's thrown over the wall to an outsourced organization (which is sometimes a viable solution, especially since it can increase outsourcing savings by 1.5X with the right provider)
- optimization-backed RFX/e-Auction platform
  where junior buyers are always able to select the best deal presented to them with all of the requirements taken into consideration
- an e-catalog solution
  where as many products are dumped into the catalog as possible
- a true tail-spend solution
  which is designed to capture, and manage, all kinds of tail-spend

But most of these solutions are not always appropriate, if they are even solutions, for the average organization. Why?

- ignoring tail spend costs the average organization 3% against the bottom line on an annual basis
- p-Cards, like credit cards, capture only the supplier, not the items purchased, and they only capture the spend after the fact
- strategic suppliers want to supply high-volume or high-value products, not low-volume or low-value products, and forcing them to do so will only cause prices to rise or service to fall
- GPO pricing is only as strong as their constituents and if the majority of the constituents don't want the products or services that constitute your organization's tail spend, their prices won't be much better, and will be burdened with service charges; plus, the GPO will need an appropriate platform itself to manage the spend
- Tail spend is too unpredictable to be managed though a single catalog, especially since only a portion of tail spend should generally be made as catalog spot-buys
- an optimization-backed RFX/e-Auction platform is a viable solution, but only if the buyer understands how to appropriately source the category as these platforms provide the power but not the guidance

The only viable solution for many organizations with junior buyers, who don't have expertise, get swamped by the complexity, and have no idea how to properly prioritize projects and spend, is a true tail-spend solution enabled by a platform that guides all of the buyers through the process of the proper handling of tail-spend.   But this is easier said then done.

Why is the creation and identification of a tail-spend solution difficult?

Tail spend is fragmented. It is made by a large number of organizational "buyers" who purchase products and services from a large number of suppliers in a haphazard fashion.

Tail spend is complex. It often consists of a dozen different categories of spend, required by half a dozen different departments, that vary in size from a few thousand dollars a year through a few hundred thousand. Some categories are one-time buys, some are almost monthly. Some categories are consumed, and others are for products that are used to support operations over time (like furniture, electronics, etc.).

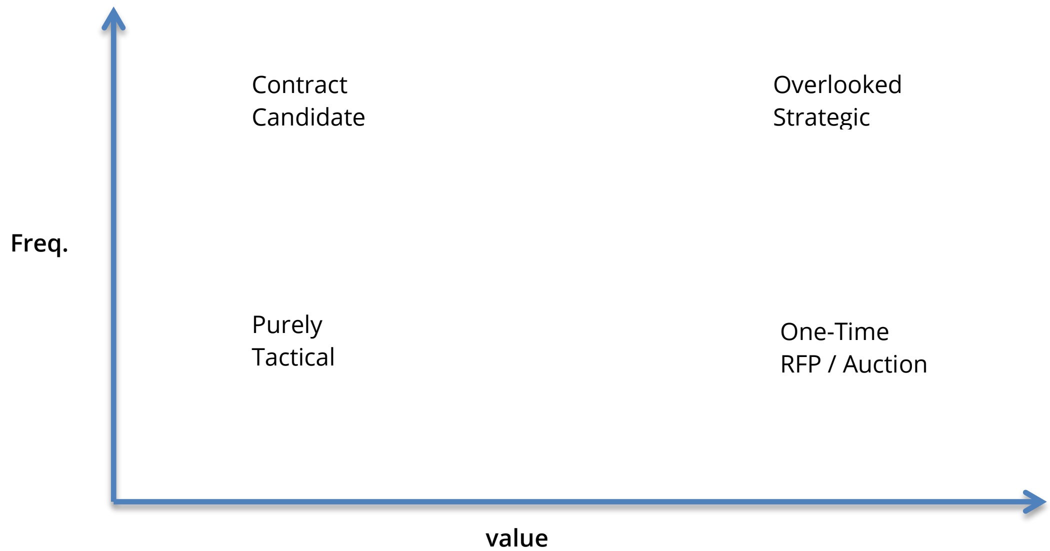
Tail spend is distributed. It is not only made with hundreds, if not thousands, of suppliers but with suppliers all over the globe, especially in far-flung geographic locations.

Tail spend transactions are numerous. There are typically four to ten times as many transactions and invoices as there are non-tail spend transactions and invoices.

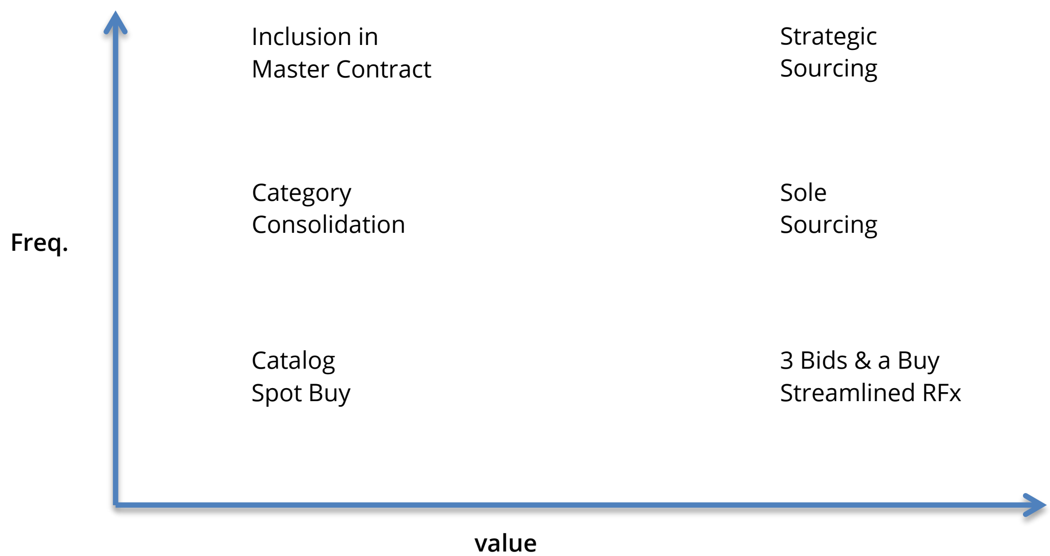
The return on any individual purchase is small. As a result, it’s hard to visualize how any process or platform that manage these purchases can yield significant savings. But once the organization has a process in place, it becomes easier.

How can an organization define the right tail end management process?

The first thing an organization needs to do is come up with a classification scheme for tail spend. Earlier in this paper we defined different interpretations of tail spend, which commonly revolve around spend that is low dollar, low frequency, or atypical. One of the simplest methods is to classify the tail spend along dimensions of value and frequency and build a simple 2*2 Kraljic matrix, such as the following:



This allows an organization to determine appropriate strategies for each tail spend category (and define what it needs in a platform to manage tail spend), as follows:



This provides a starting point for buyers to begin to get tail spend under control. But just having a strategy is not enough.

How can an organization increase its chances of tail spend management success?

An organization can increase its chances of tail spend management success by implementing best practices and approaching tail spend management in a logical manner.

For example, the first step in any best practice tail spend management initiative is to properly classify and segment tail spend. This should result in a classification that identifies:

- the frequency and value of the spend so it can be mapped using the matrices in the last section
- traditionally misclassified spend so that all spend is properly addressed
- (intentionally) maverick spend so that key identifiers can be defined and appropriate chokepoints / roadblocks implemented to prevent such spend without explicit management approval.

This not only helps an organization identify the tail spend that needs to be appropriately managed, as well as the appropriate management techniques, but helps it scope the true extent of the tail spend. In some organizations, tail spend can be 30% or more of spend, well beyond the typical 20% that is expected. And all of this tail spend can represent a significant savings opportunity (of 15% or more, as per the introduction).

Another critically important best practice is training. A buyer can not be expected to know how to manage tail spend appropriately, or to implement the appropriate strategies successfully, unless she has the proper training.

A third critically important best practice is to make sure there are dedicated resources for tail spend management and support. Most buyers do not have expertise in tail spend categories, so the center of excellence, or third party GPO, should have expert staff available to help buyers implement the appropriate strategy as needed. Without the right support, a buyer will simply use whichever purchasing method appears to be the quickest and easiest method for buying the product or service, whether it is appropriate or not.

A fourth best practice is a good change management plan that ensures that

- (tail) spend is regularly analyzed, scoped and segmented
- talent is appropriately trained
- dedicated support resources are in place and appropriately resourced
- appropriate platforms are identified, implemented, and utilized

Finally, an organization serious about getting its tail spend under control will adopt the right technology platform with the right capabilities, which will be discussed in the sections that follow.

How can the right technology platform get tail spend under control?

A platform designed for tail spend can help get spend under control as it will, among other things:

- centralize spend
  as all spend will flow through the platform, which is the first step to visibility
- organize spend
  as it will support the creation of taxonomies that will allow for visibility, reporting, and analytics on tail spend
- streamline spend
  as it will support rules for routing the spend to the appropriate buyers, and processes to support those buyers.

How does it do this?

- single P2P platform for all tail spend
  this means that all transactions, with associated enrichment information, get into one common data store
- customizable taxonomy support
  which allows the spend to be mapped to the sourcing / organizational taxonomies and spend cubes for visibility and analytics
- integrated catalogs
  for any purchases that can be made off-the-shelf
- integrated RFX …
  for any purchases that have to be custom
- … with (searchable) template support
  for common tail-spend purchase types that only require a few specifications to be entered by the buyer
- rate-card support
  for standard services
- statement of work support
  for custom services
- p-Card support
  for anything that has to be made outside the platform such as off-site (travel & event purchases) or emergency replacements
- e-Invoicing and m-way match
  to insure that only ordered products are accepted and only received products are paid for, and only at agreed to processes, and that as many invoices as possible are processed automatically

With this integrated suite of capabilities, every single category of tail spend discussed earlier in this paper can be properly addressed. And, because of this, the platform will help the organization break through the spending silos as departments and Procurement can come together to share knowledge and best practices and make a better buy for all.

What are the key components of the right platform?

Some of the key requirements of a good platform for tail-spend management should be clear from the last section, but some will not be. In this section we will outline the critical component list to help an organization in its selection of the right tail-spend platform.

*** dynamically customizable user-defined taxonomy**
a UNSPSC, H(T)S, or other pre-defined taxonomy is generally not appropriate for sourcing, nor is a taxonomy based upon the strategic spend taxonomy that is customized for the buyer upon initial implementation of the platform -- as the organization gets tail spend under control, it will find that it needs to optimize its taxonomy

*** integrated analytics for 100% data exposure**
to allow for detailed analysis of tail-spend to identify what categories should be strategically sourced and, more importantly, if any categories being strategically sourced should actually be sourced using more efficient tail-spend methods

*** drill-down and filter capability**
that allows a buyer to drill into tail spend, and only see purchases that meet a set of well-defined criteria (which will help the buyer determine if spend is properly categorized)

*** extensive templates and wizard-based guidance**
anything that can't be bought using a standard catalog or rate card item whose need can be predicted should have an RFX or (weighted) auction template, and a wizard that will help guide a junior buyer through keyword analysis and a few well-chosen questions

*** extensive catalog support and deep search capabilities**
so that, if an item or pre-negotiated service rate that meets the need exists, it can always be easily found and requisitioned

*** easy to use requisitions and RFX that anyone can use**
as a lot of tail-spend is done outside of Procurement and if the spot-buy can't be done through the catalog, it has to be just as easy to do it through a requisition or RFX

*** primary P2P platform integration**
as the spend not only has to be captured, but integrated with whatever P2P, payment, and AP platforms are already in use by the Sourcing and Finance organizations

*** service provider support**
this is absolutely critical and almost always overlooked -- if you are using a GPO, plan to use a GPO, or want to engage experts at tail-spend management to support you, a platform set up to be managed by the Procurement organization is not at all optimal -- especially if you currently do store-room management for MRO and consumables, VMI with strategic products from the same suppliers (and would like them manage tail-spend items as well), and want a service provider or GPO to help manage the rest as this takes a platform built with distributed third-party management in mind, fine-grained roles and role-based security, the ability to manage supplier offerings and buyer views, etc. as the right platform is typically one that blends self-service, assisted sourcing, and on-demand sourcing through a GPO, depending on the need

What benefits will the organization see from the right platform?

An organization that selects the right platform for tail spend management will see a considerable number of benefits when the platform is implemented and adopted across the organization. These benefits will include:

*** cost savings**
organizations can achieve hard dollar cost savings of up to 30% (average 15%), resulting in a 3% or more bottom line improvement

*** increased tail-spend visibility and Procurement policy compliance**
as the platform will make it easier for buyers to use the platform to get what they want than avoid it; this will, intrinsically, increase compliance with SOX and MWVDBE (Minority Women Veteran Disabled Business Entities) policies

*** better supplier management**
as all suppliers will be known, the products and services purchased from them available in one place, and complete performance scorecards readily available at all times

*** increased efficiency**
buyers can spend less time finding the products and services they need for those one-time purchases, and more time analyzing the options and making the best decision; productivity increases of 20% or more have been reported

*** more customer satisfaction**
when an organizational buyer can find, requisition, and obtain what they want faster, easier, and cheaper, they will be more satisfied

In other words, the organization will begin to see sustainable value generation from its tail-spend platform that allows it to be effective and efficient, which is the way a Procurement Value Engine should run.

What evidence is there that the organization will see the ROI?

First of all, the organization will finally know how much the organization spends in the tail. Consider this representative quote from a VP of Indirect Procurement EMEA at a global pharmaceutical company:

“I believe we spend between €50m and €250m per year on print, but I just don't know.”

Most Procurement organizations do not even know how much spend is in the organization’s tail spend because it is not managed and made using processes and platforms that capture, and classify, the spend accordingly. If nothing else, the right tail spend platform will once and for all provide 100% visibility into spend. And when the organization can see the spend, and apply the right strategy, the savings specified in the introduction will materialize.

The fact that the organization will also know how much it spends on each tail spend category and product cannot be overemphasized. Not only will a big company have 50 different supplier records for I.B.M. (with every spelling and misspelling imaginable and then some), but it will also have 42 variants of “standard A4” letterhead, all purchased from different suppliers at a price variance of 240%.

And it will be able to detect and prevent collusion and fraud, which is very important in the public sector (where awards must be spread out between multiple small suppliers) and the private sector (where criminal charges can be laid for fraudulent behavior). For example, when a London Council first implemented a tail spend management solution, they found that one supplier was winning a disproportionately high number of bids (97%), that the supplier did so by always bidding last, and that the award was always made by the same buyer. This situation was easily corrected when only blind bids were allowed and when secondary approval was required to accept a bid and make an award, but could have gone undetected for years without the platform. With a tail spend platform, value materializes.

About Sourcing Innovation:

Sourcing Innovation, which started in June of 2006, is a leading resource for sourcing, procurement, and supply management professionals who are interested in improving themselves and the overall performance of their supply management organizations. Sourcing Innovation is education about, and in-depth analysis of, technologies and approaches that can have a profound impact on the way an organization conducts business. More information about Sourcing Innovation can be found on the blog itself, at http://blog.sourcinginnovation.com/.

About Claritum:

Claritum's cloud based spend management platform enables many of the world's largest enterprises, leading businesses and fast-growing procurement service providers to gain real time visibility and control of their tail spend.

Over 150,000 users in 35 countries rely on Claritum to deliver significant, measurable and sustainable cost savings and process efficiencies from categories such as print & marketing services, signage & display, gifts & premiums, packaging, uniforms & apparel, office supplies, professional services, temp labour and facilities.

Find out more about Claritum at www.claritum.com or request a call back from http://www.claritum.com/solution-tail-spend/

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