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Analysis

How CFOs Can Secure Savings by Focusing on Indirect Spend

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Biography

Keith Hausmann is the Chief Revenue Officer at Globality (https://www.globality.com), the sourcing platform that maximizes outcomes from companies' indirect spend. Keith is a hugely experienced executive in the procurement space.

He was previously the Managing Director, Global Procurement & Supply Chain Operations at Accenture, and a Senior Vice President at Procurian.

Keith shares his insights in Globality company blogs at https://www.globality.com/innovation-blog

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Paper type Research

Abstract

In this article, the author discusses why inflation means Chief Financial Officers can no longer rely on the old idea of squeezing cost out of global supply chains. The article shows how rationalizing indirect spend is an area that provided you have the right tools is a perfect area for cost optimization.

Introduction

Traditionally, when challenged by rising costs and economic pressure, Chief Financial Officers (CFOs) have turned to squeezing the supply chain. But after years of rationalization, we've exhausted that way of cutting budgets as the best cost-saving option.

Due to inflation, costs are going up and will continue to go up, not just for you but for everyone in your market. U.K. inflation has eased but is still stuck near a 40-year high[1]. Reducing direct spend via the supply chain is no longer an option for the foreseeable future. This has huge ramifications for how you, as a CFO, manage your spend. Reducing people overhead will help the bottom line, but it is short-term relief that is likely counter-productive: the work still needs to be carried out, and the costs of recruiting the new talent you need is a much larger set of costs.

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The 20 to 40% indirect spend iceberg

CFOs need to finally look at their indirect spend, namely, all the elements that are non-product related. This hasn't happened to date, as, notoriously, indirect spend is a huge, and poorly managed area of a company's outgoings. Most companies spend significant money on items that aren't supply chain-related at all – on their technology, on marketing, their people and facilities costs, real estate, and so on.

A pharma company, for example, might record the cost of making a medicine as quite low, unit-wise, but the Research & Development (R&D), marketing and sales activities associated with getting the medicine to patients is a far bigger ongoing cost. By the same token, the technology function within a company will spend more on third parties than on paying its own internal staff costs.

The problem is, traditionally it's been challenging to track indirect spend. Profit & Loss (P&L) statements place indirect spend at 20% of revenue to as much as 40% or more[2] at the high end. In the average Global 2000 company this amounts to a lot of cost, which, if we could get a better handle on, would be a fantastic resource for optimization.

Finance can struggle to get genuine numbers on indirect spend, however. For direct spend, the cost base is predictable but beyond buying stationery and pencils, professional services are complex and bespoke – something that organizations must define every time suppliers contract for them.

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The cult of the Purchase Order (PO)

Companies consider they're on top of this spend. The cult of the signed-off purchase order means the spend is approved and the company gets invoiced for it so this must be a rational process with the right governance and approval mechanisms in place, after all.

But very little indirect spend is ever genuinely managed through a fair and inclusive sourcing process. In our recent survey of global procurement leaders, only a quarter of respondents had a transparent, competitive buying model for their indirect spend. This clearly contrasts with the situation with direct spend, which undergoes aggressive negotiations, auctions, and fierce competition.

Your procurement colleagues say they are making savings they can't properly attest to. They may have saved money through rationalizing indirect spend, but the savings (the £90 out of the £100 you were spending before) tend in practice to never get properly accounted for. Even under a scenario where budgets are cut proactively, that is rarely followed through with procurement efforts to ensure the remaining budgets are stretched and utilized optimally.

Times are finally changing. Accenture talks about closed loop spend management[3], McKinsey says we need a revolution in indirect procurement[4], and there's increasing interest in zero-based budgeting (ZBB), a method of budgeting in which all expenses must be justified for each new period.

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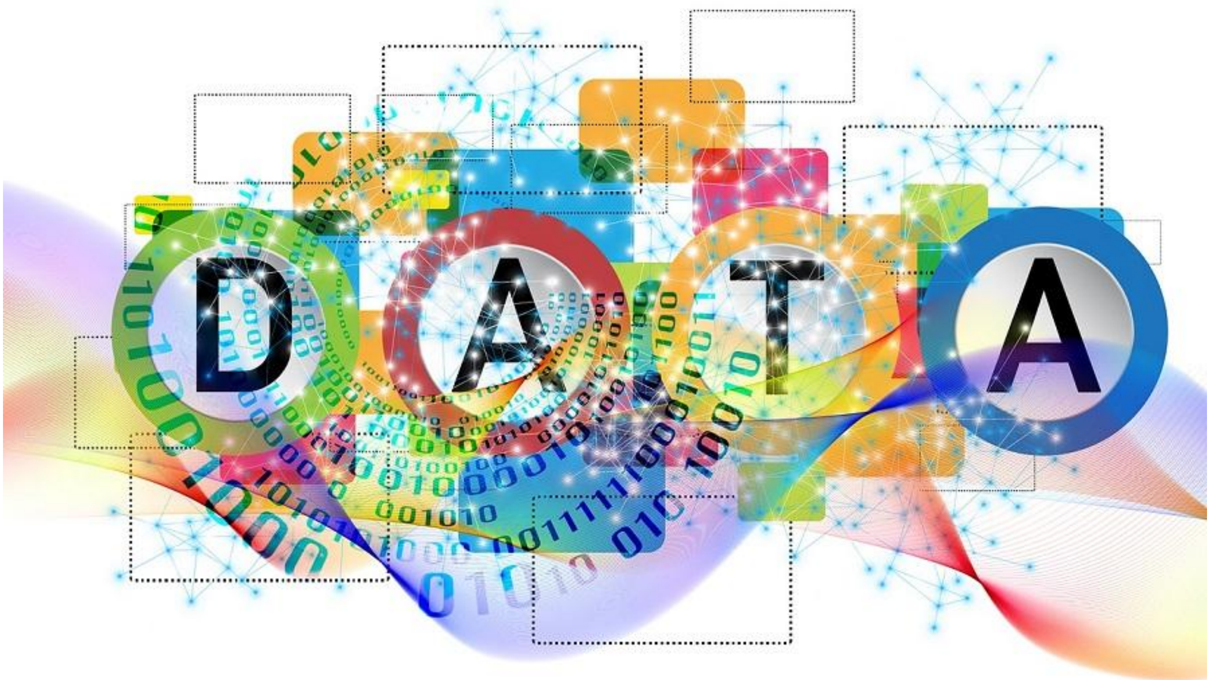

Use the power of data and AI to unlock your indirect spending at last

However, turning such thinking into tangible benefits requires bridging work. This can be accomplished introducing smart technology, like machine learning and artificial intelligence, into decision making.

With the help of data at scale and the application of AI, new and better ways of sourcing even the most bespoke indirect spend is deployable – providing a streamlined, intuitive way of managing and optimizing this substantial, but often overlooked, area of your outgoings.

If the next few months prove as challenging as we expect, you are going to want that help.

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