The Spending Analysis Benchmark Report
Dissecting a Corporate Epidemic

January 2003

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Table of Contents

3 Executive Summary
3 Preface
4 Methodology
5 Spending Analysis: A Baseline
5 Hurdles to Spending Analysis
7 Emerging “Best Practices” in Spending Analysis
   Extend analyses to cover a broader portion of total spending
   Analyze spending on an enterprise-wide basis
   Classify spending data at a detailed level
   Enhance base spending data with associated business information
   Automate key spending analysis processes
11 Conclusions
12 Featured Sponsors
13 Sponsor Directory
14 About the Authors
   Tim A. Minahan
   Mark W. Vigoroso
15 About the Research Organizations
4 Spending Analysis Basics
8 Spending Analysis: A Real-World Case Study
Executive Summary

With the economy struggling to recover from a global recession, cost control has become the new mantra of business. Struck with a sudden inability to grow revenues, businesses have been forced to develop strategies to rein in costs to maintain profitability.

By now, most companies have exhausted strategies for reducing internal operational costs, and have begun targeting costs in their extended supply chains. And for good reason: spending with external suppliers is the single greatest expense for most enterprises, accounting for half of every dollar earned. The first step to effectively controlling such spending is a thorough analysis of corporate spending patterns.

Spending analysis is the process of aggregating, cleansing, and analyzing corporate spending data for the purposes of reducing costs and improving operational performance. In November 2002, Aberdeen Group and Penton Media’s supply chain group examined the spending analysis processes of 157 enterprises around the globe. The findings of this joint Spending Analysis Benchmarking Project were equally enlightening and disturbing.

This research uncovered the fact that enterprises around the globe have been harboring a dirty little secret. Few businesses truly understand how much they spend, on which products, and with which suppliers. Specifically, while nearly 80% of enterprises surveyed view spending analysis as "very important" or "critical" to their success, only half of businesses currently have a formal spending analysis program. Worse yet, firms with formal spending analysis procedures analyze only about half of their total spending.

Insufficient visibility and analysis of spending information limits a company’s ability to understand spending patterns; maximize buying leverage; execute informed sourcing and supply management decisions; drive continuous improvement in contract compliance and supplier performance; optimize budgeting and planning; and measure the impact of changes in cost, inflation, and other factors.

Such factors leave Aberdeen to estimate that inadequate spending analysis capabilities are costing businesses $260 billion in missed savings opportunities annually. In short, spending analysis is a corporate epidemic that is keeping enterprises from controlling cost maximizing performance.

What’s the cure for this corporate disease? The Aberdeen/Penton Media study identified five "best practices" that are common to the enterprises currently achieving the greatest return from their spending analysis programs:

1. Extend analyses to cover a broader portion of total spending
2. Analyze spending on an enterprise-wide basis
3. Classify spending data at a detailed level
4. Enhance base spending data with associated business information
5. Automate key spending analysis processes

Enterprises deploying spending analysis strategies have been able to reduce total spending by 12%, based on a weighted average.

This report on the Aberdeen/Penton Media Spending Analysis Benchmarking Project examines the factors driving the increased emphasis on spending analysis; benchmarks current spending analysis processes on an industry; geographic, and company-size basis; and identifies procedures for maximizing spending analysis performance.

Preface

As was the case with previous recessions, the initial round of corporate cost cutting strategies have focused on internal operations, including reducing headcount, trimming benefits, and curbing travel. Having exhausted these avenues, companies are now targeting costs in their extended supply chain. It is not difficult to understand why: Spending with external suppliers is the single greatest expense for most enterprises, accounting for half of every dollar earned. And, unlike other functional areas that carry a high overhead cost - such as sales - reductions in procurement costs can yield dollar-for-dollar improvements in the bottom line.

Spending analysis is the process of aggregating, cleansing, classifying, and analyzing corporate spending data for the purposes of reducing costs and improving operational performance.

It may seem obvious, but the first step to effectively controlling corporate spending is a thorough analysis of spending patterns. Spending analysis is the process of aggregating, cleansing,
classifying, and analyzing corporate spending data for the purposes of reducing costs and improving operational performance. (See “Spending Analysis Basics” sidebar for more information.) Enterprises use spending analyses to support a wide range of corporate activities - from strategic sourcing to budgeting and planning.

When executed properly spending analyses can provide the insight necessary to identify spending patterns; maximize buying leverage; execute informed sourcing and supply management decisions; drive continuous improvement in contract compliance and supplier performance; optimize budgeting and planning; and measure the impact of changes in cost, inflation, and other factors. When overlooked or executed on only a cursory or ad hoc basis, spending analysis can result in highly fragmented buying strategies that fail to fully leverage a company’s purchasing power and that result in misguided purchase decisions and missed opportunities for cost savings.

### Spending Analysis Basics

Related research by Aberdeen Group has identified five key processes required for effective spending analysis (see chart):

1. **Extraction**: Ideally, companies need to collect n of 100% of spending information from both internal and external business systems.

2. **Validation**: Prior to classifying or analyzing spending information, companies must ensure that data files are accurate and complete.

3. **Cleansing and classification**: Companies must rationalize and classify spending data elements and attributes, eliminating discrepancies between incongruent naming conventions. For effective analysis, companies must map cleansed spending information to industry-standard classification systems or enterprise-specific taxonomies.

4. **Enhancement**: Detailed spending analysis requires companies to complement cleansed spending data with related business information, including contract terms, alternative parts references, suppliers’ financial status and performance information, etc.

5. **Analysis**: To make effective use of spending information, various employees within the enterprise — from commodity managers to planners to financial managers — must be able to access and analyze this information using advanced reporting and analytical tools.

The ability to execute the above activities on a frequent and repeatable basis is currently a best-in-class capability that can provide a competitive advantage in the market.
Methodology
In November 2002, Aberdeen Group and Penton Media’s supply chain management (SCM) division - TotalSupplyChain.com - surveyed 157 supply chain executives (e.g., manager-level and above) on their company’s spending analysis procedures. The survey was administered online and included questions focused on the following areas:

- The degree to which spending analysis impacts/supports corporate operations
- How spending data is aggregated, cleansed, and analyzed
- The use of automation to aid these activities
- What benefits, if any, have been derived from spending analysis initiatives

The responding sample included the following demographics:

Industry: The research sample included respondents from multiple manufacturing and service industries. The largest single group represented in the sample was from the high-tech (24.6%) sector, followed closely by industrial manufacturing (20.3%). Other sectors ranked in descending order of representation, include financial services, transportation and utilities, retail and distribution, construction and engineering, and government and education.

Title: All respondents were all high-level supply chain executives, including Vice Presidents, Directors, chief officers, and Managers, and of procurement or supply chain operations.

Geography: The study included respondents from every major geographic region. However, over 67% of respondents were from U.S.-based companies. European respondents were a distant second at 14% of the total sample, followed by Asia-Pacific companies, which represented 8% of the sample. Just over 3% of respondents were from companies in the Middle East and Africa. Remaining respondents were from companies based in either Latin America/South America or Canada/Mexico regions.

Size of company: Respondents were split about equally between large enterprises (i.e., revenues above $1 billion); mid-size enterprises (i.e., revenues between $50 million to $1 billion); and small businesses (i.e., revenues of $50 million or less).

Solution providers recognized as sponsors of this report were solicited after the fact and had no influence on the direction of the Spending Analysis Benchmark Project research effort or the content of this report. Their sponsorship has made it possible for Aberdeen Group and Penton Media to make these findings available to readers at no charge.

Spending Analysis: A Baseline

Considering the critical importance of controlling costs in today’s sagging global economy, it is not surprising that nearly 80% of responding supply chain executives view spending analysis as "very important" or "critical" to their organization’s success. Another 13% of supply chain executives view spending analysis as "important." The remaining 5% see spending analysis as "somewhat important." No respondents said spending analysis was not important at all (Figure 1).

What is surprising is that only 51% of enterprises have a formal spending analysis program in place. Although, it should be noted, that even the laggards conduct spending analyses on an ad hoc basis.

Overall, larger firms were more likely to have a formal spending analysis program in place than were smaller firms (Figure 2, next page). The standardization of spending analysis techniques is a likely reason that larger enterprises were able to reduce spending by 16%, on average, through spending analysis versus reductions of 11.8%, on average, for small and mid-size firms.
The chief reasons enterprises execute spending analyses include:

1. Support strategic sourcing projects
2. Identify opportunities for volume aggregation & buying leverage
3. Support corporate budgeting & planning processes
4. Manage supplier performance
5. Drive supplier rationalization efforts

Other business activities supported by spending analysis include improving contract compliance, supporting inventory management strategies; and supporting e-procurement initiatives (Figure 3).

Particularly troubling was the finding that, even firms with formal spending analysis programs currently analyze just 56% of their total spending.

**Inadequate spending analysis capabilities are costing businesses $260 billion in missed savings opportunities.**

These findings lead Aberdeen to conservatively estimate that inadequate spending analysis capabilities are costing businesses $260 billion in missed savings opportunities annually. Faced with such factors it is not hyperbole to describe spending analysis as a corporate epidemic that is keeping enterprises from lowering cost structures and maximizing operational and supply chain performance.

Considering these factors, it is not surprising that 58% of respondents were less than satisfied with their current spending analysis capabilities.

**Hurdles to Spending Analysis**

If spending analysis is so critical, why is it so challenging for most companies? Spending analysis has historically been a time-consuming and labor-intensive process, requiring the consolidation and analysis of data from multiple business systems within and outside the enterprises. Not surprisingly, the typical spending analysis project takes weeks if not months to complete. Nearly half of respondents said that commodity managers are responsible for managing and analyzing spending data. This finding correlates to related Aberdeen research that found that spending analysis activities account for 12% to 15% of the total sourcing cycle and can consume more than a third of a typical commodity manager’s time.

Aberdeen has identified five chief barriers to effective spending analysis:

1. **Disparate data sources:** Spending information exists in multiple business systems within the enterprise, including accounts payable (AP), general ledger (GL), enterprise resource planning (ERP), purchasing, and legacy systems. Critical spending information also resides in systems outside the enterprise, including credit- and procurement-card (P-card) systems, automated clearinghouse (ACH) and bank feeds, and business systems installed at outsource service providers, such as contract manufacturers and logistics providers. Aggregating
data from these disparate systems has historically been a manual and time-consuming process. Even worse, most companies limit collection of spending information to financial data available in internal financial systems (Figure 4). This narrow focus limits visibility into total spending, forcing companies to make procurement and supply management decisions based on partial information.

2. **Inaccurate and incomplete spending data:** The detailed information needed for effective spending analysis is found in unstructured data within ERP and other business systems. This information is often rife with errors or missing critical data fields, such as supplier name, product attributes, or account codes.

3. **Limited category domain expertise:** Correcting spending data errors requires intervention by employees with domain expertise in both products and data attributes. Such expertise varies greatly by employee, resulting in unpredictable results from data validation, cleansing, and classification activities. Complicating matters further is that companies attempting to automate this process often put data cleansing and classification duties in the hands of information technology (IT) professionals who lack a deep understanding of the goods or services that require review. Such assignments often result in misclassification of spending information. In fact, additional research by Aberdeen suggests that as much as 30% of all spending records are either incorrectly categorized, categorized at a level too high to be meaningful, or classified as "miscellaneous," further complicating efforts to analyze and leverage spending.

4. **Incongruent naming conventions:** Multiple part numbers are often assigned to a single product across the enterprise. Similarly, a single vendor is often given different names in different systems (e.g., I.B.M., IBM, International Business Systems, etc.). Organizations often unknowingly conduct business with multiple suppliers that are business units of a single company. Such disparities must be reconciled so that spending information can be classified to a common taxonomy and to a level of detail that is meaningful for analysis. Nearly 65% of responding enterprises use an internally developed schema to classify spending information. Such proprietary schemas make it difficult to integrate and analyze spending information from external sources or from newly acquired entities. Also, it is not uncommon for these proprietary schemas sometimes vary from division to division within a single company.

5. **Limited analytics capabilities:** Over 60% of enterprises sampled still use basic spreadsheet applications as their primary tool for managing and analyzing spending information. This practice limits the breadth and depth of the analyses that can be executed. It also generates inconsistent results across the company because the sophistication of analysis executed varies by the spreadsheet skills of individual buyers.

**Emerging "Best Practices" in Spending Analysis**

The above findings clearly indicate that insufficient spending analysis capabilities is a corporate affliction. However, the Aberdeen/Penton Media study also showed clear evidence of the value of deploying an effective spending analysis strategy. Specifically, the majority of companies with formal spending analysis programs were able to reduce total spending between 1% and 20%. Across the entire sample, spending analysis programs generated a
12% reduction in spending, based on a weighted average. (See side bar for a specific case study.)

The Aberdeen/Penton Media study also identified five "best practices" that were common to the enterprises currently achieving the greatest return from their spending analysis programs:

**Extend analyses to cover a broader portion of total spending**

Enterprises applying spending analysis to more than half their total spending were able to reduce spending by 13.7%, on average. By comparison, respondents applying spending analysis to less than half their spending achieved reductions of 10% or less (Figure 5). The categories of spending most

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**Spending Analysis: A Real-World Case Study**

Company background: Multinational manufacturer of electronic instruments and electric products with annual sales over $1 billion and 45 manufacturing plants worldwide, including 15 operating divisions in the U.S.

Business challenge: Rapid growth through acquisitions, including the purchase of six companies over the past two years, resulted in 15 different enterprise resource planning (ERP) systems as well as thousands of supplier relationships. These factors have made it difficult to implement a common information technology (IT) platform. They have also frustrated the company’s efforts to centralize procurement operations for improved purchasing leverage and process control.

Business goals: Standardize on a common ERP system enterprise-wide and develop strategies to reduce spending and streamline procurement operations.

Improvement strategy: Deploy a commercially available spending analysis automation solution to gain better visibility into spending. Use this information to identify areas for procurement cost savings and supplier and contract performance improvements.

Execution: Aggregated vendor master files and 12-month snapshots of its spend by vendor from every business unit and division. This information was channeled to the solution for data cleansing and categorization to an industry standard taxonomy. The solution provider also "enhanced" this core spending data by assigning the correct parent-child relationships. The manufacturer analyzed this enhanced data using the spending analysis system.

Early results: Although still early in the process, the manufacturer has already been able to achieve significant savings through improved visibility into its spending information.

One specific savings came in the area of small-package delivery. The initial analysis revealed that the manufacturer was spending twice as much on with a major small-package carrier than it originally thought. The analysis also indicated that the manufacturer’s spending with its primary package carrier was increasing incrementally year over year. Armed with this information, the manufacturer decided to negotiate a three-year, national contract with the carrier, instead of separate, short-term contracts for each of its operating units. The move resulted in a 9% rate reduction at a time when freight rates were increasing across the industry.

The manufacturer also used the spending analysis information to target other areas, such as machine tools, where it negotiated a 15% price savings. All told, the manufacturer used the spending analysis to negotiate five new contracts within the first six months, resulting in $2.6 million worth of savings.
commonly analyzed included operational goods and services that are common to all enterprises, including IT equipment, office supplies, professional services, software, office equipment and furniture, MRO goods, IT services, and travel.

As a group, manufacturers applied spending analysis techniques to a larger percentage of spending than non-manufacturing firms. On geographical basis, European firms were the most aggressive in applying spending analysis strategies to a larger portion of total spending. Not surprisingly, European firms were also able to derive the greatest savings from their spending analysis efforts (Figure 6).

Analyze spending on an enterprise-wide basis
Cost reductions generated by spending analysis corresponded directly with the scope of the program across the enterprise. Enterprises that employed spending analysis on an enterprise-wide basis were able to generate nearly twice the reductions in total spending than those that limited spending analyses to the site level (Figure 6).

Classify spending data at a detailed level
Enterprises capable of classifying spending data at a detailed, line-item level were able to gather greater insight into spending and generally realized greater savings from spending analysis than those classifying data merely by high-level spending category or supplier.

Enhance base spending data with associated business information
Companies that complement cleansed spending data with related business information were able to realize a 13.5% savings from spending analysis versus 12.4% for enterprises that did not enhance this data. The most common "enhancement" to core spending data is assigning "parent-child" relationships for each supplier (e.g., recognizing that GE Plastics and GE Commercial Finance are both divisions of the General Electric Company).

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Automate key spending analysis processes
Less than half of enterprises have applied automation tools to the spending analysis process. Overall, enterprises applying automation tools to spending analysis were twice as satisfied with the results of their spending analysis programs than enterprises that continue to execute these activities manually (Figure 8). Likewise, the large majority of enterprises view the use automation as a key strategy for improving their companies’ spending analysis processes and results (Figure 8).

Even so, the majority of spending analysis automation systems used by respondents had been developed in-house (42.1%). These homegrown systems were chiefly built on existing IT infrastructure, specifically basic spreadsheet applications (60%) or data warehouse applications (26.7). Such analytics based solutions still require enterprises to develop other strategies for extracting, cleansing, and categorizing spending data. More than a third of firms said they use the analytics capabilities of commercial ERP systems to support spending analyses. Other commercial systems used for spending analysis duties included e-procurement and e-sourcing systems (19.8%). Only 5% of respondents had wholly outsourced spending analysis capabilities to a third-party consultant.

Figure 9: Top Areas for Spending Analysis Improvement

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<tr>
<th>Area</th>
<th>% of Respondents</th>
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<tr>
<td>Automate Spend Data Collection</td>
<td>67%</td>
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<tr>
<td>Accuracy of Spending Data</td>
<td>58%</td>
</tr>
<tr>
<td>Automate Spend Data Cleansing</td>
<td>53%</td>
</tr>
<tr>
<td>Internal Communication of Spend Analysis Data</td>
<td>51%</td>
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<tr>
<td>Standardize Spend Analysis Company-wide</td>
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Conclusions

The Aberdeen Group/Penton Media Spending Analysis Benchmarking Project provides strong evidence that insufficient spending analysis capabilities are a corporate epidemic. The general lack of insight into spending is sapping corporate profits by keeping enterprises from fully leveraging their purchasing power and from identifying opportunities for cost and performance improvements. All told, poor visibility into and analysis of corporate spending information is costing business $260 billion in missed savings opportunities on an annual basis.

Enterprises that have made the effort to develop sound and formalized spending analysis programs have been able to gain the insight necessary to identify spending patterns; maximize buying leverage; execute informed sourcing and supply management decisions; drive continuous improvement in contract compliance and supplier performance; optimize budgeting and planning; and measure the impact of changes in cost, inflation, and other factors. Such spending-analysis generated improvements typically generate a 1% to 20% in total spending.

In the face of a global recession, companies can ill afford to overlook such opportunities. These factors should make the improvement of spending analysis processes as a vital business strategy both for surviving the current downturn and for gaining a competitive advantage when the economy recovers.
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The Spending Analysis Benchmark Report

Author Profiles

Tim A. Minahan  
Vice President and Managing Director, Supply Chain Research Aberdeen Group, Inc.

Tim Minahan is Vice President of Aberdeen Group’s supply chain management research practice. In this role, Minahan provides analysis and assessment of software and services that automate and streamline procurement, sourcing, and supply chain management operations.

Minahan has published research reports on Total Cost Management (TCM), Best Practices in e-Procurement, e-Sourcing, and Logistics Resource Management (LRM). He has completed survey research on supply chain technology user experiences and solution functionality and is currently benchmarking enterprises’ supplier performance measurement activities and examining future buying intentions for SCM technologies.

A recognized expert on supply chain and technology issues, Minahan has appeared on CNN and ABC News as well as in several business publications. He was recently named one of "50 Pros to Know" in the supply chain management sector by iSource Magazine. Supply Chain Technology News also named him one of the sector’s most influential analysts. Minahan has served as the keynote speaker at the Institute for Supply Management’s (ISM) conference and at several vendor conferences.

Mark W. Vigoroso  
Research Product Manager, e-Business and Enterprise Applications Aberdeen Group, Inc.

As the Research Product Manager in Aberdeen’s e-Business & Enterprise Applications group, Mark Vigoroso spearheads new product development, forges and manages strategic alliances with new and existing partners, and contributes to research in the supply chain management and strategic sourcing arenas.

His current efforts include developing a network of enterprise-facing Web sites geared towards supply chain management and customer relationship management professionals; monitoring and ranking the performance of supply chain technology providers; evaluating and quantifying the penetration of Internet-based sourcing (e-sourcing) technologies within supply chain operations; and tracking the evolution of best practices in e-sourcing.

In May 2002, he launched Aberdeen’s Enterprise Research Alliance (ERA) program, where Aberdeen conducts research on business technology purchasing and usage trends, and delivers findings in partnership with widely recognized trade, business, and industry media firms.

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About the Research Organizations:

Aberdeen Group

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