Procurement Savings: Types of Savings, Tracking, and Best Practices To Realize Them



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Effective supply chain management is crucial to have a profitable business.

Finding procurement savings should be a priority for any business, as it can consistently ensure a positive bottom line.

According to the Deloitte Global CPO Survey, cost savings is a priority for 76% of Chief Procurement Officers. When procurement costs are kept to a minimum, profits will go up.



What Is Procurement Savings?

Procurement savings are any type of savings initiative that's intended to reduce the cost of procuring the goods and services your business needs to operate.

This includes negotiating better pricing, cutting unnecessary purchases, and creating future cost reductions through things like extended warranties and using more efficient systems.

The Three Types of Procurement Savings

There are three main types of procurement savings you can aim for creating at your organization. These cost-saving strategies include:

1. ## Supplier Cost Savings

   Rethinking your interactions and choices with suppliers is a great place to start finding procurement savings. Some ways to go about creating savings from your supplier base include:

   - ### Restructure Existing Contracts

     If you have an established supplier, it's quite possible that you

could negotiate favorable pricing and payment terms with them.

For trusted suppliers, it could be beneficial to both them and your company to form a long-term partnership and with that, a special discount for your committed business.

- ### Introduce Competition

  Contrary to the point above, you can also bring on new suppliers to introduce competition for your business.

  Inform your existing suppliers that you're sourcing the same products for cheaper prices and they may extend an offer that can help you create substantial savings.

- ### Switch Suppliers

  Unless you're purchasing a monopolized product (which is rare) there are always alternatives.

  Switching to a cheaper supplier can definitely create savings, but make sure that the quality of their product meets your standards before doing so.

Example: Negotiating a 10% discount with a regular supplier for bulk purchases.

2. ## Purchase Demand Savings

Finding ways to decrease the amount or volume of purchases a company makes is another method to find savings in procurement. There are a couple of options:

- ### Reduce Unnecessary Purchases

  Every company goes through ebbs and flows with consumption of non-essential goods and services.

  Usually these coincide with external economic conditions. Some

areas may have increased purchasing during boom times but those purchases are no longer necessary now.

- **Innovate for Cost Effectiveness**

  Much of innovation is driven by cost. Finding ways to make production cheaper such as innovating low-cost production methods, using alternative materials, or finding a way to reuse byproducts can generate significant savings.

Example: Cancelling a subscription to a software service that you no longer use.

3. Total Cost Savings

The last type of procurement savings comes from reducing the total cost of ownership (TCO), which is all costs associated with acquiring products and services.

Rather than stretching suppliers or reducing demand, this looks at creating internal efficiency throughout the procurement process. Some ways to reduce TCO include:

- **Reduce Cost of Doing Business**

  While purchasing an e-procurement system system adds to the balance sheet in one area, it can create significant overall savings by reducing manual work such as data entry, back-and-forth communication, and paper form approvals.

  It can also decrease the time procurement takes, all of which reduces TCO.

- **Reduce Supply Chain Costs**

  Procurement departments can find TCO savings by implementing efficiency practices such as Kaizen, Kanban and Six Sigma on their supply chain. This is another area where utilizing an e-

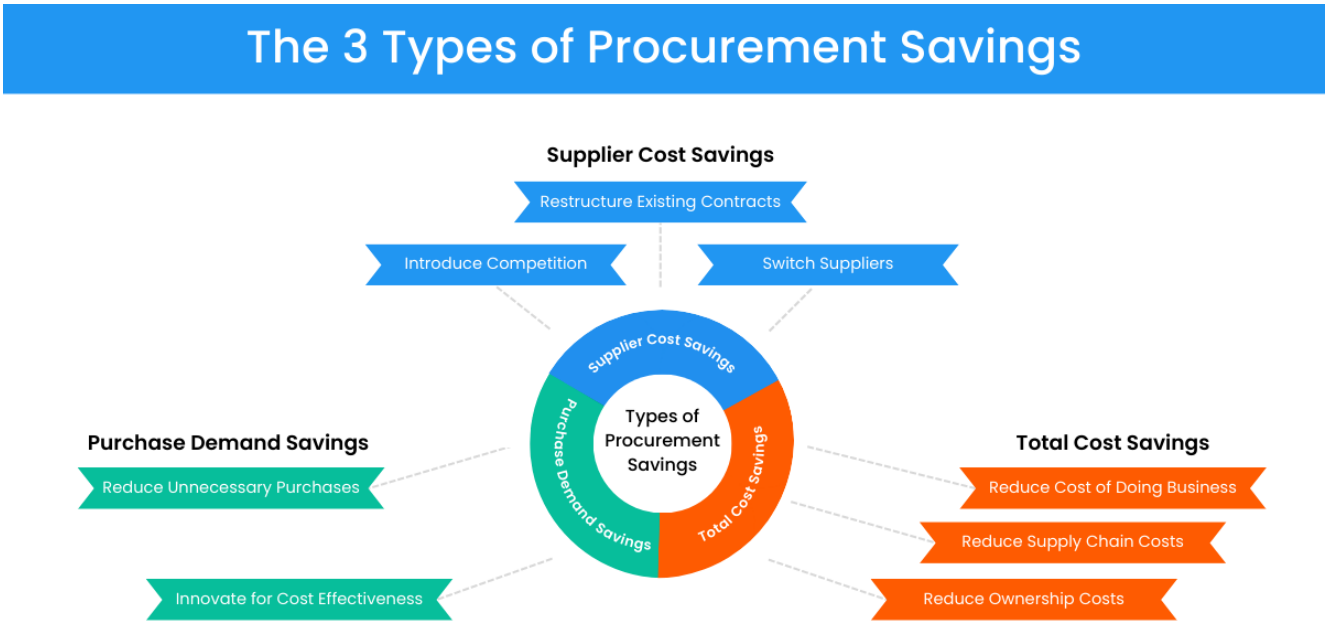
procurement system rather than manual procurement can help.

- **Reduce Ownership Costs**

  Often it’s unnecessary to own a piece of equipment or product outright in order to achieve the production utility it provides.

  Instead, the equipment can be leased, facilities can be shared, or products can be invented instead of purchased. Procurement teams can ask these questions to find cheaper solutions that help reduce TCO.

Example: Decreasing the cost (both in terms of labor and time) to process purchase orders and invoices by switching from using Excel to an automated procurement software system.



What Is the Difference Between Cost Savings and Cost Avoidance?

Procurement teams find savings with two different cost management methods: cost savings and cost avoidance. One type of savings is looking to avoid future costs, and the other is looking to reduce current costs. To be clear:

- ## Cost Savings

  These are “hard savings” that reduce current costs, debts, and spending. An example of this would be negotiating a contract that reduces the price of a regularly purchased item.

- ## Cost Avoidance

  These are measures taken to avoid future costs and are known as “soft savings”. An example could be purchasing an extended warranty on equipment that is likely to need servicing and repairs.

  While the warranty is a cost, the total cost avoided over time is where the savings come in.

How Are Savings Calculated in Procurement?

Procurement teams calculate both cost avoidance and cost savings using a method called realized cost savings.

These are the ‘realized’ procurement cost savings that actually happen after savings initiatives have taken place, and are usually looked at retrospectively after a fiscal year.

There are several ways to calculate realized cost savings from both cost savings and cost avoidance:

- ## Direct Cost Savings

  More common with cost savings initiatives, this is the direct reduction in cost for a product or service.

  For example, if you negotiate a contract that reduces the price of a product by 10% in exchange for bulk purchasing, those savings would fit here.

Indirect Cost Savings

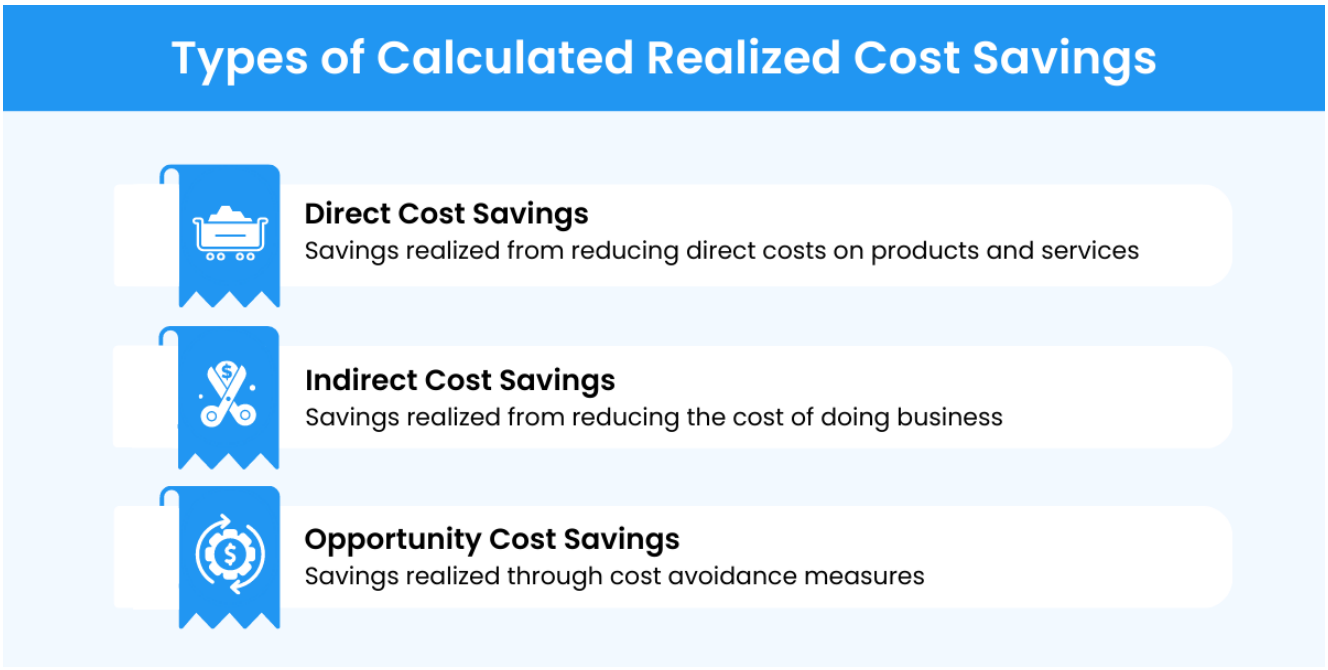
This is savings from reducing the costs of a process or streamlining supply chain activities. It's the time and money saved from doing things faster and more efficiently.

For example, spending 1,000 fewer labor hours processing purchase orders is an indirect cost savings.

Opportunity Cost Savings

This is savings from avoiding additional costs.

For example, if you stop making an unnecessary purchase, switch suppliers because of price increases, or decide not to buy a piece of equipment but lease it instead, those are opportunity cost savings.



An example of a realized cost savings calculation could look like this: Your company spent $30,000 on shipping in the southwest region last year.

Your procurement team negotiates a deal with FedEx to reduce those costs by 15% over the course of the upcoming fiscal year. The identified savings are 15%, or $4,500.

Over the course of the year, your team mostly sticks to using FedEx per the terms

of the negotiated contract. However, some newer team members come on board and aren't trained on this for the first six months of their employment.

At the end of the year, you end up spending $27,000 on shipping, with a realized cost savings of $3,000, which is $1,500 less than what you identified.

While this example shows some success, it also shows how not having a unified, easy-to-use system that everyone shares can make sticking to negotiated contracts more difficult.

Using a system like PLANERGY for managing supplier contracts could have made it easier for this company to realize the full $4,500 cost savings.

How Do You Track Savings in Procurement?

Procurement savings tracking is done via reporting. Procurement teams will use common procurement reports such as spend analysis reports, supply base reports, and contract management reports to track and forecast realized vs identified savings throughout the course of the year.

These reports can help stakeholders steer decision-making in real-time by identifying blind spots that would otherwise go unnoticed until the end-of-year reporting is complete.

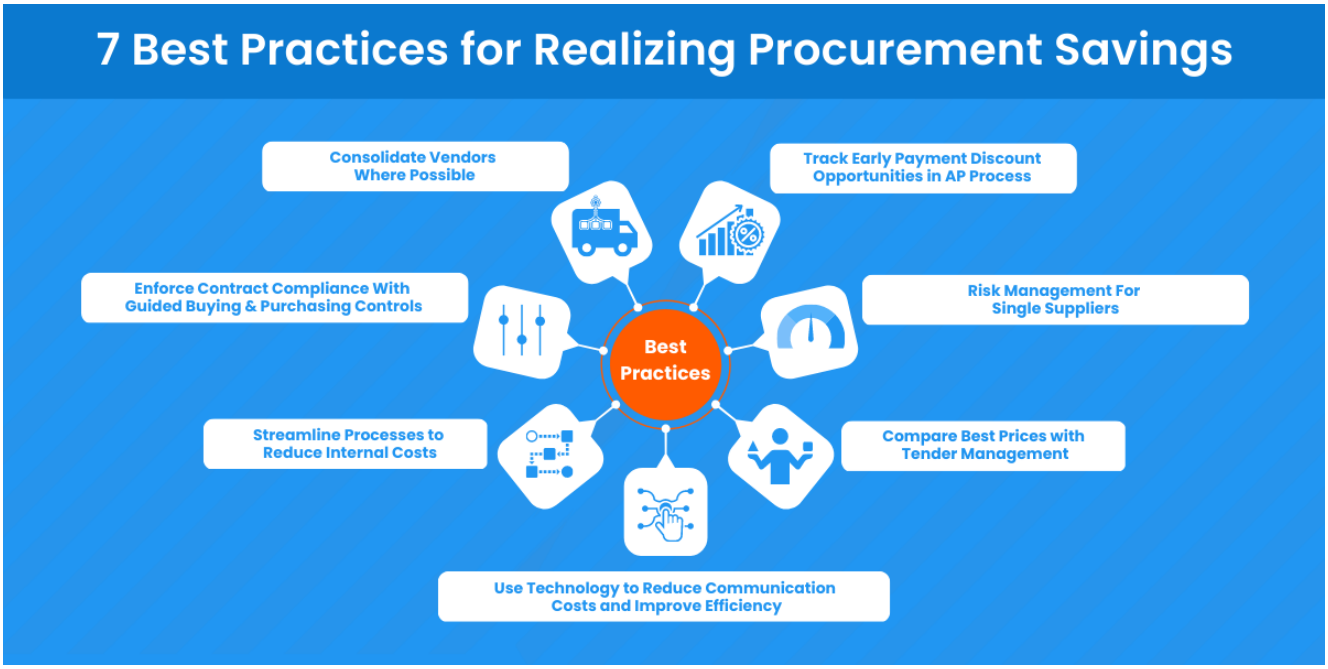
Using an e-procurement system for reporting savings with real-time metrics can help procurement teams achieve their savings goals.

> *Maverick spend can decimate procurement savings. Using an e-procurement system for guided buying and enforcing internal controls can make it next to impossible for maverick spend to occur.*

What Are the Best Practices for Realizing Procurement Savings?

Following best practices can help procurement professionals to maximize realized savings from identified savings opportunities.

There are many best practices to follow, all of which are easier to implement with procurement software as opposed to manual methods. These best practices include the following seven strategies and tips.



Consolidate Vendors Where Possible

Supplier relationship management is critical to maximizing procurement savings. By consolidating the total number of vendors you work with, you can save time and money.

Consolidation often means you can get volume discounts and higher quality goods or services, and because there are fewer suppliers to manage overall, the process becomes more efficient.

Consolidating vendors can also help with cost avoidance. By focusing on ways to reduce the rate of cost increases or negotiating contracts with value-added services—such as extended warranties or free shipping—you avoid future costs and create procurement savings.

Track Early Payment Discount Opportunities in the AP Process

No vendor likes waiting 30 days more to receive payment, and many will offer discounts in exchange for early payment. Set up a system to track

opportunities for early payment discounts—ideally in your e-procurement system—to increase cash flow.

Once your system has those opportunities identified, you can streamline the payment process to maximize these discounts.

You'll need to ensure that your invoice processing system (which can be part of your procure-to-pay software system) is agile and able to fast-track approvals and payments when necessary.

Slow and manual payment systems will cause you to miss out on these opportunities.

Enforce Contract Compliance With Guided Buying and Purchasing Controls

Maverick spend, also known as spend leakage and rouge spend, is when employees make purchases outside of negotiated contracts and preferred suppliers.

This often disregards procurement organization goals and best practices and is made to satisfy immediate needs with no regard for cost, quality, or savings.

Maverick spend can decimate procurement savings, but procurement teams can take action by making it easier to purchase in the right way with a guided buying system.

This system is a catalog of preferred suppliers with contracts in place that teams can choose from to make the purchases they need.

Another way to avoid this cost is to enforce internal purchasing controls. These controls are a set rules for purchasing that include approvals, spending limits, preferred vendor restrictions, and more.

Using an e-procurement system can help you automatically enforce these controls and make it next to impossible for maverick spend to occur.

Supplier Risk Management

One of the biggest risks companies face is supplier dependence. While you should aim to consolidate suppliers and vendors when possible, one of the key ways to manage risk is to ensure procurement doesn't depend too much on any single supplier.

Procurement teams can mitigate this risk by always having a backup supplier available to cover the most important goods and services required to keep operations running smoothly.

Streamline Processes to Reduce Internal Costs

By streamlining processes, you can reduce operational costs. Procurement should work with other departments to define transparent processes. With improved visibility into overall spending and data accuracy, it's easier to reduce transaction costs and failure costs.

Using e-procurement software is one of the easiest and fastest ways to define processes, collaborate with other departments, and reduce internal procurement costs over the long haul.

Compare Best Prices with Tender Management

Tender management is the process of soliciting bids, or tenders, that include competitive pricing, usually done through an RFP or RFQ.

When you provide numerous companies with the opportunity to bid for the work, their bid should include how their company will solve your business problem and provide a competitive price for the work.

Using tenders you can see baseline costs and set benchmarks for what you should be spending. It will help find you the best and most cost-efficient options for getting the supplies you need and help you make the right choice.

- ### Use Technology to Reduce Communication Costs and Improve Efficiency

  Use e-procurement software and other technology so you can communicate faster and more efficiently with your procurement department and suppliers.

  You'll have improved access to supplier catalogs, giving you a better range of product choices that could lead to increased savings.

  Good procurement function management is necessary to ensure your company remains profitable.

  Keeping an eye on procurement savings opportunities and actively reducing costs gives you more freedom in your budget to invest in other ways to help your company grow.

  To realize your procurement savings goals, using the right tools matters. PLANERGY can help you hit your savings target and reduce inefficiencies throughout your procurement process.

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