

How To Optimize All Addressable Spend



Imagine the following:

Your company's total spend is \$10 million. Your procurement department manages \$8 million of your total spend. Of that amount, \$7.2 million is under contract.

You've negotiated rates with suppliers and use processes so that buyers in your company will use those contracts. Once you conduct a spend analysis, your information says \$6.48 million of your spend is on contract.

So what's your addressable spend? If you answer \$8 million, you're limiting your savings potential.

Ultimately, you should have your entire spend within your control, to allow for maximum savings potential. That's addressable spend.

What is Addressable Spend?

Addressable spend is the spend that can be impacted through sourcing activity. Why does this matter?

Procurement departments may track spend under management, and this only part of addressable spend.

Your organization has implemented a source-to-pay solution and processes are optimized to bring additional value beyond savings. Your business is doing well and your suppliers are under contract negotiated prices.

You have surpassed the goal of getting rid of maverick spend and reducing your cycle times. You're saving as much as you possibly can, right? Maybe not.

The higher the portion of money within the domain of control of the procurement department is in relation to the company's total revenue. the better.

As the company looks for ways to cut costs, the ability to spot areas where it can increase its addressable spend is just as important, as it can potentially uncover millions of dollars of savings.

Spend analytics is a crucial part of addressable spend because you can't save any of the spending you cannot see.

With the right spend analytics in place, you can get insights and information from your real-time spend data and analytics at every stage of your procurement process.

Addressable vs Nonaddressable Spend

Nonaddressable refers to any money the company spends that is not within the control of the procurement department.

Spend not within the purchasing mandate for things like office leases, professional services, payroll benefits, etc., could be made addressable.

It would require procurement to work to negotiate specific rates with specific suppliers. However, nonaddressable spend, which procurement cannot take control of, is part of every business.

Nonaddressable spend typically includes employee salaries, expense reimbursements, taxes, and other required payments that you cannot convert to spend under management.

Addressable spend is the total amount of money that could benefit from some type of procurement oversight.

There is growing evidence that supports placing all spend through the procurement department. It not only saves money but reduces risk. Case studies and estimates conservatively suggest that 6% of non-addressed spend can be saved when brought under procurement management.

Regardless of whether your organization is in growth mode, protecting what they have on hand, or adjusting to a new normal, responsible procurement and expense management is never far from the chief financial officer (CFO) or the chief procurement officer's (CPO) mind.

Though you may need to be frugal in the short-term, looking for expense reductions without considering the medium and long-term objectives or specific stakeholder needs, may mean you actually end up with higher costs.

Supplier relationships can be damaged easily and employees may go around procurement policies to purchase products and services they need as opposed to using the supplier contracts in place.

Spend Optimization Tactics

You have a variety of tactics to choose from, which can be broken down like this:

- **Demand management tactics:** Anything related to reducing the volume of products or services you purchase.
- **Category management tactics:** Looking at the company as a whole across categories to change how, what, and from whom you buy while still achieving the same delivery outcomes.
- **Incumbent supplier tactics:** Anything related to reducing the cost of products and services with your existing suppliers.
- **Sourcing tactics:** Reducing prices paid by leveraging market conditions with suppliers.
- **General tactics:** Any other expense reduction strategy that makes use of cost avoidance or produces cost savings.

Demand Management Tactics

These include things like tightening your approval authority level, reusing products and services purchased by other departments in a company, reselling or recycling products that are no longer necessary.

It means relying on category managers to keep a closer eye on the bottom line, and reducing the amount of money employees can spend without explicit approval.

Category Management Tactics

Consolidating spend categories and the supply base is a foundational strategy that category management was based on. But, it isn't typically a quick win strategy because you have to align contracts, and implementation can be complicated.

You can adjust your volume mix across multiple suppliers for opportunities in commodity markets where you have a small number of dominant players.

Consider substituting products and services by replacing what you buy today with an alternative approach that provides the same or better results.

For example, you could substitute lower-quality flights with Frontier or Spirit compared to JetBlue, or opt to deliver statements via email rather than traditional snail mail.

Another option is to consider local sourcing to reduce the total cost of ownership.

Incumbent Supplier Tactics

These refer to things like renegotiating or restructuring your existing contracts with more favorable pricing. This can be done as a result of changes in market conditions. You may wish to consider giving contract extensions, too, if you can lock in a deal that's working for you.

Terminating for convenience clauses also make it possible to renegotiate terms, but you should use this option carefully and only with suppliers who provide true commodities.

Alternatively, you can use less aggressive metrics to reduce the cost to serve you. For example, reduce your over-specified KPIs (do you really need them to be available 99% of the time, or could you live with 95%?) or reduce your payment terms.

Talk with your suppliers to ask them if they can help with ways to reduce their costs to serve you without impacting your desired outcome.

Sourcing Tactics

Go to the market to request proposals (RFPs) for contracts within 12 months of expiration. Don't wait till the last minute to go to market.

Issue an RFP for any product or service whose current contract is within 12 months of expiration and if your incumbent wins the RFP, make your award contingent upon the new deal being effective from the time of award versus the original contract expiration date.

If you choose a new supplier partner, you will have time to fully implement your new contract so you can take advantage of the new agreement from the first day.

Strategic sourcing is something many procurement organizations rely on for cost reduction.

General Tactics

These include things like:

- Instituting spend governance to reduce the savings leakage
- Auditing supplier invoices for accuracy
- Creative bartering
- Using a GPO model

Putting more of your company's spend within the hands of procurement, and finding ways to build a solid expense management program will go a long way toward creating financial stability within your organization.

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