


# Spend Analysis



A spend analysis is a process for analysing the historical spend (purchasing) data of an organisation to provide answers to questions concerning spend visibility, compliance and control (Pandit and Marmanis, 2008).



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### Introduction

A spend analysis is a process for analysing the historical spend (purchasing) data of an organisation to provide answers to questions concerning spend visibility, compliance and control (Pandit and Marmanis, 2008).

The spend analysis aims to inform strategies that realise savings on total spend and better purchasing and supply management outcomes (Pandit and Marmanis, 2008). It is often the first step in aligning a firm's sourcing strategy with its competitive strategy. In order to analyse all goods and services purchased and to forecast purchases for the future, firms need to aggregate total purchases across all organisational divisions (Rendon, 2005). The objective (output) of the spend analysis is to produce a fully documented understanding of the company's prior and future spend for supplies and services, segregated by users and suppliers (Rendon, 2005).

The spend analysis should address a number of key issues including corporate-wide spending associated with cost centres, the top commodities that represent opportunities to reduce spend, spend associated with contracts and purchasing with preferred versus non-preferred suppliers (Pandit and Marmanis, 2008). For example, if non-preferred supplier spending is high, this category clearly highlights an area of spend 'leakage' because prices and terms negotiated with preferred vis-a-vis non-preferred suppliers are usually better.

Recently, various reports have detailed the prevalence of spend analysis among firms and their perceptions of its importance. For example, a Portland Group/CIPS survey (2009) found that 77% of respondents had undertaken a spend analysis within the past 12 months, whereas only 6% had allowed two years to lapse since conducting one. This suggests that spend analysis is becoming an important part of the procurement function. However, another survey of 280 multinational firms conducted in 2008 by the Aberdeen Group (Bartolini and Dwyer, 2008) found that 52% of firms made no connection between using information on spend and categories to enhance purchasing. This same report also highlighted the major hurdles to undertaking a spend analysis successfully. These factors related to poor quality data, too many sources, lack of standardised processes, and insufficient process automation (Bartolini and Dwyer, 2008).

### Definition

Spend analysis is the process that “integrates internal spend data and external supplier and market data and applies analytical and benchmarking techniques to help identify risks and opportunities for performance improvements and savings by applying best practices in purchasing and supply management” (RAND, 2004).

### Successful Application

In order to analyse historical spend data, Pandit and Marmanis (2008) suggest reflecting on the following five sets of considerations: 1. What was the organisation-wide spend associated with each cost centre in the previous year, will the aggregate spend amount enable the company to increase leverage with suppliers; 2. What are the top commodities, what does the spend trend look like over the past few years, which commodities present opportunities for spend reduction; 3. Which suppliers are the most valuable and strategic; 4. How much is the organisation spending with preferred suppliers and how much is being spent with

underperforming suppliers; and 5. What percentage of spend is associated with contracts.

### Steps to Successful Application

- Ascertain true category spend.
- Identify strategic sourcing opportunities through demand aggregation and supplier rationalisation.
- Identify a means of reducing expense through increased compliance. This usually involves looking at vendor rebates, maverick spend, contract compliance, and budget variance.

*Pandit and Marmanis (2008)*

### Hints and Tips

- Spend analysis is unlikely to improve the procurement process if a strategic sourcing programme and the right organisational 'mindset' are not in place (Pandit and Marmanis, 2008).
- The information entered into the spend analysis must be high quality. Around 55% of companies believe poor quality information to be a major obstacle (Supply Management, 2008).
- Innovative companies tend to classify their spend by vulnerability and value. The former includes risk or exposure to market failure in procuring goods or services and strategic importance of purchased goods or services. The latter refers to the effect of purchased good or service on overall costs or profits (RAND, 2004).

### Potential Advantages

- A spend analysis reveals targets of opportunity where adapting purchasing practices can significantly enhance performance and generate savings (RAND, 2004).
- The savings from a spend analysis usually fall within 2-25% of total spend (Pandit and Marmanis, 2008).
- A spend analysis can be used to review corporate family relationships to identify interrelated or duplicate suppliers (RAND, 2004).

### Potential Disadvantages

- Spend analysis may require analysing considerably large volumes of data (tens or hundreds of millions of transactions across an enterprise). This process is inevitably resource intensive (Pandit and Marmanis, 2008).
- A challenge to using spend analysis is gathering the raw information necessary to undertake the process in the first place (Pandit and Marmanis, 2008).
- Spend analysis requirements present numerous challenges that make it demanding for traditional data warehousing to implement (Pandit and Marmanis, 2008).

### Performance Monitoring

- A traditional measure of procurement impact on a company is the percentage of all non-payroll related spend falling under the management of this group (Bartolini and Dwyer, 2008).
- Strategic alignment: measure visibility of a formally documented procurement strategy, percentage of objectives linked to business strategy and percentage of procurement time spent on global and enterprise-wide focus (CIPS: How do we measure up?).

- Use a supplier scorecard to assess the performance of key suppliers, such as the financial spending details with each supplier, e-transactions, supplier performance (quality of goods, service, logistics ability, etc.) and payment terms (Eakin, 2003). Also, measure suppliers' compliance to negotiated contractual agreements (Bartolini and Dwyer, 2008).

### Case Studies

- The UK Northumberland County Council carried out a major supplier spend analysis in partnership with the New Economics Foundation. The benchmark evaluation revealed that local suppliers re-spent on average 76% of their contracts with local businesses. By shifting 10% of its current spending on non-local to local suppliers, the Council could generate an extra £34m for the local economy (Department for Environment, Food and Rural Affairs, 2006).
- Ahold, a company responsible for sourcing goods and services for six grocery brands and over 1,200 supermarkets in the US, launched a strategic sourcing programme in 2003 which generated US\$350m worth of savings in two years on indirect procurement. Ahold relied in part on a web-based spend analysis application allowing corporate-wide spend visibility and giving managers the ability to 'slice and dice' spend data in real time, identify vendor consolidation opportunities and generate actionable reports on a continuous basis (Pandit and Marmanis, 2008).
- A RAND (2004) report showed the potential benefits of a spend analysis for improving US Air Force purchasing. Identifying around 240 purchase office codes would allow the purchasing department to consolidate duplicated purchasing efforts across the Air Force, reduce transaction costs, and realise savings from volume discounts. Additional savings were found to be achievable from consolidating purchases across the Department of Defense.

### Further Reading/References

#### Web Sources

- Key insights of a 2008 spend analysis survey  
<http://www.supplymanagement.com/news/2008/most-spend-analysis-comes-to-naught/?locale=en>
- UK Government spend analysis framework and flow chart  
<http://ccs.cabinetoffice.gov.uk/about-government-procurement-service/buying-solutions>
- Measuring e-procurement: includes details of spend analysis  
[http://www.summitmagazine.com/Articles\\_Columns/PDF\\_Documents/060104.pdf](http://www.summitmagazine.com/Articles_Columns/PDF_Documents/060104.pdf)
- Procurement Transformation Blog by Capgemini  
<http://www.capgemini.com/blog/procurement-blog>
- Penn University spend analysis  
[http://www.purchasing.upenn.edu/supply-chain/spend\\_analysis.php](http://www.purchasing.upenn.edu/supply-chain/spend_analysis.php)

#### Books

- Spend Analysis: The Window into Strategic Sourcing – Kirit Pandit and H Marmanis  
Complete and insightful introduction to spend analysis
- On-demand Supply Management: World Class Strategies, Practices and Technology - Douglas Smock, Robert Rudzki, Stephen Rogers - Good chapter detailing spend analysis and visibility

- Category Management in Purchasing: A Strategic Approach to Maximize Business Profitability - Jonathan O'Brien - Excellent category management text covering spend analysis
- Purchasing and Supply Chain Management: Robert M Monczka, Robert B Handfield, Larry Giunipero and James L Patterson - Practical steps for carrying out spend analysis
- *Purchasing and Supply Chain Management*(7<sup>th</sup> Edition): Dr Kenneth Lyons and Dr Brian Farrington - Popular and broad text spanning all major aspects of P&SM

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- Supply Management (2008) Most spend analysis 'Comes to naught'. [online] Available at: [www.supplymanagement.com/news/2008/most-spend-analysis-comes-to-naught/?locale=en](http://www.supplymanagement.com/news/2008/most-spend-analysis-comes-to-naught/?locale=en) [Accessed 18 November 2011].

## Video

Basics of spend analysis – sample course

<https://www.youtube.com/watch?v=HeK4SOLXqKg>

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