

BirchStreet Systems e-Procurement – Quantifying ROI

The Purchasing Process Defined

The primary value that hospitality organizations derive from the BirchStreet solution (regardless of whether they negotiate their own supplier contracts or subscribe to a program like Avendra) is cost savings via an increase in purchasing compliance.

“Purchasing compliance” is the percentage of spend “on contract” versus “off contract.” “On contract” refers to purchases against contracts that the organization’s corporate purchasing department has negotiated with suppliers or with a group purchasing organization (GPO) such as Avendra. These contracts are often referred to as “programs,” i.e. “the beef program,” “the dairy program” etc.

Typically a large hotel company can negotiate contracts (“put programs together”) that reduce prices from 10 to 15 percent below retail price. However, because of several factors in the lodging industry, it is often difficult for an organization to get all its hotels to buy on contract consistently. The “compliance percentage” is a measure of how effective the organization is in having its hotels “buy on contract,” i.e. use the “programs” that its corporate purchasing department has put in place.

Compliance Percentage = On Contract Spend / Total Spend

As an example, Corporate Purchasing might negotiate a contract with a specific supplier to purchase telephones at \$20 each – a 20% discount from the retail or “street” price. Although Corporate Purchasing negotiates the contract, they typically do not actually purchase the telephones. It is typically the property’s responsibility to purchase the telephones (and most other goods and services) according to their budgets and needs.

Theoretically the above telephone contract should provide the organization with an across-the-board 20% discount on phones. However, the actual savings achieved is often far less because many hotels end up buying telephones from other suppliers and often end up paying more.

When a property buys from the wrong supplier this is referred to as “off contract” or “rogue spend.” Because of the geographic dispersion of the lodging industry, the fractured ownership structure and the autonomous nature of each hotel, off-contract spend can become a large percentage of total spend. Unmanaged compliance rates as low as 30% are common. This means that off-contract spend accounts for 70% of total spend.

Quantifying the Value of Compliance

BirchStreet’s e-procurement solution has been proven to significantly improve the compliance percentage, which can generate significant savings.

The discount below street price that a hotel company’s corporate purchasing department can achieve is impacted by several factors, including:

- The skill level of corporate purchasing department employees to negotiate supplier contracts

- The volume the hotel company predicts to spend on the category pertinent to a given supplier
- The demonstrated degree of control the hotel company has with their spend (i.e. can the hotel company move the spend to another supplier if it does not get the price it wants)
- The profit margin of the supplier

Typically, a reasonably large hotel organization's purchasing programs can achieve discounts an average of 10% to 15% below street price.

This means that for every dollar of spend moved from "off contract" to "on contract" saves the company 10 to 15 cents. Several BirchStreet customers have reported that using the BirchStreet solution has allowed them to grow their compliance percentage from 30% to 80% - an increase of compliant spend of 50%. *For a company that spends \$100 million a year, this translates to moving \$50 million under contract, resulting in a savings of \$5 to 7 million to the bottom line.*

Increase in Compliance x Avg. Price Discount x Total Spend = Total Savings

BirchStreet offers additional value in automation and financial controls. However, for most large customers, increased compliance has been the primary driver of savings.

Compliance can be measured at the vendor level (percentage of spend with contracted suppliers) and the item level (percentage of spend on items under contract purchased from suppliers under contract).

In most cases, item-level compliance is the most useful because typically Corporate Purchasing puts programs in place for specific items for which they can obtain the best value. However, most organizations cannot determine their item-level compliance without a procurement system because their accounts payable (AP) systems typically do not include line-item detail (most AP systems typically capture invoice totals, but not line items). Accordingly, BirchStreet provides its customers with a great deal of visibility into compliance, making it much easier to measure and manage item-level compliance.

Improving Supplier Integrity

Another very important value that BirchStreet brings to an organization is increased supplier integrity. A given hotel company may have good supplier contracts in place, and the hotels may be purchasing the right products from the right supplier, *but the suppliers may not be honoring the contracted prices*. Many BirchStreet customers are surprised to uncover how often this occurs and the size of the dollar amounts involved.

Item substitution is a common way in which a supplier may bypass contracted pricing. By *sporadically substituting an 'out-of-stock' contracted item with a non-contracted item* (perhaps yielding a better profit margin to the supplier), the supplier is able to improve his margin when rotating this substitution across an entire hotel portfolio. BirchStreet's system allows the hotel organization to run a simple report that analyzes the entire portfolio, immediately highlighting such occurrences.

The increased supplier visibility that BirchStreet brings and the ability to report all variances between purchase order and invoice is key to uncovering situations in which suppliers are over charging. In the BirchStreet system, most purchase orders are created from BirchStreet's online catalog, which contains your contracted pricing. Item-level variances

between purchase order price and invoice price often reflect a contract violation that would typically go undiscovered with a standard AP solution. With BirchStreet, these variances are fully reportable. BirchStreet customers often find these discrepancies immediately after implementing the BirchStreet solution. They sometimes discover that the issue has been going on month after month, for years.

Value at the Property Level

Part of BirchStreet's appeal to its large customers is the ease of use and productivity advantages the system provides at the property level. Although automation helps the customer's organization improve productivity, the primary interest from the point of view of Corporate Purchasing (typically our corporate champion) is that the ease of use and productivity improvements help ensure that the system will be used by the buyers within the properties. Without widespread user adoption the goal of improving compliance cannot be achieved. Additionally, no corporate sponsor wants to be the champion of a new software system that is rejected by the hotel rank and file.

For that reason, BirchStreet distinguishes itself from other "generic" e-procurement systems that are not specifically designed for the hotel sector. A number of factors make generic e-procurement systems difficult to use in the lodging industry, especially in full-service hotels where the majority of the spend is. These factors are:

- High percentage of food and beverage spend
- High autonomy given to local buyers within the hotels
- Hotel staffs' low computer competency (housekeepers, chefs, etc.)
- Broad geographic dispersion of properties and suppliers
- Wide disparity in size and sophistication of the supplier base

Accordingly, BirchStreet has successfully competed for major accounts in side-by-side comparison against large well-known procurement systems such as Oracle. BirchStreet beat Oracle's iProcurement in a Hyatt agreement, and it replaced existing implementations of Oracle iProcurement at Omni and Marriott UK.

BirchStreet's ease of use and wide industry adoption (even by chefs!) provides corporate sponsors at its new customers with the confidence to go forward with an agreement to rollout the BirchStreet e-procurement solution in all their hotels. Furthermore, a recent trend is for hotel organizations to implement a BirchStreet "mandate policy," whereby properties are absolutely required to use the system for all purchasing activities.

Hilton International and Interstate Hotels and Resorts (IHR) moved to a "mandate policy." Their internal policies state that invoices *will not be paid* unless there is a corresponding PO in BirchStreet. This forces the buyers within the properties to run all their purchases through the BirchStreet platform, allowing these customers to achieve better visibility and much higher compliance rates.

In the last 12 months, IHR has moved \$20 million in spend from "off contract" to "on contract," enabling an estimated savings of more than \$2 million a year. Similarly, Marriott UK has reported very high compliance gains with BirchStreet over the past several years. They have recently decided to mandate usage of the BirchStreet solution also -- after conversations with Hilton International in London.

Customer ROI Testimonial – Interstate Hotels and Resorts

"Over the last 12 months, the BirchStreet system allowed IHR to move \$30 million in spend from 'off contract' to 'on contract.' We estimate this is saving us over \$2 million a year.

"We were able to increase our compliance of approximately 30% to about 75% today. In the last year alone (after we made a concerted effort to mandate BirchStreet use among all of our properties) we have been putting about \$2.5 million more through BirchStreet each month than we did before, even though we now have fewer properties under management than we did last year. This is translating into large savings for us as a result of driving more spend under contract.

"As a management company, our use of and success with BirchStreet is a prominent part of our sales pitch to new owners. Considering the current economy highlighting cost savings makes sense."

Customer ROI Testimonial – Hilton International

"The implementation of BirchStreet was a resounding success, and achieved the dual goal of highlighting/capturing spend data, as well as providing the impetus for improvements to legacy processes and procedures. In one of our Paris properties, the ROI was immediate, with annualized savings of \$18,500 for a single hotel identified in the first day of go-live. Shortly thereafter, after implementing the new supplier adoption process and enforcement of price regulation, we uncovered additional savings such as a 21% reduction in the price of photocopy paper, a \$57,000 cost savings in hotel stationery, and 2% savings on the meat supplier's catalogue for that particular property.

"At one of our all-inclusive properties in Egypt, spend capture more than doubled, and we were able to consolidate our main supplier base from 422 to 183 vendors as a result of implementing the BirchStreet system. Productivity improvements reduced the typical processing time of one grocery order from three man days to a maximum of one, and provided a huge reduction in paperwork: for example, we reduced a typical 130-page weekly order from one of our large suppliers down to five pages.

"At our 19 properties in Egypt, we are confidently forecasting annualized savings of more than \$1 million, and the projected savings / cost avoidance for the remainder of 2008 and 2009 is estimated at 3 to 4% of spend, when compared to hotel-centric purchasing. In more mature markets, such as France and the UK, this forecast should be in the region of 2%."

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