

The Post-Pandemic Recession Playbook

Protecting Profit Margins During Economic Slowdown



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INTRODUCTION

In the face of a likely post-pandemic recession, business leaders are focused on how to navigate the changing market and manage costs.

During the Great Recession from 2008 to 2012, we helped hundreds of organizations mitigate financial risk by accelerating bottom-line savings during a time where it was challenging to grow top-line revenue. This experience has informed our perspective that companies must embrace new ways of managing spend, and those that do will outperform their peers.

We will look at strategies to think about and manage spend differently, leverage data to ensure you are well-positioned in a volatile market and ultimately mitigate risk to your business as you navigate the “double impact” of recession at the heels of inflation.

WHAT CAN YOU AFFORD TO SPEND?

Recessions require a mindset shift from, “How can I pay less for what I already buy?” to, “How much should I spend, period?” To do this, it is critical to understand the current spending landscape by leveraging data to build a spend cube and appropriately classify spend into relevant categories. Once spend visibility is achieved, it becomes possible to partner with key business stakeholders, closely scrutinize spend and make the important decisions around what is needed from the bottom up. Once you go back to ground zero and determine what you can afford, you can challenge what to buy, including the need, specification and service level. Then, and only then, should you focus on how much to pay for what you’re buying through sourcing and negotiations.

CHALLENGE SPEND & MANAGE DEMAND

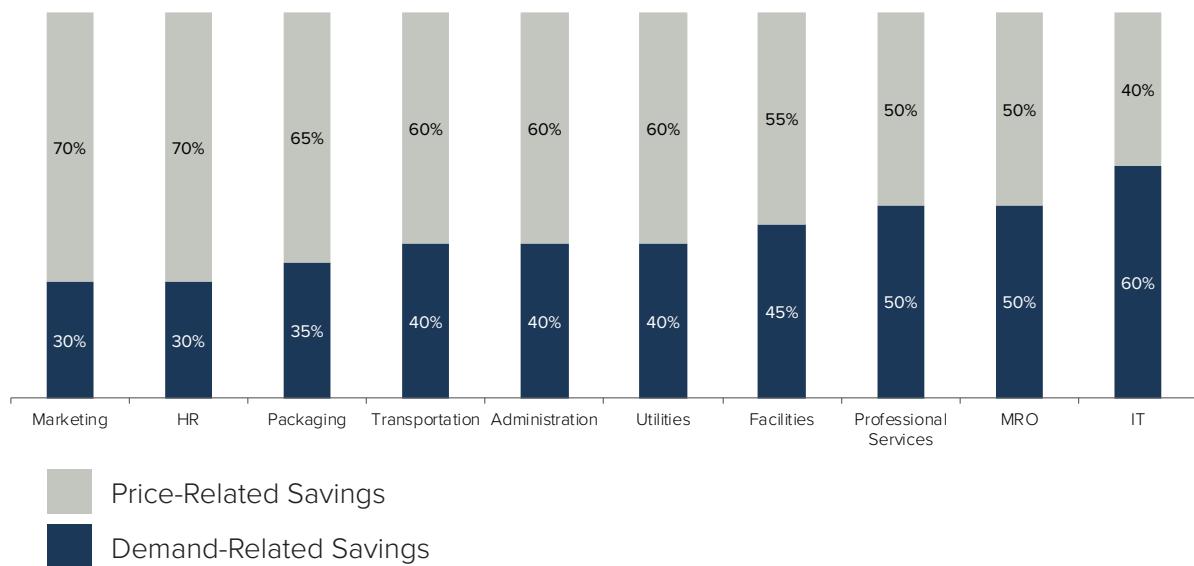
One way to challenge spend is to use **top-down benchmarking** as a tool to determine whether you are overspending in certain areas. Common methods include reviewing your spend categories as a percentage of revenue, per employee, per location, or even per square foot. Once you have estimates, you can compare these ratios both internally and externally to understand what your costs should be. Then, engineer specifications and service levels to meet your cost targets.

EXAMPLE CASE STUDY

We recently benchmarked Facilities Maintenance costs for a manufacturer and found internal cost per square foot (PSF) ranged from \$2.50 to \$3.50, depending on location, while median spend for similar companies was \$2.00 PSF. This became the new cost target for which we developed scopes of services and service frequency.

Demand Management, which includes strategies such as reducing consumption, standardizing or substituting what you buy, or changing what you buy altogether (re-specification), can often drive up to 60% of the value and related cost-out from a spend optimization initiative (Figure 1).

Figure 1. Proportion of Value by Lever and Category



In normal times, it can be challenging to get organizational alignment to make these types of changes; however, in recessionary times when every dollar matters, if analyzed and presented in the right way, there is significantly more openness to change.

EXAMPLE CASE STUDY

For one client with thousands of locations, we examined the number and type of dumpsters used for municipal solid waste disposal across locations and found that 10% of the dumpsters, representing 35% of the total spend, were open top, more typically used for construction debris. We determined that 84% of these locations did not need this style of dumpster based on the waste they produced. In other cases, dumpsters were bigger than necessary based on historic usage patterns. By changing to different dumpsters that better fit the needs, the savings were 20% of total spend. Additional savings were achieved through price negotiations.

USE DATA TO LEVEL THE PLAYING FIELD

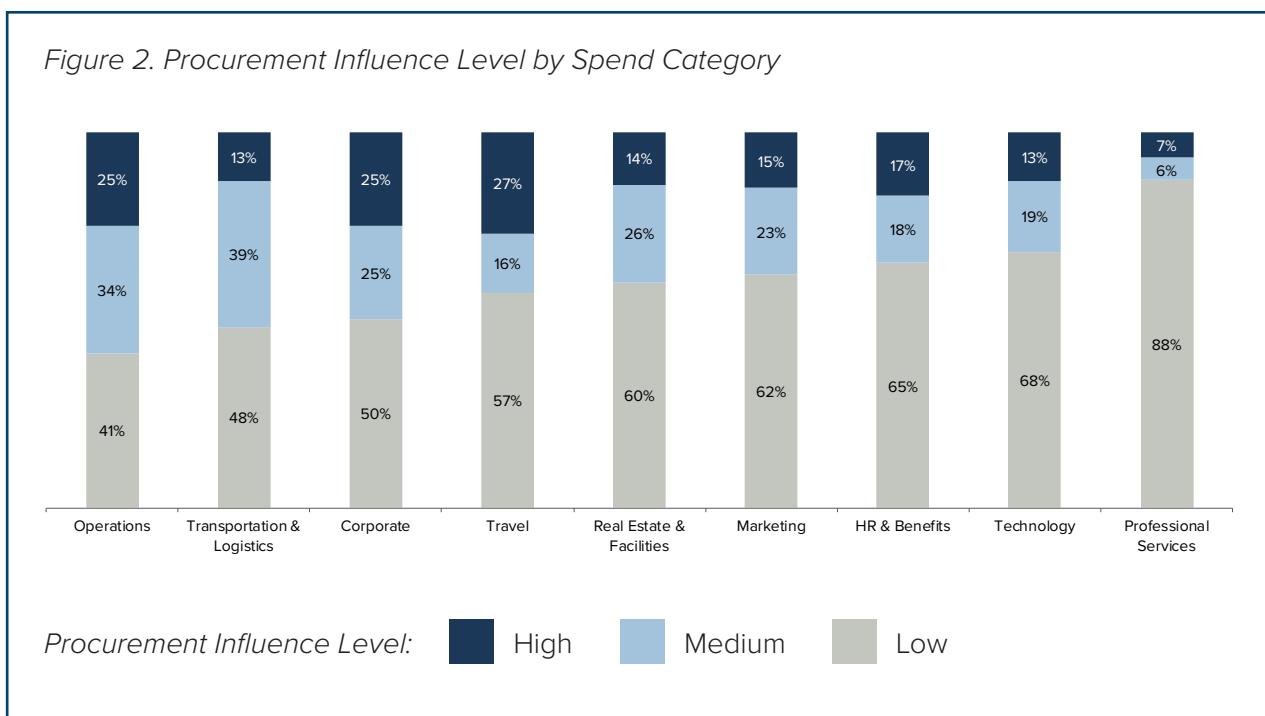
Uncertain conditions and a softening economy create unique opportunities to drive aggressive price-related savings via volume optimization, unbundling, disintermediation, and global sourcing, to name a few levers. Given the unprecedented changing forces of supply and demand in today's economy, it is critical to closely monitor market conditions and dynamics for a given category to determine the best-fit savings levers and sourcing strategies to capture value.

One approach to determining whether you are paying the “right price” is should-cost modeling. Understanding the underlying cost structure within a category and leveraging a “bottom up” approach to determine the should-be price will clearly illuminate savings levers and, as such, allow you to determine the best-fit sourcing strategy to pull those levers. Whether market conditions are changing favorably or unfavorably, this approach allows you to understand:

1. Is your pricing fair? Are adjustments you are receiving from suppliers appropriate?
2. Are there unidentified cost savings in other areas that may not be accounted for?
3. Is there a way to better leverage indices, whether actual or synthetic, that will tie to market fluctuation so that if you see another dip, you get a pass back?

LEAVE NO STONE UNTURNED

On average, **Procurement organizations influence only 30-40% of spend** in a strategic manner, meaning they proactively challenge needs and specifications, and lead supplier negotiations and selection processes (Figure 2). Our analysis shows that procurement typically has the least influence in five areas: Real Estate & Facilities, Marketing, Human Resources, Information Technology, and Professional Services. **In an economic downturn, it becomes essential that business leaders such as CFOs and CEOs partner with procurement leaders to deliver savings in every area possible.** For significant spend reduction opportunities, this especially applies to areas that are traditionally untapped. In fact, based on reports from hundreds of our clients, CFOs who work alongside their procurement officers can dramatically improve their EBITDA through procurement-related optimization, mitigate risk through supplier resiliency, and ultimately achieve a competitive stance in the marketplace.



Successfully penetrating these areas where procurement has historically been on the sideline requires more than a simple RFP process. Instead, it requires a deep understanding of the supply market, best practice cost structures, and analytical expertise. Armed with the right approach, procurement can partner with business leaders to deliver meaningful savings during a time when every dollar matters.

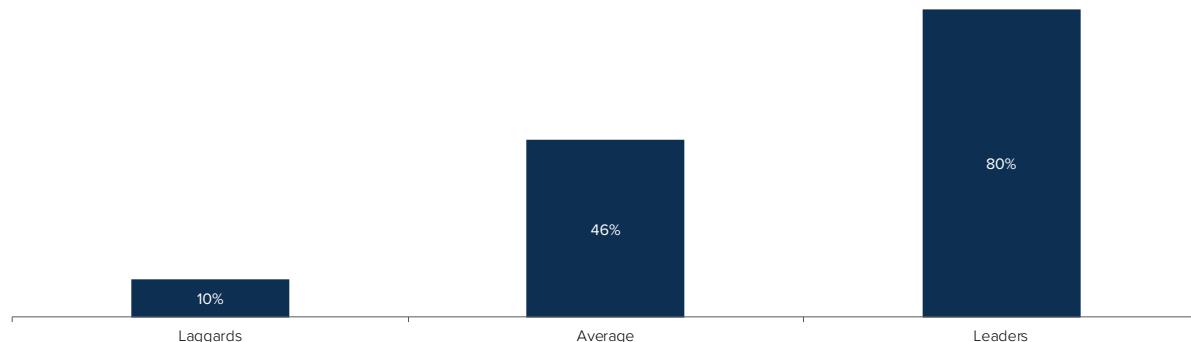
EXAMPLE CASE STUDY

We reduced digital marketing agency spend by over 40% through disaggregating costs, benchmarking fees to market, and the negotiating with agencies using an advantaged fact base. In addition to the massive spend reduction, the company gained much greater transparency into cost structures for labor, technology, and other fees which enabled better spend management over time.

DRIVE QUICK WINS THROUGH COMPLIANCE MANAGEMENT

We regularly see that even where procurement is involved in the pricing and supplier selection process in a spend category, the level of compliance, defined as the proportion of spend with preferred vendors, averages 46% (Figure 3). This leads to significant savings leakage, which cannot be afforded or allowed to occur, especially during a recession. There could be legitimate reasons for this, but assuming qualified suppliers were selected, and requirements were well understood, companies can capture immediate opportunities by effectively driving greater compliance against preferred programs.

Figure 3. Proportion of Spend with Preferred Suppliers



EXAMPLE CASE STUDY

A large manufacturer negotiated supply agreements with key raw material suppliers; however, due to decentralized decision-making, over half the locations were buying materials from non-preferred suppliers and, as a result, less than half of the projected savings were realized. Given the agreements had market competitive pricing, we implemented spend visibility to track compliance and a governance structure and meeting cadence to report out and take action. In six months, compliance improved to over 90%.

Enforcing compliance requires organizational alignment that starts with the C-suite; clarity regarding decision rights; defined roles and responsibilities between procurement and business or functional stakeholders; and a systemic method to track compliance and execute against corrective action plans. This governance structure works together to establish and manage accountability, minimize savings leakage, and ultimately drive meaningful savings results.

CONCLUSION

The bottom line is that while challenging economic conditions create stress on our businesses and the leaders who run them, they also present opportunities for those who are willing to look in hard places and challenge the status quo. For companies bracing for economic downturn, the degree and rigor with which spend is managed will be a key factor in determining how severely impacted they will be by a recession and where they will stand after the fallout. Remember to always start from ground zero before spending, think about cost well beyond the price, leverage data to stay in front of market changes and maintain disciplined spending to ensure maximum savings are achieved.



ABOUT INSIGHT SOURCING GROUP

Insight Sourcing Group is the leading boutique consulting firm in North America focused exclusively on strategic sourcing and procurement-related services.

Founded in 2002, the firm works with senior executives and procurement leaders to accelerate strategic sourcing savings, increase spend visibility, provide ongoing category analytics for savings tracking, and implement procurement best practices.

Insight Sourcing Group has worked with hundreds of corporate clients of all sizes and over 50 private equity firms.

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