

MANAGING INDIRECT SPEND





Managing Indirect Spend

There is a tendency among some procurement professionals to be dismissive of indirect spend if they perceive it as less critical to company operations, especially for manufacturing companies. We want to show you why this perception needs to be revised. To achieve this, we will take a closer look at indirect spend, defining what it is, why it is essential, the challenges and benefits of effectively managing this area of spend, and some thoughts on strategies for managing indirect spend.

Indirect spend refers to the purchases of goods and services not directly related to the production of a company's core products or services. Unlike direct spend categories directly tied to producing goods or services, indirect spend categories may not be considered critical to a company's core business. Examples of indirect spend categories include marketing, travel, IT services, office supplies, and facilities maintenance. Although these categories may seem less critical than direct spend categories, they can still represent a significant expense for a company, and therefore, they require procurement focus.

The Importance of Indirect Spend

Indirect spend can represent a substantial portion of a company's overall spending, accounting for up to 50% of a company's total procurement spend.¹ Expenditure in the indirect area is usually proportionally higher for businesses providing services than manufacturing companies that use raw materials and manufacturing equipment, with manufacturers spending more than 20% of total revenue on indirect spend.¹ Considering the significance of this expense, companies must give indirect spend the attention it deserves. This lack of awareness can result in missed savings opportunities and increased costs for the organization.

In contrast, companies focusing on indirect spending can reap significant cost savings. According to a report from Supply Chain Quarterly in 2016, companies can recognize savings of up to 25% thru the use of tools that improve control and visibility of purchasing that lies outside the established procurement pipeline.² Additionally, the Hackett Group estimates that costs can be reduced by 7% on average when tail-spend is managed effectively.² Procurement organizations can achieve these savings by identifying cost savings opportunities, negotiating better prices, and reducing supplier risk.

By optimizing indirect spend, companies can improve their bottom line and increase their competitiveness. McKinsey looked at the five years immediately following the financial crisis of 2008 thru the lens of procurement capabilities. McKinsey found that companies with top-quartile procurement capabilities realized total returns to shareholders 42% higher than those with bottom-quartile procurement operations.³ Additionally, the valuations of these companies returned to pre-crisis levels three years faster on average, lowered their costs of goods sold as a percentage of revenue, and improved their EBITDA by up to 3% over bottom performers.³ Therefore, companies that neglect indirect spend risk falling behind their competitors who focus on optimizing indirect spend.



Indirect Spend Categories

We can categorize indirect spend into several categories, each presenting unique challenges and opportunities for cost savings. Some of the most common indirect spend categories include:

01. Marketing

Marketing refers to a company's activities to promote its products or services. This category includes advertising, market research, and public relations. Marketing can be a significant expense for companies, especially those highly dependent on advertising to promote their products.

02. Travel

Travel refers to the expenses associated with business travel. This category includes airfares, trains, hotel accommodations, and rental cars. Travel expenses can add up quickly, especially for companies with employees who travel frequently.

03. IT Services

IT services refer to the technology and software services a company uses to support its operations. This category includes software licenses, cloud services, and IT consulting services. As companies increasingly rely on technology, IT services have become a significant expense for many companies.

04. Office Supplies

Office supplies refer to the products and services that support the day-to-day operations of a company. This category includes office furniture, cleaning supplies, and printing services. While office supplies may seem insignificant, they can add up quickly for companies with a large workforce.

05. Facilities Maintenance

Facilities maintenance refers to the expenses of maintaining a company's facilities. This category includes expenses for cleaning services, building repairs, and security services. Maintaining a company's facilities can be a significant expense, especially for companies with large and complex facilities.



The Challenges of Managing Indirect Spend

One of the main challenges is the decentralized nature of many indirect spend categories. While a centralized procurement function typically manages direct spend categories, various departments handle many indirect spend categories. The fractured nature of this management can make it challenging to gain visibility into indirect spend and identify cost savings opportunities.

Another challenge in managing indirect spend is the complexity of many indirect spend categories. For example, marketing can be a highly complex category, with many different types of expenses and various suppliers. This complexity can make it difficult to negotiate favorable contracts and identify cost savings opportunities.

Furthermore, indirect spend is challenging to manage for most organizations. Often disaggregated and stored outside data systems within an organization, indirect spend is frequently overlooked as a priority for strategic procurement. Items critical to producing a company's core products or services often monopolize an organization's resources. This dismissive attitude can lead to a lack of procurement resources focused on indirect spend, making it challenging to manage effectively.

Additionally, suppliers for indirect spend categories may be less willing to negotiate on price or offer discounts compared to suppliers for direct spend categories. This is because suppliers for indirect spend may view the company's purchases as something other than critical to their own business, and hence, they may need to be more motivated to offer competitive pricing.

Finally, indirect spend categories need to be more well-defined and often vary from one company to another. This can make comparing prices and identifying cost savings opportunities across different companies difficult. A classic example of this is freight or logistics. Some companies view the transportation of goods to their customers as part of the cost of the delivered product and view it as direct spend, while others see this as post-production cost and treat it as indirect spend. The key challenge here is agreeing on what falls under indirect spend at the start of the process.



1 How to reduce your indirect spend | Robobai indirect (archive.org)

2 030918 CFO_Corcentric wp_v2.indd

3 Reimagining procurement for the next normal | McKinsey

AUGUST	621,898.07	139,980.78	53,651.15	67,529.36	190,047.42	2,654,491.21
SEPTEMBER	657,730.55	143,090.25	54,023.50	68,725.94	1,978,750.54	
OCTOBER	680,015.73	141,855.80	54,980.75	794,471.30		
NOVEMBER	703,879.33	1,499,712.55	635,577.04			

Strategies for Managing Indirect Spend

Despite the challenges in managing indirect spend, there are several strategies that companies can use to optimize their indirect spend.

Centralize Indirect Spend Management

One of the most effective strategies for managing indirect spend is to centralize its management under the procurement function. Centralization improves visibility into spending and aggregate volumes, identifies cost savings opportunities, and provides data to negotiate more favorable contracts.

Categorize Indirect Spend

Categorizing indirect spend can help companies better understand their spending patterns. By grouping similar expenses, companies can compare prices across different suppliers and identify areas where they can negotiate more favorable contracts.

Implement Technology

Technology can help companies manage indirect spend more effectively. Procurement software can automate many procurement processes, such as supplier selection, contract management, and invoice processing. Additionally, spend analysis software provides greater visibility into spending patterns and identifies cost savings opportunities.

Conduct a Supplier Evaluation

A supplier evaluation can help companies identify high-performing suppliers. Evaluating suppliers based on their quality, reliability, and pricing enables companies to pinpoint suppliers that offer the best value for their money.

Work with Key Stakeholders

Procurement can help to embed positive change by working closely with some key stakeholders. A travel policy is a good example where procurement can deliver savings by working with the HR team to implement a travel policy underpinned by effective supplier management to provide maximum savings.

Establish Metrics

Establishing metrics for indirect spend can help companies track their progress and measure their success. Metrics such as cost savings, supplier performance, and procurement efficiency can help companies identify areas where they need to improve and track their progress over time.

Benefits of Good Indirect Spend Management

Effective management of indirect spend can bring several benefits to an organization, including:

01. Cost savings

Effectively managing indirect spend can help organizations reduce their overall expenses by identifying areas favorable to cost savings negotiations.

02. Improved cash flow

By managing indirect spend effectively, organizations can better control their cash flow and reduce the risk of overpaying for goods and services.

03. Better supplier relationships

When organizations understand their indirect spend and work closely with suppliers to negotiate contracts and pricing, it can lead to better relationships with those suppliers, leading to better pricing and services.

04. Enhanced visibility and control

Good indirect spend management can provide organizations with better visibility into their spending patterns, which can help them make more informed decisions about future purchases and identify areas where they can achieve further cost savings.

05. Reduction of maverick spend

Managing indirect spend should stop people from purchasing goods or services without proper approvals, using unauthorized vendors, or exceeding established spending limits.

06. Increased compliance

Effective indirect spend management can help ensure that an organization complies with relevant laws, regulations, and policies related to procurement and spending.

07. Improved risk management

By managing indirect spend effectively, organizations can reduce the risk of fraud, waste, and abuse, which can help protect their reputation and bottom line.

Overall, good indirect spend management can help organizations save money, improve supplier relationships, and gain better visibility and control over their spending, all of which can contribute to their overall success and profitability.

Conclusion

Indirect spending can represent a significant company expense and deserves greater focus within procurement departments. By focusing on indirect spending, companies can identify cost savings opportunities, negotiate better prices, reduce supplier risk, and positively impact the organization's financial performance. Procurement can work with stakeholders across the organization to better understand their needs and find more cost-effective solutions, ultimately resulting in significant savings for the company.

Moreover, procurement can help ensure compliance with internal policies and external regulations, manage supplier relationships, and optimize the procurement process to improve efficiency and effectiveness.

The counter to this is that not giving indirect spend the attention it deserves can lead to missed savings opportunities and increased costs for the organization. Implementing strategies such as centralizing indirect spend management, categorizing indirect spend, investing in technology, conducting supplier evaluations, working with key stakeholders, and establishing metrics can help companies optimize their indirect spend and improve their financial performance.

Our Solutions

ProcureVue can help you more effectively navigate and manage your indirect spend across many silo's within your company. Our AI technology will clean, enrich and categorize your indirect spend data, generating expense savings and enhanced ROI.

