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Procurement Executive Insight

Complimentary Research

The Benefits of Supplier Consolidation Extend Far Beyond Sourcing Savings

By Pierre Mitchell and Christopher Sawchuk

Executive Summary

Consolidating suppliers within specific supply markets is a proven strategy to concentrate buying power and reduce purchase prices. The activity can be taken further, though, especially within non-production (indirect) spending areas. By simplifying and automating interactions with preferred suppliers, procurement can more effectively work these relationships beyond just cost savings, to include support for more strategic enterprise imperatives regarding sustainability, innovation, risk reduction, diversity, localization and other key objectives. As hard-dollar savings become ever more challenging to squeeze from traditional product sourcing, harnessing these broader benefits is where the greatest opportunity to gain competitive advantage will be found.

About this research

Based on over 10 years of data from The Hackett Group's procurement benchmark database, this research is intended to help executives create a multi-pronged business case for supplier consolidation.

To make the results applicable across multiple industries, we included only indirect spending in our analysis (i.e., spending on goods and services that are not directly included in the goods and services that the company sells to its customers) .

The Benefits of Supplier Consolidation

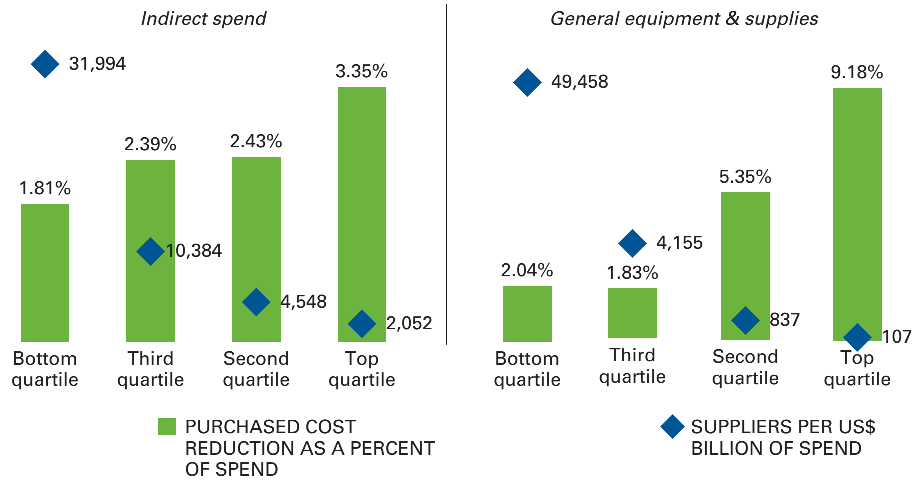
Today's global business environment is increasingly complex. Over time, this complexity costs money. For example, as more goods and services are sourced to third parties, companies invariably end up buying too many things from too many different suppliers. The resultant supply-base complexity adds cost on many fronts. Understanding the types and costs of such complexity is important in order to identify and eliminate the causes of waste, expense and risk.

Consolidating suppliers within specific supply markets is a proven strategy to concentrate buying power and reduce purchase prices. The specific business benefits include:

Supplier consolidation benefit #1: Reduced purchased costs

Historically, the largest opportunity created by supplier consolidation is financial, in the form of lower purchased costs. As the number of suppliers (for comparability, normalized per billion dollars in spend) is reduced, buying power increases. Further, strategic sourcing processes can be employed to introduce competition and lower purchase prices. Price and other associated landed costs (i.e., shipping, handling, taxes and duties/fees) are together referred to as "purchased costs." As the number of suppliers rises, the annual incremental savings associated with these purchased costs decreases, both for indirect spending overall, but also for lower-level spending categories such as general equipment and supplies (e.g., office supplies and furniture), IT, maintenance supplies and the like (Fig. 1).

FIG. 1 Supplier consolidation is correlated to reduced purchased costs

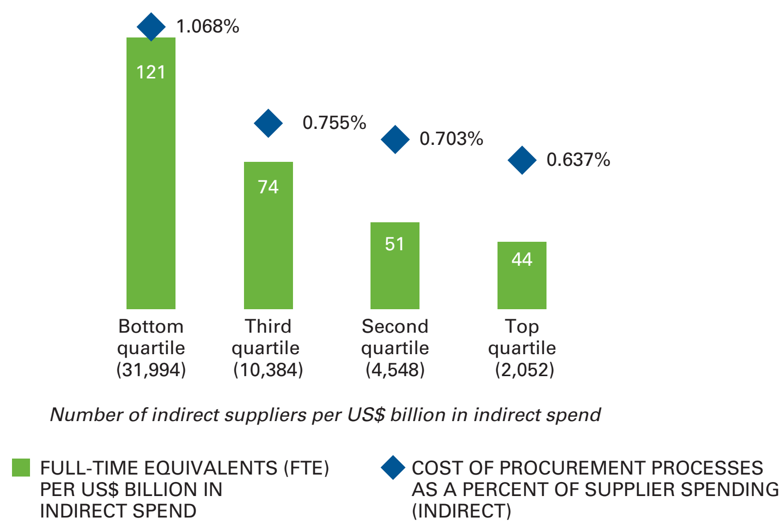


Source: The Hackett Group, 2012

Supplier consolidation benefit #2: Reduced procurement and supplier management costs

While lowered purchase price represents the largest source of hard-dollar savings from supplier consolidation, reduced process cost (i.e., increased efficiency) may be the largest opportunity. With fewer suppliers, the number of separate transactions falls, as does the amount of time it takes to manage those suppliers. It costs roughly $700-$1,400 in internal costs (i.e., labor, outsourcing, technology and related overhead) to source each supplier, set it up in internal systems, transact with it and manage the relationship on an ongoing basis.[1] So, fewer suppliers means lower interaction costs. This correlation is borne out with data showing that as the normalized number of suppliers goes down, so does the resultant labor effort in terms of FTEs required and spend-normalized process cost (Fig. 2).

FIG. 2 Supplier consolidation leads to higher procurement process efficiency overall



Source: The Hackett Group, 2012

[1] It is important to note that eliminating a supplier will not immediately create these process efficiency savings, but such improvements, over time, will indeed reduce staffing requirements and allow staff to redirect their attention to more strategic activities.

Consolidate beyond traditional spending category silos

At many procurement organizations, category managers who own various spend categories will engage the supplier market within their own spending silos. Yet, there is no reason why organizations cannot further broaden their "market baskets" to aggregate demand across the spend categories **(Fig. 3)**. For example:

- A large office supplies vendor might also have a compelling value proposition for IT equipment, print services/equipment, MRO supplies, etc.
- A building services management provider may also provide compelling MRO management services.
- A group purchasing organization could be used to aggregate demand across multiple spend categories if the company has little supplier leverage by itself.
- A minority-owned Managed Service Provider (MSP) could be used to aggregate across multiple services procurement categories and help improve supplier diversity performance.
- A large outsourcing company could subsume the spending within a category such as IT, or could also be used for business process outsourcing (BPO) in HR, finance or other business support service.

The idea is to open up a broader market basket to suppliers and see what the market will bear, rather than bring preconceptions of what suppliers can or cannot do. Of course, there is a limit to hard-dollar savings driven by supplier consolidation. As supplies become more commoditized, there are fewer price differences to be found among suppliers. At the end of the day, there are only so many dollars to squeeze out of a ream of paper or an office chair. While organizations need to explore these savings, they also need to challenge themselves to look for other ways to deliver value and ROI.

FIG. 3 Supplier consolidation can take place beyond low-level commodities and even major spend categories

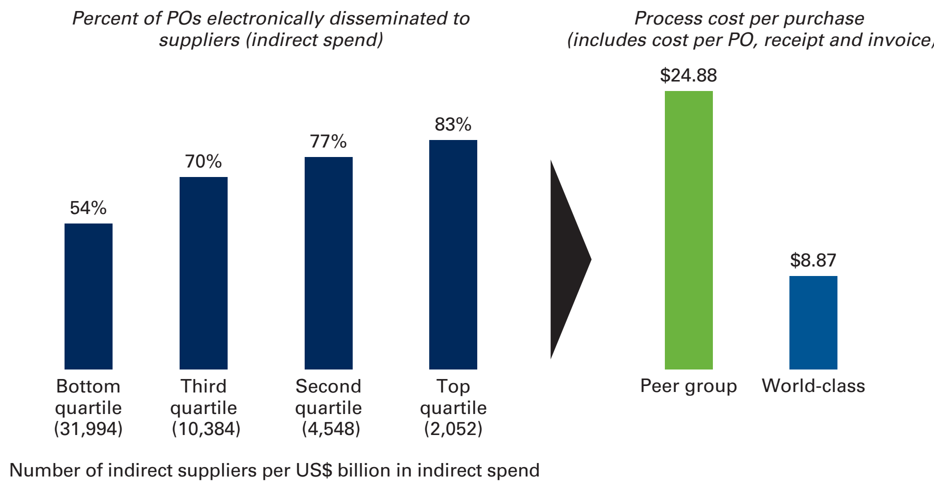
No aggregation

Example non-production spend commodities	Commodity aggregation	Category aggregation	Cross-category aggregation
	Office Equipment	Office Supplies/ Equipment Category Management	Aggregate across categories to see what the market will bear
	Office Furniture		
	Office Services - Document Management		
	Office Services - Mailroom		
	Office Supplies		
	Facilities: Real Estate and Property Management	Facilities/MRO/ CapEx Category Management	
	Facilities: Janitorial/Custodial		
	Facilities: Capital Equipment		
	Facilities: HVAC Equipment/Service		
	MRO Equipment and Supplies: Cleaning and Safety Supplies		
	MRO Equipment and Supplies: Electronics/Electrical Supplies		
	MRO Equipment and Supplies: Machinery and Equipment		
	IT Hardware: Laptop	IT Category Management	
	IT Hardware: Desktop		
	IT Hardware: Accessories		
	IT Hardware: Production Server		
	IT Hardware: Storage		
	Telecom: Cellular		
	Telecom: Data		
	Telecom: Network Equipment		

Source: The Hackett Group, 2012

This represents a virtuous cycle in that having a smaller number of suppliers makes it easier to automate interactions with them, which in turn drives down the process costs and frees up staff to make further improvements. For example, in terms of efficiency improvements, the level of purchase automation increases as the number of suppliers goes down (Fig. 4). We also see that the total steady-state cost for a purchase (which includes transactional buying, receiving and paying for goods/services) is less than $9 for a top-performing procurement organization[2], compared to $25 for the peer group. In addition, there are similar transactional benefits in terms of reduced cycle times (which also lead to improved requisitioner satisfaction), error rates, and the extent of supporting processes required for supplier set-up and ongoing management.

FIG. 4 Fewer suppliers simplifies process automation, in turn reducing P2P costs



Supplier consolidation benefit #3: Reduced noncompliance – and increased stake-holder satisfaction

In terms of effectiveness-related benefits from supplier consolidation (beyond cost savings), improved compliance ranks among the largest. It includes:

- Supplier compliance from engaging suppliers that have capable processes/systems and are comfortable performing transparently against service level agreements (SLAs). Contract/SLA non-compliance varies greatly, but savings of up to 1-2% of spending are not uncommon when companies first address this area (e.g., ensuring discount capture, minimizing duplicate payments). Picking fewer suppliers and managing them actively and professionally is critical to enabling this area of value.
- Internal compliance to contracts, especially regarding use of corporate negotiated discounts. Based on Hackett benchmark data, we conservatively estimate the benefit from reducing missed discounts from contract noncompliance at about 10% of negotiated savings.
- Internal compliance and supplier compliance to regulatory requirements including fraud reduction, supplier diversity requirements and localization requirements, among others. With fewer suppliers, it becomes easier to monitor against these ever-increasing requirements.

Of course, there is a trade-off regarding the last two items above in terms of managing requisitioners who prefer local suppliers or suppliers that better fit their individual requirements than the corporate supplier. However, this can be mitigated in various ways:

[2] "Top performer" is a designation given to companies that are in the top quartile across a broad set of purchase-to-pay performance metrics in The Hackett Group's ongoing benchmark database.

- Make it extremely easy and intuitive for requisitioners to find what they are looking for with preferred suppliers. If they have budget and can find what they need within the corporate catalog, the process should be 100% automated, foolproof and transparent.
- Offer a process to route truly nonstandard requirements to procurement to support appropriate one-off purchases or to add an exception (upon approval by senior management to accept the trade-off versus the benefits of the existing contract).
- Provide transparency of noncompliance to budget owners. For example, sending a missed-discounts report to the senior-most executive in charge of a budget is a powerful tool to change behaviors.
- Integrate all local requirements (and others such as payment term requirements to support working capital objectives) comprehensively into the sourcing process to help quantify and address trade-offs and decisions, rather than after the fact.
- Use suppliers themselves as monitoring agents and change agents in the process. The procurement organization and budget owners might be unaware that the supplier already has capabilities to meet apparently nonstandard requirements.

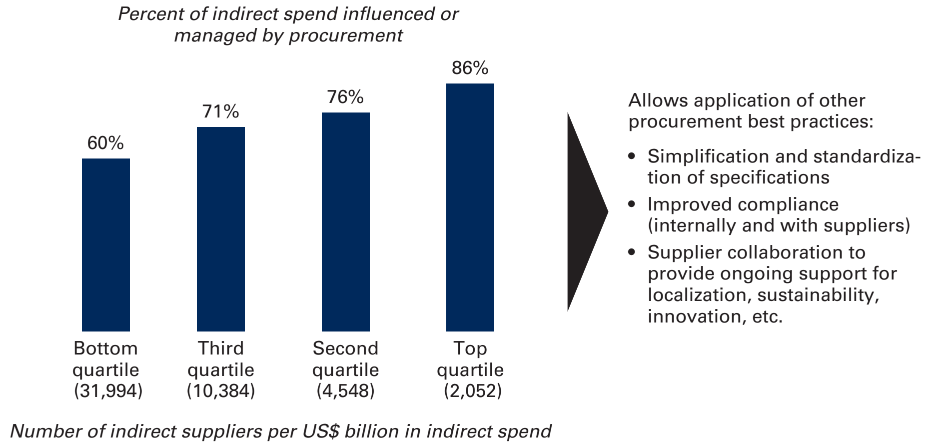
This last point is not just a compliance tactic, but also applicable for tapping suppliers' knowledge of best practices more broadly based on their work with other customers. In fact, many similar best practices go hand in hand with supplier consolidation. A few of the best are highlighted in the next section.

Making Supplier Consolidation Happen

The goal of reducing complexity should not just apply to the supply base, but also to the processes and systems that are used to interact with the supply base. For example:

- Rationalization of the few approved methods for buying and paying for goods and services. This includes not just three-way matching (which is the most onerous of all methods), but also use of procurement cards for very low-dollar and/or emergency purchases, assumed receipts, recurring invoices, evaluated receipts (i.e., no invoice is issued since the receipt serves as the invoice), etc. These should be designed based on the requirements of the spend categories that have been determined upstream during the sourcing process.
- Online catalogs (local or via "punchout" to supplier site), automated requisitioning via e-procurement systems, procurement card integration (including use of summarized invoices and integration to T&E systems) and e-invoicing applications are important technology capabilities which correlate strongly to purchase-to-pay (P2P) performance. These technologies, combined with those of the suppliers, and with best-practices-based process design, should allow for a multi-channel approach to support on-premises purchases with suppliers as well as electronic purchasing over the Internet (including mobile devices).

FIG. 5. Procurement spend influence helps consolidate suppliers and improve their ongoing management



Source: The Hackett Group, 2012

These actions not only make end-users happier but allow procurement, finance and other business staff to spend more time fulfilling higher-level objectives. When procurement has the opportunity to influence supplier spending earlier in the process, it can apply a much broader toolkit of practices to help the business get more value from that spend over the life cycle of the supplier relationship and not just at the time of the deal **(Fig. 5)**.

Supplier relationship management (SRM) has increasingly become top-of-mind for procurement leaders and business leaders alike. SRM allows deeper collaboration with the core suppliers that have emerged as preferred partners during the supplier consolidation process. SRM is a very complex subject[3], but it is clear from Hackett research that supplier consolidation is strongly correlated with SRM performance and has an even higher ROI than strategic sourcing, especially given the broader focus on innovation and growth that SRM helps enable.

One of the hallmarks of world-class procurement organizations is their ability to source suppliers strategically even though the spend itself may not be very strategic. What we mean is that suppliers that have made it through the consolidation process are managed in a way that is similar to more strategic suppliers; namely, they are held accountable to a broader set of performance requirements which are both multi-year and multi-pronged.

Rather than having dedicated category managers and non-core spending areas, companies can either outsource the procurement of this spend entirely (as done in only a minority of companies at present), or press the supplier to apply the proven best practices implemented at its other, more progressive, customers. It should consist of a multi-phase implementation plan that hits on all the best practices we see empirically demonstrated at world-class procurement organizations: specification simplification, consumption management, inventory rationalization, global sourcing and working capital programs, among others. A case study on the next page details one company's experience partnering with a preferred supplier to expand business value delivered.

[3] SRM is the topic of our newest *Book of Numbers*™, produced exclusively for members of our Procurement Executive Advisory Program. Currently on press, the book will be shipped to clients before year-end.

Case study: Guild Mortgage Company

A fast-growing mortgage banking company, Guild Mortgage was trying to instill disciplined growth from a cost standpoint, especially with the expansion of its retail location footprint. To this end, it worked on standardizing office consumption/configuration not just for office supplies/equipment spending, but for overall operations including support for nationally designed, locally executed marketing campaigns.

Strategic sourcing helped support disciplined growth by consolidating the company's supply base, which in turn led to office equipment/supplies savings that surpassed the top-quartile savings figure shown in **Fig. 1** on page 2 of this report. These initial hard-dollar savings were certainly something to be celebrated, but the effort also opened up over 40 more hours per month for operations management to focus on supporting business growth. This focus naturally extended to preferred suppliers, which Guild Mortgage actively encouraged to continuously expand the value delivered within existing spend categories and also reach into adjacent spending areas. Interestingly, the company did not have a dedicated procurement spend-category manager, but rather, asked its preferred supplier (Staples Advantage) to deliver a multi-year plan based on best practices implemented by its other clients.

The program is still being implemented but results to date include:

- Decreased business risk through improved standardization (e.g., federal regulations and internal brand guidelines regarding printed material).
- Improved corporate compliance for contract utilization in addition to supporting performance reporting to keep stakeholders updated and the programs delivering value.
- Decreased time to set up new branch locations.
- Opening up a number of new, adjacent spend categories in print and IT.

Among the biggest contributors to the success of the program have been the company's attention to demonstrating a clear ROI to kick-start the effort and its ongoing communications with stakeholders regarding where the next set of value will come from.

The ROI to date is certainly quantifiable in financial terms, but it also is a success in terms of supporting stakeholders' unique requirements. These have included support for emergency purchases and even for employee perquisites such as the ability to take advantage of corporate discounts for personal purchases. This helps the company deliver more overall volume to (and thus obtain greater leverage with) Staples.

Furthermore, supporting the requisitioners in the field by helping them easily find preferred items improved compliance upstream, thereby capturing the benefits of electronic catalogs, consolidated/electronic invoices, procurement cards, etc., that were established with this spend category and supplier.

Looking Ahead

Innovative approaches to consolidating suppliers beyond traditional boundaries and also managing those suppliers in new ways through SRM programs and other approaches will be critical to maximizing the value from third-party spending. Increasingly, procurement organizations will shift from being gatekeepers to gate openers, pushing activity downstream to customers (internal and even external) as well as upstream to suppliers to encourage them to bring true innovation to the enterprise in a win-win fashion. Being a customer of choice and harnessing the power of supply markets will in turn enable the buying organization to become a "supplier of choice" to its own customers and help guarantee its long-term success.

Related Hackett Research

"2012 Procurement Key Issues: Saving Money to Compete, Enabling Innovation and Growth to Win," February 2012
"The Benefits of Using Self-Service Solutions to Support Supplier Enablement," December 2012

About the Advisors

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Mr. Mitchell is responsible for leading the development of research and other intellectual property within Hackett's Procurement Executive Advisory Program, where he also serves as an adjunct business advisor. He has over 20 years of industry and consulting experience in procurement, supply chain and information technology. Mr. Mitchell is quoted widely in the press and speaks at numerous industry events on supply management trends and technologies. Previously he was vice president of supply management research at AMR Research and a manager at Arthur D. Little, where he led numerous supply chain and procurement transformations at Fortune 500 companies. Other industry positions include manufacturing project manager at The Timberland Company, materials manager at Krupp Companies and engineer at EG&G Torque Systems.

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Mr. Sawchuk has over 15 years of experience in supply management, working directly with Fortune 500 and midsized firms around the globe and in a variety of industries to improve all aspects of procurement, including process redesign, technology enablement, operations strategy planning, organizational change and strategic sourcing. Mr. Sawchuk is a regular contributor to business publications, a frequent presenter at industry events, and co-author of *ePurchasingPlus*. He has been recognized by *Supply & Demand Chain Executive* magazine as one of its "Pros to Know." Mr. Sawchuk's background includes engineering and operation roles with both United Technologies and IBM.

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