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Navigating the Cost Landscape: Indirect Spend Reduction as a Competitive Advantage

SEPTEMBER 2024

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Cost management in uncertain times: A strategic imperative

The economic landscape in 2024 has been tumultuous, with significant layoffs making headlines, including major corporations like Ford, Tesla and Amazon. These measures, indicative of broader economic challenges, highlight the need for companies to enhance their fiscal discipline.

While workforce adjustments are sometimes part of broader strategic changes, it is crucial to explore all avenues of cost optimization. Indirect spend reduction emerges as a strategic alternative that allows companies to manage costs effectively without immediate drastic changes to their workforce structure. By optimizing procurement processes and renegotiating contracts, businesses can achieve significant savings, thus preserving both organizational stability and competitive edge.

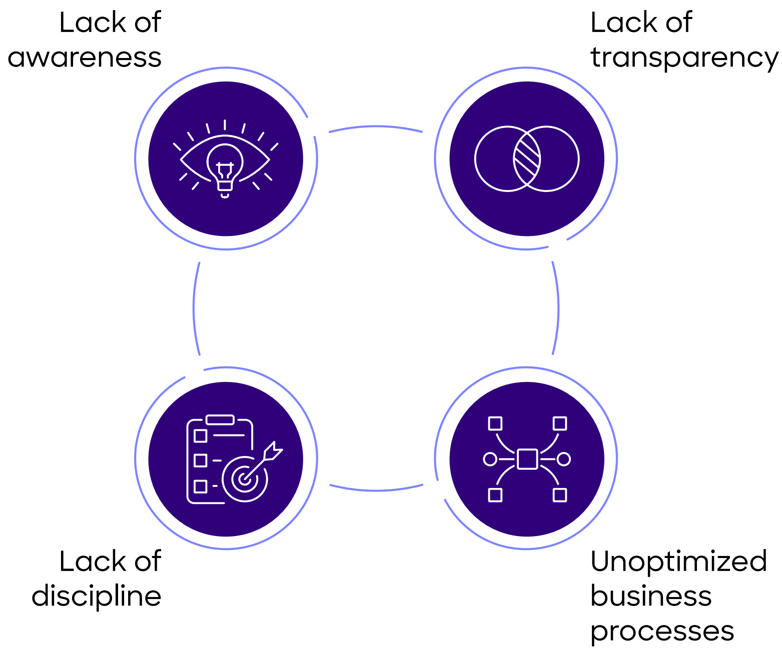
Understanding indirect spend and underlying challenges

Indirect spend refers to expenses incurred for goods and services that are not directly tied to a company's core product outputs. These can range widely, typically including categories such as logistics, IT, professional services, facilities management, utilities, sales and marketing, MRO, packaging, travel and entertainment, etc.

Although often overlooked, indirect spend can represent up to 20% of total revenue. Consequently, even a modest improvement of 10% in managing these costs can yield a substantial impact on profitability—directly improving bottom-line margins by up to 2 percentage points.

Despite the clear advantages of optimizing indirect spend, however, Roland Berger regularly finds that many companies have yet to harness its full potential.

Common reasons why indirect spend is not optimized



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In our experience, the primary challenges are:

Awareness: Indirect spend often receives less attention due to its fragmented nature. Additionally, there is often a lack of awareness regarding effective tools and solutions to control these costs.

Transparency: Many organizations struggle with acquiring standardized, comprehensive data due to siloed systems and inconsistent data collection practices.

"In times of uncertainty, companies revisit their budgetary allocations and reinforce cost discipline to weather economic volatility."

SHANTANU VERMA
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Discipline: Without rigorous procurement policies, companies may experience unchecked spending and miss opportunities to renegotiate with suppliers for better terms.

Business: Inefficiencies often stem from processes designed for convenience rather than cost optimization, along with poor coordination across departments.

A tailored indirect spend program would address these challenges by creating a spend cube, identifying and executing cost reduction initiatives and installing long-lasting processes to sustain savings.

Reflection on indirect spend performance

When addressing indirect spend, it can be beneficial for executive stakeholders to start by gaining perspective and clarity on their businesses' performance in this area through benchmarking. Benchmarks, whether they concern the proportion of indirect spend, category shares, or actual rates obtained, are crucial for identifying areas for improvement. However, executives must appreciate the subtleties of benchmarking in their specific business and industry context. Critical considerations include:

1. ***Accounting practices***
   In the manufacturing sector, logistics costs are often categorized as direct material costs, whereas for utility companies, utility expenses—typically a significant category—are not deemed indirect.

2. ***Business nature***
   Benchmarking at the segment level should reflect industry-specific characteristics. Consumer-facing industries generally allocate more to marketing, whereas manufacturing sectors have substantial MRO expenditures.

3. ***Comparative needs***
   For rate comparisons, an apples-to-apples approach is crucial. For example, logistics rates in the chemical or F&B sectors differ due to specialized transportation needs, while MRO spending in the energy sector often pertains to disaster recovery and tends to be sourced ad hoc at higher rates.

4. ***Hidden costs***
   Identical products or services may incur different rates due to vendor incentive programs, including complimentary services like repairs or shipping, or rebates. A thorough contract review is often necessary to discern these distinctions.

While recognizing the nuances in benchmarking is vital, it is important not to use "company-specific circumstances" as a blanket justification for underperformance. Although a perfect comparison is never possible, the challenges associated with indirect spend are frequently common across many companies. A benchmarking exercise remains a fundamental step to identify issues, and it is the scientific curiosity and rigor in analyzing the results that distinguish top-performing procurement organizations from others.

Engage with experts

Beyond benchmarking, the complexity of addressing indirect spend can also raise a series of imperative questions: Do I, or my direct reports, have clear visibility into the company's indirect spend? Are advanced spend management tools and data readily accessible to us? Is this the right time for a systematic initiative for optimizing indirect spend? How effectively are our procurement and cost control policies enforced?

As companies seek to navigate these complex challenges, partnering with seasoned experts can provide the necessary insights and outside impetus to challenge the status quo and fundamentally optimize indirect spend base. At Roland Berger, we specialize in helping organizations achieve a streamlined, cost-effective approach to indirect spend management. For a deeper dive into how we can assist your company in transforming your cost structures for greater efficiency and competitiveness, please reach out to our experts.

Further reading

→ *HOW DATA-DRIVEN INSIGHTS CAN BOOST RETAIL PROFIT MARGINS*

→ *THE GENERATIVE AI-DRIVEN TRANSFORMATION*

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