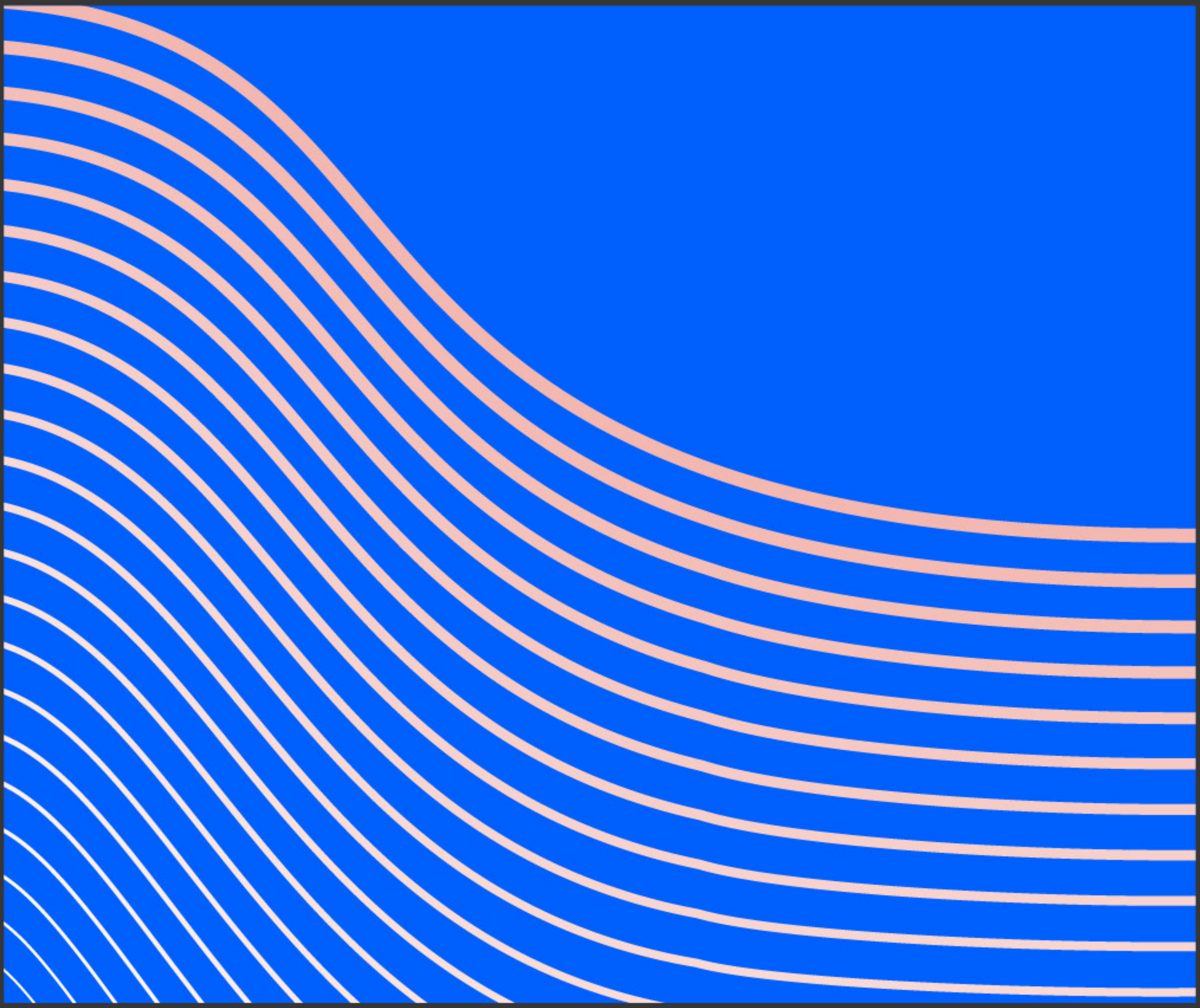
Fairmarkit

TAIL SPEND MANAGEMENT FUNDAMENTALS



Fairmarkit

TABLE OF CONTENTS

TAIL SPEND MANAGEMENT FUNDAMENTALS

INTRODUCTION

Tail spend is a $1.8 trillion problem per year in the United States alone. Tail Spend Management Fundamentals is a guide designed to walk through the benefits of identifying and managing your tail spend. You will walk away understanding why tail spend is so significant, how to define it, and the major risks that can arise if it is left unchecked. Most importantly, you will discover how to best address your tail spend and the major KPIs you can use to track your success.

WHY IS TAIL SPEND SO IMPORTANT?

Ask the CEO of any large, medium or small business if they'd be satisfied delivering products or services that were effective just 80% of the time, and their immediate reply would be "absolutely not." What if their employees were only efficient 80% of the time? "Unacceptable."

These responses are hardly surprising, yet a majority of Chief Procurement Officers worldwide continue to settle for annual spending that is effectively managed only 80% of the time. The 20% of spend that is not being optimized is commonly referred to as tail spend.

Tail spend comprises the high-touch, high-volume, small-dollar spending that totals about 20% of a business's annual spend by volume, yet makes up approximately 80% of its transactions. Today, tail spend inefficiencies caused by mismanagement practices cost companies millions of dollars and drain buyers' time and resources. As a result, procurement teams devote little attention to managing and optimizing tail spend and focus on more strategic initiatives. However, this is beginning to change.

According to Gartner, "72% of business partners indicate an increasing need to get suppliers in place quickly, yet only 41% are consistently willing to make trade-offs for a faster buy. Meeting those raised expectations requires abandoning the days of manual purchase orders, spotty category management and "three bids and a buy" and instead delivering a procurement experience that balances speed with other strategic priorities."[4] Innovative, cost-effective technology that delivers powerful automation, leverages structured data, and uses machine learning and artificial intelligence capabilities is revolutionizing procurement tail spend management. Forward-thinking companies and savvy procurement executives recognize the benefits and are seizing the opportunity.
include better visibility, reductions in risky buying, fewer invoices and less time necessary to manage sellers. Moreover, having a handle on your tail spend can enable your buyers to focus even more of their time on larger purchases, which can further fuel savings.

The bottom line is that disregarding tail spend means procurement is missing out on critical savings and overlooking risks.

THE BASICS TO DEFINING TAIL SPEND

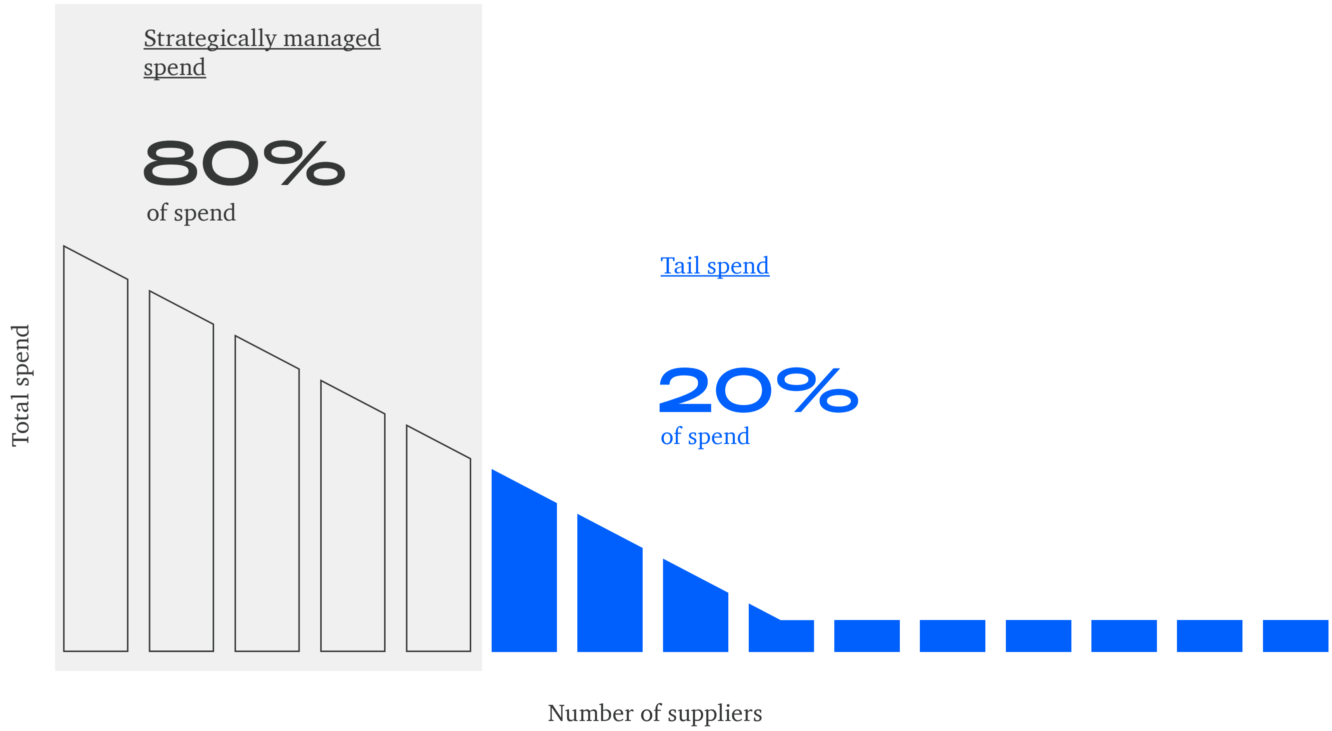
Before you can tackle managing tail spend, it is important to define what exactly tail spend is. There is no one size fits all definition for tail spend across different businesses, or even across one business, simply because every organization and business unit's spending is unique. What constitutes tail spend in one category may not be the same in another. For example, a car manufacturer and a university will probably have very different items they consider tail spend, whether we look at it by price threshold or the total number of items.

Differences aside, procurement departments always have more incentive to focus on large, multi-year contracts because of the larger savings realized. Yet this mentality has caused companies to basically ignore almost 20% of their budget. This unmanaged spend is what we define as tail spend and is typically considered the 80% of transactions that constitute 20% of a company's spend.

Another way to define tail spend is the frequent, and often unmanaged, purchases that account for a relatively small percentage of a company's overall spend, but a disproportionately large percentage of its total transaction volume. Tail spend is commonly:

- Low priority
- Nonstrategic
- Noncomplex
- High volume
- Unmanaged or not optimized
- Lacks data visibility and clarity

Fairmarkit



With tail spend encompassing such a high number of transactions, there is a vast supplier base and various product categories to tackle. Therefore, most procurement teams devote little attention to managing tail spend because it is so unwieldy. For example, an advanced materials company can have as much as $10 million in tail spend spread across 2,500 suppliers. [1] Optimizing this amount of spend and suppliers would require a lot of time and resources most procurement teams simply do not have.

Fairmarkit

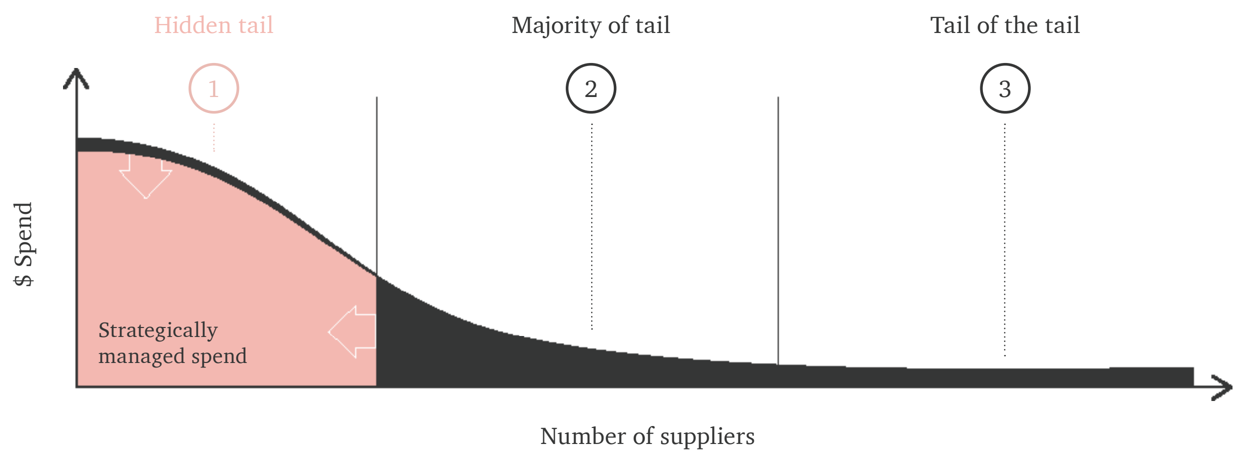
A MORE ADVANCED APPROACH TO DEFINING TAIL SPEND

It is clear that defining tail spend is very different based on the industry and types of suppliers you deal with. There is no one-size-fits-all. The pitfalls of a simplistic approach to defining tail spend include:

1. There are no clear metrics to define tail spend across the entire business, which makes organizational alignment difficult.
2. It becomes difficult to optimize suppliers who provide goods and services for both strategic spend and tail spend.
3. Procurement lacks visibility into spend, and opportunities for optimization are often missed.
4. It is difficult to scale and modify changes in the business.
5. Procurement teams can become overly reliant on BPOs (business process outsourcing) to control spend.

The best, and more advanced approach to defining your tail include the following:

1. Get a visual representation of cleansed, normalized spend information to the best of your ability.
2. Add the risk stratification so you know what spend to go after, why you want to attack that spend, and what the potential cost-savings and value add is.
3. Factor in your industry-specific dynamics.



AN UNCONTROLLABLE TAIL: THE RISK OF NOT MANAGING TAIL SPEND

The typical process to source and manage tail spend purchases is usually informal, unmonitored, and lacks analysis, which forces employees to make decisions at their own discretion. If tail spend isn't monitored, there are three dominant risks:

1. Price Risk: Procurement organizations often take the easy way out to buy a product with little to no concern about getting the best price. This is a missed cost savings opportunity and leads to unnecessary waste that can impact your company's bottom line.
2. Time Risk: The initial purchase from a supplier may have reflected the best price but without the use of technology and automation, procurement is not tracking pricing and other important supplier information. This leads to a misuse of human resources because procurement can not identify strategic suppliers and consolidate vendors efficiently.
3. Operational Risk: If the purchase is completed under the radar, it's possible that it may not meet compliance standards and could pose a liability or security risk to the company. Tail spend purchases can create an inordinate amount of risk if end-users abuse purchasing policies and procurement has no visibility.

Price Risk

The most obvious risk in procurement is overpaying for a product or service. The world of B2B selling and purchasing often lacks standardized pricing and tends to be variable and vague. It is no secret that various companies pay drastically different amounts for the exact same products; and if they're not intelligently sourced, the risk of overpaying dramatically increases. Not all tail spend purchases fall victim to this, as there are some categories and vendors that do hold consistent price discounting levels. However, without proper tracking and analysis of historical data, how can a procurement organization begin to identify their largest areas of risk?

Price KPIs:

- Documented cost savings against an internal benchmark or open market benchmark
- Overall quarterly or annual cost
- savings targets

Time Risk

Time is viewed by CPOs as one of the team's most valuable resources. The current process for sourcing most products is extremely manual. It can often include emailing or physically calling several suppliers, explaining the product or service desired, and then collecting and organizing the returned bids. Repeating that process for thousands and thousands of small purchases that are made every single year will occupy a large portion of a procurement department's time. If an organization wants to increase the number of suppliers participating to use competitive forces to drive pricing down, they have to tack on additional minutes, hours, days, months to their annual sourcing process. Doing so is extremely cost-intensive and does not create a positive work environment for procurement buyers, which is why many choose not to tackle it at all.

Efficiency KPIs:

- Time (period of time) from requisition created to PO dispatched
- Time (employee effort) from requisition created to PO dispatched
- Total number of POs created per buyer, per category or department
- Average lead time for product or service delivery

Operational Risk

In the procurement business, there is always the risk of fraud, playing favorites, supplier exclusion and cybersecurity. Whether an organization is a public or private sector entity, the possibility of operational risks is a valid concern. If a company is not tracking or managing 80% of their purchases, how can a procurement leader expect their buyers to intuitively know which businesses can supply what products at the best price, while also mitigating ongoing operational risks?

Minimizing operational risk is especially important in public organizations, who use taxpayer money, and financial institutions, whose procurement departments are most concerned with mitigating risk. In the financial services industry, companies handle a high volume of sensitive consumer information, must contend with fraud, money laundering and malware attacks and face exacting regulatory bodies (e.g. Basel III, GDPR, NY DFS). State, local government and education organizations must comply with the three bids and buy process if they use public funding. Many of these organizations, and some private as well, have diverse vendor targets, meaning they must supply to different types of vendors, such as minority-owned businesses. Even large private enterprises have policies about what should go out to RFP, but in reality, many of the purchases that should go out for RFP do not because of resource constraints. Nick Easley, Chief Transformation Officer of the MBTA says that “emphasis on transparency in bidding has resulted in new vendors, a stronger, simpler bidding process, and even more competitive prices for the MBTA,” [2] all while helping to mitigate risk for the government organization.

Operational KPIs:

- Percentage of spend under management.
- Percentage of purchases within compliance
- Average amount of bids solicited
- Average quotes received per bid
- Total Disadvantaged Businesses (DBEs) included, total POs awarded to DBEs
- Percentage of tail spend through preferred suppliers and catalogs

Minimizing operational risk is especially important in public organizations, who use taxpayer money, and financial institutions, whose procurement departments are most concerned with mitigating risk.

Fairmarkit

A STRUCTURED APPROACH TO MANAGING TAIL SPEND

Digitized processes and structured data have created an opportunity for companies to develop and implement a robust tail spend management process. Our recommendation is to take a structured approach but remember to try and keep it simple. Do not over complicate tail spend by subjecting it to a multi-step wave sourcing strategy. We suggest the
following process:

- **Preparation:** Develop a solid plan that includes a crawl, walk, run approach. Identify a business unit that has an identifiable tail spend issue and engage key stakeholders to ensure company alignment.

- **Crawl:** Roll out a tail spend management program to one business unit with a small scope to start. Ensure that implementation properly captures program success and data can flow back to your P2P (procure to pay) or ERP (enterprise resource planning) system. Be sure to socialize initial wins to the key stakeholders so they have visibility into what is working.

- **Walk:** Increase the scope within that business unit and start rolling out the initial tail spend management scope to other business units. Start introducing more automation to ensure you have structured data and a positive feedback loop. Then, you can begin further leveraging the data and get stakeholder buy-in for a larger rollout.

- **Run:** You have proven your business case, so time for a global roll out to all business units. Socialize the importance of the tail spend management program to key stakeholders and end-users. Fully automate tail spend and integrate technology directly into your P2P or ERP systems to fit within your existing processes.

IMPACTFUL BUSINESS OUTCOMES

Tail spend has become a substantial source of savings for companies willing to think beyond the traditional procurement model. Procurement is undergoing a digital transformation, making structured data more readily available. It is important to leverage new capabilities to hit savings targets and improve operational efficiencies. According to Boston Consulting Group, "firms that use digital to manage tail spend can cut their annual expenditures by 5% to 10%, on average—a significant amount, especially for global companies with total expenditures in the billions." [3] By having a sound tail spend management strategy, a procurement department can become a key competitive advantage for an organization and allow the company to beat out competitors lacking a sound tail spend management practice.

Benefits of managing tail spend

- Cost savings
- Increased spend under management
- Reduced risk
- Improved data quality and reporting
- Improved SLA & compliance enforcement
- Increased productivity per FTE

Survey results from the 2019 Gartner Procurement Diagnostic Suite Survey tells us that "procurement functions that managed predominantly indirect spend delivered higher ROI to the business in 2019 than functions that managed direct or hybrid spend. Correspondingly, these functions also delivered a higher savings rate to the business. In 2019, functions managing indirect spend type delivered ROI of 6.88x and a savings rate of 6%. Functions managing direct spend delivered procurement ROI of 5.46x and savings rate of only 4%, suggesting a greater strategic value proposition for indirect procurement."[5]

...procurement functions that managed predominantly indirect spend delivered higher ROI to the business in 2019 than functions that managed direct or hybrid spend. Correspondingly, these functions also delivered a higher savings rate to the business

THE FUTURE OF TAIL SPEND MANAGEMENT

Procurement processes for tail spend management are outdated and have not entered the digital age. The process for requesting bids on small to medium-sized purchases is still largely manual and there is a need for innovative technology that fills the gap between a team's formal RFP process and the one-off catalog purchases of single items, known as spot buys.

So, how do we move towards that?

- Automate the source-to-award process
- Vendor recommendations via machine learning algorithms
- Centralize historical data

It may not always be obvious that a procurement department can manage tail spend to realize massive savings. The companies that are using benchmarking, analytics, and automation to ensure their procurement organization can streamline the sourcing process from a large pool of qualified suppliers are going to have a significant advantage over those that do not. Large enterprises that are constantly benchmarking internally and externally to ensure they're getting the best price are going to beat their competitors.

KEY TAKEAWAYS

1. Leaving 20% of your budget unmanaged is a substantial strain on capital and human resources
2. Innovative, cost-effective technology that delivers powerful automation by leveraging structured data, machine learning, and artificial intelligence capabilities is revolutionizing procurement tail spend management
3. Keep it simple, do not over complicate tail spend by subjecting it to a multi-step wave sourcing strategy
4. There can be gold in the tail spend pile and it can be sizeable cost savings
5. Next-generation tools to automate these processes can drive more FTE efficiencies
6. Understand what you are buying and partner with a technology that allows you to embed sourcing within your purchase to order process
7. Real-time sourcing drives awareness that then equates to better decision making resulting in fewer suppliers, better savings and reduced risk
8. Tail spend is a misnomer—it can be massive so don't ignore it

Fairmarkit

ABOUT FAIRMARKIT

Fairmarkit is the intelligent sourcing platform that empowers organizations to more efficiently purchase the goods and services they need. By equipping procurement and supply-chain teams with automation and data, Fairmarkit promotes competitive bidding while reducing manual work within existing processes. Leveraged across a number of industries by innovative procurement departments, such as Univision, ServiceNow, and the MBTA, Fairmarkit aims to revolutionize the way organizations make purchases.

For more information, visit https://www.fairmarkit.com.

ENDNOTES

[1] "Materion is transforming its buyers' processes and culture with Fairmarkit." (https://www.fairmarkit.com/case-studies/materion). Fairmarkit.
[2] "The MBTA uses Fairmarkit to save over $100K every month." (https://www.fairmarkit.com/case-studies/mbta). Fairmarkit.
[3] "Taming Tail Spend." (https://www.bcg.com/publications/2019/taming-tail-spend.aspx). Boston Consulting Group.
[4] Gartner "Indirect Spend and Supplier Management Primer for 2020," Sam Berndt, 24 January 2020 (https://www.gartner.com/document/3979927?ref=solrAll&refval=242054498). (Gartner subscription required)
[5] Gartner "2020 Trends in Procurement Budget Allocation," Procurement Research Team, 17 February 2020 (https://www.gartner.com/document/3980997?ref=solrAll&refval=242059483). (Gartner subscription required)
[6] Gartner "Predicts 2020: Sourcing and Procurement Application Technology Disruptions," Micky Keck, et al,, 12 December 2019 (https://www.gartner.com/document/3976236?ref=solrAll&refval=242062675). (Gartner subscription required)

Fairmarkit

281 Summer Street Floor 2
Boston, MA 02210