Are Indirect Materials Your Big Savings Opportunity for 2011?

Are select areas of your supplier spend overlooked and consequently ripe for cost reduction opportunities? In our recent client engagements, we have found that the indirect spend ----- materials and services that are not part of the manufactured product---- often fall into this category.

Why is this? Quite often these materials and services are critical to support the company's manufacturing operations and therefore most companies delegate buying authority to the individual plants. This can potentially lead to a lack of commonality in the items purchased across plants and a fragmented supply base----resulting in missed leveraging opportunities. Additionally, speed of delivery often becomes the primary factor in the sourcing and pricing process, resulting in premium supplier pricing that gets "baked in" over time.

Compounding these issues is the economic condition over the past several years. Cutbacks in personnel handling the procurement function for indirect materials have resulted in plant buyers who wear many other hats in addition to their buying responsibility. Buying becomes a part-time job for some and a full-time job for no one.

This was the situation recently for one APD client. One of the commodities that fit this profile was plant tooling----tools purchased from outside suppliers and used in the client company's manufacturing processes.

<u>How did we know that tooling was overlooked?</u> APD uses a standard approach and process when we work with a client to find and implement cost reduction opportunities. The first steps are to gather the spend information for each commodity. For the top commodities in total spend, we segment the commodity spend by region, plant and supplier. Then we determine how each of these top commodities is purchased—who is responsible, the procurement systems used, decision-making criteria, approvals required, etc. When we did this for the plant tooling commodity, we knew there were opportunities for cost reduction.

<u>What specifically did we see</u>? First, the tooling spend was a significant portion (20%) of the total indirect spend. The spend per supplier was relatively small with few common suppliers across regions and plants and there was no single commodity strategy to provide a framework for each plant buyer to use. The fragmentation of the supply base across regions and plants was apparent.

This was by design since cutbacks within the central purchasing organization did not allow prioritization for this work. Each of the buyers at the plants had many responsibilities so buying was a part-time job. The lack of a single central procurement system did not provide the individual plant buyers with efficient and adequate supplier spend visibility to understand which suppliers are being used by other plants, resulting in missed leveraging opportunities.

<u>What did we do to uncover cost reduction opportunities?</u> First, we gathered the spend detail on a "line-by-line" basis. This was not available in a central data base so the information was obtained from each plant and its current suppliers. This information was used as the basis for a market test, selection of a reduced number of preferred suppliers, and negotiations with those suppliers. And of course, as part of this process, it was critical to obtain plant buy-in and ensure supplier performance requirements were identified and implemented, in order to allow the same or improved levels of supplier quality and delivery.

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<ins>What were the results?</ins> Cost savings of 15% and a supplier reduction of 50% were realized. The average spend per supplier went from $100,000 annually to $170,000.

<ins>The approach</ins> that we took on tooling can be used for all of your indirect purchases:

1. Get a breakdown of your indirect spend and identify the top 20 commodities.

2. Profile the annual spend for each of the top 20 commodities:
   a. Total annual spend dollars
   b. Spend for each region and plant
   c. Spend for each supplier

3. Determine how each of these commodities is purchased.

4. Look for the telltale signs for lost opportunity:
   a. High annual spend for the commodity but relatively low annual spend per supplier
   b. Lack of supplier commonality across plants and regions.
   c. No commodity strategy to provide a framework for supplier selection and pricing across regions and plants
   d. Little to no visibility across the company of descriptions and prices for items procured in that commodity category
   e. Price is not always a key criteria in making the sourcing decision

5. Rate each of the commodities based on level of opportunity and ease of implementation

6. Select the top 2-3 commodities for a high level plan. Key elements of the plan include:
   a. Input and buy-in from key stakeholders
   b. Method to gather line item detail with prices for items purchased over the past 12 months, if not available from your procurement system
   c. Segment the suppliers based on past performance to identify those you want to retain and work with
   d. Develop a high level approach to identify and implement the specific cost reduction opportunities, e.g. market test, negotiation with key suppliers, VA/VE, etc.
   e. Quantify (estimate) the savings and supplier reduction opportunities.

7. Obtain management buy-in (for all stakeholder activities) to the plan.

8. Form the stakeholder team and develop specific SMART objectives for the project with a timed action plan.

<ins>Think about your indirect spend.</ins> Do you have some or all of the conditions just discussed? If you do, there are most likely cost reduction opportunities that can be implemented. Don't overlook these areas of low hanging fruit!!