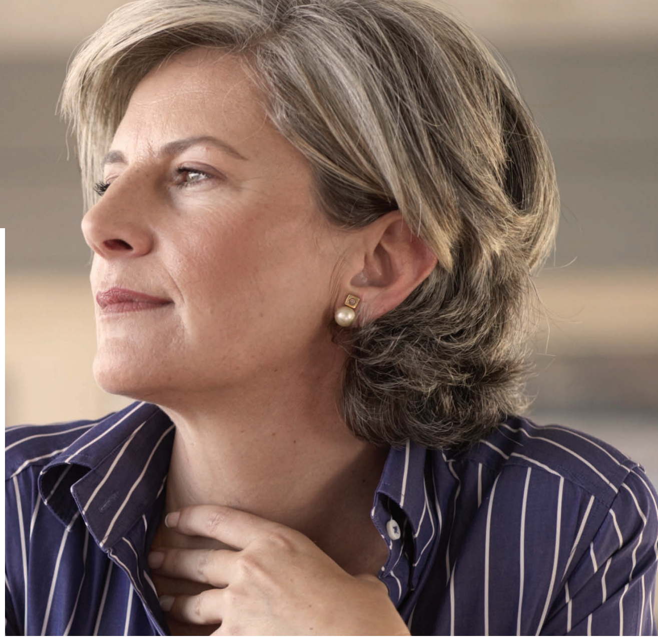
Knowing when to review your indirect supply base: 5 triggers



Depending on the company, procurement professionals have thousands of indirect suppliers to manage and limited bandwidth to manage them. With a constant stream of contracts to be reviewed and renewed or put out to bid, sometimes it's just easier to stay with the status quo.

"The sophistication of indirect procurement organizations continues to grow, and for good reason," says Chris Sawchuk, principal and global procurement advisory practice leader, The Hackett Group. "Indirect spend is woven into the fabric of all organizations across all industries. Effectively managing the indirect spend and associated suppliers can have a significant impact on an organization's performance."

In fact, according to Hackett Group data, managing indirect spend costs more than direct. Indirect represents a higher percentage of total spend — 61.7 percent of overall spending on average versus 38.3 percent for direct — and the number of employees per billion spend is also higher for indirect, making the cost to manage it higher.

Triggers

With so much money and so many resources devoted to indirect, it is important to continually review and track just how well your indirect suppliers are working for you. But for procurement professoinals that's not always the case – it can be a trigger that sets off a review. "Typically, something occurs within the enterprise that causes an organization to focus much more diligently on the management of their indirect spend or specific categories of indirect," says Sawchuk.

Here, Sawchuk identifies five of the most common events that should trigger a response from the indirect procurement organization.

Contract renewals

This one may sound obvious, but it's not always so easy. "If you have a contract renewal coming up, you may decide to stay with the same supplier and agreement, or you may not," says Sawchuk. "At the very least, the renewal should spur a review of your current situation."

Marketplace event

Any event that causes dynamic change in your company or the marketplace should prompt you to review your indirect spend for opportunities. Examples of such events may include mergers and acquisitions, regulatory changes, commodity price fluctuations and even larger economic events like recessions or bubbles in certain industries.

Indirect, not inexpensive

According to Hackett Group data, managing indirect spend costs more than direct. Indirect represents a higher percentage of total spend **— 61.7% of overall spending is indirect versus 38.3% for direct** — and the number of employees per billion spend is also higher for indirect, making the cost to manage it higher.

Staples

Continued on back

"For example, in 2008 we experienced a significant economic event with the financial collapse, and as a result, most organizations turned their attention quite rapidly to margin preservation through cost reduction," says Sawchuk. "And as it turns out, by managing both direct and indirect spend more effectively, procurement teams contributed significantly to the success of their organizations and their ability to survive, and even prosper, during this very signficant economic event."

Performance issues

"Regardless of whether a contract is coming up for renewal or not, the peformance of the indirect supplier needs to be reviewed on a regular basis," he says. "This is just good supplier management. Not only to ensure suppliers are meeting your expectations, but improving as well."

Supply base fragmentation

"Fragmented supply bases should also act as a trigger, but in this case the indirect procurement organization will need to move beyond their reactive capabilities as outlined in the previous triggers and be more proactive," says Sawchuk. "Not only does a more rationalized supply base structure allow for spend cost savings benefits due to better leverage, but it also improves supplier relationships and performance as the procurement organization is able to now focus more narrowly on select suppliers."

"Cost only" focus

Procurement organizations have established themselves based on their ability to deliver on spend cost reductions to their organizations. "Today, if there are spend areas (and suppliers) where the only derived value is purchase price reduction, this should also serve as a trigger to explore other sources of value that can be extracted from that supplier relationship," says Sawchuk. "Procurement organizations must augment their typically robust capabilities around driving spend cost reductions with other value adding activities including focusing more broadly on total cost, shaping demand behaviors and leveraging the innovation capabilities within their suppliers. To be successful, stronger relationships with suppliers will be required."

Contract renewals, marketplace events, performance issues, supply base fragmentation and a focus on cost only. If your procurement team has identified or experienced one of these triggers lately, it may be time to respond.

"Indirect spend is woven into the fabric of all organizations across all industries. Effectively managing the indirect spend and associated suppliers can have a significant impact on an organization's performance."

- Chris Sawchuk