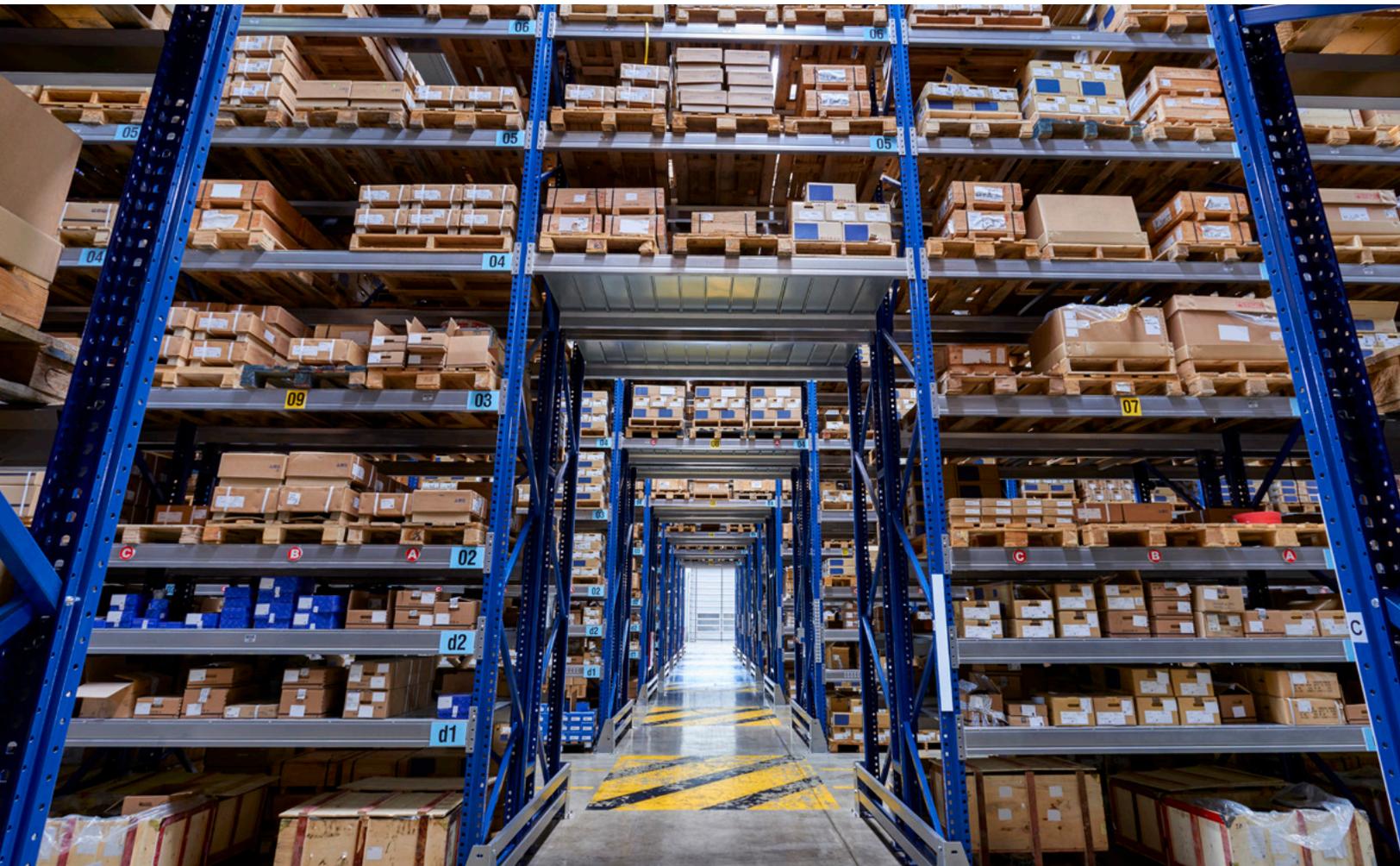


Long tail, big savings: Digital unlocks hidden value in procurement

Until recently, many companies thought it was futile to try to extract savings from the low-volume purchases in “tail spend.” New technologies are changing the equation.

Riccardo Drentin, Mauro Erriquez, Carsten Nee, and Marco Ziegler

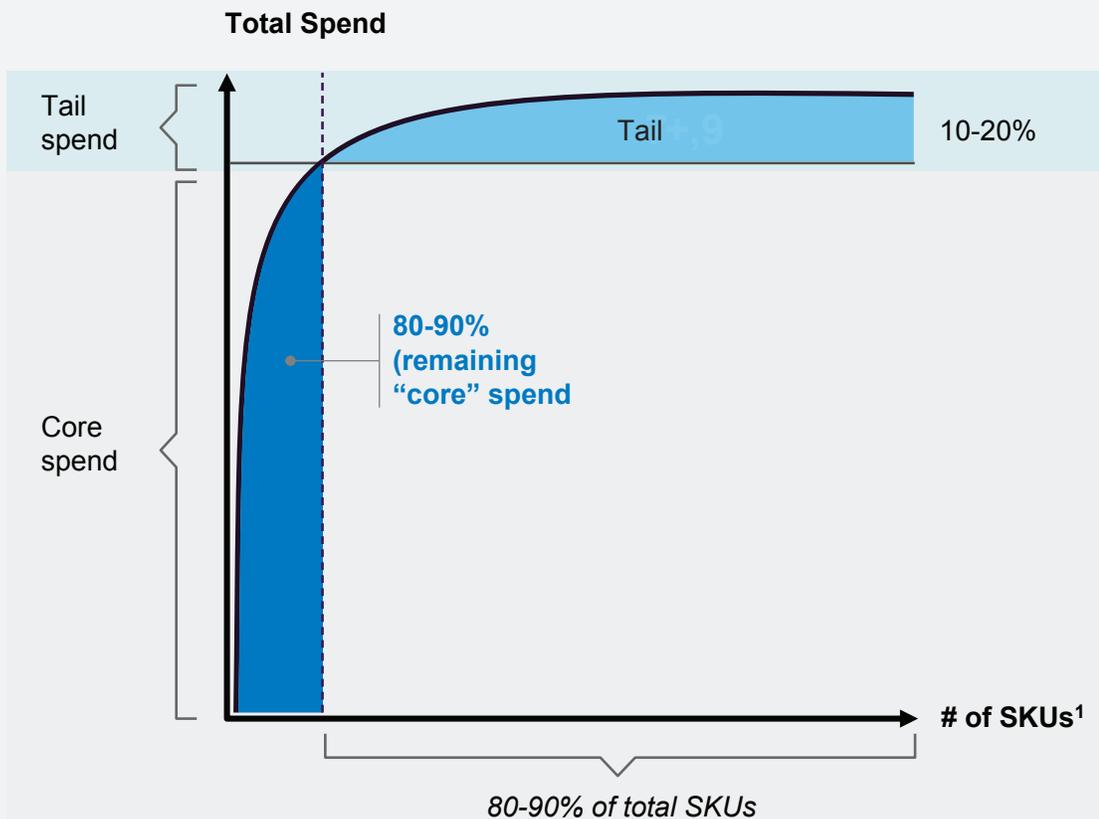


Probably every procurement professional has been asked at least once: how can we more effectively deal with our tail spend? Also called C-material spend, tail spend comprises 80-90% of all purchased items—primarily low-volume and often one-off or infrequent orders that go out to a wide array of suppliers. Despite the vast number of items included in tail spend, it accounts for just the bottom 10-20% of a company’s total spend (Exhibit 1).

Tail spend’s defining characteristics make it intrinsically more complex to handle than traditional categories. Many procurement

professionals therefore conclude that trying to optimize this spend isn’t worth the effort. But that can be an unwise conclusion. Especially in companies that haven’t handled tail spend effectively in the past, managers have an opportunity to achieve 5-15% savings in this spend category. And the harsh fact is that many companies don’t manage tail spend with the same rigor they use for their core spend—such as closely watching sourcing market trends and regularly renegotiating with suppliers for more favorable pricing. Consequently, they’re leaving money on the table.

Exhibit 1 ‘Tail spend’: Together, 80–90% of the items a typical company buys account for only 10–20% of direct spend.



Take a company that has a total direct spend of \$3 billion—\$400 million of which is tail spend with a 5-15% savings potential. By not managing its tail spend to capture those savings, the company misses out on \$40 million.

Wanted: A better way

With the advent of new digital tools and the increasing capabilities of distributors, companies can now manage their tail spend with the same rigor they apply to core spend—though in a decidedly different way. Consider digital tools. Newer web-based platforms that can easily be adapted to companies' individual needs show particular promise. Such platforms support large-scale, electronic requests for information (RFIs) and quotations (RFQs), as well as electronic document management, in ways that weren't previously possible.

These electronic sourcing, or e-sourcing, tools have matured quickly. They now offer a simple user experience that supports faster and broader implementation of sourcing events, such as a fully functional, large-scale tender that can be conducted in only two months. Indeed, one company recently reached about 300 potential suppliers in a single RFQ covering some 3,000 line items, and was able to track incoming bids and resulting savings with just a mouse-click.

Consolidating purchases with a distributor can deliver additional benefits. For a vendor, ensuring availability of a few tail-spend items might not be a priority, leaving the purchaser with few (if any) supply options. Engaging a distributor that can stock hundreds of tail-spend items increases the distributor's share of the vendor's business, creating economies of scale and incentives to find more supply-chain and manufacturing efficiencies. Seeing the opportunity, more distributors have recently begun offering supply of tail-spend items as part of their service strategy.

Accordingly, companies that use digital tools and craft smart distributor strategies not only save money and time on procurement, they also simplify their operations by reducing the number of suppliers they use. The long-term advantages are even greater as they gain valuable insights into their sourcing markets, and strengthen supplier relationships by becoming better partners that are easier to work with.

Digitized tail spend in action

Though the notion of managing tail spend more effectively isn't new in procurement, the means required to do so haven't been available—until now. To see how digital can help companies capture untapped value in their tail spend, we examine important steps in the tail-spend process below.

Preparing product data

Before a company can start the RFQ process, it must be able to tell suppliers and distributors what, precisely, it wants to buy. But because most companies don't manage tail spend closely, little effort has gone into maintaining comprehensive master data on products (with details such as manufacturing and packaging) in centralized enterprise-resource-planning (ERP) systems. In our work across a range of sectors, we found that on average only 20-40% of the data needed to tender is centrally stored and readily available. Instead, such data is scattered throughout the organization, often in non-standardized formats, across business units, manufacturing facilities, or local purchasing departments.

To overcome these limitations and make the rest of the tail-spend process more efficient and effective, companies can use text-mining tools and parsing algorithms that extract product data from all available sources, including local databases, ERP systems, and stored purchase orders and related documents. Use of heuristic rules (such as automatically converting liters into kilograms or

pounds, or translating packaging terms into UN packaging codes) can partly automate the data-check process, and boost data quality by as much as 20-50%. Moreover, by augmenting their human expertise with analytical models, data scientists can fill gaps in the data-check process that digital techniques can't catch, improving data quality by a further 10-30%. Local procurement teams can then draw on their industry and market expertise to provide a final quality check on the data.

Crafting a distributor/supplier strategy

To optimize tail spend, companies must define a sourcing-channel strategy. While many products or services may be sourced through distributors, others may require direct sourcing from the original manufacturer, perhaps because of strict specifications or lack of availability through distributors.

The first step in developing a sourcing-channel strategy is therefore to devise a product-segmentation scheme. In chemicals, for example, differentiating specialty chemicals from traded commodities provides the top-level segmentation. But the details of the segmentation matter, including factors such as distributors' availability, the buyer organization's position in the market, and size and fragmentation of spend. That means gathering a lot more information, some of which will come from the RFI and RFQ processes.

Issuing RFIs

Before a company can request price quotes from prospective vendors, it needs detailed knowledge about the supply market. That means understanding which suppliers or distributors, in which countries, can provide which products of interest at the right prices, quantities, and timing. To get these answers, company naturally issues an RFI.

Today, using a web-based platform to issue an electronic RFI to as many vendors around the

world as possible, a company can quickly build a comprehensive heat map of the supply market. The process often reveals crucial information, such as where high numbers of distributors create more competitive market (Exhibit 2). Procurement professionals can then perform a more targeted vendor search and define target prices. They can also build individualized bid sheets for bidders for the RFQ phase.

Using the knowledge gained from the eRFI tool, buyers can ensure that each bidder's bid sheet includes only those items for which it has confirmed its ability to deliver. The tool creates wins for suppliers, too, by saving them from wasting time responding to RFQs on products they can't deliver within the customer's requirements.

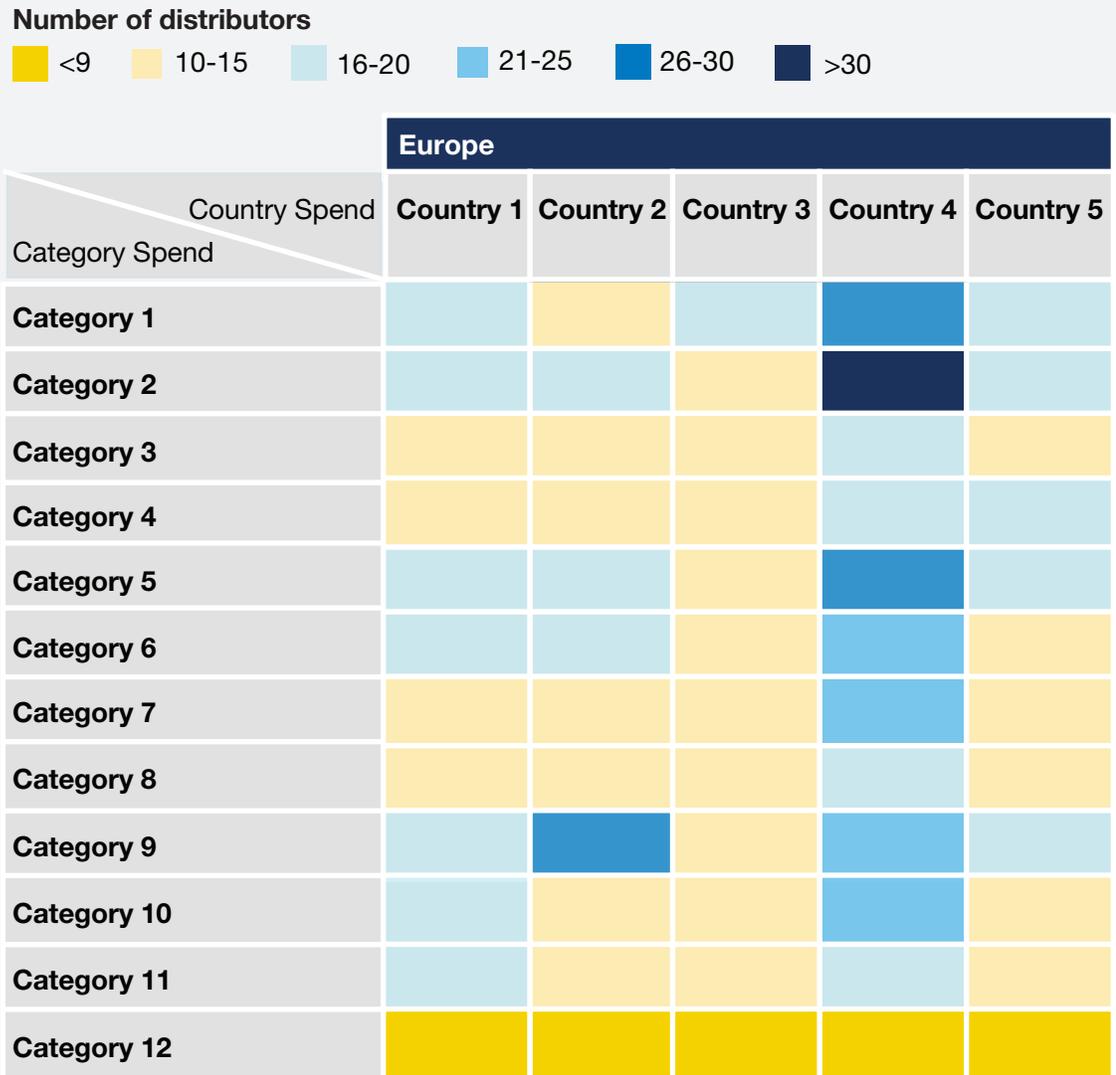
Issuing RFQs

New web-based platforms that enable eRFQs (informed by eRFIs) are ideally suited to tail spend's defining characteristics: huge numbers of products that need quotations, combined with a vast number of bidders seeking to quote. These technologies also make the tendering process easy for initiators and bidders. Neither party has to install new software. Rather, they log onto the platform, as sellers and bidders do with online auctioning.

The entire tendering process is digitized, and takes place in one database. Data-analytics tools enable multiple bidding rounds. After an initial round, bidders can see how their bids compare to a top group of other bidders, and whether their bid is an outlier. In a final round, they receive target prices, which are based on previous bidding behavior. To find the best bidders in the pool, the system's fully automated decision logic draws both on quantitative criteria (such as prices and order quantities) and on qualitative criteria (such as distributor rankings).

Speed constitutes another key advantage of this approach. The online tendering system can

Exhibit 2 A heat map illuminates the supply market



immediately discern who won a particular auction and the number of items they won, while instantly quantifying the tender initiator’s savings. Bidders don’t have to wait to learn the outcome of an auction they took part in, and initiators don’t have to take time comparing numerous different documents.

Both players need only click on a button to get the auction outcomes.

One company had piloted a tail-spend effort by sending out Excel spreadsheets to only three distributors to get quotes. The bidding process was

not transparent, involved emailing information back and forth over multiple months, and didn't result in any savings for the company. With the company's new system, the tail-spend RFQ process now happens in just four weeks and includes several hundred bidders and 25 times as many items. Conducting multiple bidding rounds has led to savings and has enabled the company to consolidate suppliers down to about 50 from several hundred previously.

Managing qualification requirements

Some industries, such as pharmaceuticals and aerospace, are characterized by strict supplier-qualification requirements in order to meet safety and other regulatory standards. Satisfying these requirements takes considerable time and

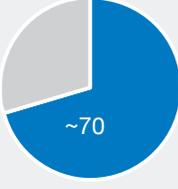
involves complex document gathering, reviews, and hand-offs. The same online tendering platforms that companies can use for eRFIs and eRFQs can sometimes also be used to simplify and fast-track the qualification process (Exhibit 3).

Features such as document exchange can automatically notify winning bidders to upload the necessary qualification documentation. For vendors that aren't yet qualified, companies can combine automated and manual processes to complete qualification for a number of products at once.

Putting it all together

As the company mentioned earlier discovered, the combination of these changes can have a dramatic impact. With the new tools and capabilities delivered

Exhibit 3 **Simpler, faster qualifications are possible for about 75% of line items.**

Scenario	Same producer, same packaging	Same producer, new packaging	New producer, same/new packaging
Qualification effort and implementation level	 <p>Quick Check comparison if material safety data sheet still applies and material indeed is the same</p>	 <p>Fast-track packaging qualification, distributor enters data in online tool</p>	 <p>Full qualification process, digitally prepared with distributor data (prepared data packages containing data sheets, packaging specifications, etc.)</p>
Share of line items covered	 <p>~70</p>	 <p>~5</p>	 <p>~25</p>

across the company's entire network worldwide, procurement teams logged total tail-spend savings of between 5 and 10 percent. Complexity for both the buyers and the supplier base decreased markedly. Meanwhile, data quality improved noticeably, measured by the number of products with insufficient available specification data for tendering purposes.

These achievements laid the groundwork for more automated processing of data collection and tendering in the future. Ultimately, the company digitized its entire sourcing process and achieved unprecedented speed in completing the qualification process.



Tail spend isn't going away. But thanks to advances in digital technologies, companies can now proactively manage the complexities and costs inherent in this spend category. Procurement teams that take advantage of these technologies now will transform what used to be a costly but unavoidable problem into a source of new value for their company. ■

Riccardo Dentin is an associate partner in McKinsey's London office, **Mauro Erriquez** is a partner in the Frankfurt office, **Carsten Nee** is an implementation leader in the Hamburg office, and **Marco Ziegler** is a senior partner in the Zurich office.

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