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# Accelerate Savings in an Economic Downturn? Really?

## A Guide for Procurement Organizations

What's the topmost thought on business executives' and managers' minds when they wake up these days? *Cut spend, increase cost savings, and manage risks* – and do it fast, even in this volatile economic climate.

Consider a company with annual revenues of US\$1 billion. By decreasing external spend by 5%, that company would add US\$28 million to its bottom line.<sup>1</sup> These numbers are significant (see **Figure 1**), and they're a call to procurement organizations to identify additional spend to manage or cut, and to deliver increased cost savings to the business.

### How Can Procurement Organizations Cope with Such a Tall Order?

Now more than ever, procurement and supply organizations need to focus on meeting strategic business goals. They must influence the business change and realignment that current economic conditions require while accounting for market and supply risks. To do this, there is an urgent need to manage spend, costs, and risks across the business (see sidebar on the next page).

#### Cut Spend

Controlling supplier and trade costs directly contributes to retaining and even growing margins. While some costs are difficult to control – for example, fuel surcharges or commodity prices such as corn, wheat, or feedstock – there are still many categories of third-party spend where savings can be achieved:

- In indirect categories – telecom, for example – strategies such as vendor consolidation and internal policy changes based on a spend consolidation exercise could reduce telecom spend by upwards of 10%. To achieve this, companies first need to consolidate spend – not just spend that is contracted with vendors, but also employee

Income Statement	Current (\$ millions)	Decreasing external spend by 5% (\$ millions)	Increasing revenues by 5% (\$ millions)
Revenues	\$1,000	\$1,000	\$1,050
Cost of revenue	\$700	\$677.50	\$735
Gross margin	30%	32%	30%
Selling general and administrative	\$200	\$178	\$210
Operating margin	10%	15%	10%
Operating income	\$100	\$145	\$105
Taxes at 38%	\$38	\$55	\$40
Net income	\$62	\$90	\$65
<b>Change in net income</b>		<b>\$28</b>	<b>\$3</b>
<b>Change in net income %</b>		<b>45%</b>	<b>5%</b>

expenditures submitted for reimbursement. Once spend is consolidated and accurately classified, companies can identify the supply source for telecom services and establish a local, regional, and global telecom policy, as applicable.

- Similarly, in the printing or supplemental staffing categories, establishing standard rate cards, standard skill levels across jobs or projects, and a preferred supplier list are strategies that can evolve out of visibility into intelligent spend and supply information across the company, resulting in spend reductions of 5% to 15%.

#### Increase Cost Savings

Strategies such as sourcing automation – online auctions and bidding, for example, or template-driven sourcing strategies – help bring quick savings; AMR Research estimates an average of between 10% and 15% in hard dollar savings.<sup>2</sup>

However, AMR also estimates that by going beyond a reactionary approach and applying strategic, demand-driven

**FIGURE 1** ▲ The impact of external spend reduction on the bottom line

<sup>1</sup> "Enabling Profitable Growth Through Procurement: Transforming the Sourcing and Procurement Organization," an SAP Insight paper by Vanessa C. Smith, Shruti Goel, and Tushar Gulhane, published by the ASUG/SAP Benchmarking and Best Practices program (2007).

<sup>2</sup> "Supply Management: A Cornerstone of Demand-Driven Transformation," by Mickey North Rizza, AMR Research (Fall 2008).

tactics – for example, applying continuous spend analysis techniques, such as continually refreshing spend data and ensuring that it's consolidated, normalized, and classified for accuracy in order to identify incremental savings opportunities at each refresh – companies typically enjoy an additional 6% average increase in savings by category. Applying effective contract management and compliance techniques helps companies then realize those savings.

### Manage Risks

Companies also can't forget about supply risks, especially when they relate to on-time delivery, quality, and compliance. A common risk across many industries is a single supply source for both critical and noncritical items. What happens to your supply if your only supplier declares bankruptcy or is unable to deliver the goods or services?

To avoid this risk, you first need to proactively identify single-sourced suppliers and establish alternate suppliers or take other mitigative action. You also need to understand global trade complexities (to ensure that selected suppliers are not on a sanctioned list) and the impact of additional trade costs on the overall costs of goods purchased. This involves leveraging international trade policies, as well as optimizing the total landed cost. Reducing supplier prices to effectively decrease company margins and avoid disrupting the supply chain is therefore critical, especially in this economic downturn, where supply risks are mounting.

### How SAP Applications Can Help Make It Happen

SAP delivers integrated applications that can uncover significant savings and contextual insight that helps you:

- Improve sourcing strategies
- Apply project-based and best-practice-based sourcing processes to manage negotiations effectively

## Keys to Success for Procurement Organizations

To cut spend, increase cost savings, and grow margins in a downturn economy, procurement teams must tie spend information to supply risk alerts, trade costs, and demand and supply plans, yet make allowances for discretionary spending. Heads of purchasing must account for cross-business impacts – including budgets, plans, demand details, import costs, trade compliance factors, market trends, and historical spend, price, and supplier performance information – when establishing and executing strategic initiatives. In turn, these initiatives can contain and reduce spend, increase savings, and contribute to the company's financial KPIs while delivering high-quality goods and services to customers on time and at an optimal price.

- Automate time-consuming trade complexity and landed cost calculations to screen and select the right suppliers
- Streamline and automate the contract authoring, management, and compliance process
- Minimize import process costs for a more streamlined procurement process

Solutions from SAP and the SAP BusinessObjects portfolio help drive accurate insights to procurement users, enabling better decisions supported by intelligent information.

With the SAP BusinessObjects Spend Analytics application, you can track and act on opportunities related to top key performance indicators (KPIs), including spend under management, identified and addressable savings, and spend with diversity suppliers, for example. You can directly launch sourcing and procurement initiatives to meet performance goals.

With the SAP BusinessObjects Global Trade Services application, you can automate complex, time-consuming supplier screening processes; reduce the trade complexity, risks, and costs of logistics services; and leverage global trade agreements for compliance and cost benefits. During the operational process of purchasing and receiving, SAP BusinessObjects Global Trade Services helps track compliance with these regulations and keep trade costs in check.

And if you combine these solutions with the SAP E-Sourcing on-demand solution for online bidding and auctions and the SAP Contract Lifecycle Management (SAP CLM) application for authoring contracts and monitoring contract compliance, you can apply best practices for sourcing across your centralized – or decentralized, as needed – sourcing groups.

### Act Quickly Yet Carefully

Many companies are starting to realize the importance of acting now – of implementing and realizing the benefits that SAP solutions offer to access the right data, make the right decisions, and deliver on cost savings and spend containment measures as quickly as possible. The technology does not involve time-consuming deployment efforts; companies are typically able to deploy and use these solutions within a few months or even weeks.

My advice? Conduct some detailed spend analysis to quickly identify and act on savings opportunities. When you start to realize savings, you directly influence your company's bottom line and net income, and you play a strategic role in your company's growth. For more information, please visit [www.sap.com](http://www.sap.com). ■