

Procure to Pay (P2P) - Spend Management

Working Capital Series

By Perry Tong

Overlooked in many firms 'spend management' is a pro-active way of containing cost and contributing to overall profitability. It falls into the strategic level of enlightened decision making in a firm but requires operational execution at many levels.

A quick look at Figure 1 shows that this area does not fall into the regular purview of most functional management teams. Often confused with cost cutting or cost controlling measures, spend management fails, as it is mainly defined today, to capture the imagination of executives though the benefits can be both operational and strategic in nature.

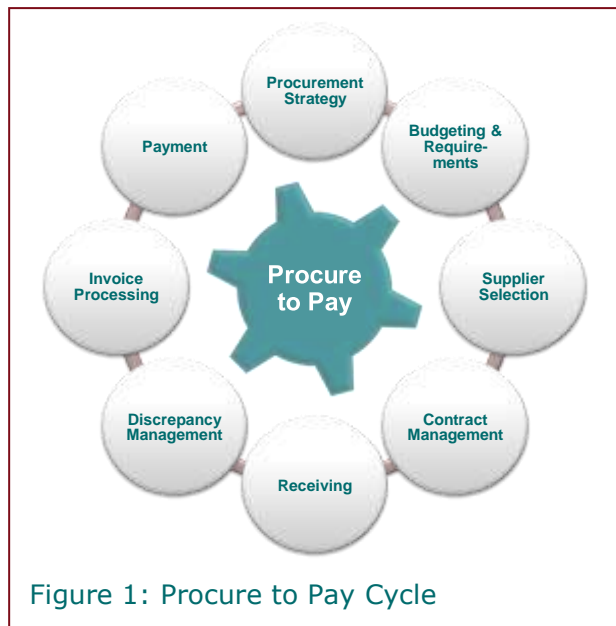


Figure 1: Procure to Pay Cycle

Spend Analysis

Spend or expenditure management involves the classification of spend for analysis and policy making. Primary classifications are typically 'core' and 'non-core' spend. Industries closer to the 'ground' typically spend higher percentages of revenue or capital on 'core' items such as commodities or raw material in various forms. Those closer to the end customer typically tend to spend more on 'non-core' activities including SG&A. Benchmarking is also difficult to obtain in this area as one firm may feel that an activity is core while another firm in a similar industry may feel otherwise. Much arbitrariness remains on the classification of expenditure, or spend, as we know it.

An analysis of the past year or two's expenditure patterns may reveal that a seemingly large amount seems to be attributable to 'non-core' or expendable items. These often include stationery and consumables. Understanding exactly to where, as in which vendors, these expenditures are assigned are an important part of the spend analysis since this will drive policy actions that remedy the situation.

Granularity is key in a spend analysis. The greater the level of detail retained from prior transactions the greater one's ability to propose appropriate solutions for the future.

Maverick Spend

Similar occurrences of excessive spend, in our experience, have occurred in 'core' spend areas as well. A common and very real scenario is one of purchases made outside the contract thus incurring high additional and repeated one-off servicing costs. These costs may include expedited freighting costs, additional handling costs, documentation costs, inbound logistics cost at the warehouse and even contract re-negotiation costs among others. Often these 'one off' costs end up eroding the price breaks that a firm obtains through a standardized bulk purchase contract.

Root cause analysis of these 'core' spend 'budget busting' purchase occurrences often reveal poor quality products or processes that lead to 'necessary' urgent orders. Herein lies a close link between what is colloquially known as 'payables,' production & inventory management as well as customer fulfilment.

Proliferation of uncontrolled or generic P-cards (any credit card as opposed to a 'purpose only' credit card) for 'non-core' spend items may also lead to a loss of bulk pricing capabilities. For the Fortune 500 firms that we have worked with, the 'losses' here, with discretionary spending on 'non-core' items can run into the tens of millions of dollars per year.

Benefits of Spend Management

Policies may be drawn up to address 'non-core' spend issues to prevent discount leakages. Process improvement initiatives such as Lean Six Sigma may be employed to address some of the 'core' spend issues. As opposed to the blunt but often used tool of 'cost cutting exercises', a well executed spend management programme from analysis through policy making and improvements puts management in firm control of the future. Relationships with vendors stand to be improved along with increased efficiencies in the procure-to-pay process thus reducing operational expenditure.

For firms with turnovers beyond USD \$500M a year the 'savings' gained from spend management range from 2% to 15% of overall spend. This immediately translates into increased EBITDA and definitely an EVA activity.

About the Author

Perry Tong is the Singapore-based Managing Consultant for Centre for Organisational Effectiveness Pte Ltd. He helps companies in Asia, Europe and North America understand the importance of process improvement with impacts on working capital as a primary objective and increased customer service levels as a secondary objective. He has extensive experience in implementing process and organisational improvements for various industries. Perry can be reached at Perry.Tong@COE-Partners.com