Expense Reduction Analysts

How Your Company Can Tame the Tail Spend Beast

What Is Tail Spend?

Is your company familiar with the concept of tail spend? Even if you're not familiar with it, you have it. Simply put, "tail spend" refers to approximately 20% of non-core procurement transactions that are largely left unmanaged, usually due to a high volume of suppliers and limited in-house resources. The best way to illustrate tail spend is through the Pareto Principle, wherein 80% of an organization's spend is strategically managed with 20% of the suppliers. This 80% spend typically includes the cost of goods, tooling, and other capital expenditures, occupancy, and utilities.

Conversely, 20% of the spend, or "tail spend," is with 80% of the suppliers. Included in this 20% segment are thousands of operating consumables SKU's (MRO, PPE, packaging, shipping and warehouse supplies, janitorial and sanitation supplies, industrial gases), logistics by multiple modes, insurance, telecom circuits and services, and other services such as waste, uniforms and payroll processing. Consider, too, that the cost of processing and paying invoices for these purchases often exceeds the value of the goods or services received. This spend segment is not only challenging to manage effectively but also to realize industry-best pricing with suppliers that most closely align with your requirements.

For example, a recent manufacturing client with $56M in spend revealed the following:

	Spend (000's omitted)	% of Spend	Supplier Count	% of Count
Managed Spend - CoGS, Tooling & Facility	$47,351	83%	191	23%
Tail spend	$9,411	17%	631	77%
	$56,762	100%	822	100%

This $9.4M tail spend is comprised of MRO, packaging, insurance, information technology, logistics, telecom, uniform and waste services, office supplies, marketing, education, regulatory, etc.

Savings of 10-40% or more are typically available in certain expense categories. These potential savings are often overlooked due to a low expectation of return, lack of visibility and internal resources, and benchmark data. Executives and procurement leaders must change the way they look at tail spend. **Executives might reason that tail spend is too costly to manage from a process point of view, but that's the reason they should not ignore it, as it's too costly from a business point of view.**

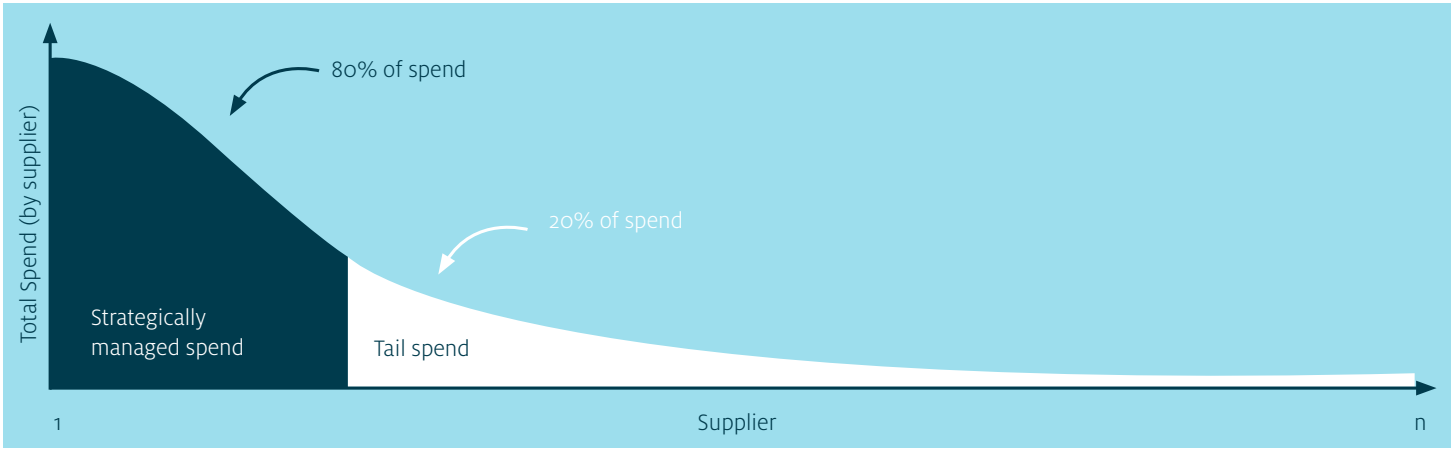
What is the First Step in Addressing Tail Spend?

Have you charted your company's spend as shown below? Your spend can be evaluated by supplier or expense category. However, it's a great rule of thumb to do both - as it provides a compelling profile and identifies potential opportunities for reduction. If an internal expense reduction initiative is contemplated, this must be the first step. Improvement cannot be measured without a starting point.

Valuable insights can be revealed to a CEO or CFO who is viewing their spend data for a historic accounting period in this format. Rather than typical line items such as raw materials, outside processing, labor, packaging, shop supplies, etc., this reporting model offers a much more in-depth snapshot of spend by expense category, as well as supplier makeup.

Drilling down further within a category can yield even greater understanding. Within the MRO (maintenance, repair, and operations) category, the spend data can be reported by product such as cutting tools, lubricants, fasteners, personal protective equipment, etc., and cross-tabulated against the suppliers.

As a result, your organization will be able to methodically shorten the tail, leverage your dissipated purchasing power, gain visibility to your expenses and create metrics to measure implemented future state objectives against the current state status quo.



8 Reasons Why Tail Spend is Difficult to Manage

Category Expertise

Each expense category has its own cost drivers, market conditions, contract terms, and other nuances. A deep understanding of each of these facets is required to manage tail spend effectively.

Benchmark Data

It's only possible to ensure that industry-best pricing is realized by having external benchmark data. Securing benchmark data is a challenge as it's not readily available. Note, too, that suppliers are trying to maximize their revenue and margin on every item they supply your company.

Internal Resources

Procurement teams rarely have the time or the benchmark data to dedicate adequate attention to this area of spend. Purchasing is often too busy feeding the production floor, quoting new production, and resolving production material quality issues. Additionally, many organizations have a list of high, competing priorities. Tail spend is usually much further down on the list.

Executive Buy-In

With a common misunderstanding of low potential for savings, many executives neglect this area of spend in favor of strategies that offer more immediate (and visible) rewards. Thus, there is a reluctance to commit resources to uncover savings opportunities in the tail spend.

Internal Controls

Suppliers are often added to the supply base in an ad hoc fashion, resulting in maverick spend without suppliers being part of a strategic plan. Without a documented strategy and designated point person(s), the tail spend will go on largely unchecked.

Fragmented Spend

In a given expense category, there are usually several to many more suppliers than are necessary. In addition to multiple categories to manage, organizations may simply not have the time to dive into the established support relationships with each one appropriately. Of course, in these instances, potential economies of scale are negated through weakened buying power.

Visibility

SKU level detail of products or services purchased is rarely reported and reviewed internally. P-cards, used by many companies, obscure the spend data in favor of purchasing convenience.

Processing Cost

The cost of generating and receiving a PO, along with processing and paying an invoice, will often exceed the value of the item purchased. Inefficient ordering and fulfillment models are often in place as well, contributing to the difficulty in managing tail spend.

Start a Tail Spend Opportunity Assessment:

Maybe your organization doesn't have the time or resources available to address the potential impact of tail spend. Perhaps your executive leadership knows the areas that need to be addressed but just hasn't made the first step in conducting a review. Gain a competitive advantage by ensuring your business has an adequate assessment of actionable tail spend opportunities. Why continue to leak cash that can either improve your bottom line or be redeployed to higher priority initiatives?

About the Author

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Paul is a Principal Consultant of Expense Reduction Analysts (ERA) in Northern Illinois. As an advisor and advocate, his focus is to build strong relationships and deliver comprehensive cost containment solutions for his CEO and CFO clients. Paul's client experience within ERA includes a range of manufacturers within the transportation industry, construction materials, health and beauty products, medical devices, biofuel and agricultural products, retail display, machine tool, and contract manufacturing.

Outside of manufacturing, Paul has worked in the distribution, association, social services, hospitality, private school, and professional service sectors. Paul's clients include private equity portfolio companies and divisions of publicly traded corporations. Before joining ERA, Paul spent 25 years in the contract metal stamping industry, supplying the automotive and appliance industries primarily. His experience in that industry includes financial management and benefits plan administration, along with sales and marketing. During his tenure, he implemented three ERP systems.

Paul's formal education includes a B.S. in Accounting from Indiana University and an MBA from the Keller Graduate School of Management. Additionally, Paul has successfully completed the Certified Management Accounting (CMA) exam sanctioned by the Institute of Management Accountants. Paul's professional affiliations include membership on the Exit Planning Institute West Michigan Chapter Leadership Team.