MANAGING THE “LONG TAIL”:

How Focusing on Tail Spend Management Can Directly Impact a Firm’s Bottom Line

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Introduction: The “80/20 Rule”

The “80/20 Rule” is something that we see repeatedly in our business and personal lives. It is simply an accepted “rule of thumb”—a shortcut that helps us manage our affairs and focus our energies. It is rooted in the ideas of Vilfredo Pareto, a trailblazing Italian economist noted for being one of the first people to analyze economic problems using mathematics. In the late 1800s, he observed that 80% of the land in Italy was owned by 20% of the population, then later, while gardening, he observed that 20% of the peapods in his garden yielded 80% of the peas that could be harvested. Thus, Pareto combined what he found in society and in nature to form what became known as Pareto’s Law, now known as the 80/20 rule. In a nutshell, this axiom holds that that 80% of outcomes can be attributed to 20% of the causes for a given event.

Quality guru Joseph Juran was the first to apply the 80/20 rule to organizations in what he termed the principle of the “vital few and trivial many”. Juran postulated that 20% of tasks (and people) are always responsible for 80% of the results and that, in terms of quality, 20% of the defects cause 80% of problems. Thus, by focusing on the “vital few” (the critical 20%) rather than the “trivial many” (the remaining 80%), one could get far more accomplished. (Narula, 2011) Today, we have come to see the 80/20 rule as applying across a whole host of situations as a rule of thumb for business. (Koch, 1999) Indeed, in the majority of instances, we see that across companies large and small, approximately:

- 80% of sales come from 20% of clients
- 80% of complaints come from 20% of customers
- 80% of profits come from 20% of the time spent
- 80% of warehouse space is used by just 20% of stock
- 80% of sales come from 20% of products
- 80% of sales are made by 20% of sales staff
Likewise, the 80/20 rule applies in many aspects of our lives. For example, in health care, we see that 20% of patients consume 80% of all medical resources and comprise 80% of the spending. In the area of criminal justice, just 20% of criminals commit 80% of all crimes. And personally, we see the 80/20 rule at work in our own lives in that for most of us, 20% of our efforts generate 80% of our results.

**Procurement’s “Useful Many”**

So how does the 80/20 rule apply in corporate procurement? Today, we have come to regard the procurement function as having a more strategic position than ever before in organizations, fulfilling a vital link in the management of the firm’s value chain. We have come to rely more than ever on the concept of strategic sourcing and partnering with key suppliers and in turn, positioning our own firms to be key partners with our most important customers. Thus, we see the 80/20 rule at work with the focus and concentration on the “vital few” of our supply base.

While it’s true that valuing relationships and partnering the 20% of suppliers who comprise 80% of procurement spending is important, today there is an increasing realization that there are vast gains to be made in overall procurement efficiencies from a renewed focus on the “trivial many”. In truth, later in his life, Joseph Juran rephrased his axiom to be “the vital few and the useful many,” in order to signal that the remaining 80% should not be disregarded and ignored in looking for improvement. (Phillips-Donaldson, 2004)

Thus today, there is a focus on the “long tail” of a company’s spending—the 20% of procurement spread-out amongst the remaining 80% of an organization’s total supply base, potentially the “useful many”. That is what is now known as “tail spend,” and today, companies of all sizes around the globe are recognizing that both the opportunities and challenges for better managing the “tail” of their purchasing is great. Through addressing their tail spend, companies have found an opportunity to:

- Maximize savings and minimize the total cost of procurement.
- Coordinate and aggregate purchases across the organization.
- Cut-down on maverick and “off-contract” spending.

Companies that better manage their tail spend will find that such efforts can have a direct impact on the firm’s bottom line. This is the focus of this white paper, which spotlights what tail spend is and why it is so important for companies of all sizes to focus upon today.

**The “Long Tail”**

In 2004, Wired magazine editor, Chris Anderson, gained a tremendous amount of attention for proposing the idea of the “long tail”. Anderson’s thesis was that the Web had changed the way people consumed media and in turn, this changed the very basis of business models in the Internet era. In the pre-Internet era, media companies primarily focused on producing and selling “megahits”—the relatively small number of films, books, songs and other products that delivered the highest sales volume. These best sellers drove the media business and there was simply no business case for distributing lesser-known, niche works, given the associated physical production and distribution costs. In general, making the low-grossing, niche offerings available was considered financially unattractive or even cost prohibitive.
A statistical viewpoint, the long tail is a “power law of distribution,” used to explain any expanding market. In this case, the long tail worked to explain how the Internet changed the distribution and availability of media in a new age as the market expanded greatly. In analyzing sales of online music, books and video content at the time (remember DVDs and CDs were the media of the moment), Anderson found that the real depth and size of these markets was likely far understated. While best sellers and “core products” indeed constituted 80% of sales/rentals for companies such as Amazon, Barnes and Noble, Walmart and Netflix, the long tail of inventory for these sites/stores could be just as big, if not bigger, than the so-called “big head” of sales. Anderson made the case that in the age of the Internet, companies such as these, along with Google (which markets to users and advertisers on the long tail of interests) and eBay (whose wide array of items up for auctions were the very definition of the long tail) would succeed. In Anderson’s (2004) words, “When you think about it, most successful businesses on the Internet are about aggregating the Long Tail in one way or another.” (n.p.)

Anderson’s long tail took on a life of its own. It produced not just a mega best-selling book of the same name by Anderson on the subject in 2006, but a series of academic studies and debates on the validity and nature of the tail and the potential for companies to exploit it. Most of this debate centered on the size of the “big head” (the primary focus of the market) versus the relative size and potential of the long tail. (Manjoo, 2008; Orlowski, 2008)

The long tail was indeed not a new concept, since it was essentially built around the 80/20 rule as it applied to new media and new digital sales and distribution methods. However, much like the rules of Pareto and Juran, the long tail concept works and is vital in today’s commerce. Countless companies today, both large and small, have proven how they can build successful platforms and businesses by catering to our panoply of choices in media, hobbies, breakfast cereals—essentially everything. Niche markets and products are “in”, as demonstrated by everything from television shows catering to our interests in storage auctions, parking in major cities, house hunting, pawn shops and hand fishing, to the rapid growth of microbrews. Yet, perhaps nowhere is the long tail concept more vital today than in the area of procurement, as companies of all sizes recognize the opportunity—and necessity—of tackling tail spend.

**Moving from “The Long Tail” to “Tail Spend”**

In Anderson’s (2004) Wired piece, he quoted Kevin Laws, a venture capitalist and music industry expert as saying that the long tail simply meant that, “The biggest money is in the smallest sales.” (n.p.) Now, let’s update and flip this statement for the procurement equation, which is that the biggest savings may come from the smallest purchases and procurements made in the edge of your supply base. With greater ability to contract with outside expertise in the areas of spend analysis/analytics (Hodge, 2009), the ability for firms to gain insight into and take greater control of their tail spend is greater than ever before.
The 80/20 Rule and Corporate Procurement

The 80/20 rule holds true in the area of procurement. With most firms, 80% of their total spend on goods, services and materials are with just 20% of their total number of suppliers. And conversely, there is a long tail where the remaining 20% of spend is spread among a large number of suppliers, typically amounting to 80% of the total number of suppliers. Likewise, most companies find that typically, 80% of their expenditures are concentrated in just 20% of their total number of categories of supplies and services. This “big head” —the core spending for the corporation—typically includes direct spending on raw materials and vital components, as well as indirect spend for most consumables, including things like maintenance, repair and operating (MRO) and personal protective (PPE) equipment supply purchases. Yet, in aggregate, the amount of money involved with tail spend may comprise more than most, if not all, of core suppliers.

For over a decade, procurement and supply chain management have placed primary focus on the 20%—the core of supply base. It is with the firm’s largest suppliers that we see strategic efforts made at integration—both operationally and technically. Also, when firms look to shave their MROs, most often the targets are the suppliers in this core group.

According to a recent article in Purchasing Practice:

“Practically all organizations will find that approximately 80% of the spend will be covered by 20% of the suppliers and conversely 20% of the spend will be comprised of a long ‘tail’ of suppliers (80%), each with progressively smaller amounts of spend. They will also find that cumulative spend versus cumulative orders will follow the same principle in that 20% of the spend will be comprised by 80% of orders. With this visibility, organizations can analyze its composition in order to determine the best strategies to managing it.” (Anonymous, 2012, n.p.)

While it’s true that at the onset, spend management efforts aimed at the firm’s largest suppliers (the 20% vital few) produce the most return, after years of focus on spend management and cost-cutting many large companies have literally squeezed-out most of the savings to be gained from such efforts with their core suppliers. Thus, as Loughlin (2012) pointed-out, “Ignoring tail spend is potentially leaving huge amounts of money on the table....(as) the significant benefits available from managing tail spend could be a new and as yet untapped source of savings.” (n.p.) Likewise, companies tend to focus their efforts on the 20% of their spend in their top categories of supplies and services, not the 80% in the long tail of their procurements.

It is important to bear in mind that 80/20 is an approximation, not a hard and fast, magic ratio. The precise percentage will vary not just across industries, but across firms within them as well. The true “core/tail” ratio may be 79/21, 81/19, 84.6/15.4, or any other combination. In fact, Ramachandran and Lawless (2003) postulated that the size of the tail could range up to 30% of spend in some cases. So, the first step toward managing tail spend is for the firm to conduct a spend analysis on its procurement, in order to ascertain how large the tail is in their unique situation.
What Constitutes Tail Spend?

What are the characteristics of the items and services that fall into the tail of a company’s spend? There is no exact categorization criteria to say this is tail spend vs. this is not tail spend, but some general characteristics include the following:

- Tail spend covers a large number of categories of goods and services, rarely including direct materials.

- Most categories of tail spend will be low value items (both goods and services). However, some items that fall into the tail spend area will have surprisingly high transaction volumes.

- Tail spend items are procured in a wide variety of ways, outside of normal procurement modus operandi, as non-compliance and maverick spend are rampant in this area.

- Items that were formerly in the managed, core of company spend can fall into tail spend if they are contracted items that are simply renewed without reviewing/re-negotiating the contract to ensure market rates are being paid for the items.

- Items that are highly technical in nature may be so sophisticated that the procurement of these articles is handled by experts in the field, rather than by procurement staffers.

- In a global organization, analysis will show that a disproportionate level of tail spend comes from procurements made by the most remote outposts of the company.

- Due to their relative standing in the company’s supply base, tail spend is largely carried-out with suppliers that are “not on the radar” of the company’s main procurement operations.
Tail Spend Can Incorporate:

- Maverick spending—Spending that falls outside of the organization’s procurement guidelines.

- Misclassified spending—Items that are being purchased individually that should be consolidated into existing supply contracts and competition systems.

- Fragmented spending—Like items that are repeatedly purchased by various locations across an organization that could be consolidated into procurements that would fall into the company’s core spend based on the aggregate value of the buys.

- Unaddressed spending—Any spend items that have not been addressed by procurement in a reasonable period of time (generally considered to be 2-3 years).

- Unusual spending—High-value items that are new procurements or are procured only once, or so rarely, that the organization’s procurement staff has no expertise in this area.

- Low price, high frequency items—Items that have low individual value, but in over time, see a significant amount of spend as spot buys of like items are repeated, both within units and across the organization.

- Low price, low volume items—Items at the far end of the tail of spending, which have very little value to look at in tail spend analysis efforts due to these characteristics.
The Challenge of Managing Tail Spend

With the significant costs involved, and the vast potential for cost savings and process improvement efficiencies, it is surprising that tail spend is not closely managed by most companies. This is due to perceived tail spend management challenges, including:

- Poor data visibility
- Lack of effective controls
- Little market coverage
- Seemingly low potential savings
- Lack of interest from other stakeholders
- Lack of category expertise in the very high number of categories in the tail

For example, let’s examine the single area of indirect spend. According to a 2012 survey of conducted by HCMWorks (2012), almost three-quarters of C-level executives in firms with revenues of over $1 billion annually reported that they had little to no visibility or insight into their firm’s indirect expenditures. Thus, even though indirect spend can represent anywhere from 20-40% of a firm’s revenue, it is commonly an “overlooked” area in the scope of procurement. (Weyn, 2012) Why is this tail spend so difficult to manage? It is because it is fragmented, often across the entire organization.

In, a recent article, aptly titled “Indirect Procurement: From Back Office to Board Room” (2012) Robert Brust, the former chief financial officer of Sprint, Eastman Kodak Company, and Unisys, framed the issue well:

“The purchasing of indirect goods and services in categories such as professional services, plant/facility services, utilities, MRO and travel is often managed at the department level and finance executives rarely see the magnitude of overall spend that these categories represent. When looked at individually, the dollar amount of indirect spending in each department seems insignificant when compared to raw materials. But, when added together, they can account for hundreds of millions of dollars. This spend is highly fragmented across business units, locations and departments. It spans thousands of end-users and encompasses hundreds of unique sub-categories, all requiring specialized supply market knowledge.” (n.p.)

What Tail Spend Costs Companies

Undoubtedly, tail spend costs organizations significant amounts of money. For large, multinational companies, the total could be in the hundreds of millions of dollars. And for small and medium-sized businesses, the toll in unnecessary costs and lost potential efficiencies can be just as significant, if not more so, even if the dollar amounts are on a smaller scale. And it’s a multifaceted “cost”, paying higher prices for goods and services for individual, spot purchases and not taking advantage of the power of aggregation and competition to lower prices paid across the organization for multiple, successive tail spend buys.

However, the impact of tail spend reaches beyond the procurement area—dealing with the scattered nature of the suppliers who constitute the tail costs the organization both financially and operationally. Unnecessary and unmanaged tail spend forces an organization’s accounts payable personnel to process more invoices and handle more queries from largely unknown and remote suppliers. By reducing tail spend, companies gain access to both better payment terms with suppliers and tools available to more strategic buyers, as opposed to being a one-off buyer for a company.

As Stegenga (2011) and others have urged, companies need to look at better managing tail spend to reduce their total acquisition costs, not just their actual procurement outlays. Only through looking at the total impact of tail spend on the organization
can the potential for savings and efficiencies be accurately gauged. **With better execution and focus on tail spend, procurement can have a direct impact on efficiency and hence, the bottom line. In fact, “externally procured goods and services constitute anywhere between 40 percent and 80 percent of companies” operating costs.** That's a sizable chunk of change and an effective procurement function can have a direct impact on the bottom line. (Cummings, 2008b, n.p.)

According to a recent white paper on tail spend from Proactis (2012), for the average company, “a 5% savings on tail spend can be the equivalent of a 10% increase in net profit.” (p. 4)

**Controlling Tail Spend—Internal vs. External Solutions**

Many metrics that are used in assessing procurement performance are internally focused, dealing with spending, savings and process measures. Today however, the gold standard for measuring procurement's value and importance in an organization is “spend under management”, which was defined by Bartolini (2012) as: “the percentage of total enterprise spend (which is comprised of all direct and indirect, including capital services spend) that a procurement organization manages or influences.” (n.p.)

Additionally, according to a recent study from CPO Agenda, companies today have an average of just 60.6% of their procurement outlays “under management”. Thus, there is great potential for procurement to demonstrate their value to the organization by contributing to the bottom line through increasing their spend under management, as according to Bartolini (2012), “For every dollar/pound/euro that is placed under management of the procurement department, the average enterprise sees a benefit of between 6% and 12%.” (n.p.)

Given the substantial savings to be gained, it’s surprising there isn’t a greater widespread push to get corporate procurement under control and increase spend management efforts. Unfortunately, given traditional methods, these additional efforts are simply not practical in most scenarios. Most often, with limited resources managing such a diversity of sources and goods/services, the idea of reaching beyond the core and attempting to manage the tail—and increasing the range of spend under a procurement department’s span of control—can simply seem overwhelming to purchasing executives. As Simon Aldred (2009) put it bluntly, what typically limits corporate procurement executives from tackling tail spend issues are two factors, their resources and their “appetite” for doing so, based on the constraints and realities they face today. Procurement executives reason that trying to address the broad range of spending—suppliers beyond the big head and the specific items in the long tail of purchases—are far too difficult to track and manage. And besides, with limited internal resources, often stretched to the breaking point, it is far easier to make gains in dealing with the company's core spending and its key, strategic supply partners. Taken in isolation, the low value of tail spend items may make the ROI of efforts to “fix” spending in any single area far lower than in addressing core spend categories. (Raja and Bardell, 2011) However, the overall value of tail spend makes the ROI of such efforts perhaps more potentially valuable than in any other area of procurement.

There also is a common misperception that P-Cards (purchasing or procurement cards) are the answer to the tail spend problem. While arming employees with P-Cards gives organizations a great deal of visibility into “who’s buying what”, these controls work only after the fact—after the purchases have been made. Thus, P-Cards provide a control mechanism over employees’ purchasing decisions, but not over the purchases themselves. If you look at P-Card reports, the procurement staff can see what is being bought by who and make sure purchases are within specified limits and not on prohibited categories of items and services. For example, in the case of office supplies (probably the most commonly purchased
P-Card item category in many organizations) P-Cards enable employees to make the purchases they need at the moment at the local office supply store or other retailer. Yet, through spend analysis, one can determine office supply items and entire categories of purchases that can and should be consolidated into the spending core of the organization.

Much of the effort to attack the problem and opportunity of tail spend management can—and should—be done in conjunction with outside resources, given the limited internal resources available for such tasks and the ready availability of outside expertise in the area of spend analysis/analytics. There is research demonstrating the solid ROI for such efforts, which are estimated to be between $3 and $8 in returns for every $1 expended in procurement efficiency/savings initiatives. (Cummings, 2008a) This accounts for the rapid growth of procurement outsourcing market, which is expected to grow by 14% in 2012 alone. (Weyn, 2012) Some efforts may not produce either savings or process efficiencies. However, there are such tremendous opportunities for big wins through better tail spend management that the upside of such efforts will produce significant results. (Ramachandran and Lawless, 2003)

Analysis

Pathak and Menon (2008) observed that, “Traditionally, companies have looked to strategically address the top 80-90% of spending, while paying little attention to the remaining 10-20%, which was uncategorized, unstructured and decentralized.” (n.p) Today, it is clear that for organizations of all sizes, tackling the challenge of the “long tail” of their spending is one of the most effective ways to reduce costs, streamline operations and in turn, have a direct impact on the bottom line. From the bluest of blue chip companies in the Fortune 500 and Global 1000, right down to small and growing businesses, procurement executives would be well-advised to look to tail spend as an opportunity to have a direct impact on the financial and operational health of their companies.

How big an opportunity is better tail spend management for your own organization? Try this simple formula, applying the 80/20 rule (although as stated earlier, the exact breakdown may indeed be proven different for your organization through spend analysis). Examine 20% of your total procurement outlays. If your organization undertakes efforts to better understand the who, what, where, how and when behind compromised tail spend and then takes steps to make those purchases more uniform and more coordinated where possible, you could reasonably expect to save between 5-10% of that amount in terms of lower purchase prices. Additionally, as highlighted earlier in this report, your company will see additional internal efficiencies from better understanding and managing tail spend that may well match the actual dollar cost savings achieved through the effort.

A coordinated, serious tail spend management effort may enable you to reduce your overall procurement spend and lower the total cost of acquisition by a range of 10-20%. Such savings can have a dramatic impact on the firm’s bottom line and enhance the standing of any chief procurement officer willing to attack what is a chronic, widespread issue for all companies.

The size and scope of the potential cost savings and efficiency gains to be derived through better tail spend management makes for an opportunity that stretches beyond procurement to the top levels of financial and corporate management. Today, tail spend management should be a C-level issue, not just for chief procurement officers (CPOs), but for chief financial officers (CFOs) and chief executive officers (CEOs) as well.

It is critical that top-level executives support and encourage the procurement executives and staff in such efforts—both with the resources to properly do
so and the top-level backing to support such an undertaking across the organization. Tail spend management efforts may not be a priority item for those outside of the procurement operation, therefore it is incumbent that top leadership make this an organizational priority, not just a procurement initiative.

**Conclusion**

This white paper has focused attention and shed light on the size of tail spend and significant potential gains for companies to take steps in addressing spend of the remaining 20% of their procurements and with the “useful many” in the long tail—the "other" 80% of their supply base. As has been shown, there is widespread agreement on the size and scope of tail spend management issues for companies of all sizes globally. Yet, there is a surprising lack of consensus on exactly what steps can and should be taken to better manage this increasingly important area of corporate outlays.

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He presently serves as the Executive Director of the Reverse Auction Research Center ([http://www.reverseauctionresearch.com/](http://www.reverseauctionresearch.com/)), which serves as a hub of research and news in the expanding world of competitive bidding. In recognition of his research accomplishments, Dr. Wyld has been awarded Southeastern Louisiana University’s “President’s Award for Excellence in Research” and been named a Rising Star in Government Information Technology by Federal Computer Week Magazine. Dr. Wyld and his family reside just outside New Orleans in the small town of Hammond, Louisiana.

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