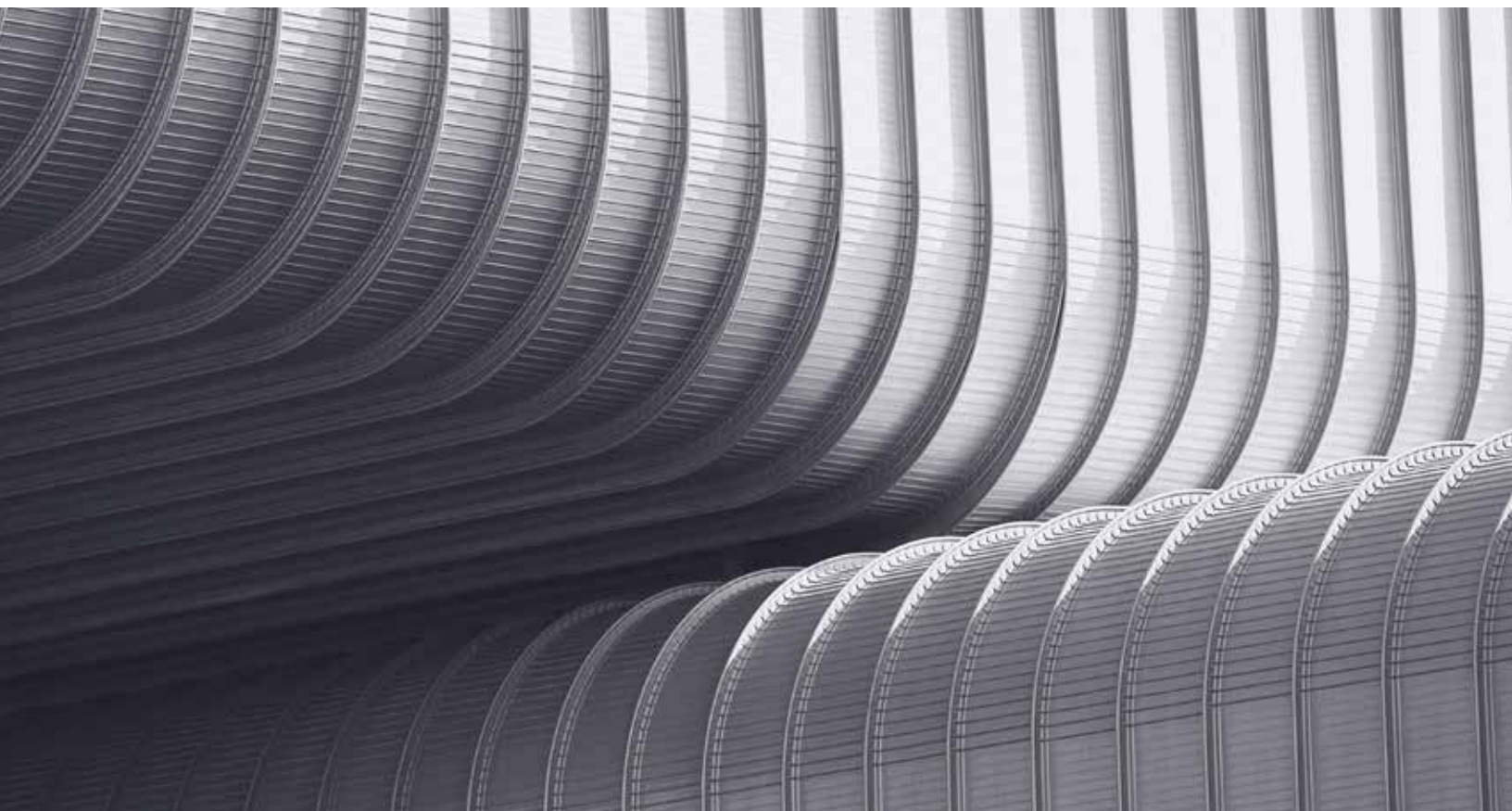# McKinsey & Company

Chemicals Practice

How advanced analytics can optimize tail spend for raw materials

Chemical companies can extract large savings from parts of their procurement budget that are undermanaged. A four-step approach shows how.

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Many chemical companies focus on procurement of their large, strategic raw materials, as it is an integral part of generating profits. At the same time, the bottom 25 percent of a company's spending, otherwise known as the "tail," is often undermanaged and not structurally addressed. The reasons for this undermanagement include a fragmented supplier base, the complexities of a large number of low-value transactions, and lack of data on how this money is being spent (exhibit).

Recent innovations in procurement, such as procurement automation and advanced e-procurement tools, have increased the capabilities of chemical distributors to tackle the tail with the same rigor as raw materials. Significant benefits can be generated quickly if these new capabilities are implemented correctly, including overall cost savings and a consolidated supplier base. Take, for example, a global distributor with a total direct spending of $2 billion (of which $500 million is tail spend). By harnessing the available technologies, this company was able to save 8 percent of its tail spending, or $40 million—money that would otherwise be left on the table.

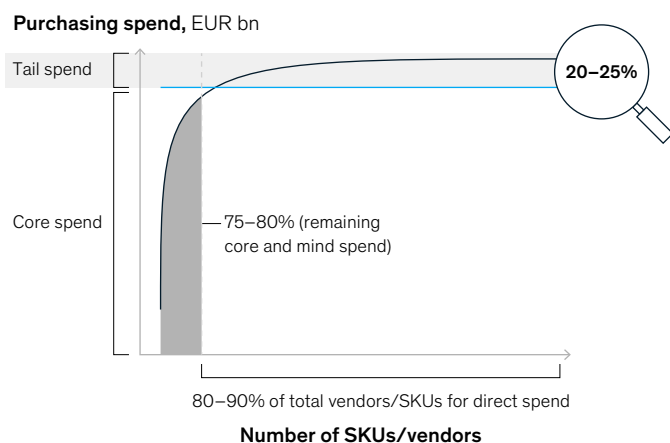Getting this right need not be complicated. The following four-step approach can help:

1 **Collect and prepare the procurement data**
Before a company can start either the request for information (RFI) or request for quotation (RFQ) processes, it must first be able to tell suppliers and distributors what, precisely, it wants to buy. However, it is typical for chemical companies to store this information locally at sites, often in disconnected databases and in nonstandardized formats. As a result, they often don't know what materials to prioritize. In response, companies can use advanced analytics to sort through and filter out the procurement data. Companies can also create neatly collated and uniformly designed documents, which allow for easier classification and categorization and a faster, more efficient RFQ phase. This means that companies will make necessary procurements, saving on costs that would otherwise go unnoticed.

Exhibit

The typical profile of a raw materials procurement budget includes up to 25 percent of tail spending.

Typical tail category spend profile

Purchasing spend, EUR bn

Tail spend

20–25%

Core spend

75–80% (remaining core and mind spend)

80–90% of total vendors/SKUs for direct spend

Number of SKUs/vendors

Typical observations on tail spend

Low order frequency (~20% of SKUs **purchased one-off,** 60% of SKUs with fewer than 5 annual product orders)

For >20% of SKUs received, **no active price change** in long period, despite requests for price increase

Large number of **low-value transactions (90%** of SKUs with average value of product order **<EUR 10–30k)**

Organizations typically not set up to manage such level of complexity

Fragmented, mainly local/regional supplier base **(95%** of suppliers **serve only one region)**

② Carry out the RFI and RFQ

To make the RFQ as effective as possible, the company must better understand which suppliers or distributors, in which countries and locations, can provide which products in the right quantities and at the right times. Therefore, companies can launch an RFI using an e-procurement platform. This platform then consolidates the results and displays heat maps of the supply market that break down the level of competitiveness per segment and per region.

Skipping the RFI and starting directly with an RFQ could result in suppliers being overwhelmed with a massive bid sheet, even if they are only supposed to supply a small share of the portfolio. Therefore, the knowledge gained from the RFI ensures that each bid sheet includes only items that can be delivered.

The RFQ is typically a combination of SKUs and suppliers, principals, and distributors, all of which will be combined based on the findings of the RFI. While the resulting scenario is often a complex allocation matrix, new web-based e-procurement platforms can enable eRFQs, which are ideally suited and able to handle such complexity. Furthermore, the platform can ensure that bidding is fully automated and done in multiple rounds (with supplier feedback and target prices) and that all correspondence is done on a single channel.

③ Analyze the scenario and allocate SKUs

This step is the real game changer. State-of-the-art e-procurement tools can immediately analyze hundreds of replies from suppliers on thousands of items and decide which supplier can and should be awarded a particular item. As a result, the potential tender savings can be instantly quantified. Complex scenario analysis capabilities also allow various awarding scenarios to be run—for example, optimizing the number of suppliers, creating supplier allocation per region, or prioritizing existing vendors or any other decision driver the procurement organization wants to employ. As part of this "awarding" analysis, prices should be checked against the underlying index of materials. For instance, historical order prices can be visualized alongside related indexes as part of the negotiation preparation. This information can then serve as a sanity check to identify savings opportunities as well as provide the buyer with everything required to align the price target.

④ Qualify and implement

Once the tender savings have been quantified and the item allocation is complete, the qualification process can begin. A digital platform can help support and design the qualification plan as well as manage its execution. However, there are a few pitfalls that must be avoided. For instance, a lack of coordination between the tail and other procurement projects, a limited data-driven approach, and limited knowledge of the supplier base. Each of these pitfalls can hinder deployment and jeopardize a "first time right" approach.

Therefore, improving tail spend management through the use of digital tools and advanced analytics requires support from a chief procurement officer. The CPO can help facilitate the qualification and implementation of new items or new suppliers, helping to identify both priorities and cost-effective solutions. If the benefits of qualification outweigh the costs, it should be done. Finally, companies should embrace a "can do" attitude and be willing to try new approaches to deal with low-spend items.

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