

Strategically Sourcing Suppliers and Commodities

New ways of thinking about Short Term Savings vs. Long Term Sustainability

FIVE YEARS! Five years is the timeframe organisations should consider when making long-term strategic sourcing decisions. Here are some of the critical areas to consider before making choices that will impact how your business unit and/or organisation will ultimately be viewed and perceived by its most important asset, your own customers.

Select suppliers and commodities not only on short-term savings potential but more importantly on their ability to sustain long-term cost elimination

Volume purchasing is a no brainer that most consulting organisations claim to be expert at. While volume purchasing may represent your quickest hits, they can also create your worst long-term problems if you are not careful of the implications of your decisions. Depending on your long-term goals (5+ years), people, process, and technology will invariably play a significant role down the road. Forming contracts with suppliers that are not aligned to your business and unable to 'grow with your organisation' will ultimately create bottlenecks and add to your internal costs.

Selecting your suppliers and commodities based on short-term savings may be risky. The right balance must be achieved by balancing a lower price with lower risks to your organisation. So how do we achieve that? The authors advise reaching down to three levels into your supplier base before recommending and selecting a successful supplier that is able to expand with your growing requirements. Consequently, when selecting a supplier, we also select its supply chain. That particular supply chain is what ultimately determines the total cost to serve an account such as yours. Selecting the best 3-Tier down suppliers represent 'your' opportunities to work with your supplier on the most profitable long-term savings and add to the long-term sustainability of your procurement operations.

Another challenge is to aggregate buyer requirements. For instance, how would you

seek savings in travel management? Are you able to achieve these savings if each organisation or even department has a different travel policy? If you bring just an additional volume of spend to a travel management supplier, what is his/her incentive to reduce prices if you have done nothing to eliminate his/her costs and/or risks? Another example is office machines - Do you buy, lease, lease/purchase? Have you harmonised and standardised the products to improve the predictability of your buying behavior? Have you aligned different policies and procedures? Improving buying behavior, predictability, and creating alignment is key to achieving long-term sustainable benefits.

Finally, "it may be unwise to pay too much, but it is worse to pay too little" (J. Ruskin: 1819-1900). When you pay too much, the only risks are monetary; however, when you pay too little, you sometimes lose everything because the agreement reached with your supplier cannot be sustained. The common law of business prohibits paying a little and getting a lot. It cannot be done.

Whether it's the consulting firm working for you or the supplier, get them involved in the implementation of the contracts, and accountable for the result

We recommend that if you are using a consulting organisation to assist you in your supply activities that the consulting organisation be 'fully accountable' for your long-term success, not just for the first or second year, but for the entire contract lifecycle. Picking a commodity on its potential for savings alone may represent short-term success but create long-term problems. It may indeed satisfy both the consulting organisation and yourself as a client in achieving short-term savings, but not being accountable for 'banking the money' is unfortunately what most consulting organisations are good at.

There are additional considerations that must take place to avoid the 'long-term problems' of such an approach. We look at the most effective sequencing of sourcing activities to achieve the greatest total savings

returns over the life of your contract (not just on year 1 or 2). Savings must not be dependent on selecting a commodity that may support the consulting organisation's quest for fees, but rather benefit you as the client, so that you can achieve long-term sustainability. Be aware of consulting organisations that promise you great savings but are unwilling to stick around. Too many consulting firms sell their services based on expectations of what the savings 'could be', claiming they have achieved these percentages in the past. Then ask if they have been around to implement and help clients bank the savings as well? While it is easy to be attracted by such numbers, usually such organisations do not wish to be around and be accountable on a 5-year basis. They may even try to sell you additional services 'just to check' whether or not some of their recommendations have been followed. Invariably there will be gaps. Who then will be to blame for the lack of results?

It is one thing to 'find the money', it is more difficult to 'get the money', and even more challenging to 'keep the money.' A consulting partner must be accountable during these three stages.

What is your philosophy? Beating suppliers on price or collaborating for a win-win outcome?

An organisation will gain a performance advantage by pursuing collaborative relationships with its suppliers. It is important to adopt this philosophy to gain a competitive advantage in the market today. The first benefit is the development of mutual trust. When a relationship lacks trust, little incentive is present for either party to share information or work jointly for each other's benefits. Trust makes it possible, for example, for the seller to provide insights into its cost structure, which can result in a joint effort to reduce a supplier's cost through a mutual sharing of ideas. Trust provides the foundation to realise mutual benefits.

Unfortunately, many organisations still practice the traditional approach to supplier

relationships (bid wars) which does not provide the opportunity to pursue purchasing strategies that lead to longer-term performance benefits and win-win scenarios. One last point, while it is very common practice to negotiate suppliers 'penalty clauses' in contracts, how often do you include supplier 'incentive clauses' and give your suppliers a chance to suggest and/or implement cost reduction programmes and share in the collective benefits?

Practice Systems Thinking Procurement

The approach of systems thinking is fundamentally different from the other traditional forms of analysis. Traditional analysis focuses on separating the individual pieces of a problem being analysed. Systems thinking procurement, in contrast, focuses on how the item being studied (i.e. commodity, supplier, contract, people, process, technology etc) interacts with the other constituents of the system (i.e. other departments). This means that instead of isolating smaller and smaller parts of the system being analysed, systems thinking procurement works by expanding its view to take into account larger and larger numbers of interactions as an issue is being studied. This results in sometimes strikingly different conclusions than those generated by traditional forms of analysis from silos solutions experts.

The systems thinking procurement approach has proven extremely effective in the most difficult types of problems to solve: those involving complex issues dependent on the past or on the actions of others, and those stemming from ineffective coordination among those involved.

With systems thinking, procurement decisions are based on an organisation-wide approach and the implications of such decisions onto other departments from a people, process, technology, and departmental perspective.

What a lower price to you means to your suppliers

The lower the price you seek to achieve with a supplier the more problems you should expect coming your way. Common sense shows that a supplier servicing an account that generates very little profit will not receive the same attention as a more profitable account. As a result, quality, communication, servicing, delivery, so on and so forth, might be affected by buyers having achieved what some call 'rock bottom price.' Price reduction alone is much easier to define and measure than measuring the total cost of working with a supplier over a five year period.

In addition, the supplier will have very little incentive and/or means to invest in perfecting its business and take cost out of its operations by re-investing in new technologies, providing training for its own employees, or growing as an organisation to reduce its internal costs. In the end, having achieved rock bottom price will affect every employee and every one of your customers.

Beware of silo strategic sourcing/ procurement solution experts

Procurement is probably one of the most unrecognised strategic functions in businesses today. Each decision that procurement makes has repercussions across all organisational departments and failing to recognise this connection between departments is where organisations also fail to achieve real savings.

This can be compounded by selecting a consulting partner that specialises in procurement/sourcing but has no expertise in the procurement events that flow across your organisation and impact on other departments such as marketing, forecasting, sales, financing options, payment mechanisms, IT, so on and so forth. Not taking the flow of events into account will prevent you from achieving the full benefits of strategic sourcing. Cross-functional knowledge and skills are required to help you achieve the full benefits of strategic sourcing.

Do you want to buy better or do you want to become a better buyer?

The answer should be yes to both. Too often, organisations concentrate only on achieving lower unit prices. However, the only way to achieve sustainable long-term savings for your Organisation is to consider both in harmony, not in isolation. To become a better buyer, an organisation must take the hard steps across all its parts to fundamentally change behaviours, processes, and technology that enable internal efficiency.

The net result is that these efficiency gains not only benefit your organisation, but also significantly reduces the suppliers' risks and/or costs in doing business with you.

* About the Authors

Christophe Barriere-Varju

Christophe is the founder and managing director of BvW Global. Christophe has been consulting with fortune 100 clients for the last 10 years and has built his experience from working and partnering with worldwide consulting organisations such as Andersen Consulting (now Accenture), PricewaterhouseCoopers, Arthur Andersen, EDS, and AT Kearney. He was instrumental in developing consulting offerings and best practices in procurement, supply chain, e-procurement and digital market for several of these firms. In the last five years alone, Christophe has saved organisations a total of \$427 million. Those savings are a mix of strategic sourcing, procurement card, procurement, and supply chain process improvements. Savings ranged between 5% and 20% on price reduction alone.

Harry Moyer

Harry has 24 years of business industry experience. Some of his previous work was to deploy a single global procurement system to capture over \$5 billion USD per annum and to improve purchasing contract compliance with key regional and international suppliers. As the GM of Strategic Sourcing for one of the largest procurement marketplaces in Australia, Harry worked on the standardisation and rationalisation of specifications across the following categories: Print Management, Office Products, and Corporate Real Estate, achieving cost savings between 5% and 20%. In addition, Harry developed/implemented process and procedures to ensure continual attractiveness and competitiveness of strategically sourced commodities.

About BvW Global

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For more information, visit their website at www.bvwglobal.com or email them at info@bvwglobal.com



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