Funding Growth and Innovation in the "New Normal":

The Next Generation of Cost Savings

Consumer Products

ICG COMMERCE

AN EXECUTIVE PERSPECTIVE

A recent Consumer Products Executive Advisory Board roundtable discussion centered on the challenge facing today's CEOs, CFOs and other corporate leaders - the challenge of meeting board and investor expectations for simultaneous revenue and margin growth in an improving but still difficult economic environment. Roundtable participants agreed that with consumers more value-focused than ever, top-line growth must come from additional marketing, new product innovation and new market penetration. However, with commodity prices trending higher and putting more pressure on existing margins, these critical activities must be funded by new, incremental cost reduction efforts.

The roundtable highlighted that while new sources of cost savings are critical to funding innovation and growth, many companies have still not tapped a key area of hidden cost. This paper outlines the discussion in greater detail, including the nature of the challenge, considerations for industry leaders and an opportunity for "next generation" cost savings.

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A CHALLENGE, AND OPPORTUNITY, FOR LEADERS

The past eighteen months have been anything but easy. Throughout the economic downturn, consumer products executives were faced with an unprecedented rate and rise in commodity costs, among other economic factors, forcing them to focus heavily on taking costs out of the organization. At the same time, growth has been significantly harder to achieve. Price, volume and market share increases became increasingly elusive, and traditional sources of funding to support critical go-to-market efforts seemed to evaporate as cost containment ruled the day.

Moving now from the dire economic environment of 2008/2009 into the next phase – referred to by pundits as the "new normal" – consumer products executives face continuing pressure to identify new ways to fund innovation, expansion and growth. Although economic conditions seem to have stabilized, operational efficiency and cost reduction are still of paramount importance. Leaders are looking **for the next generation of cost savings.**

"THIS IS AN OPPORTUNITY TO UNCOVER A MARGIN POINT, OR MORE, IN SAVINGS THAT CAN BE REINVESTED TO FUND INNOVATION AND REFUEL THE GROWTH ENGINE."

Dean Hollis,
CP Executive Advisory Board Member

Even after the cost focused efforts of the last 1½ years, there remains an often overlooked and untapped area of opportunity for cost savings within Fortune 1000 CP companies – one which represents this next generation of savings. It is an area many executives believe they have already attacked, but where the anticipated returns have in fact not been fully realized – where the expected savings are neither hitting the bottom line, nor being reinvested into other growth-focused efforts. This opportunity area can yield as much as a margin point, or more, of savings – a figure which any corporate leader would acknowledge as materially significant. This paper details the opportunity.

A HIDDEN AREA OF COST

In the drive for cost reductions to date, management has gone down the list of obvious cost cutting strategies – plant closings, employee layoffs, benefit reductions, brand rationalization, and so on. Many leaders would say they've exhausted the possibilities for significant savings, and are concerned that more of these traditional cost reductions would jeopardize the long-term success of the business. Yet, in many organizations, there remains an area of potential savings which, for a variety of reasons, has been overlooked.

Under the Radar

This area of hidden cost is missed because much of it sits "under the radar", a few layers down from the executive suite, and is highly fragmented across business units, geographies, plants, and other budget areas. Many organizations don't look at these costs together **as a whole**, and therefore do not fully appreciate the magnitude. Finding this savings opportunity requires the attention and sponsorship of senior leadership, who are in a position to foster the right view, see the full magnitude, and lead to the necessary solution.

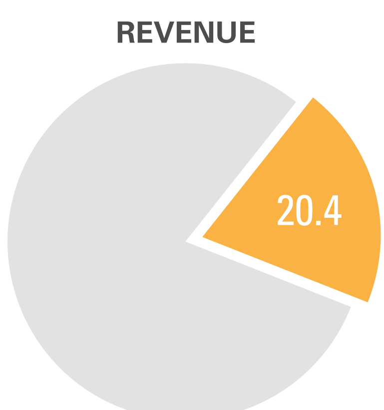
What is this area of "hidden cost"?

Non-core spend. In most consumer products organizations, non-core spend represents upwards of **twenty percent of revenue.*** Positively impacting just one percent of this spend can unlock millions of dollars in capital for reinvestment into the business, and the greater the level of spend addressed the greater the returns. Non-core spend includes all purchases that are not core to the finished product. In addition to traditional areas of indirect expense, marketing services is another large spend area, and one increasingly included in spend management initiatives. A view to the major categories of non-core spend is provided below:

"MOST COMPANIES DON'T LOOK ACROSS THE FULL SPECTRUM OF NON-CORE COSTS IN THE AGGREGATE, AND SO DON'T SEE THE MAGNITUDE OF THE OPPORTUNITY."

Daryl Brewster,
CP Executive Advisory
Board Member

20.4% of CPG company revenues go to non-core* purchases



* Non-core spend sometimes is referred to as "indirect" or "not for sale-related" spend.

- 20% Logistics
- 17% Marketing Services
- 15% Secondary Packaging
- 10% Accounting/Audit/Tax Services
- 9% IT/Telecom
- 9% Professional/Corporate Services
- 6% Plant/Facility Services
- 5% Utilities
- 4% MRO
- 2% Travel
- 1% Industrial Chemicals/Gases
- 1% Administrative Supplies
- 1% Other

Major categories of Non-Core Spending are detailed below

Below is a sampling of the subcategories within each of the major categories of non-core spend. There are hundreds of subcategories in the aggregate, with savings opportunities hidden across the board in many companies.

Logisitics	Marketing Services & Supplies	Professional & Corporate Services
Over the Road (Truckload/LTL)	Ad/PR Agency	Legal
Small Parcel	Direct/Web/Social Media	Tax/Audit
Air Freight/Forwarding	Market Research/Data	Consulting
Ocean/Vessel Charter	Trade Show/Exhibit Furnishings	Employee Benefits
3PL/Warehousing	Media Buying Services	Recruiting/Relocation
Freight Payment	Print/Fulfillment	Contingent Labor
	Promotional Displays	Corporate Travel/Meetings

IT/Telecom	Secondary Packaging/Chemicals	MRO/Facilities
Hardware	Corrugated/Linerboard	Electrical/Electronic
Storage	Poly Films/Bags	General Industrial
Software	Folding Cartons	Cutting Tools/Tooling
IT Outsourcing	Chemicals	Safety
Help Desk		Pumps/Hydraulics/PVF
Data Center		Waste Management
Long Distance Voicedata		Janitorial
Wireless Services		HVAC/Elec./Mech.
Application Development		Catering/Cafeteria
		Construction

WHY IT'S SO DIFFICULT

Finding and addressing non-core spend comprehensively across a large, complex organization is challenging because...

1. It is highly fragmented across the enterprise
2. It covers so many different and unique buying categories
3. Line of business owners for select categories and associated budgets often resist efforts to apply a standardized sourcing and procurement process to their areas -- either based on past practice or because their internal procurement organizations don't have the specialized functional expertise required to satisfactorily support them.

Building the necessary levels of expertise – procurement expertise combined with specialization in all of the major categories/functional areas – is almost impossible to do internally. The resources required to properly support it amount to more than a company can rationalize for a non-core area of the business.

Past Efforts Have Fallen Short

"EXECUTIVES ARE FRUSTRATED WHEN EXPECTED RETURNS FROM COST SAVING INITIATIVES DON'T MATERIALIZE."

Manly Molpus,
CP Executive Advisory Board Member

Many executives have recognized that these hidden costs exist, and have sponsored efforts - such as consulting or technology initiatives, or internal organizational restructuring - intended to drive efficiencies across procurement. They have approved business cases outlining the anticipated gains from such approaches, and followed the progress of the work, but many still find themselves wondering why the expected cost improvements are not materializing.

Savings from these efforts were quantified, identified and even applied to forecasts, but are not in fact being fully realized. Why? Because these types of efforts often only address one area or another but do not cover the full end-to-end procurement process completely. For example, technology solutions can enable an improved process, but without the right sourcing/category expertise and broad supply market insight, sourcing results will fall short. Consulting solutions generally address the front-end of a program, but fall short on sustaining/expanding savings year over year. Without proper expertise, oversight and ongoing hands-on management, there is savings leakage throughout the process - the extent of which can significantly reduce actual realized savings.

THE DIFFERENCE BETWEEN AVERAGE AND WORLD-CLASS SPEND MANAGEMENT

An analysis of non-core spend across top consumer products companies yielded the following comparison, showing that those excelling at managing non-core spend are achieving savings levels five times greater than the average – or the equivalent of a margin point for a $10B consumer products company.

The greatest disparities between average and world-class companies are in

1. The level of **spend managed**, with companies on average managing 51% of non-core spend while world-class companies are managing over 90%.

2. the level of **savings realized** (actual savings at the point of invoice) – with companies on average realizing 61% of anticipated savings while world-class companies approach 90% realization of anticipated savings.

Two other areas – **optimizing sourcing results** and **driving continuous improvement** year over year – contribute additional savings in world-class environments as well.

A Margin Point of Savings

	AVERAGE		WORLD-CLASS	
	Benchmark	**Impact on $2B of annual spend***	**Benchmark**	**Impact on $2B of annual spend***
Spend Managed	51%	$1,040 MM	93%	$1,897 MM
Sourcing Results	7.7%	$80 MM	12.8%	$242 MM
Savings Realized	61%	$49 MM	89%	$215 MM
Continuous Improvement	0.5%	$5 MM	3%	$57 MM
Bottom-line impact		**$54 MM**		**$272 MM**

* Calculations against base of $2.04B

5 times greater savings

Four Key Levers to Maximizing Savings

Maximizing returns from non-core spend management revolves around the following key levers. Most consumer products companies are under-performing on two or more of these levers, and therefore achieving only a fraction of their potential for cost reduction.

Spend Managed

Best Practice 93%
Average 51%

Most companies have not amassed the full magnitude of non-core spend under central management – and **many are addressing only 50%** or less with the required combination of category expertise, supply market intelligence and sourcing rigor. They may focus on only a short list of categories, versus bringing together all non-core categories for maximum impact. Or they may exempt certain geographies or lines of business from a program, thereby missing significant savings. One other key reason for sub-optimized results is a **lack of sufficient resources and buying category expertise**. Consumer Products companies are increasingly reallocating internal procurement resources to critical, strategic areas of their business, such as direct materials. Resources against non-core are kept flat, or decreased. Hence, in-house teams focused on non-core are disadvantaged because they rely upon a small number of generalists working across multiple categories. It is difficult for these small teams to build the requisite category expertise and provide high service levels to varied stakeholders across the organization.

Sourcing Results

Best Practice 12.8%
Average 7.7%

On average, most companies are **only achieving 65% of the potential savings from their strategic sourcing efforts**, because their negotiating power is constrained. Many rely upon internal volume aggregation, and have sourcing resources that are not "in market" often enough to build the supply market intelligence needed to maximize negotiating power. Internal procurement departments generally source a particular buying category only once every 2-3 years, versus multiple times per year and may miss real-time market adjustments that could yield interim savings.

Savings Realized

Best Practice 90%
Average 60%

One of the most significant areas of missed opportunity is that of realized savings – that is, savings that actually achieved at the point of invoicing. Most companies are **only realizing 60% of the savings identified in the sourcing process, while 40% of these identified savings never hit the bottom-line**. This is because true "savings realization" requires compliance from thousands of end users as well as suppliers, along with a comprehensive, formalized tracking process to ensure that the savings are captured. Even after implementing new technology or consulting efforts, most companies find that there is still oversight and attention required to avoid savings leakage. Prices may not be adjusted correctly based on the terms agreed. A large portion of expenditures may never go to the preferred supplier. For non-core spend, most companies don't have the resources to monitor compliance or to audit pricing, let alone work with suppliers to drive continuous cost improvements. Most categories are sourced and forgotten. The savings never materialize or quickly erode.

Continuous Improvement

Best Practice 3%
Average .5%

Maximizing sourcing results requires continually re-evaluating the procurement process and suppliers to identify opportunities for improved negotiation and leverage. Because most categories are sourced and forgotten, companies often forgo 2-3% of additional savings (on total spend managed) that comes from a rigorous and ongoing continuous improvement process.

Achieving World-Class Non-Core Spend Management

Organizations looking to address the challenges outlined in this paper, and get to world-class management of non-core spend, have several options including:

Build In-House: companies choosing an internal solution for non-core procurement often hire 3rd party consultants to execute a sourcing program. Or they will implement a new technology solution expecting that the technology will solve the problem. Or a combination of the two. The internal procurement organization is typically not built out, but kept very lean. This approach can be quite costly. In addition, once the new suppliers have been selected, and technology installed, the company is still left with the same challenge – how to effectively manage thousands of buyers and suppliers and ensure savings make it to the bottom line, and identify continuous improvement areas all along the way. This requires a level of supply market intelligence and procurement specialization which is difficult to build internally, and usually cost prohibitive.

In-house Combined With Some Outsourcing/Offshoring: this option is similar to in-house build above, except that transactional aspects of the procurement process (such as purchase order and invoice processing) are turned over to less costly offshore resources. This solution largely serves to reduce procurement-related labor costs but does not provide the fundamental expertise required to continuously manage individual spend categories.

Procurement Business Process Outsourcing: this option enables companies to put the needed focus and expertise on the problem, to drive maximum savings from non-core areas of the business, but without having to build the requisite knowledge and capabilities internally. In the right model, this is done at a cost that is fully offset by the savings achieved, and yields substantive ROI as well. Companies selecting procurement outsourcing have recognized the challenges associated with in-house approaches and instead chosen to leverage a third party provider's infrastructure to achieve world-class management of non-core spend. Procurement BPO providers have invested heavily in building and continually innovating solutions that would be difficult, if not impossible, to replicate internally. These solutions are designed to optimize each of the four key levers described on page 7.

Internal vs Outsourced Procurement

Value Levers	Key Drivers	Internal Approach	Outsourced Approach
Spend Managed	Specialized Expertise	**10-20** sourcing generalists	**250+** specialists
Sourcing Results	Negotiating Power	Categories sourced **once** every 2-3 years	Categories sourced **10-15** times a year across multiple companies and industries
Savings Realized	Integrated Process	**Disconnected** sourcing and buying Savings **claimed** before spending	**Integrated** source-to-pay operation Savings are **guaranteed** and calculated post spending
Continuous Improvement	Visibility and Ownership	No real-time visibility; little post sourcing attention	Dedicated specialists armed with spend, savings, and market intelligence.

The First Step

In order to determine the best approach for your business, the first step is to complete a comprehensive spend assessment to estimate the potential savings opportunity. Critical in this assessment is access to and comparison of company-specific cost data against current and accurate supply market data. Obtaining accurate supply market data is the biggest challenge for any individual organization, but 3rd parties specializing in procurement will have extensive supply market data and offer spend assessment services.

As we move through the "new normal", companies that have successfully tapped their non-core spend and captured the hidden savings will be better positioned to fund innovation, expansion and growth. Procurement Business Process Outsourcing offers companies a proven solution to drive the next generation of cost savings to fund and support these critical business initiatives.

To request a comprehensive spend assessment for your organization, or for additional information on how consumer products companies are improving non-core spend management through Procurement Outsourcing, please call **877-935-4242** or go to **www.icgcommerce.com/consumerproducts**

ABOUT ICG COMMERCE

ICG Commerce, the procurement outsourcing specialist, is driving a fundamental change in the way today's businesses achieve financial agility and fund growth. ICG Commerce is the only procurement outsourcing specialist with superior market intelligence integrated into an operational approach, resulting in hundreds of millions of dollars in realized savings.

In its work to date with a growing list of consumer products companies, ICG Commerce has done extensive analysis of spending patterns and identified significant opportunities for savings - even within companies that have leveraged sourcing consultancies and implemented technology to address this area.

The ICG Commerce Executive Advisory Board for Consumer Products includes current and former executives from leading industry companies and associations. The board helps to guide ICG Commerce's ongoing efforts to deliver solutions specifically designed to help consumer products companies better manage outside spending and optimize cost reduction opportunities.

ICG Commerce is a privately held company and a member of Internet Capital Group's (Nasdaq: ICGE) network of partner companies. The company has earned recognition from Forbes, Fortune, The International Association of Outsourcing Professionals (IAOP) and numerous industry analysts for its leadership in procurement outsourcing.

FOR MORE INFORMATION

To learn more about ICG Commerce's innovative Procurement Outsourcing offering for consumer products organizations, please call **877-935-4242** or visit us on the web at **www.icgcommerce.com/consumerproducts**

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