

Strategic Approach to Procurement

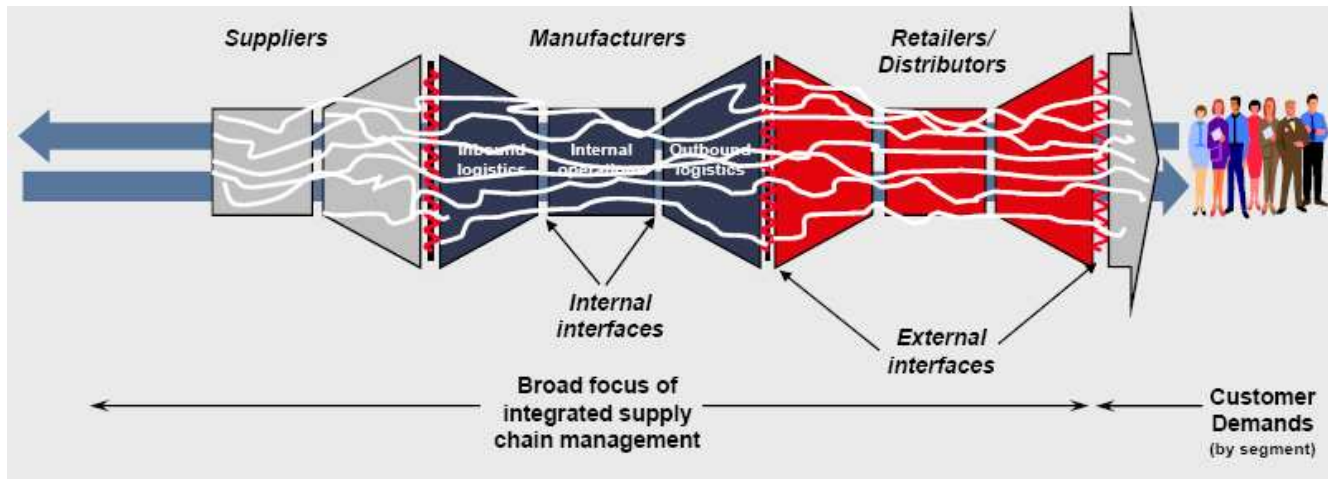
Session Outcomes

- Explore role of Procurement in an integrated supply chain
- The importance of effective Procurement strategy to a organisation
- Demonstrate how to build a procurement strategy
- Give examples of good practice in procurement management
- Examination of typical supplier development issue and how to develop a solution

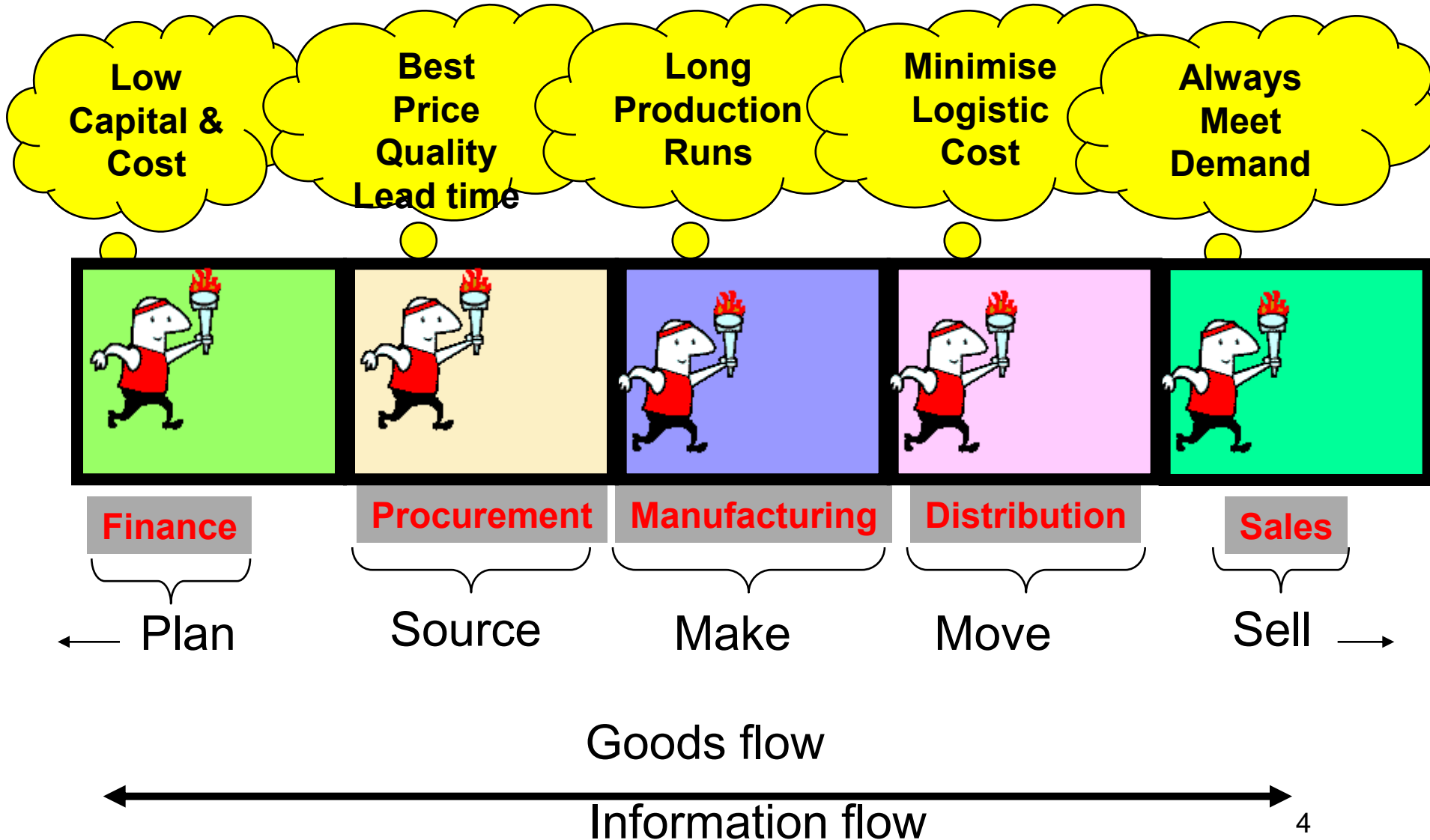
What is a **SUPPLY CHAIN** ?

One version . . .

- *Network of connected and interdependent organisations*
- *Mutually and co-operatively working together*
- *To control, manage and improve*
 - *Material flow*
 - *Information flow*
 - *Cash flow*
- *From suppliers to end users*



Procurement as integral part of a SC.



Supply Chain Cost Inefficiencies...

...arise through a number of reasons and are the responsibility of several organisational functions but Procurement can cause problems in following ways:

- **Product & parts complexity**
- **Excessive multiple sourcing**
- **Inefficient procurement process and information management**
- **Waste**
- **Procurement strategy lacking**
- **Inadequate quality operation**
- **Pursuing local/functional targets at expense of supply chain performance.**



A Definition - Procurement

A **systematic** series of activities which need to be performed
to
acquire and deliver an item, material or a service to a
user

World Class Procurement Is Not

“Get three quotes and take the cheapest”



Coming in to negotiate price **after** a supplier has been chosen



Procurement

Placing orders for budget holders



Negotiating the lowest price at the expense of quality

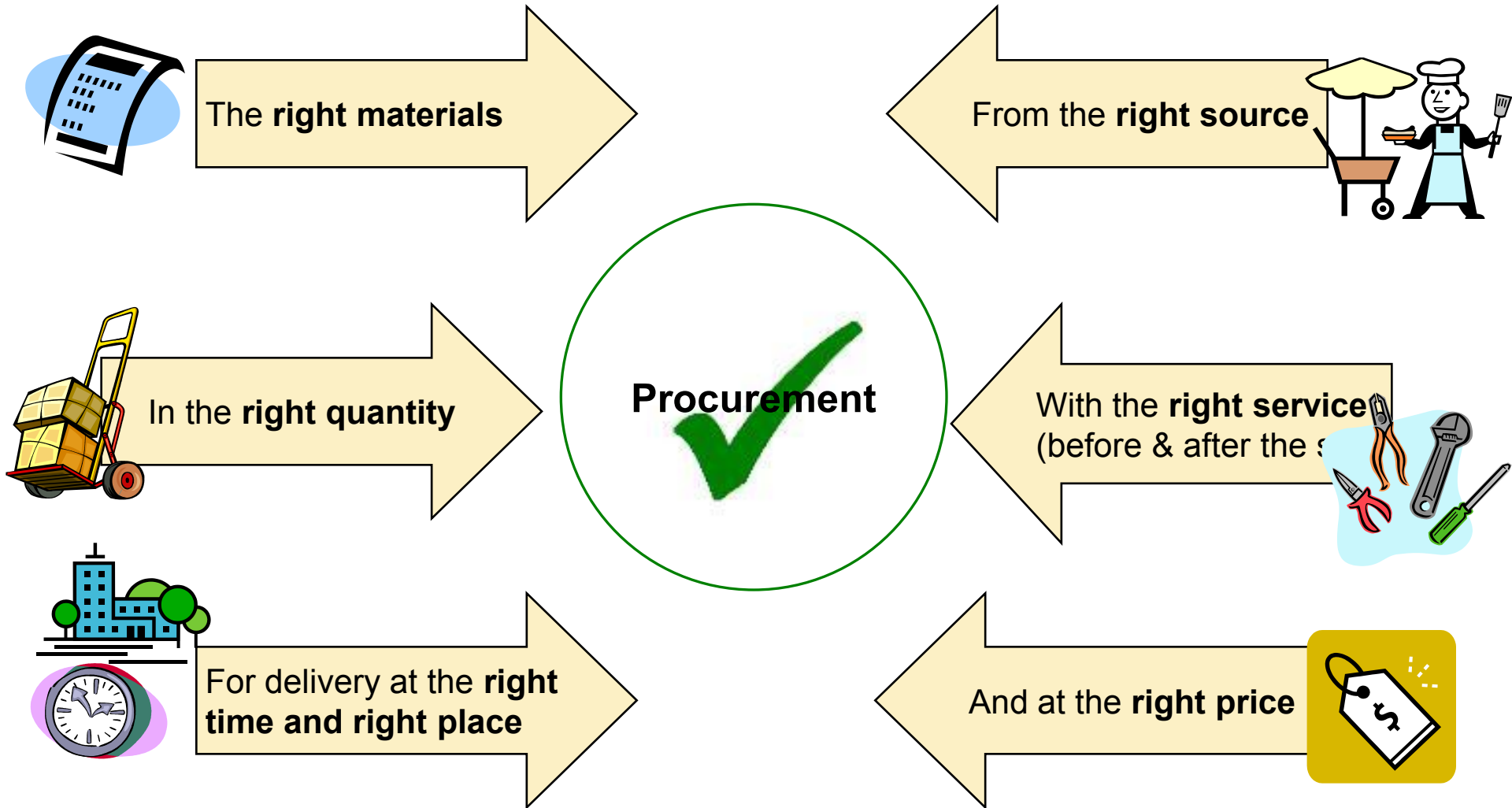


Sorting things out

- When the right things don't get delivered
- When invoices don't get paid



World Class Procurement Is, Obtaining



Satisfying the **NEED** not the **WANT**

Why is Procurement so important?

“When the goal is boosting profits by dramatically lowering costs, a business should look first to what it buys.” – *Fortune*

Procurement determines an important part of the competitive position of most firms.

- Procurement is an area where large cost reduction can be made.
- Procurement cost savings go straight to the bottom line
- Purchasing and Supplier collaboration can reduce the need for large inventories, accommodate new product initiatives and reduce the cost of those initiatives
- Streamlining of processes allows organisations to acquire goods more quickly. “Speed to Market”

Purchasing Must Become Supply Management

The Leverage of Procurement

- No other activity affects a company's bottom line as powerfully as the process of procurement
 - Example – 17% net profit improvement at ETSA Utilities through
 - improved procurement processes
 - Example – 16% reduction in the cost of non-core goods and services at Wesfarmers through the implementation of a strategic approach to procurement

Procurement and Supply

- The challenge in procurement is to extract maximum benefit from the activity of acquiring goods and services
 - Benefits can be achieved in a number of areas –
 - Direct cost savings through lower prices paid
 - Indirect savings through value adds
 - Savings achieved through procurement process efficiencies
 - Savings achieved through a more efficient supply chain e.g. freight efficiencies, visibility
 - Utilization of appropriate technologies:
 - getting eProcurement ready!

Procurement Issues

- There are many issues that need to be addressed –
 - Do I know what I am buying and how much it is costing?
 - Am I buying at the best possible price and how do I sustain best pricing?
 - Is my procurement providing competitive advantage?
 - What risks exist with procurement and are these properly managed?
 - Does my approach to procurement complement my business strategy?

Procurement Issues (continued)

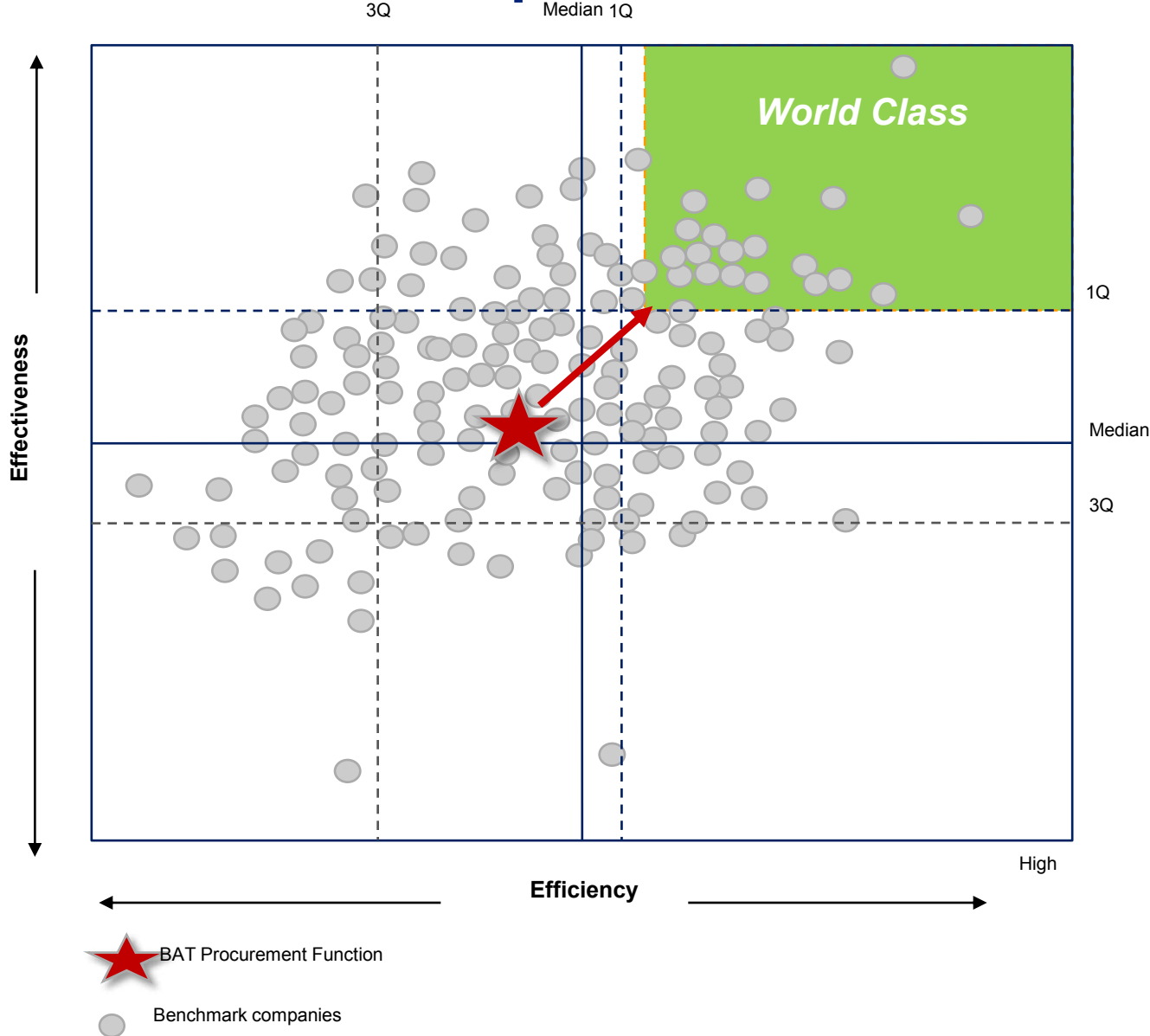
- Is my procurement process efficient and does it deliver value?
 - Are all opportunities in my supply chain being exploited?
 - What opportunities does technology offer and what is right for me?



A short story.....

- How **not** to shop for artificial Christmas trees!!!

Procurement must continue to change and improve



Systematic Approach will Identify Procurement Cost Opportunities



Auditing the Current Situation will Highlight the Benefits to be Gained

Objective

- To identify opportunities that can be leveraged from adopting best in class procurement practices

How

- Evaluate spend categories and volumes and benchmark
- Understand:
 - existing supplier arrangements
 - information and product flows
 - internal procurement processes
- Evaluate 'fit' between procurement strategy and business strategy
- Assess 'fit' between suppliers and the business
- Understand current information technologies

Deliverable

- Development of a benefits statement and action plan

Critical Point

- An initial audit of the current procurement operation is an essential starting point

The fundamentals underpinning the procurement function must be in place



One or more elements may need overhauling

PROCUREMENT STRATEGY

PROCESS DESIGN

SUPPLIER SELECTION and IMPLEMENTATION

PERFORMANCE MANAGEMENT

ePROCUREMENT READINESS

Critical Point

- Each element contributes to overall procurement success
- Optimal outcomes only occur when each has been done to best practice standards

A Procurement Strategy is essential in ensuring Procurement Success



Objective

- To develop a plan that ensures maximum procurement benefit and compatibility with other business imperatives

How

- Understand:
 - overall business strategy and objectives
 - the size of the procurement task
 - the nature of goods and services supplied and the market for each category
 - E.g. sources, competitiveness, inbound supply chain
 - the risk profiles associated with different categories
 - existing procurement processes and resources used
 - the supply chain issues associated with each category
 - the application of information technology - eBusiness potential

Deliverable

- Provide an integrated approach to procurement that addresses –
 - procurement organisation structure
 - business risks that have to be managed
 - procurement methodologies that should be employed
 - capacity for benefits from eBusiness

Supplier Selection is Critical to being able to Achieve Desired Outcomes



Objective

- To develop a supplier base that can consistently deliver best practice procurement outcomes in terms of direct price, value-added benefits and supply chain efficiency

How

- Develop detailed requirements specifications
- Conduct market research to target pre-qualified suppliers
- Develop tender documents and tendering rules
- Develop evaluation models
- Issue tenders and receive responses
- Determine a shortlist and seek clarification and validation of offers
- Conduct detailed evaluation and compare with benchmarks

Deliverable

- Suppliers that can consistently deliver desired outcomes
 - that are a good fit with the overall business strategy
 - that deliver benefits today and into the future
 - that can keep up with the pace of change
 - that are innovative and progressive

Implementation is Difficult – Turning Plans into Reality and making it Stick!



Objective

- To implement arrangements with suppliers and/or changed processes so that benefits are achieved

How

- Develop an implementation plan
- Develop contracts with suppliers and communicate new arrangements
- Train and familiarize staff - both internally and at supplier
- Establish accounting and payment processes
- Joint roll-out of new arrangements
- Establish required IT systems

Deliverable

- Changed arrangements and/or processes that work!
- New supplier contracts
- Documented information and product flows

Critical Point

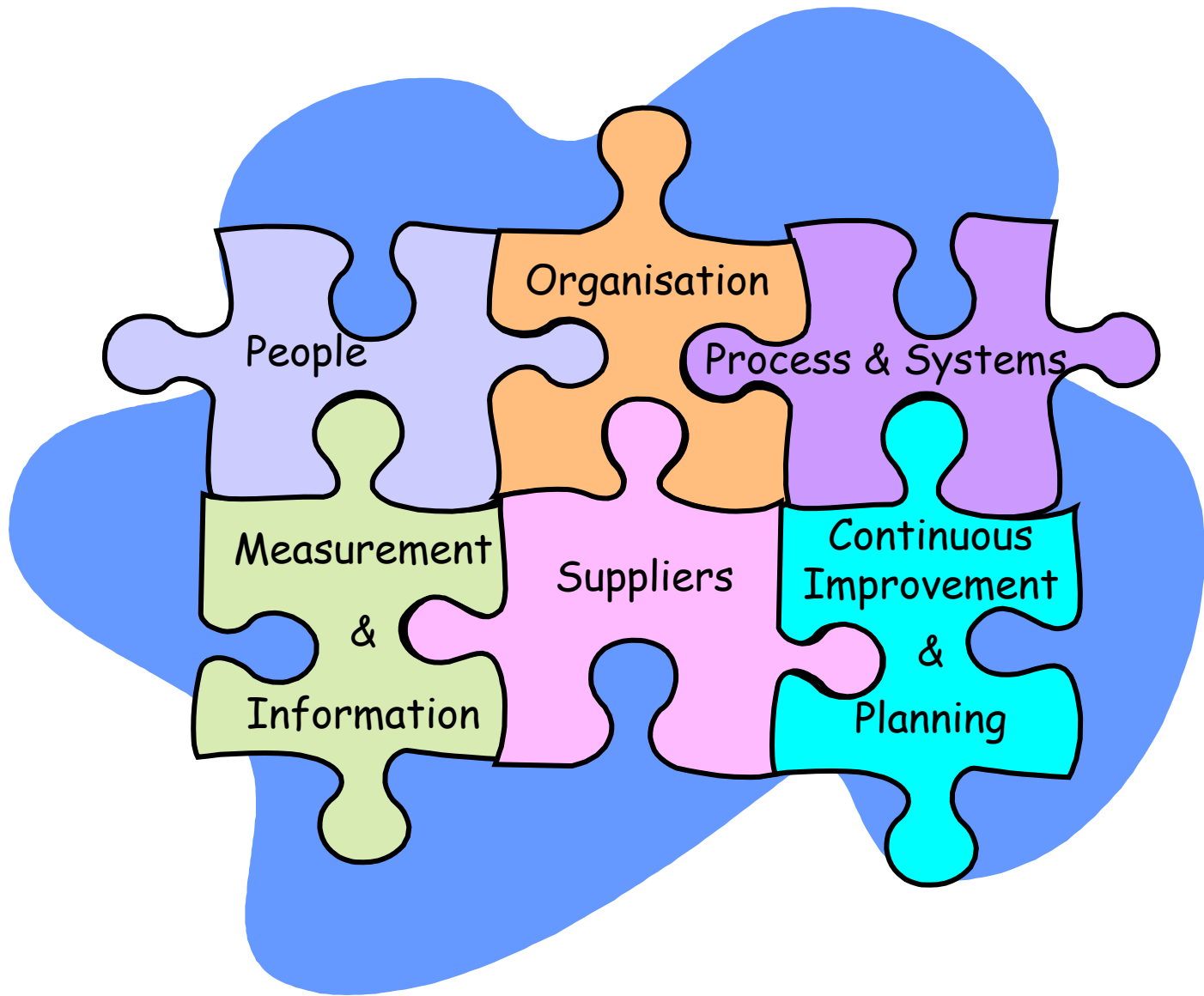
- Change issues and how well they are managed will have a major impact on successful implementation

eProcurement? The Fundamentals must be Right

eProcurement
requires a solid
procurement
foundation

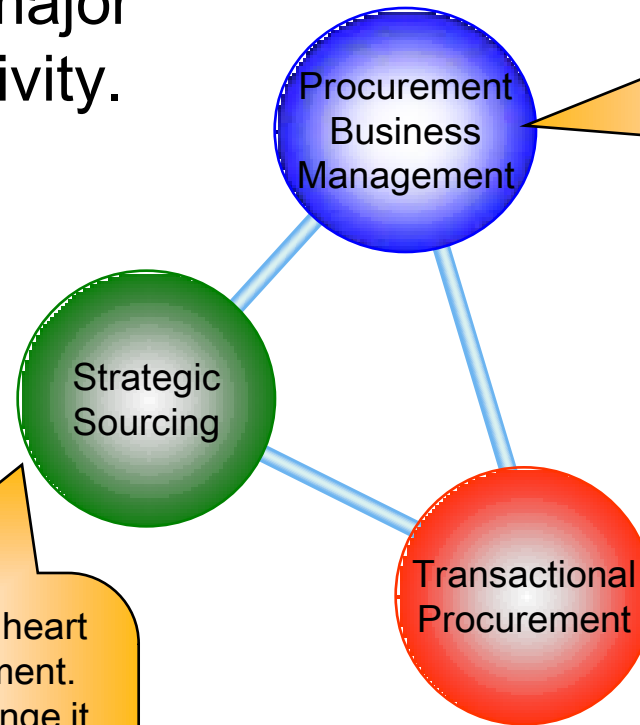
- eProcurement facilitates access to and greater sharing of information
- eProcurement can bring about transaction efficiencies
- Redefinition of procurement structures and product flows can occur
- How well the elements of best practice procurement are managed will determine the gains to be achieved through eProcurement

Winners
and
Losers



Overall Landscape

Consists of 3 major spheres of activity.



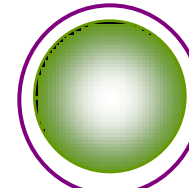
Procurement Business Management – is the process we use to ensure that we have the right plans in place and the governance to manage the function effectively.

Strategic Sourcing – The heart of Professional Procurement. For every sourcing challenge it is the process that takes us through from initial stakeholder engagement to the final contract and implementation.

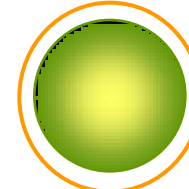
Transactional Procurement – is the process that turns contracts into commitments such as purchase orders through to the payment of invoices.

Segmentation in the Strategic Sourcing Process

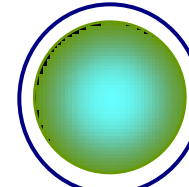
An example



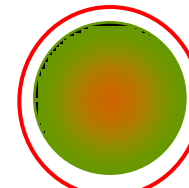
Driven by Account Mgt
Note that key stakeholders may be engaged throughout the process



Driven by Category Management



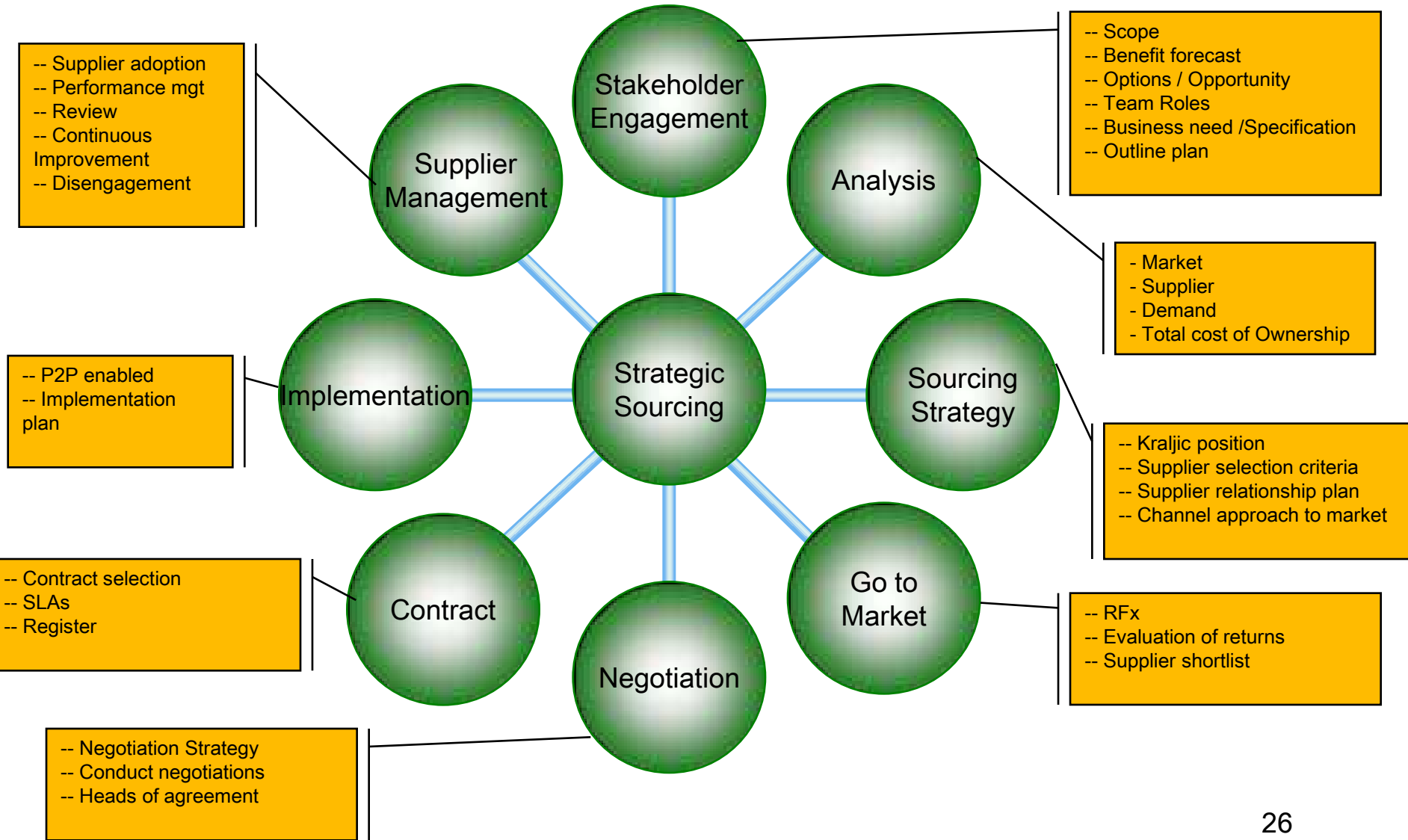
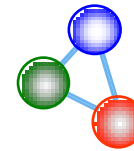
Driven by Sourcing Management



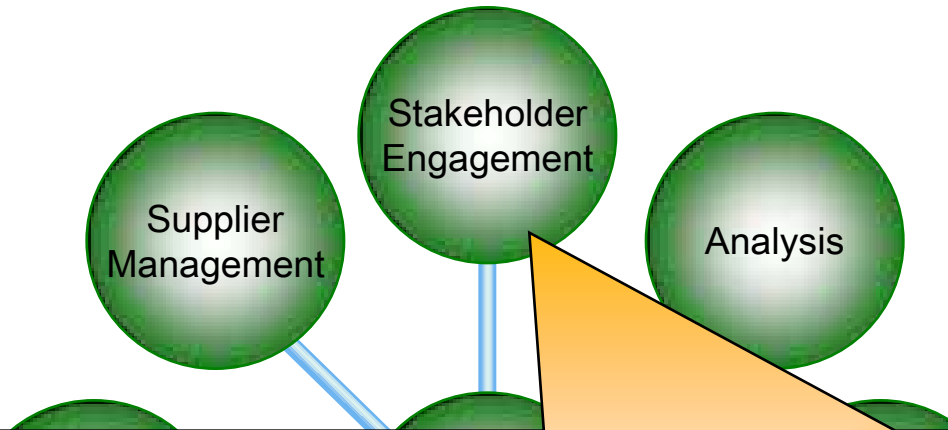
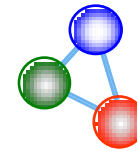
Driven by Supplier Management

Note that Implementation requires Sourcing Mgt & Account Mgt to work together to ensure a good fit between supplier offering and stakeholder requirement

Strategic Sourcing - Overview



Strategic Sourcing



Stakeholder Engagement

Stakeholders include budget holders and other people with a significant interest in, or knowledge of a commodity.

It is vital that these people are involved in the following key activities:

- Defining the true business need
- Identifying potential sourcing opportunities capable of satisfying the business need
- Agreeing the sourcing project scope and plan
- Updating the benefit forecast

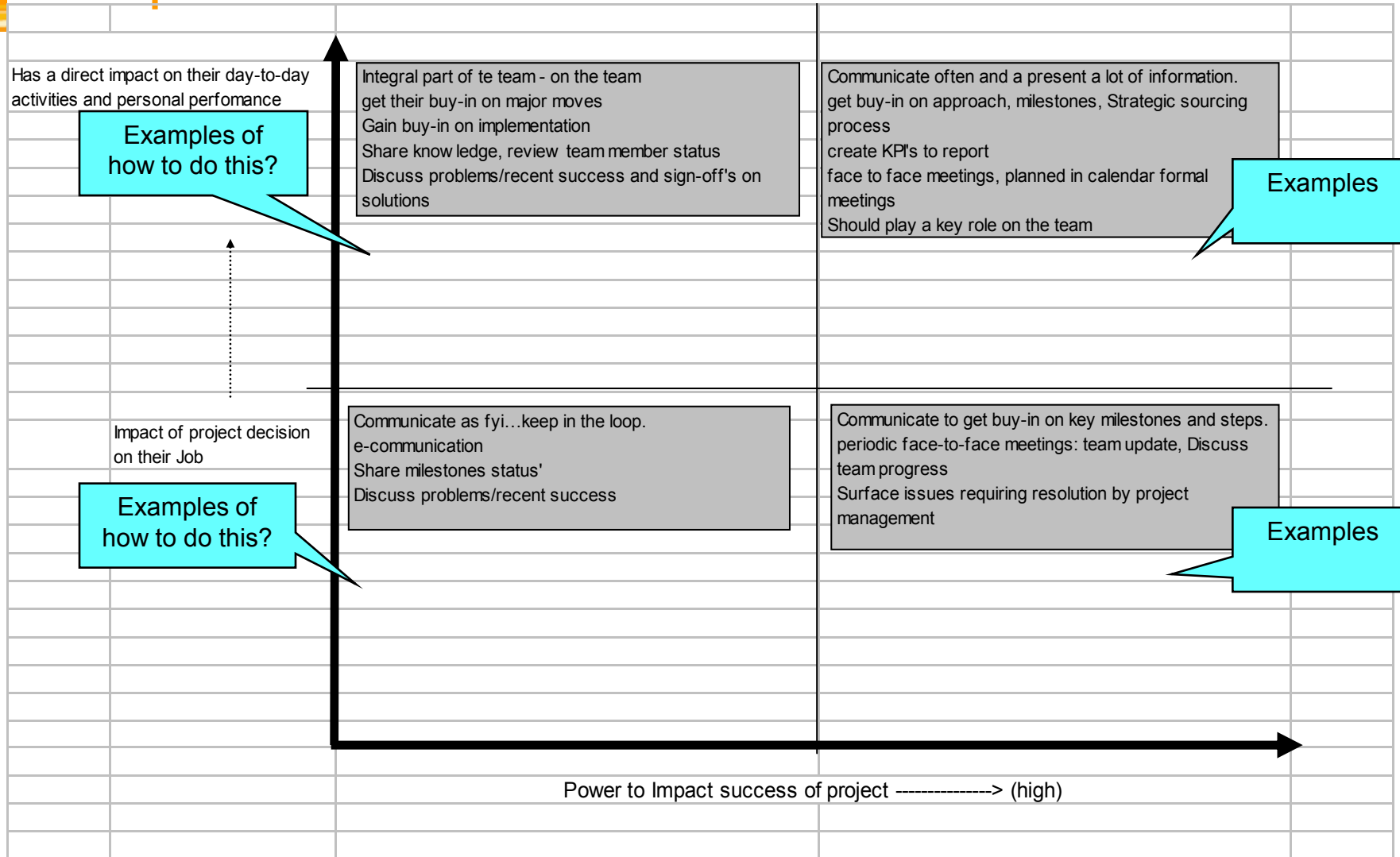
The project plan and benefit forecast are approved at Checkpoint 1



Relationships Module

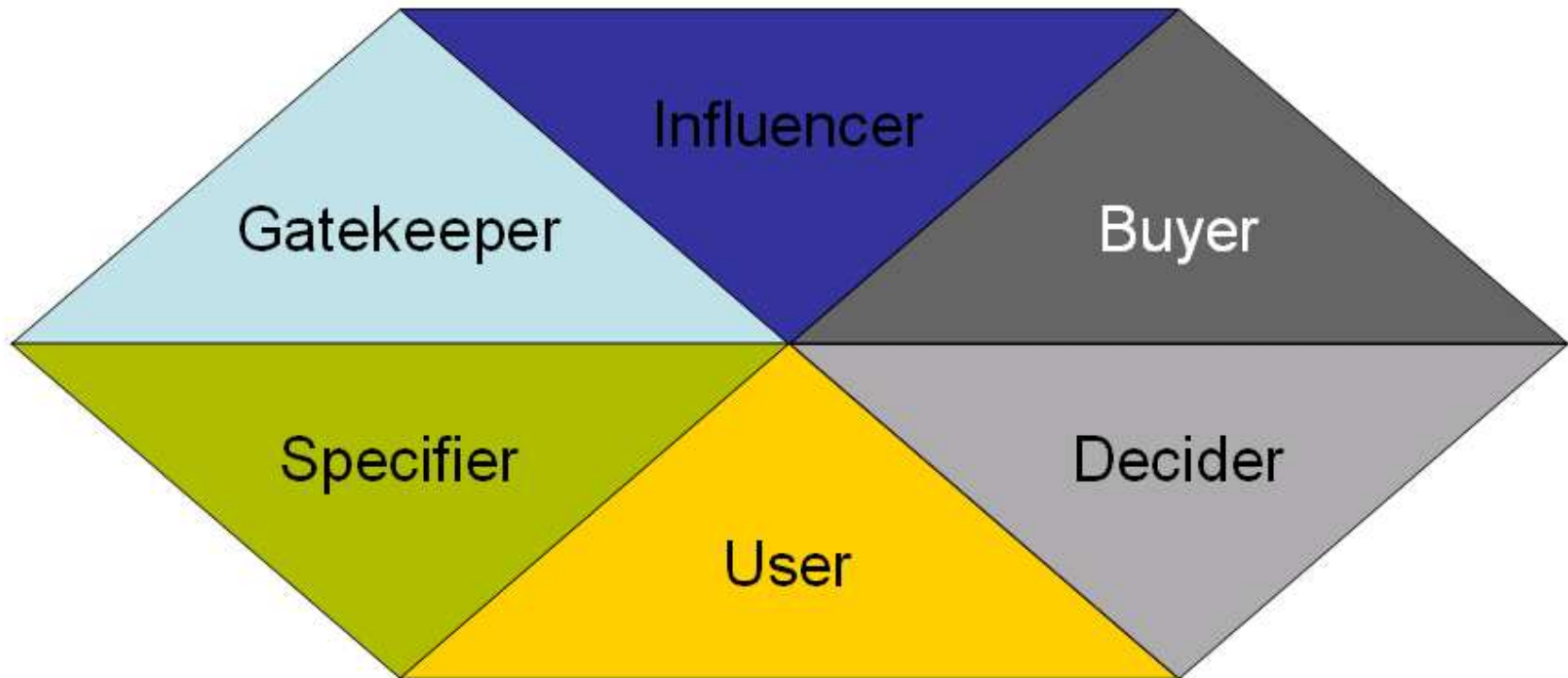
- Recognise the critical role that PAcMan plays in the organisation's strategy to optimise value obtained by managing spend effectively
- Understand critical touch points within the organisation
- Recognise the characteristics of customer relationships
- Techniques to engage, influence, negotiate and overcome resistance

Map out stakeholders so you can develop a plan



The Decision Making Unit (DMU)

We have used the 6 “customer” roles that form the start of a customer assessment for help clarify who the key people are within the business unit and define the approach needed.



What does it meant?

Influencer	Influences what supplier is selected. May even be outside the organisation, e.g. a consultant. May be influenced by a variety of factors (brand, personal relationships, previous experiences).
Buyer	Places the contract. Likely to be motivated by price and by negotiating a deal. Usually the key contact for the representative.
Decider	Someone high in the organisation who makes the final decision on which firm to go with. Brand and reputation of supplier.
User	An individual or team who will be using the service. Likely to be influenced by personal relationships and previous experience. Can sometimes have surprisingly little influence on the decision but may have a high 'grumble factor' that might affect, e.g. contract renewal.
Specifier	Some organisations formally specify the quality etc that they expect from a firm's legal expertise. Sometime specifiers may also determine service level agreements (SLAs). Likely to be influenced by performance guarantees.
Gatekeeper	Controls access to others, e.g. secretaries, assistants or other team members. Has 'negative power', which is the power to prevent things happening.

Map Stakeholders, plan how you will involve them from the start so you have their buy-in and.

Purpose of this step

To gain agreement and commitment to:

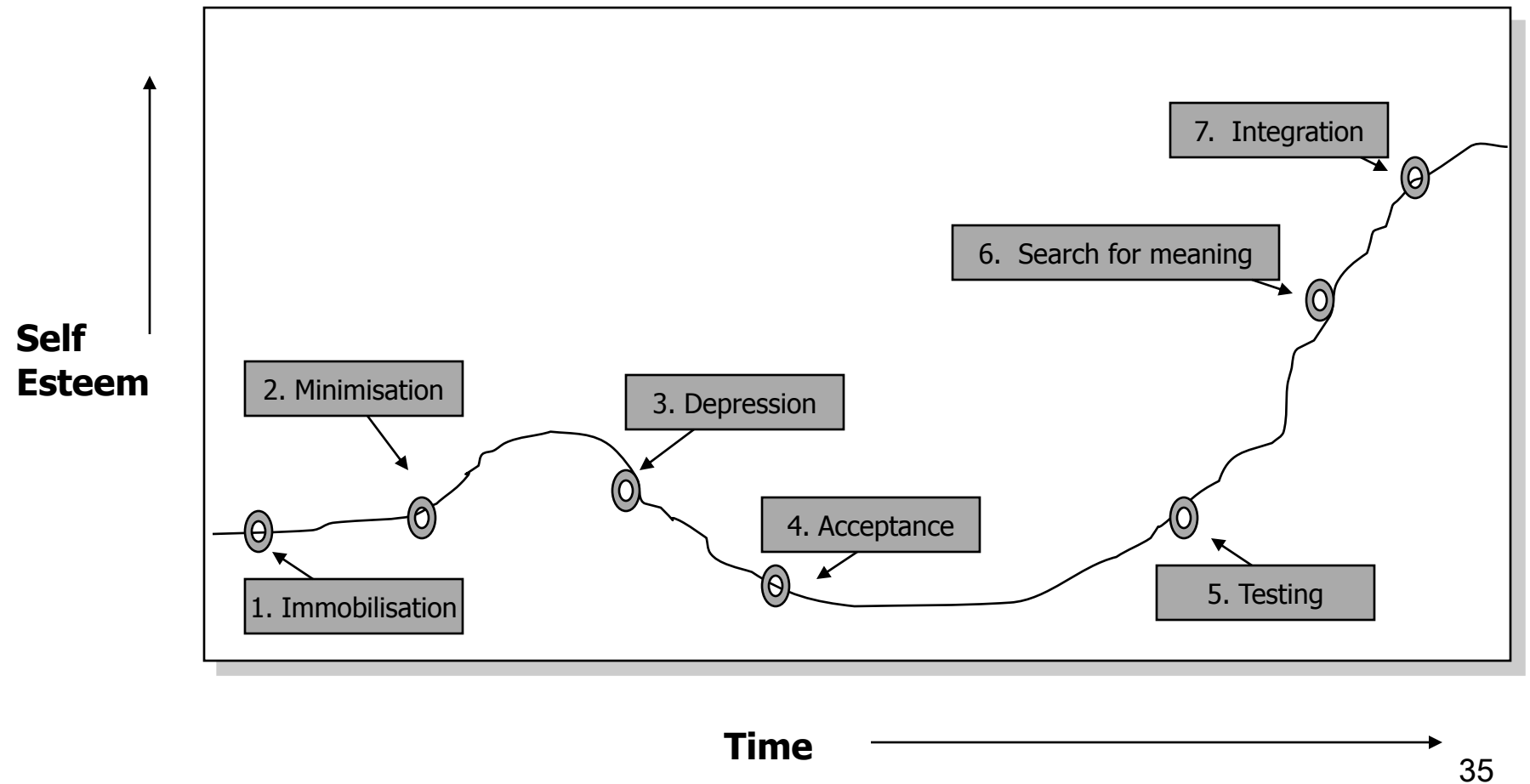
- The sourcing strategies
 - The RFI/RFP evaluation criteria
 - The RFP high-level content
 - The supplier communication strategy
- To canvas opportunities to improve the strategy
 - To reduce resistance at a later stage
 - To ease implementation

Matters to discuss

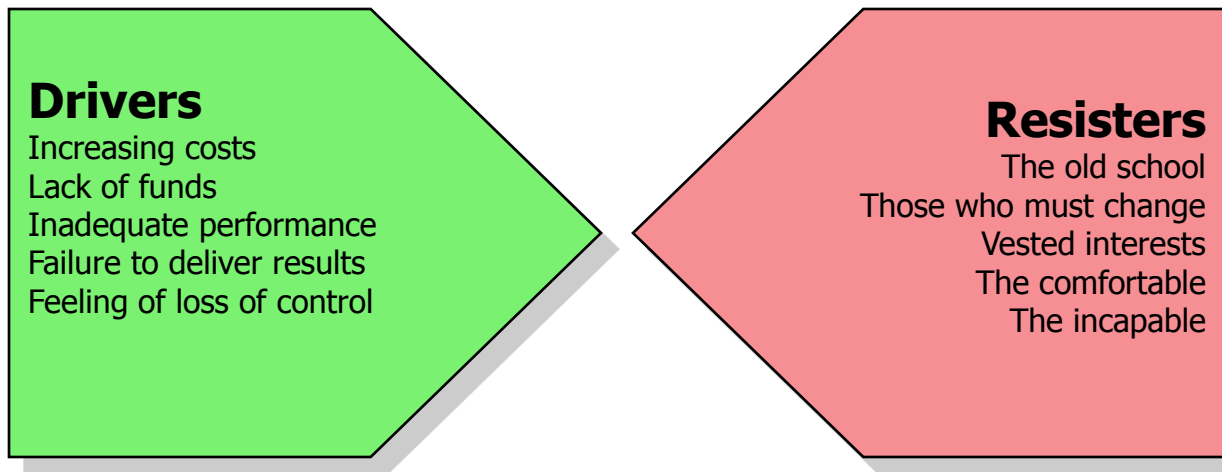
- Review a summary of:
 - Category spend analysis
 - Market dynamics and trends
- The proposed sourcing strategies and savings targets (by region/OpCo)
- The proposed selection criteria and key supplier/product issues to be addressed
- Agree approach to supply market and communication messages

Remember that there is no better way to reach agreement with stakeholders than to involve them from the start of the process

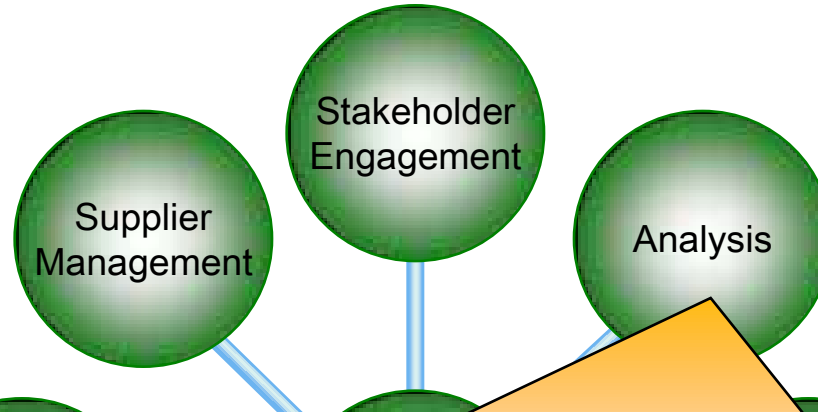
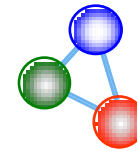
What does change feel like?



Force field analysis



Strategic Sourcing



Analysis

Analysis is undertaken by the project team.

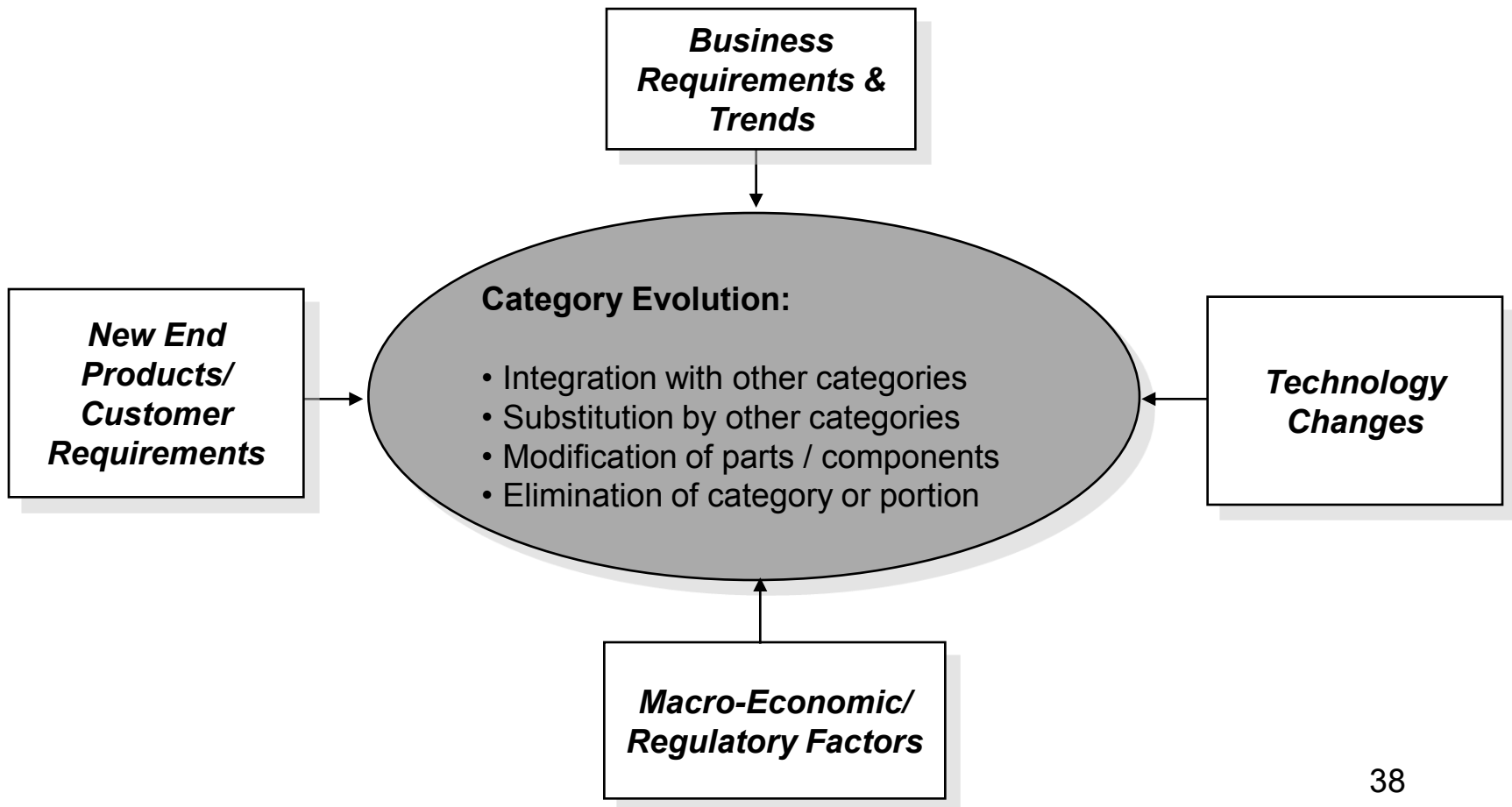
Its purpose is to evaluate each potential sourcing opportunity in detail and to select the one which best meets the business need.

Analysis covers:

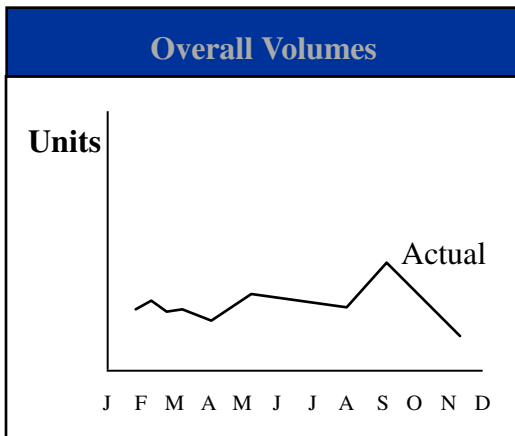
- Internal demand (spend and volume trends and forecasts)
- External supply (market and supplier characteristics)
- Lifetime cost calculation (Total Cost of Ownership)

Determine the business needs

Analyse the potential evolution of the category by understanding changes in our business environment



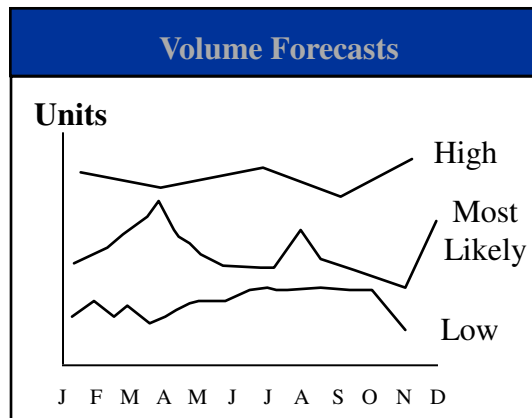
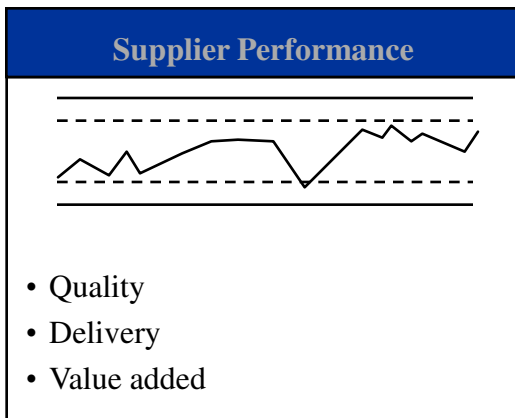
Analyse the spend



Current Suppliers

Supplier	Volumes
Moore	\$ _____
Staples	\$ _____
Standard Register	\$ _____
Corporate Express	\$ _____
Total	\$ _____

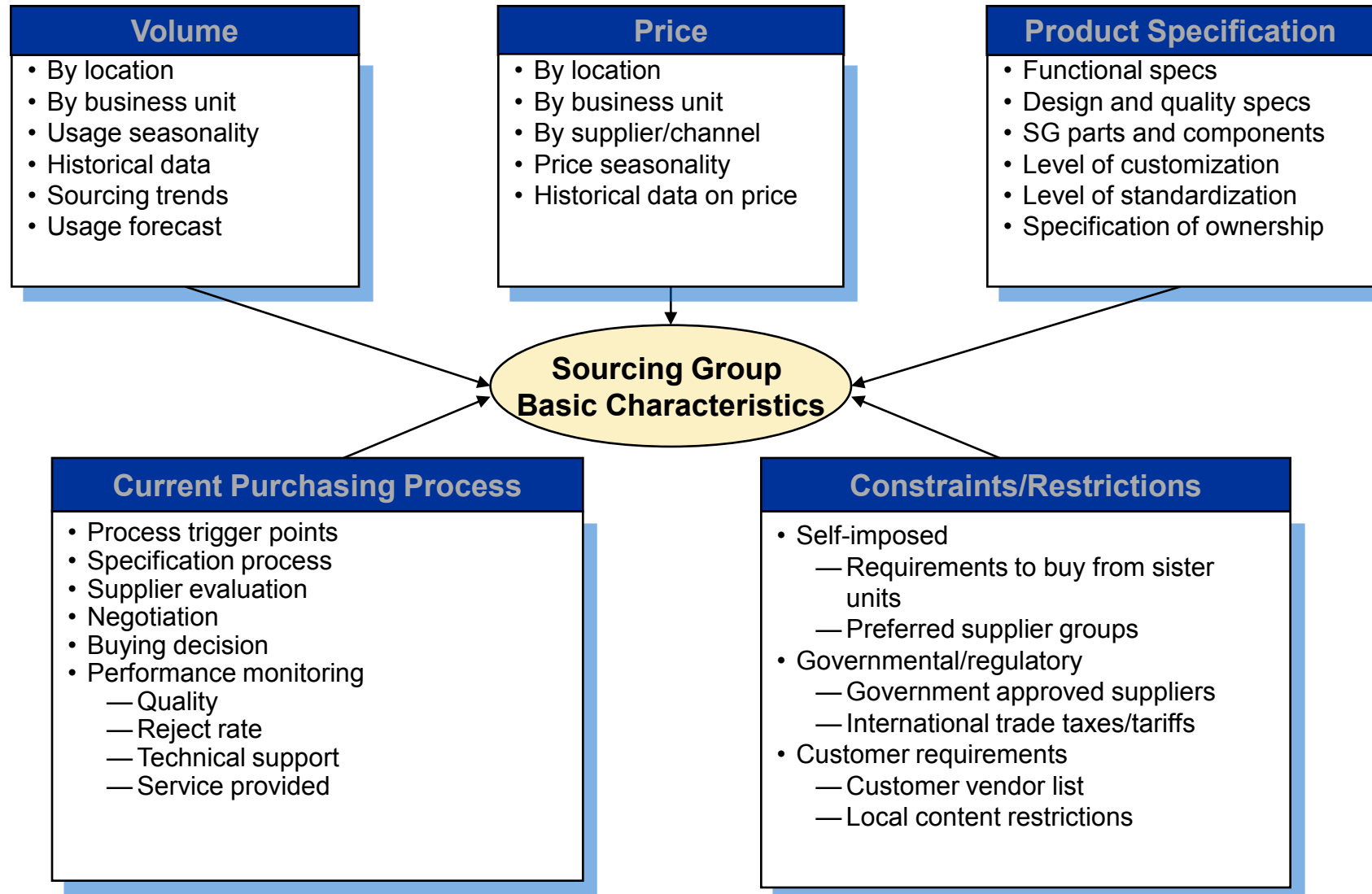
- ### Pricing
- Applicable quantity/timeframe
 - Formulas
 - Scope of products/services
 - Assumptions
 - Contracts



- ### Specifications
-
- Paper weight and grade
 - Finish and quality
 - Size and number of pages
 - Colors
 - Graphics

Develop an in-depth understanding of what we buy, from whom, and how much

Basic data needs



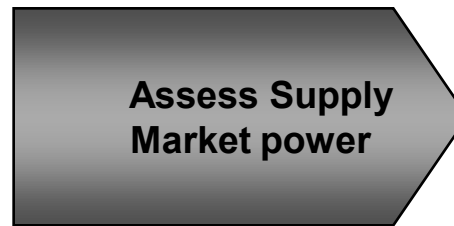
Understand the supply market by...

Step 1



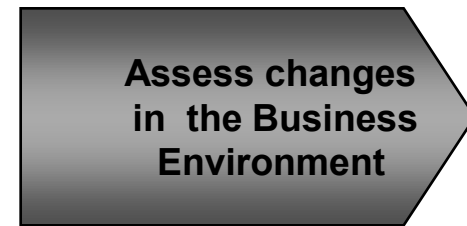
- The logical grouping of suppliers into market segments to assist the identification of ALL suppliers capable of meeting our business needs.
- Assessment of suppliers key competitive characteristics (capability and strengths and weaknesses).

Step 2



- “5 Forces” analysis of market competitiveness;
- Supplier Power
 - Buyer Power
 - New Entrants
 - Substitutes

Step 3



- Economic
- Regulatory
- Technological
- Geographic / Global
- Customer / Consumer

Information from many sources

Accounting Dept

- History of purchases (G/L)
- Unit prices by suppliers (invoice files)
- Volume purchased by supplier (A/P)
- Seasonality of purchase (A/P, G/L)

Purchasing Dept

- Information on current and past suppliers
- Unit prices
- Price and pricing bases
- Supplier characteristics
 - Capacity
 - Quality
 - Location
- Term of payments
- Supplier constraints
- Product specs
- Potential suppliers

Technical/Engineering Dept.

- Product specs
- Potential suppliers (name, capabilities, quality)
- Current supplier (capability, quality, certification)
- Bill of material structure
- Possible alternative products

Sales Dept.

- Seasonality of end product
- Sales Dept. requirements to Purchasing Dept. (local, content, advantaged suppliers...)
- Target sales markets

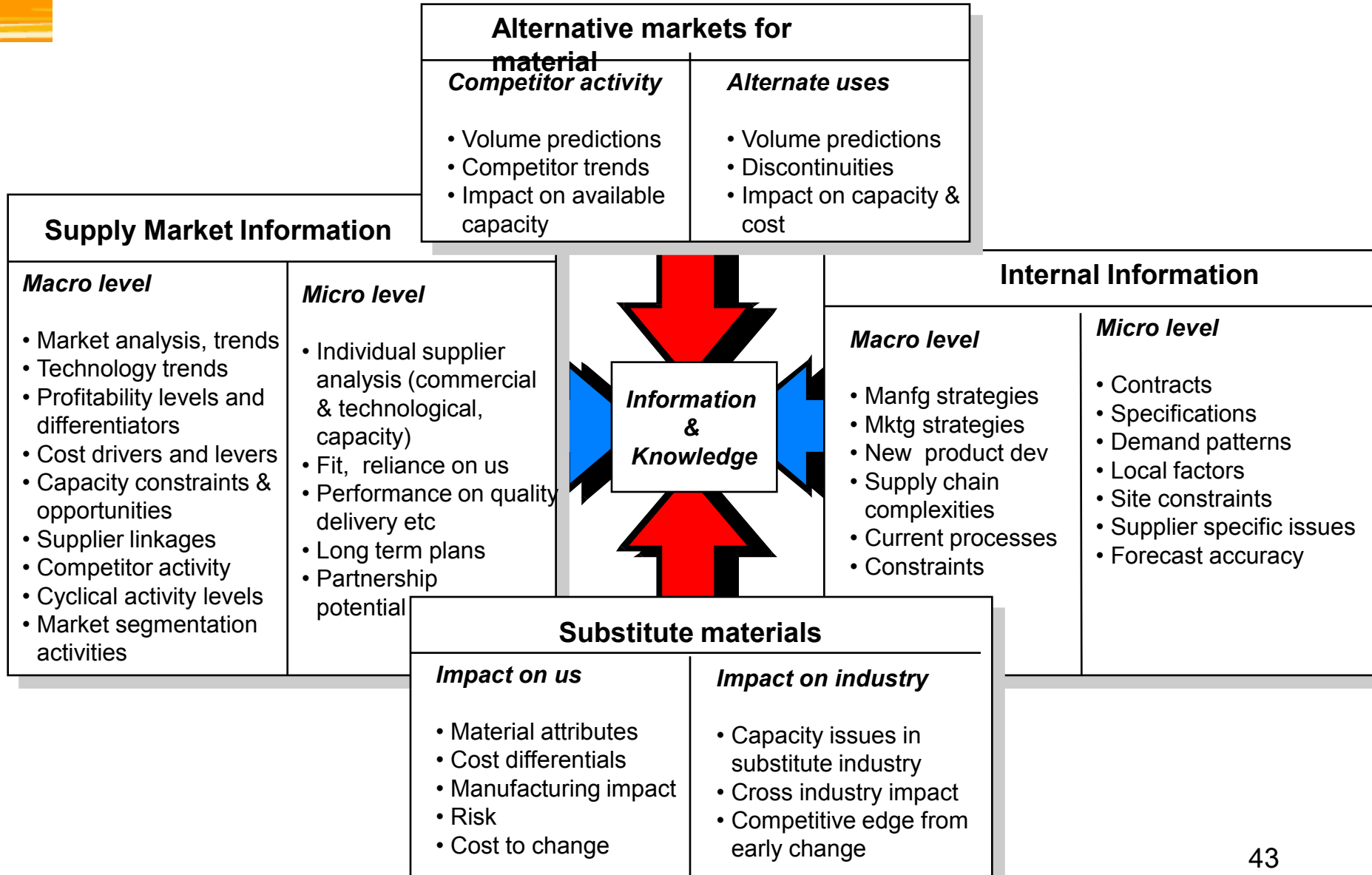
Manufacturing Dept

- Incoming quality history
- Volume by site
- Seasonality of usage

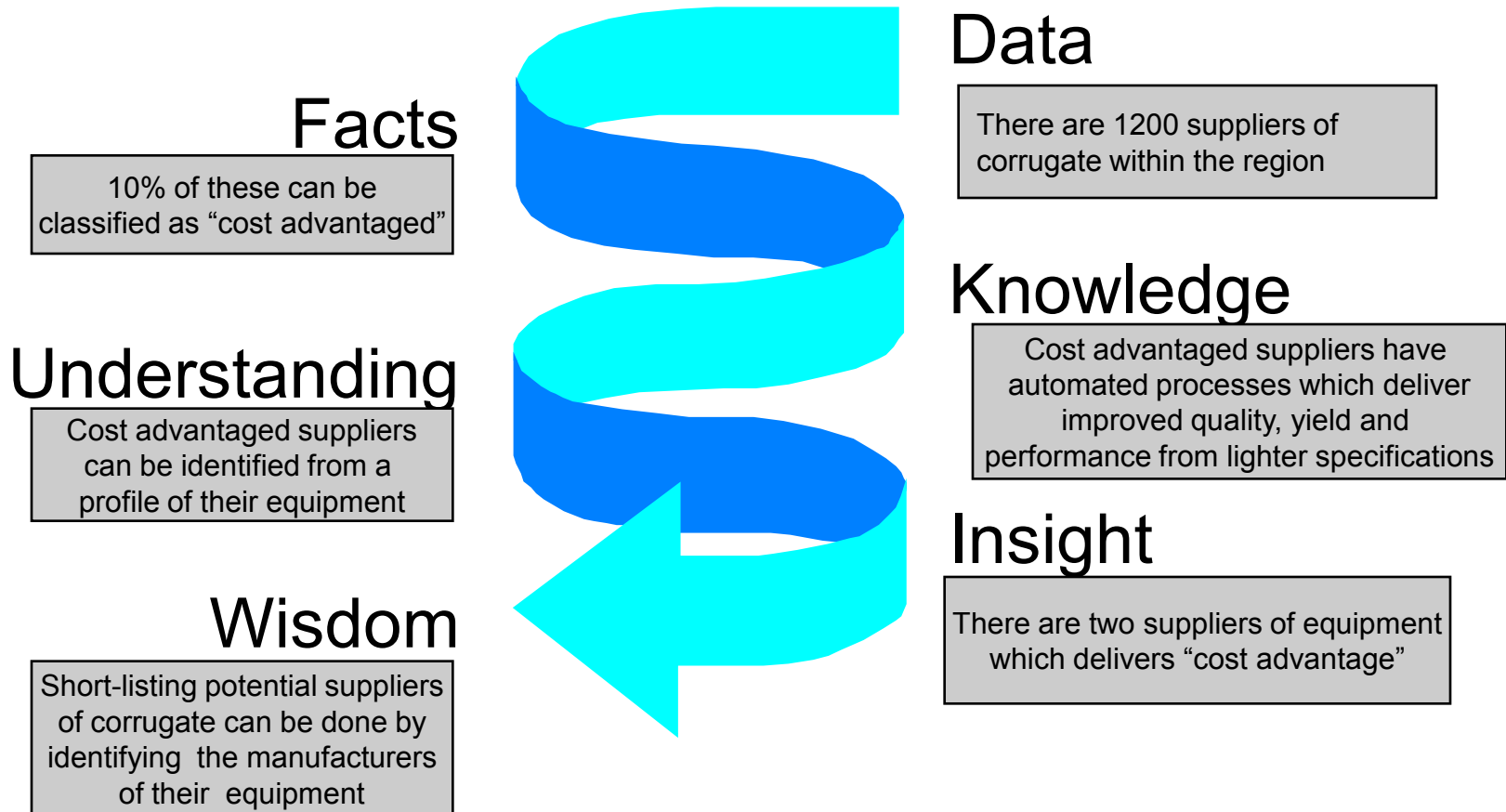
Suppliers/Others

- Volume history
- Pricing
- Service performance
- Technical specs
- A.T. Kearney Sourcing Group profiles

Market research is key

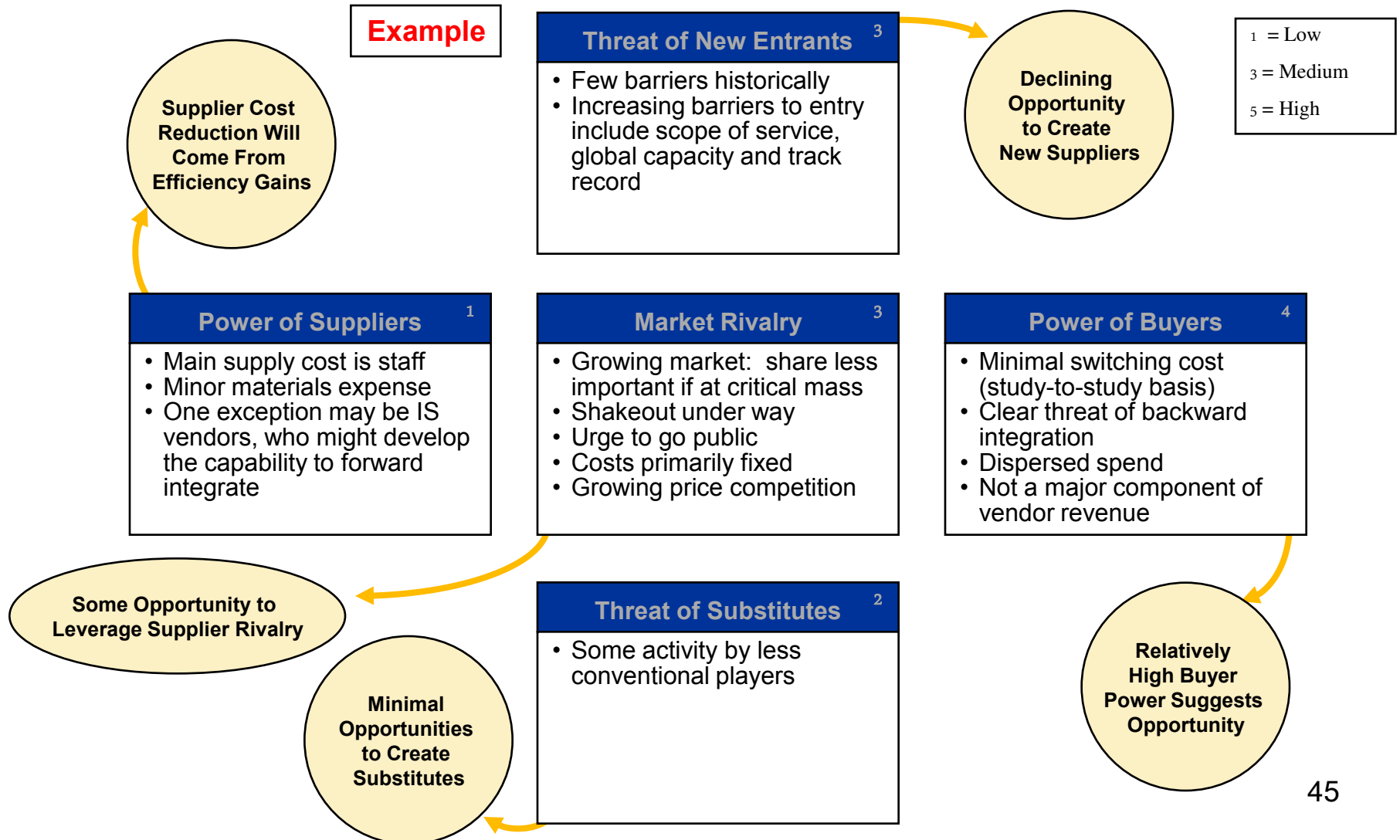


Data needs to be turned into insight and wisdom



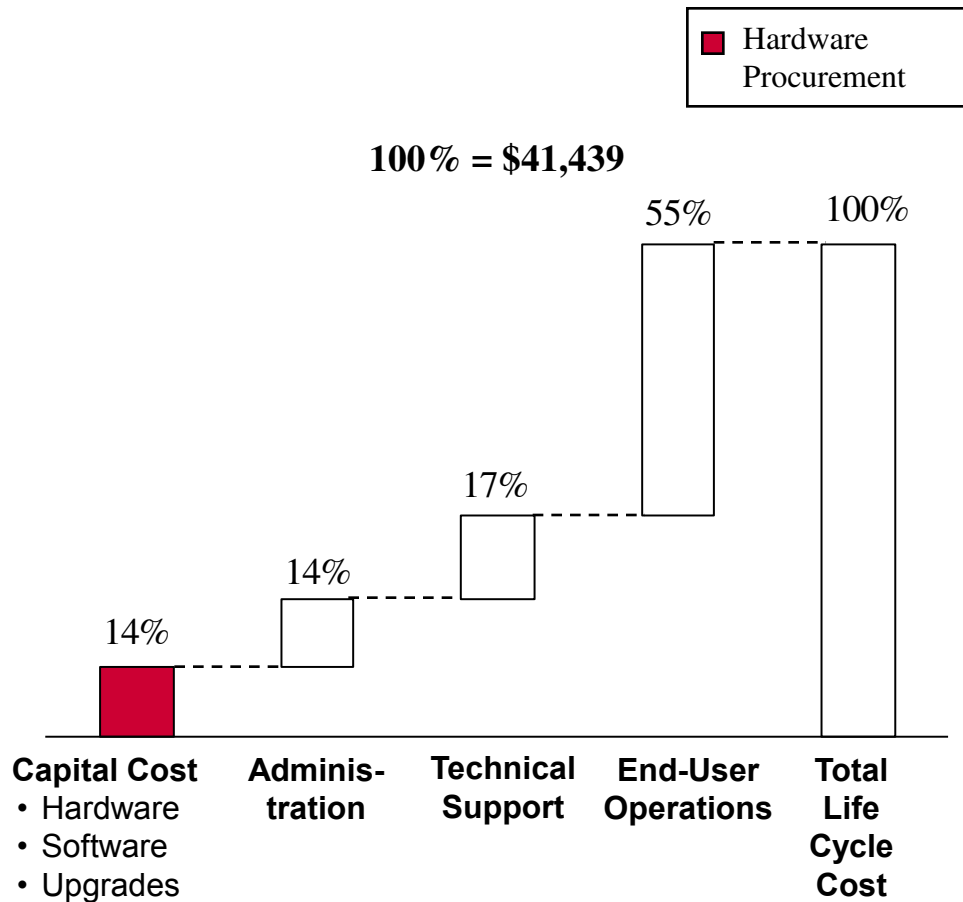
There is always a danger that the buyer ends up with “analysis paralysis”. It is important not to focus on data, but to use the data to generate insight and wisdom

Demonstrate insight into the market



Demonstrate an understanding of total cost

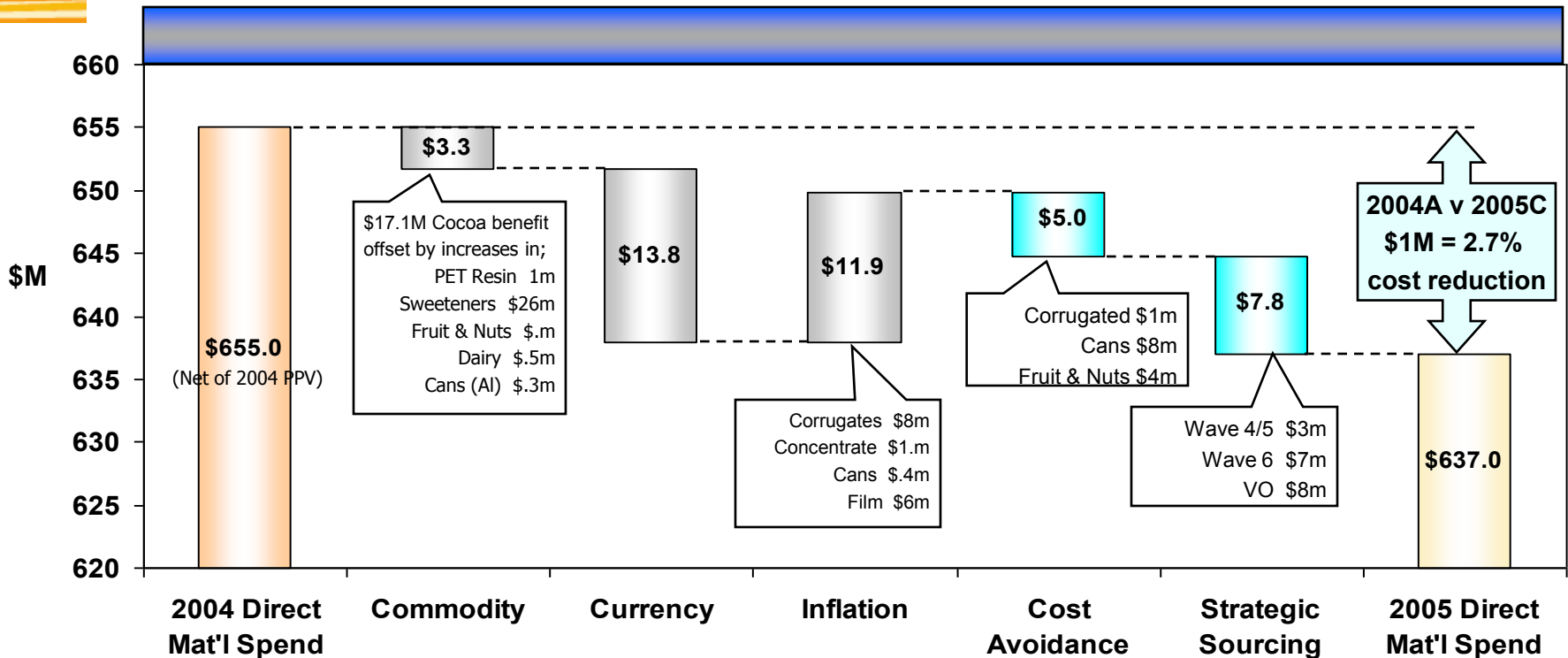
Life Cycle Cost of Desktop Technology (Five-Year Total Cost of Ownership)



Preliminary PC and Peripheral Hardware Sourcing Strategies

- Develop enterprise wide asset management strategy, including cascading and retiring
- Reengineer procurement process to support standards and simplify distribution
- Further leverage VAR or third-party testing and configuring capabilities
- Consolidate volume

Use this slide to show your value proposition



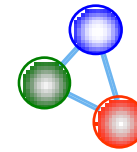
2005 Strategic Sourcing PPV Contract is \$6.5m v Standards;
 direct cost \$3.7m
 VO \$2.8m

2005 Target is \$4.1m

Notes:

- **\$9.6m of Sourcing benefits** have been built into 2005 standards (such as \$3.0m benefit from Sugar)
- This analysis excludes the impact of **Project VVV** - which will increase costs by approx. **A\$3.4 m** across the business

Strategic Sourcing



Sourcing Strategy

The Sourcing Strategy defines how we approach the supplier market to procure the product/service, based on the analysis findings.

The Sourcing Strategy will define:

- The best go to market and negotiation approach (e.g. RFX, eAuction etc.)
- The criteria we will use to select supplier(s)
- The ideal supplier relationship (e.g. transactional, strategic)
- The type of agreement, including contract duration and payment terms

The Sourcing Strategy is developed by the project team.

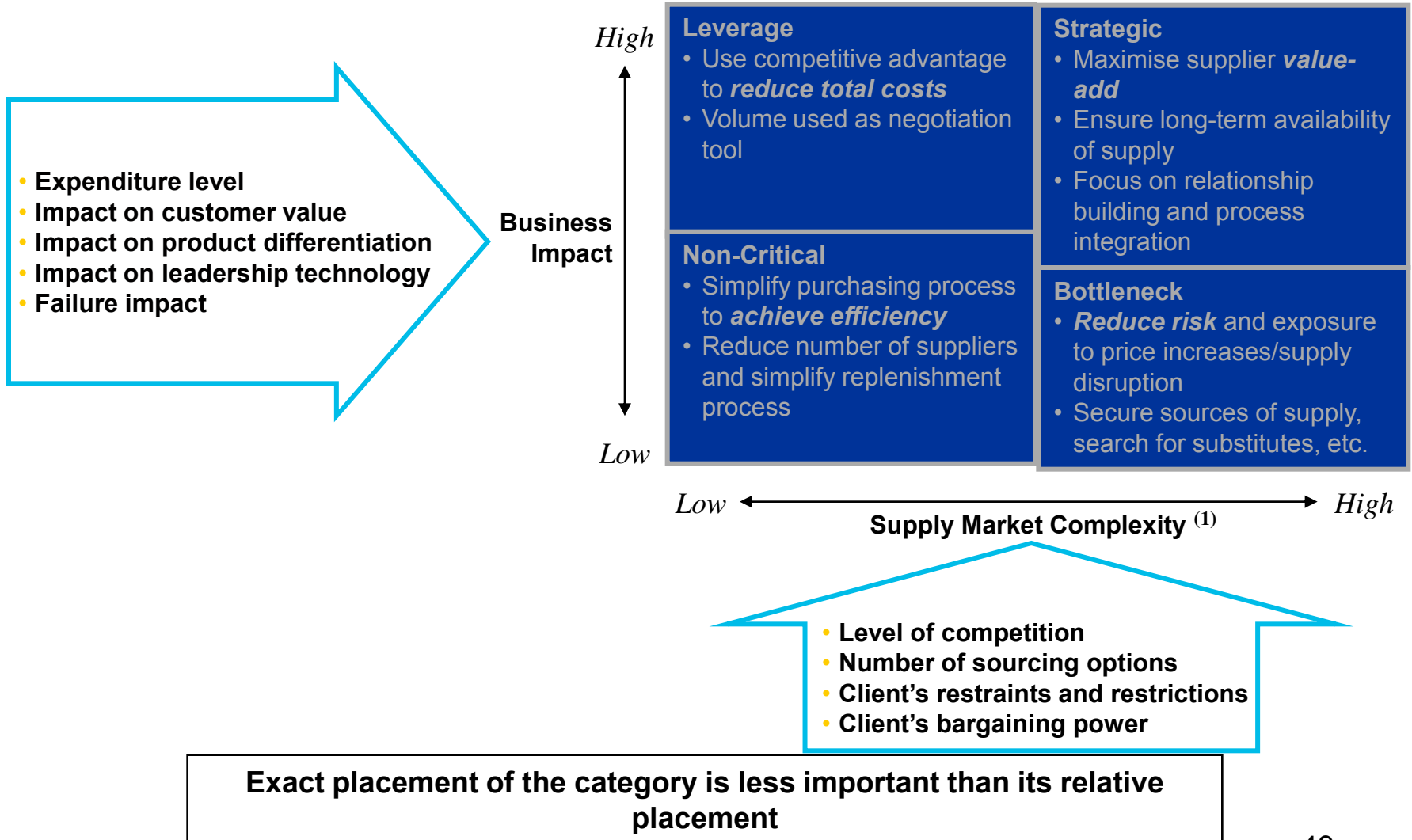
The Sourcing Strategy is approved at Checkpoint 2.

Analysis

Sourcing Strategy

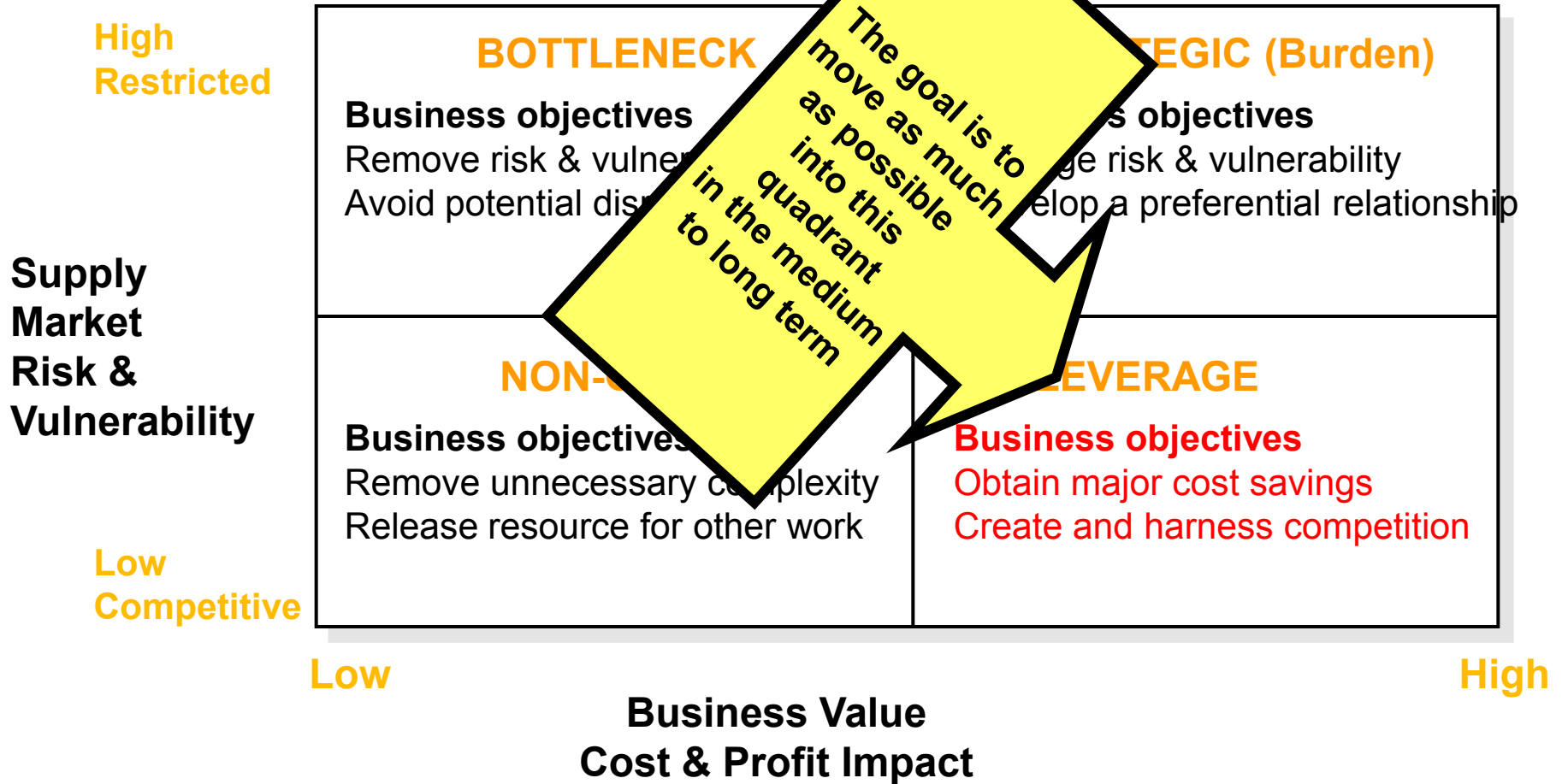
Go to Market

The positioning grid: Segmented approach

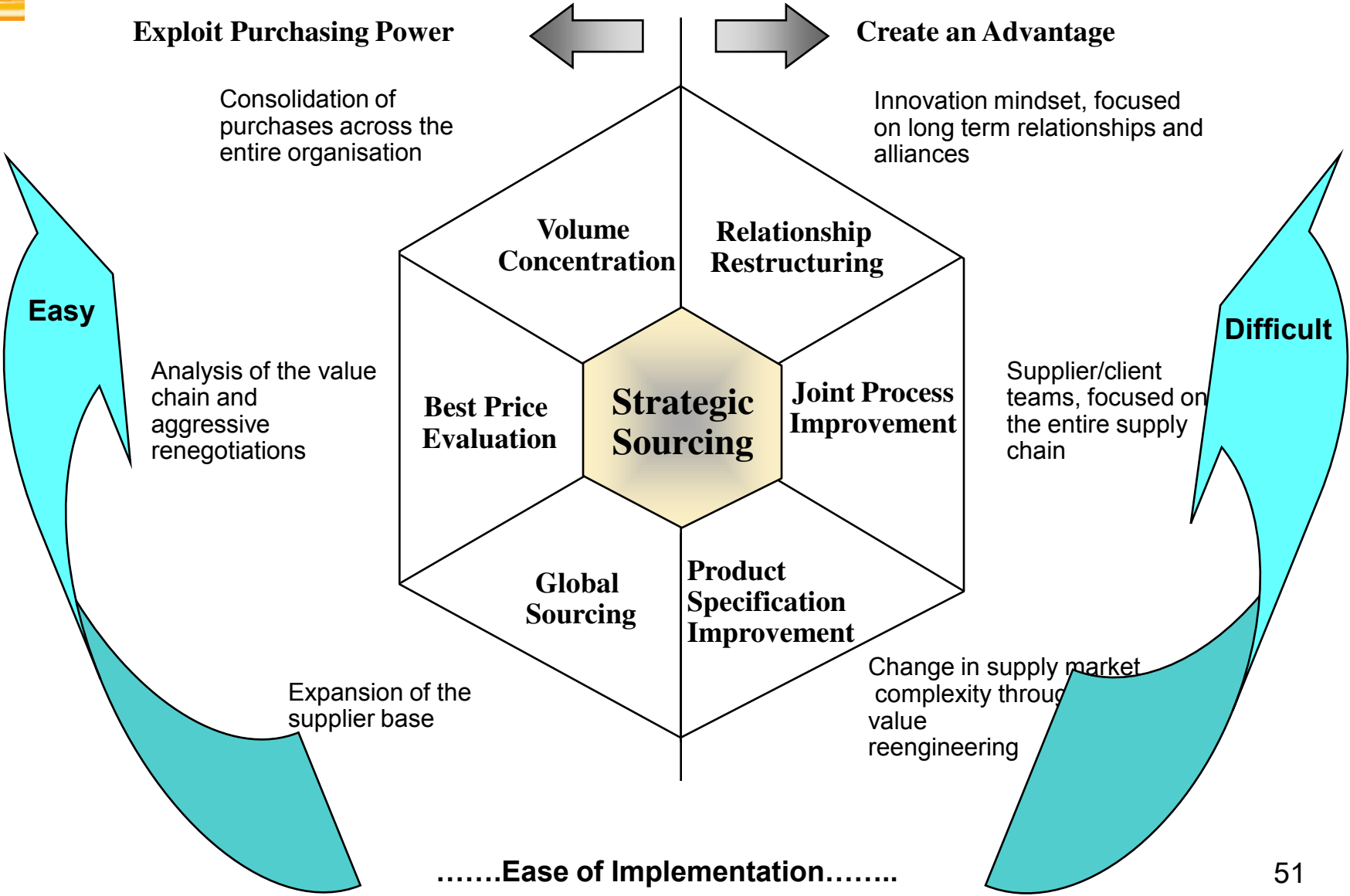


Notes: (1) High supply market complexity generally equates with higher levels of supplier "power" vis-à-vis the buyer. Low supply market complexity translates to increased buyer power (i.e., during negotiation)

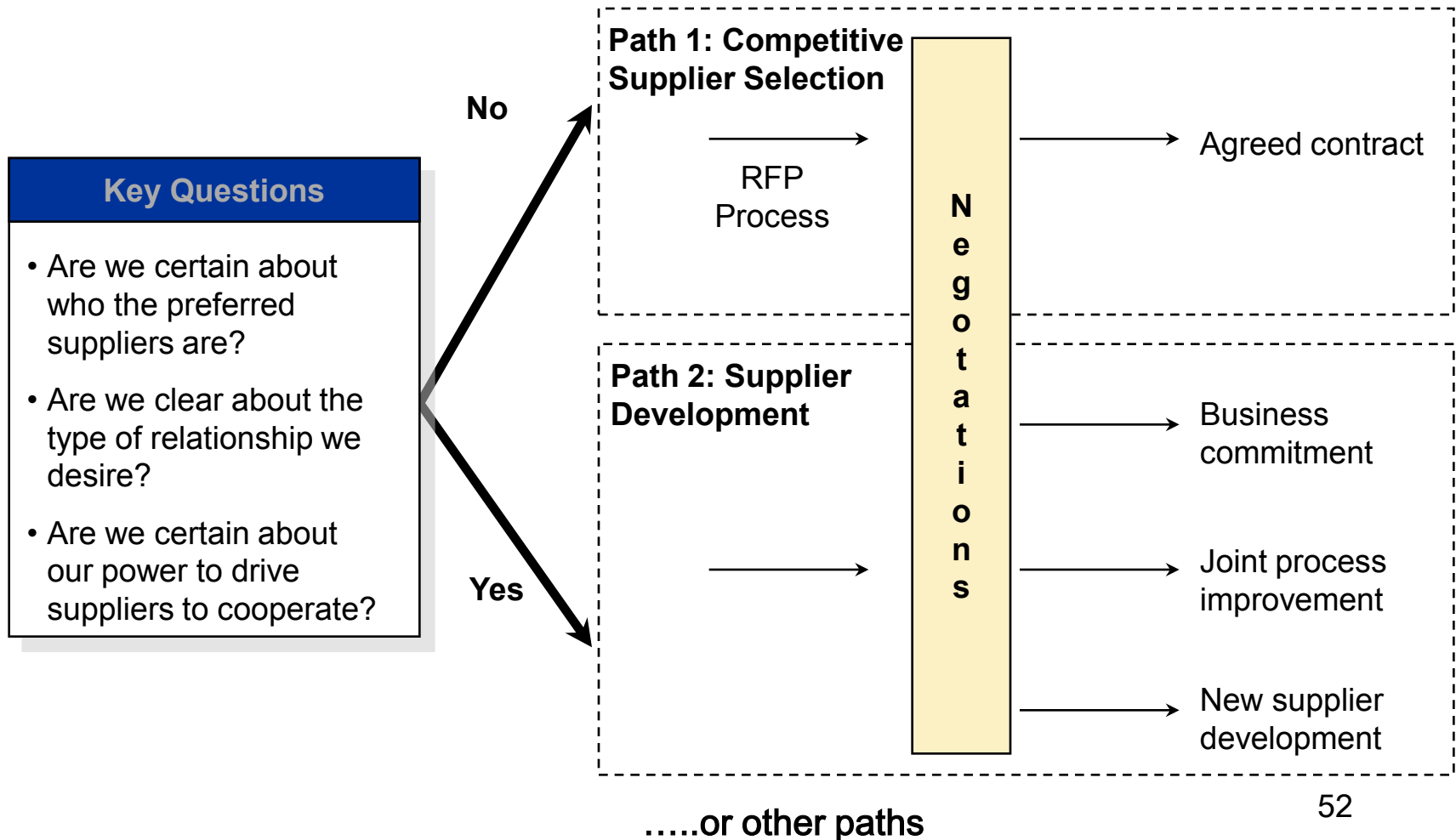
The long term game



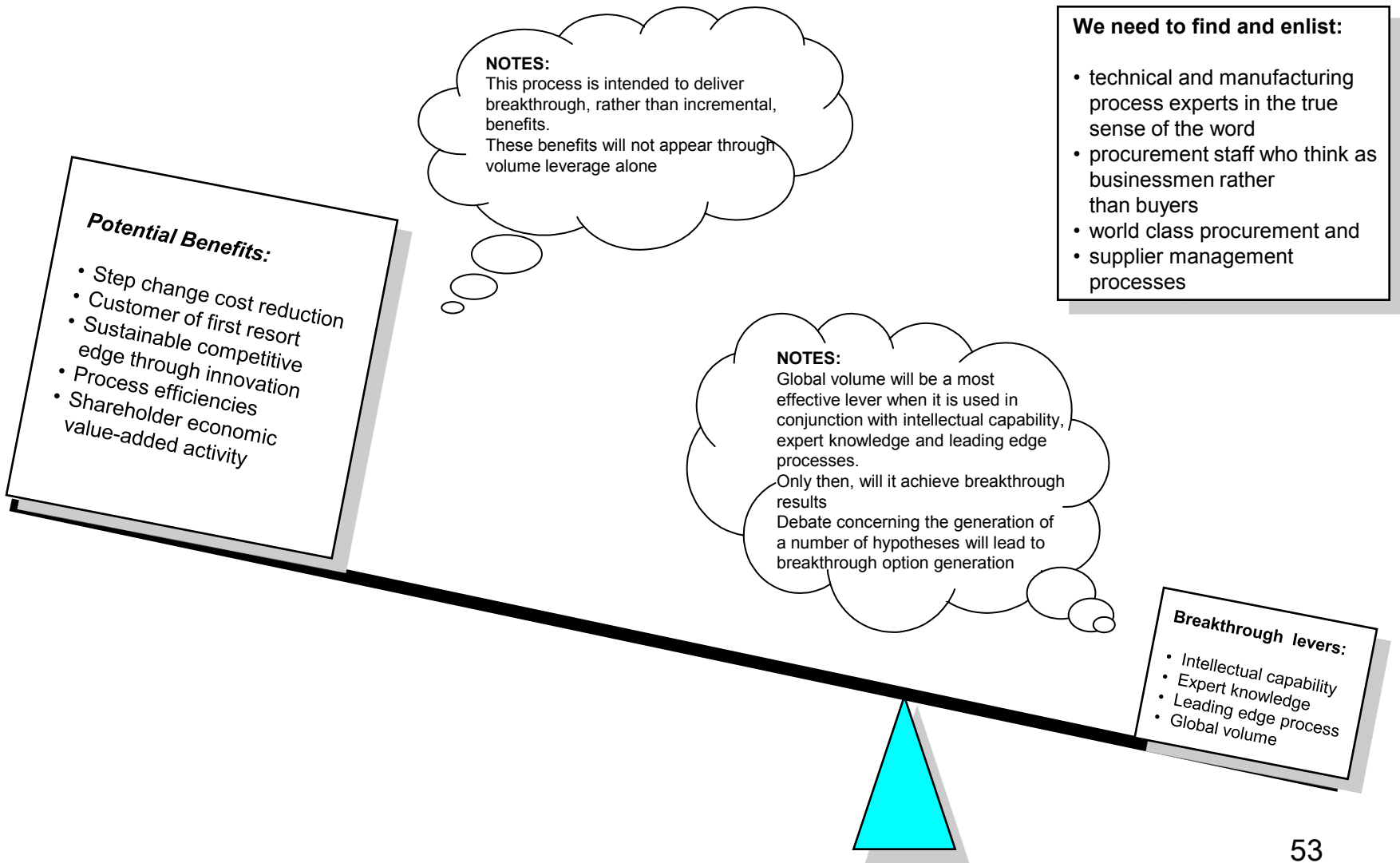
Strategic sourcing approaches



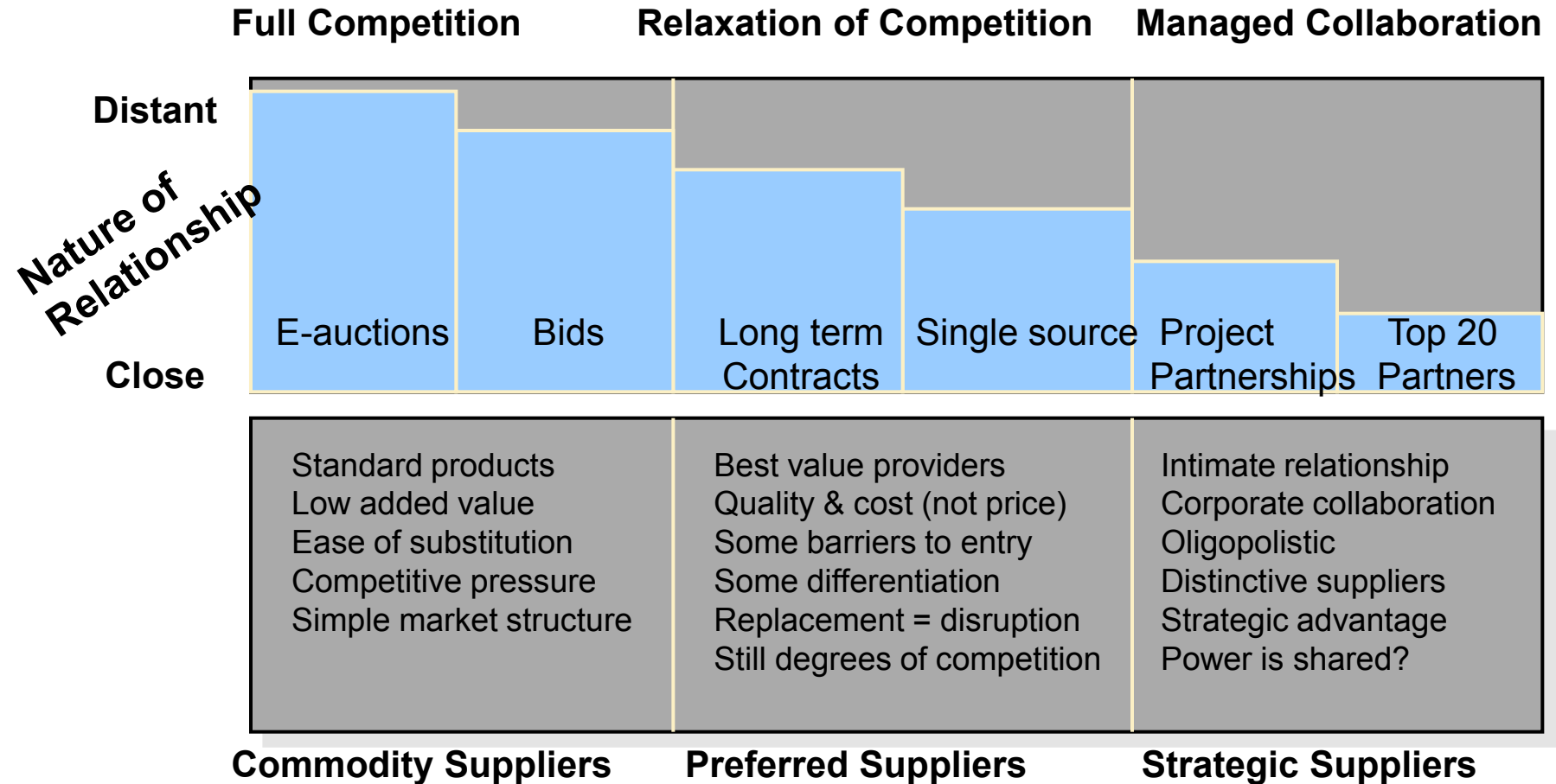
Develop Category Strategy



Look for leverage:



The Supplier Relationship issue



Techniques for volume leveraging

Technique	Description
<ul style="list-style-type: none"> • Reduce number of suppliers • Pool volume across business units • Redistribute volume among suppliers • Combine volume from different sourcing categories • Develop alliances among purchasers • Rationalize/standardize parts (used in combination with Product Specification Improvement) 	<ul style="list-style-type: none"> • For volume concentration, we can: <ul style="list-style-type: none"> — Reduce number of suppliers. Reducing the total number of suppliers used, thereby giving each remaining supplier an opportunity to gain volume — Pool volume across units. Increasing the total volume available to offer to a supplier by combining volumes across decentralized buying units. Sometimes called “cross-unit leverage” — Redistribute volume among suppliers. Shifting volume among suppliers in order to increase the volume for a given supplier or suppliers — Combine volume from different sourcing categories. Negotiating with the same supplier for total volumes across different sourcing categories. Sometimes called “cross-commodity leverage. Increased total volume provides opportunities for supplier cost reduction in areas such as administration and logistics — Alliances among purchasers. Where companies or individuals join together to pool their total purchasing volume in order to gain leverage with suppliers. These are often called buying groups or buying co-ops — Rationalize/standardize parts. Involves selecting a common specification, supplier or part number for an item across users. This increases the potential for a given supplier to get more volume, and should also result in less inventory and reduced engineering costs

Techniques for best price evaluation

Technique	Description
<ul style="list-style-type: none"> • Benchmark internal prices • Renegotiate/rollback prices • Un bundle prices and model “should-costs” • “Threaten-back” leverage • Use competitive bidding • Use commodity hedging/trading • Index/cap prices • Compare total cost among potential suppliers • Base pricing on profitability • Develop long-term contracts 	<ul style="list-style-type: none"> • For best price evaluation, we can: <ul style="list-style-type: none"> — Benchmark internal price. Equalize prices and commercial terms to the best available in the company — Renegotiate/roll back prices. Identify lower priced sources of supply (e.g., via global sourcing) and asking existing suppliers to match these conditions — Un-bundle prices and model should costs. Request separate price quotation for unique cost elements of the product or service purchased (e.g., product price separate from transportation, or production setup cost separate from unit run costs) to provide better insights into cost drivers — “Threaten-back” leverage. Use the company’s volume to develop, or threaten to develop new or alternative sources of supply that create a competitor to a current supplier. Can create an “avenue of escape” from being captive to a supplier — Use competitive bidding. Identify a broad list of candidate suppliers (e.g., via global sourcing), and soliciting proposals from the supplier (via an RFP process) — Use commodity hedging/trading. Establish current or future trading positions based on expected prices — Price index/cap. Tie price levels and price increases for an item to the underlying changes in the price of the key materials (e.g., corrugated box prices tied to the price of liner board, cheese prices tied to the cost of milk) — Compare total cost. Analyze all the internal and external costs that the company has to sustain during the life cycle of the product as a way to understand the true cost of purchasing from one supplier versus another — Base pricing on profitability. Identify product costs and define target price as cost plus margin as agreed upon by both parties — Develop long term contracts. Create long term agreements with suppliers to ensure supply and pricing. Provides a stable base of business for supplier allowing investments that can reduce costs

Techniques for global sourcing

Technique	Description
<ul style="list-style-type: none">• Expand geographic supply base• Examine new suppliers• Capitalize on currency fluctuations• Take advantage of trade incentives• Optimize counter trade• Leverage second-tier suppliers	<ul style="list-style-type: none">• For Global Sourcing, we can:<ul style="list-style-type: none">— Expand geographic supply base/examine new suppliers/capitalize on currency fluctuations. Identifying the best suppliers on a worldwide basis. Includes exploring new regional markets and pursuing competitor's suppliers. A broader selection of suppliers should help identify those with the lowest cost structures, superior technologies, highest quality levels, while also taking advantage of currency rate imbalances— Take advantage of trade incentives. Assessing trade regulations and identifying potential benefits due to trade incentives in certain countries/regions— Optimize counter trade. Balancing your export with flows of goods and services from countries you are exporting to— Leverage second-tier. Reducing purchasing costs for first tier suppliers by requiring second tier suppliers to also offer the same prices they charge you to your first tier suppliers. Alternatively it can involve requiring first tier suppliers to concentrate their volume on a smaller number of second tier suppliers

Techniques for specification improvement

Technique	Description
<ul style="list-style-type: none"> • Rationalize/standardize parts • Substitute materials/parts • Apply product value analysis • Apply product value engineering • Use functional/black-box buying • Examine life cycle costs • Develop long-term contracts 	<ul style="list-style-type: none"> • For Product Specification Improvement, we can: <ul style="list-style-type: none"> — Rationalize/standardize parts, material/parts substitution. Involves de-proliferation of parts or specification to reduce complexity and concentrate volume — Product value analysis. Evaluating alternative solutions to provide the functions of an existing product at a lower cost with the same or better performance. Improves value/price relationship for existing products — Product value engineering. Producing a new functional design with improved performance at a lower cost. Creates a new product with an improved value/price relationship — Functional buying. Specifying functional requirements to supplier and allow them to design or provide items to meet the specifications. Can reduce cost by allowing suppliers to find creative solutions to meet functional specifications. Also known as “black box” buying — Life cycle costing. Calculating all the internal and external costs that the company has to sustain during life cycle of the product as a means of supporting value analysis — Develop long term contracts/partnering. Establishing strategically important linkages between a supplier and a customer over a long period of time for purposes of product research and development

Techniques for joint process improvement

Technique	Description
<ul style="list-style-type: none"> • Reengineer processes • Optimize physical material flow • Integrate logistics • Use simultaneous engineering/joint R&D • Develop long-term contracts • Share productivity gains 	<ul style="list-style-type: none"> • For Joint Process Improvement, we can: <ul style="list-style-type: none"> — Reengineer processes. Redesigning the supplier's processes or shared processes to eliminate waste and duplication across the chain — Optimize physical material flow. Changing the transportation modes, the location and mission of facilities and the material handling techniques employed to move purchased product from the supplier's location to the customer's point of use — Integrate logistics. Redesigning the product and information flows between the supplier and customer. It includes techniques such as JIT, continuous replenishment, EDI, vendor managed inventory, etc., to reduce joint cost, time and investment and to eliminate duplication of effort — Use simultaneous engineering. Involves concurrent product development across functional units and with suppliers. The objective is to reduce development cycle time and cost, and to leverage supplier's knowledge and technology. Also called joint R&D — Develop long-term contracts. Establishing strategically important linkages between a supplier and a customer over a long period of time — Share productivity gains. Establishing gain-sharing formulas and metrics for productivity improvements, both joint and within the supplier's business. Allows purchaser to share in supplier's productivity improvements (i.e., cost reductions) and in joint supply chain improvements

Techniques for relationship restructuring

Technique	Description
<ul style="list-style-type: none"> • Analyze core competencies • Examine strategic make versus buy decisions • Adjust degree of vertical integration • Create market entry alliances • Establish joint ventures • Employ strategic alliances/partnering • Establish/develop key suppliers 	<ul style="list-style-type: none"> • For Relationship Restructuring, we can: <ul style="list-style-type: none"> — Analyze core competencies. Analyzing and identifying the distinctive capabilities of the company and evaluating the capabilities can guarantee the long term sustainability of the company — Examine strategic make versus buy. Evaluating the strategic importance to the company of producing an item or carrying out an activity and assessing the competitiveness of the company relative to outside sources. Can lead to outsourcing of non-strategic items where the company is not competitive. Benchmarking and gap analysis identifies improvement opportunities for “make” items — Adjust source of critical integration. Making the decision to produce (make) or to source (buy) a certain sourcing category, given the make/buy analysis — Create market entry alliances/establish joint ventures. Applying the often used slogan “to buy in order to sell”. Involves identifying potential suppliers that can help you to make a new market entry. This alliance can take the form of a joint venture — Employ strategic alliances/partnering. Establishing strategically important linkages between a supplier and a customer over a long period of time for purposes of pursuing new product development, marketing and operations’ opportunities — Establish/develop key suppliers. Providing financial, managerial and/or technical support to suppliers to help them gain technical competencies, improve processes, and improve costs, quality and service

Agree strategy with stakeholders

Purpose of this step

To gain agreement and commitment to:

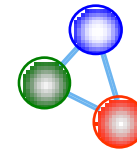
- The sourcing strategies
 - The RFI/RFP evaluation criteria
 - The RFP high-level content
 - The supplier communication strategy
- To canvas opportunities to improve the strategy
 - To reduce resistance at a later stage
 - To ease implementation

Matters to discuss

- Review a summary of:
 - Category spend analysis
 - Market dynamics and trends
 - TCO implications
- The proposed sourcing strategies and savings targets (by OpCo/BU)
- The proposed selection criteria and key supplier/product issues to be addressed
- Agree approach to supply market and communication messages

Remember that there is no better way to reach agreement with stakeholders than to involve them from the start of the process

Strategic Sourcing



Go to Market

The purpose of this stage is to identify a shortlist of potential suppliers with whom we wish to negotiate.

Supplier selection is based on:

- Their response to our RFx
- The supplier's ability to satisfy BAT's Health & Safety, and wider CORA requirements

This evaluation is conducted by the project team.

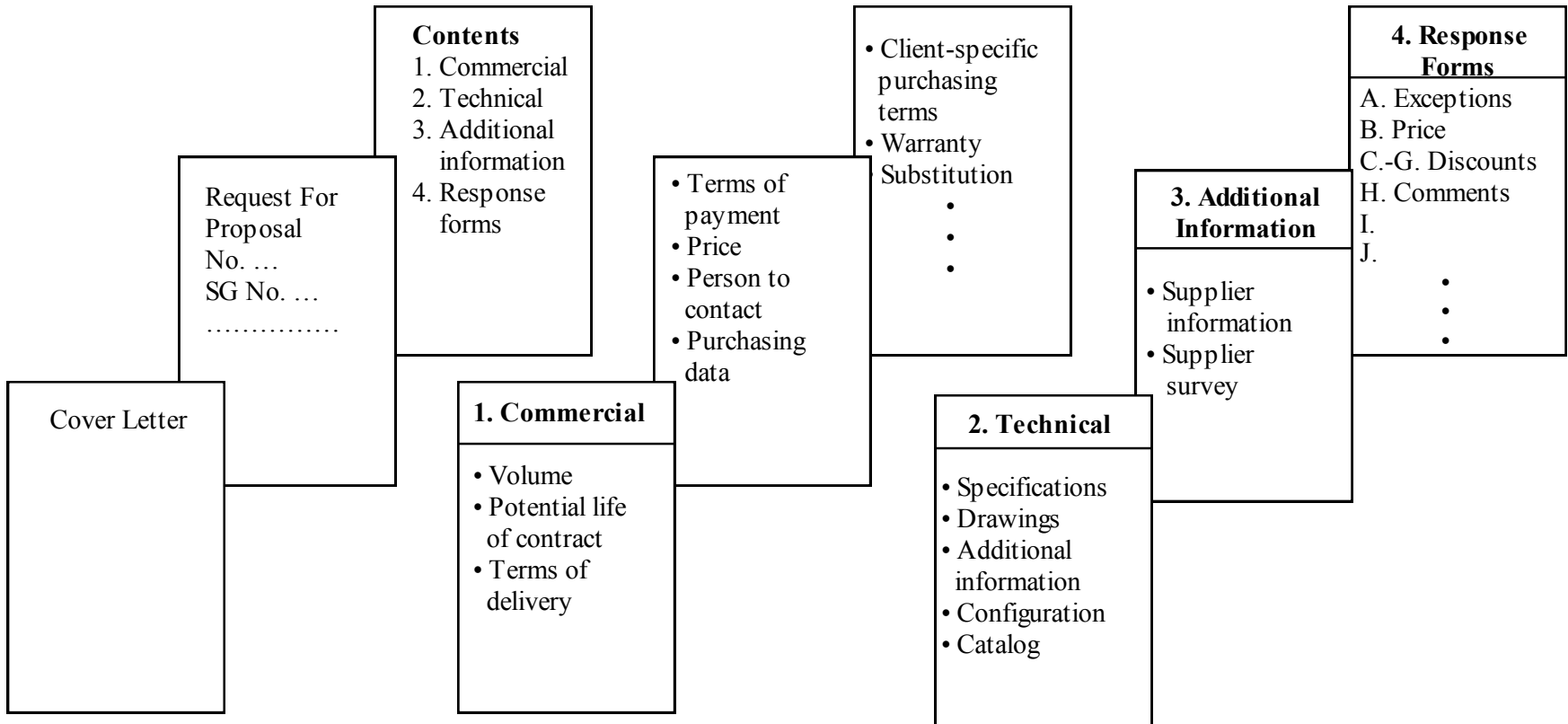
Results are consolidated in a Supplier Evaluation matrix.

Analysis

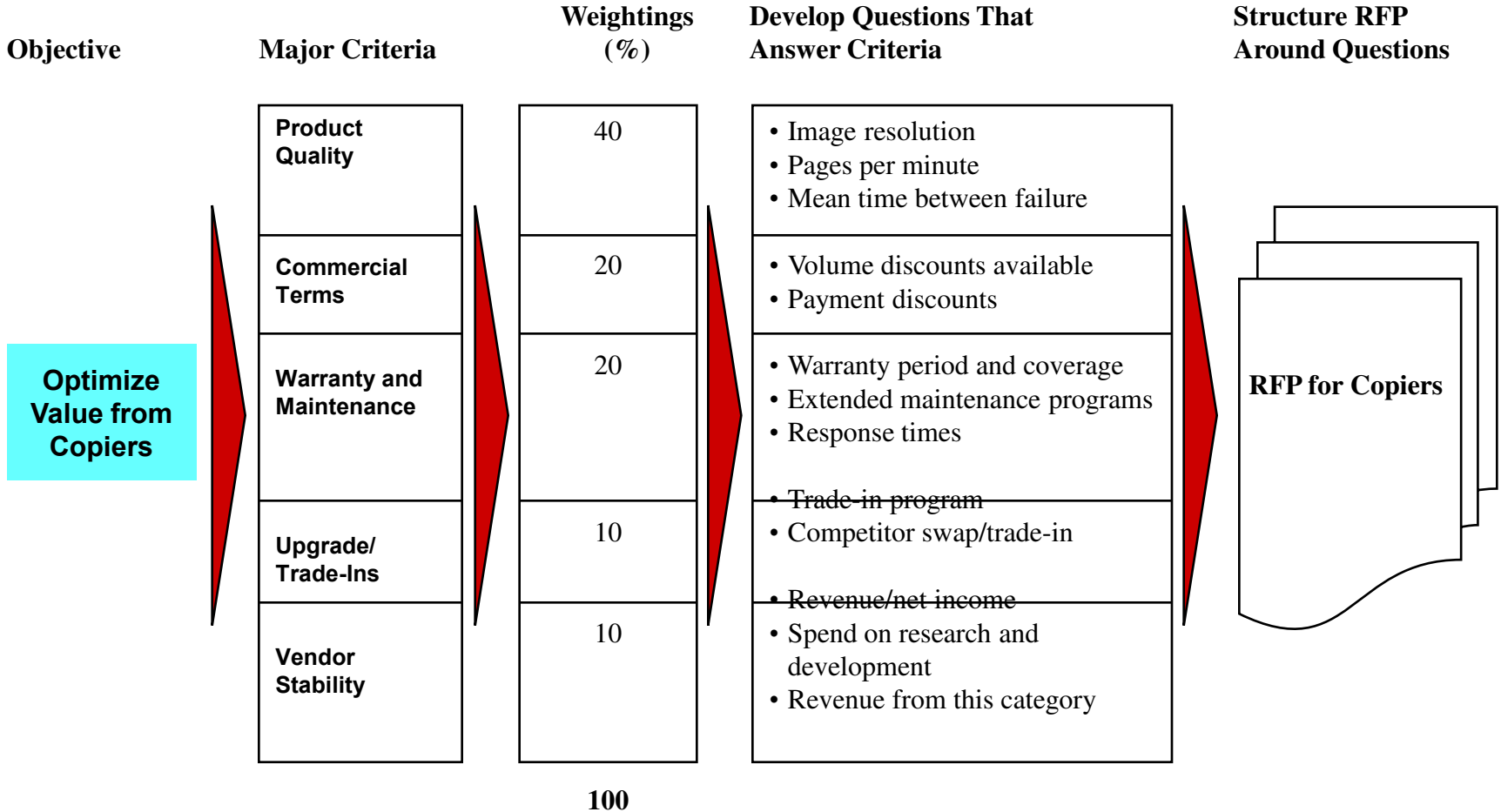
Sourcing
Strategy

Go to
Market

The RFP must be carefully designed



The RFP should be developed from the top down



Which suppliers meet our needs?

Critical Questions

Which Suppliers ?

In Which Geographic Regions ?

In Which Markets or Segments ?

Sample Data Requirements

- Size / Growth
- Cost structure
- Financial performance
- Strengths (competitive advantage)
- Weaknesses
- Competitive strategies
- Technology / IP
- Ownership
- Compliance / risk

- Local
- National
- Regional
- Global
- Freight
- Duties
- Logistics
- Service

- Differentiated by:
- Market positioning (niche vs generalist)
 - Supply chain level (tier 1 vs tier 2, etc)
 - Innovation
 - Customer size
 - Cost structure
 - Diversification
 - Branded vs non branded
 - Services offered
 - Product quality
 - Technology / Process

Know your supplier better than he knows himself !

Screen the list to qualify potential

Capabilities

- R&D
- New Product Development, introductions
- Plant and equipment
- Capacity (total available for company)
- Housekeeping
- Multiple plants
- Quality system
- Financial
- Cost control
- Sub-suppliers
- Geographic locations, distance
- Planning flexibility
- Scope of product program
- Logistics integration
- Innovations (products, processes)
- Electronic communications

Time

- On-time
- Lead time
- Delivery time/flexibility
- Service response
- Cycle time reduction
- Bid on time

Quality

- Rejections
- Preventive maintenance
- Quality-control of sub-suppliers
- Using ISO-standards

Cooperation/Service

- Supplier management commitment
- Quality response
- Sales service
- Technical service
- Admin / service
- Organization
- Ethics
- Partnership

Others

- Company's percentage of supplier revenue
- Environmental programs
- Quantity fulfillment
- Labor stability
- Currency risk
- EDI and other communication systems
- Engineering/factory/scheduling system
- Transport/packaging quality
- Warranty/penalties
- Support for offer process
- Inspection services
- Local content

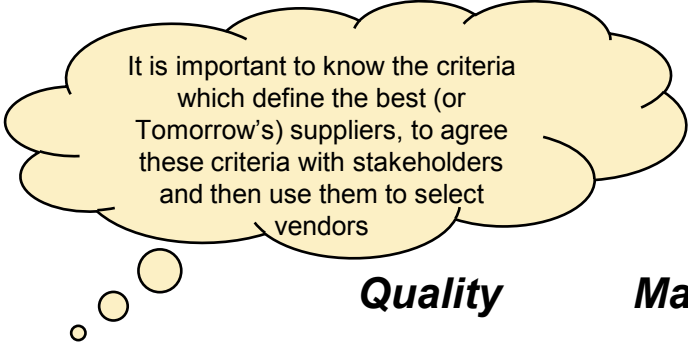
Cost

- Price stability
- Low-cost sourcing
- Inventory, JIT

Ten key financial ratios

	Ratio	Definition	Tells us
1	Current Ratio	Current Assets : Current Liabilities	Can they pay their bills?
2	Acid Test Ratio	Current Assets less stock : Current Liabilities	Can they pay their bills without being stretched?
3	Return on Capital Employed	Profit (before interest and tax) divided by Capital Employed (total assets less current liabilities) multiplied by 100	Are they getting a good return on the money invested in the business?
4	Profit on Sales	Profit (before interest and tax) divided by sales, multiplied by 100	Are they getting a healthy profit on sales?
5	Sales on Capital Employed	Sales : Capital Employed (total assets less current liabilities) NB Often turned into number of years sales	Are they using their assets productively?
6	Current Assets Turnover	Sales : Current Assets NB Often turned into number of years sales	Are they using their current assets efficiently?
7	Working Capital Turnover	Sales : Working Capital (current assets less current liabilities) NB Often turned into number of years sales	Are they using their working capital efficiently?
8	Stock Turnover	Sales : Stock NB Often turned into number of years sales	Are they turning their stock over efficiently?
9	Debtors Turnover	Sales : Debtors NB Often turned into number of years sales	How good are they at getting their money from customers?
10	Creditors Turnover	Purchases (if known) : creditors	How good are they at paying suppliers?

Select vendors on pre-agreed criteria



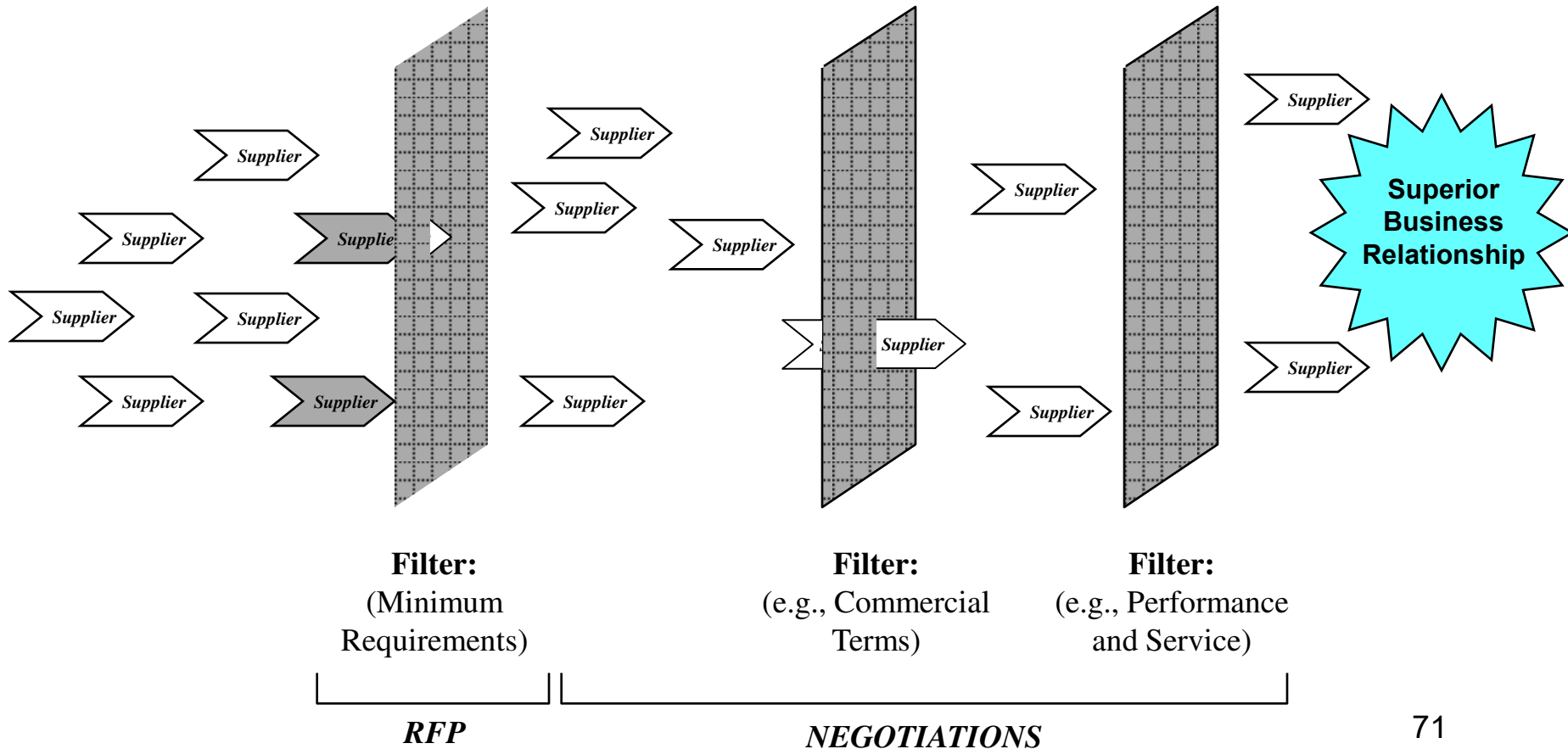
	Quality	Manufacturing	Information	Management
Tomorrow's Suppliers	Zero defects. Total quality management. Capable processes	Flexible manufacturing systems. Synchronous capable	EDI. Bar coding. Open access	Demonstrable willingness to work with customers. "Star Trek".
Today's Suppliers	ISO 9000 Acceptable quality levels	Economic batch quantities. MRP and MRPII	Limited EDI Limited access.	"Me too" culture. Mismatch between intent and actions.
Today's Monopoly Suppliers				No "burning platform". No customer culture. No desire for change.
Yesterday's Suppliers	Consistent failure to meet specifications	Inflexible. Consistent failure to meet lead time requirements.	Directed channels for information	Stale and predictable. Change resistant.

Making BAT “Sexy”

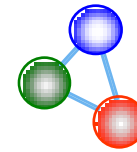
The Prospectus approach

- **The Global Procurement team as part of Project Battalionb decided that documents such as ITT’s, RFP’s, RFQ’s were pretty bureaucratic, and did not have much of a positive effect when “selling” the company to its suppliers.**
- **As part of an improvement project, they decided to re-invent the request for proposal / quotation process in a way that “sold” the company. They developed a three part “Prospectus”**
- **Part 1 unashamedly sold the company by detailing growth, market position, plans for the future etc. The intention was to have suppliers wanting to do business with the company. This section concluded by asking suppliers “Do you want to be part of our future?”**
- **Part 2 set out the requirements to be one of the company’s suppliers**
- **Part 3 was a template which potential suppliers had to complete to be selected**

The RFP and negotiations narrow the field of potential suppliers to create better relationships with the best suppliers



Strategic Sourcing



Stakeholder

Negotiation

Negotiation is generally undertaken by the senior Procurement representative in the project team. He/she will generally be accompanied by another member of Procurement or a stakeholder representative.

The purpose of negotiation is to agree final “best” terms and conditions with preferred supplier(s).

The process allows for two forms of negotiation:

- Traditional face to face fact-based negotiation and
- Online price-based negotiation

Contract

Negotiation

Go to
Market

Price analysis is a core activity

Coupling this information with the results of the supplier assessments can help to substantiate low bids and to identify areas for improvement for preferred suppliers

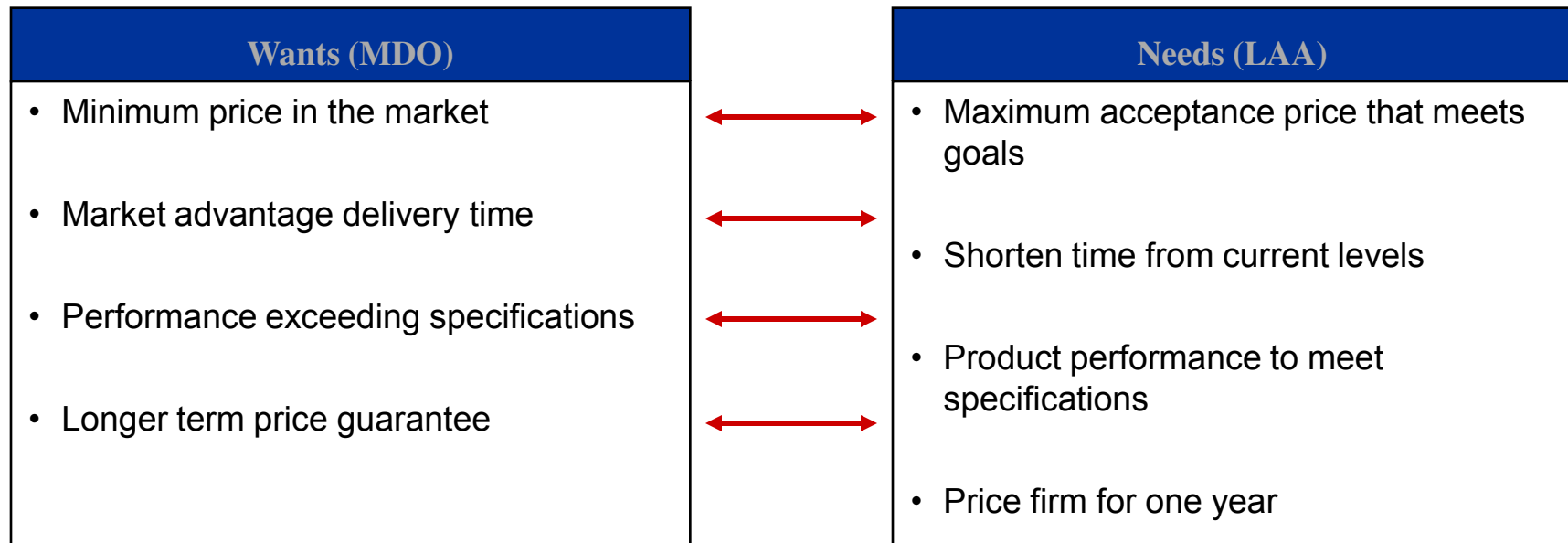
Cost Element

Supplier	Raw Materials (€ /1,000 Units)	Machine Setup (€ /Setup)	Machine Run Cost (€ /1,000 Units)	Finishing, Packaging, Shipping (€ /1,000 Units)	Total Cost For 100,000 Units	Quoted Price For 100,000 Units
A	€17.50	€125.00	€32.50	€ 7.90	€ 5,915	€ 6,800
B	19.95	160.00	29.00	6.80	5,735	6,595
C	21.80	110.00	31.80	11.00	6,570	7,560
D	16.40	170.00	27.00	9.50	5,460	6,280
“Best Case”	16.40	110.00	27.00	6.80	5,130	

 = Benchmark

Needs versus wants

- Use wants as a basis for MDO (Most Desired Outcome) and needs for LAA (Least Acceptable Alternative)



At a minimum, needs must be attained / fulfilled to successfully conclude negotiations

The golden rules of negotiating

Critical Rules

1. No free gifts! Trade every concession! Use the big “if...”
2. Start high
3. Make small concessions, especially at the end
4. Crunch early and often
5. Be patient
6. Remember to nibble at the end
7. Keep looking for creative concessions to trade

Important But Obvious Rules

8. Do your homework
9. Keep the climate positive
10. Remember that everything is negotiable
11. Never accept the first offer
12. Leave the other side feeling it has done well

Nice-to-Do Rules

13. Start slowly
14. Set a complete agenda
15. Discuss the small things first
16. Settle everything at the end
17. Use/beware the power of legitimacy
18. Keep your authority limited. Try to negotiate against people with higher authority
19. Consider using good guy/bad guy scenario
20. Try to induce the other side to make the first offer on the issue being negotiated
21. Keep teams small and under control
22. Try to get them to come to you

Sourcing Group Negotiation Baseline Work Sheet

Sourcing Group: Exercise Equipment

Today's Date: April X, 20XX

Objectives And Potential Negotiating Issues

Category	Objectives	Sourcing Techniques	Potential Negotiation Issues
Price/Cost	<u>Reduce price by 10%</u>	<u>Threaten-back leverage</u>	<u>Payment terms</u>
	<u>Reduce spare parts cost by 5%</u>	<u>Should cost modelling</u>	<u>Some parts that are price sensitive</u>
Supply	<u>_____</u>	<u>_____</u>	<u>_____</u>
Product Specs	<u>Service calls to be completed in 72 hrs</u>	<u>Joint process improvement</u>	<u>Internal target</u>
	<u>_____</u>	<u>_____</u>	<u>Both parts have to improve</u>
Other	<u>Reduce return incidents by 3%</u>	<u>Long-term contract incorporating</u>	<u>Establish recourse levels</u>
	<u>Reduce service in-warranty incidents</u>	<u>recourse</u>	<u>How to monitor the performance</u>
	<u>by 7%</u>	<u>_____</u>	<u>Investigate cost/benefit of buying w/warranty</u>

Most Desirable Outcome (MDO)

- Establish best product quality in the industry
- Establish solid working relationship with prime supplier
- _____
- _____
- Profitable contribution

Least Acceptable Agreement (LAA)

- Dramatic improvement in product quality
- Partnership
- _____
- _____
- Breakeven for the product line

Best Alternative To Negotiated Agreement (BATN)

- Get out of business; high costs of quality make business not viable
- _____
- _____
- _____

Communication Plan


Action	Responsible	Date
<u>• Brief potential suppliers on sourcing process</u>	<u>Buyer/Consulting</u>	<u>Next week</u>
<u>• Make visit to current supplier to stress importance of relationship</u>	<u>Buyer/Vice President</u>	<u>In 15 days</u>
<u>• Distribute RFP packages</u>	<u>SC team</u>	<u>In one month</u>
<u>• _____</u>	<u>_____</u>	<u>_____</u>

Negotiation Strategy Worksheet

supplier: Knight Tires Estimated value of this initiative: _____

€ 300 million

Date: 1995

 "Red Flag": missing or unverified information, uncertainties, or vulnerabilities.

Benefit <i>"For each seller, what are..."</i>		
Seller/Title	Seller Role(s)	Benefits from getting our business
1. Mr. Moon	Chairman/CEO	Increase share w/lqst private label customer
2. Mr. Plant	VP Operations	Potential to improve ops thru new volume
3. Mr. McCormick	VP Sales	Gain high performance tires
4. Mr. Bill	Ntl Acct Mgr.	Can't afford to lose account
5. Mr. Bean	CFO	Can further spread overhead

Hot Buttons		
This Seller's Hot Buttons	Benefits from Addressing their Hot Buttons	Seller Receptivity to our MDO
• Continued growth/profitability • <u>Wants to leave legacy</u>	<u>Announcement could positively impact share price</u>	• <u>Guarded acceptance</u>
<u>Wants to build new Greenfield plant</u>	Provide enough volume demand to warrant need for new "Greenfield" plant	• Very receptive • <u>Wants new volume</u>
<u>Got passed over for presidency</u>	Score points with CEO	
<u>Close to retirement</u>	Could go out a hero	
<u>Must be profitable for both parties</u>	Wants long term partnership	• <u>Concerned about mix</u>

Supplier Objectives/Criteria			
Issues	Need (LAA)	Want (MDO)	Relative Importance
1. <u>Maintain profitability</u>	X		A
2. <u>Increase volume</u>		X	C
3. <u>Improve product mix</u>		X	A
4. <u>Provide platform for growth</u>		X	B
5. <u>Continue low cost producer status</u>	X		A
6.			

Messages <i>"What repeated messages best increase our probability of reaching our MDO?"</i>	
Selected Messages (Use Single Word or Short Phrase)	
1.	<u>Risk losing everything</u>
2.	<u>Could gain substantially</u>
3.	<u>We intend to dominate this business</u>
4.	<u>Align with a winner going forward</u>
6.	<u>You've made a lot of money on our business in the past</u>

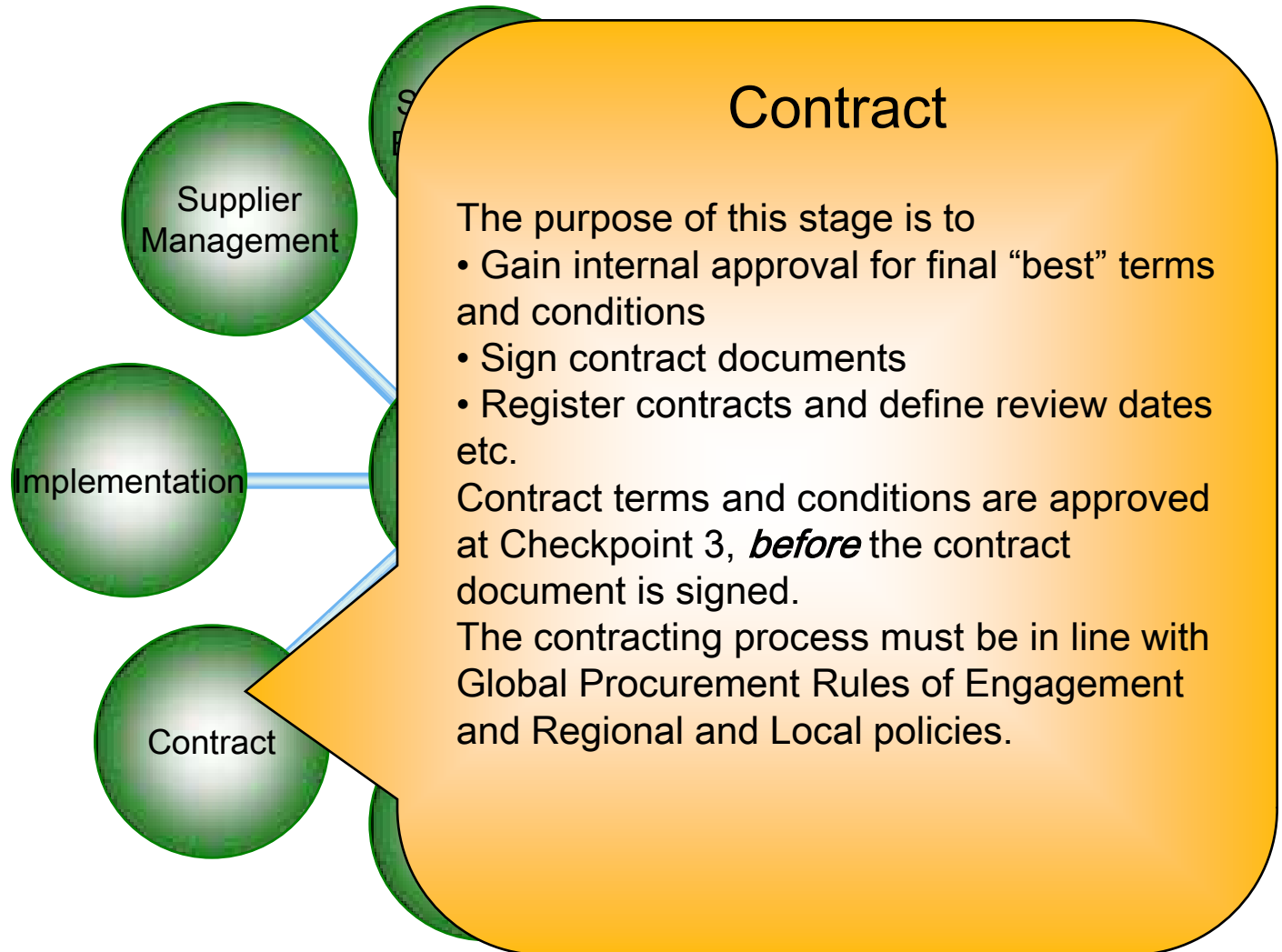
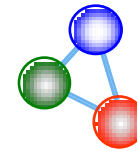
Our leverage		
supplier's Competitors	Competitor's Strengths	Competitor's Weaknesses
• Ferrari Tire	Current vendor for 1/2 of volume	• <u>Bad plants</u> • <u>High costs</u>
• Blue Tire	Biggest player	• <u>Uncooperative management</u>
Buying Power: "our demand relative to supplier's available capacity" ...		
<u>We are their largest current/potential customer</u>		
Demand of other SG buyers ...		
<u>Slow Boys recently shifted volume to Knight</u>		
<u>Capacity tight across industry</u>		
Others (Image...)		
Publically announced intent to double our business next 5 yrs		

Summary of Negotiating Issues/Levers <i>"Likely to come up during session"</i>
<u>Value of longstanding relationship</u>
<u>Product cost/quality</u>
<u>Most profitable supplier in the industry</u>

Potential Actions to Leverage Our Strengths or to Eliminate Red Flags
<u>Need to create serious alternatives for moving the business</u>
<u>Demonstrate effect if deal on Knight's stock price</u>

Plan for Negotiating Session	
Objectives	• <u>Face to face – round 2</u> • <u>Phone follow-up as needed</u>
Participants	• <u>Two buyers with consulting support</u> • <u>Don't introduce CEO's until last round</u> • <u>After all bids are in</u>
Timing	

Strategic Sourcing



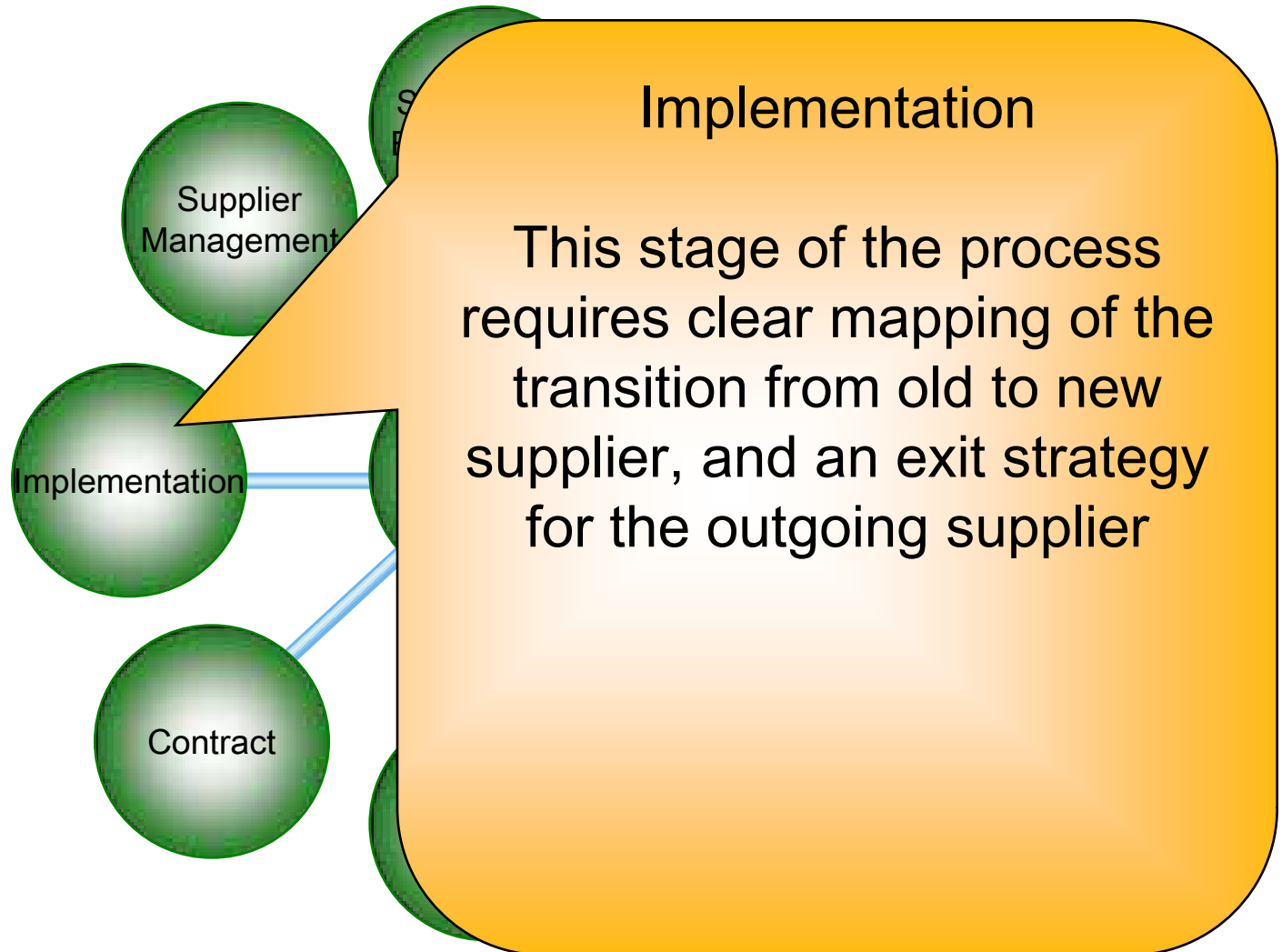
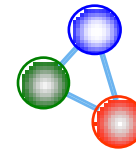
Contract considerations

- Purpose and scope
- Inventories of equipment
- Planning phase
- Contract period
- Performance standards and service levels
- Damages and service credits
- Risk ownership and management
- Procedural issues including disaster recovery
- Continuous improvement
- Cost reductions
- Management information
- Employment T & C
- Reporting standards
- Relationships with third parties
- Quality assurance
- Open book / rebate audit
- Warranties and indemnities
- Continuity and training
- Data ownership and security
- Contract management role
- Non disclosure
- Audit
- Standard housekeeping
- Partnership
- Termination and exit strategies
- Many others?

Contract review process

- Red team review
 - A peer group review to consider objectively whether the contract and planned negotiation outcomes deliver a successful outcome. Part of the peer group review includes a negotiation planning process whereby some staff consider the issues from the suppliers perspective
- Mid negotiation review
 - Before the negotiation is concluded, a review is held to determine the probability that the negotiation will have a successful outcome. Stumbling blocks and “die in a ditch” issues are re-considered
- Post negotiation review
 - At this point it is necessary to consider whether the outcome still delivers the strategic requirements and satisfies the business case
- Legal cross check
 - This is both a final cross check of spelling, cross referencing, clause numbering; and is also a strategic review of the risk still attached to the outsourcing project
- Senior management sanity check
 - No major contract should be concluded without a senior management sign off. This process gives the team senior mgt support, and gives senior mgt the chance to raise any concerns

Strategic Sourcing



Plan Transition

Communicate outcome of the Negotiations

- Specify benefits to users — savings and quality
- Communicate rationale
- Obtain buy-in

Conduct Internal Implementation Planning Sessions

- Finalise contractual requirements
- Develop plans to ensure operational continuity
- Address site-specific concerns

Conduct Supplier Implementation Planning Sessions

- Establish new or modified relationships
- Finalize supplier capability certification
- Develop site-specific Transition plan

Manage the Transition

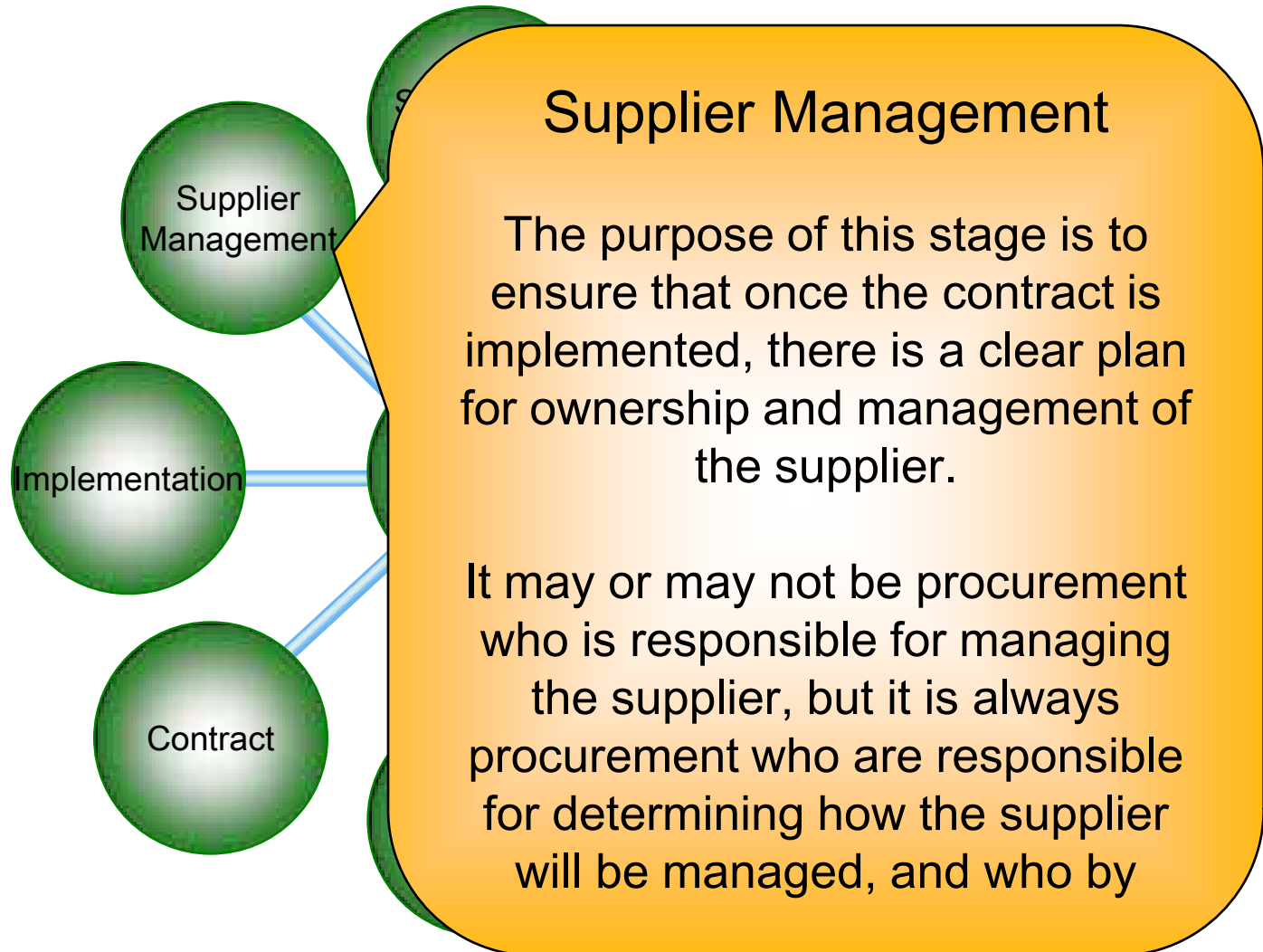
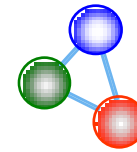
- Establish clear channels of communication
- Execute implementation plans
- Manage plan adherence and conflict



Finally...

At the end of the process,

- We need to review what worked well, and what didn't.
- We need to take on board the views of our stakeholders on how the process went from their perspective
- We need to assess the benefits we achieved against those which were projected



Supplier Management is....

Selecting and Managing the ***appropriate relationship*** with suppliers to optimise ***performance*** - ensuring smart cost management and security of supply in a ***Win-Win Environment***.

From cost reduction



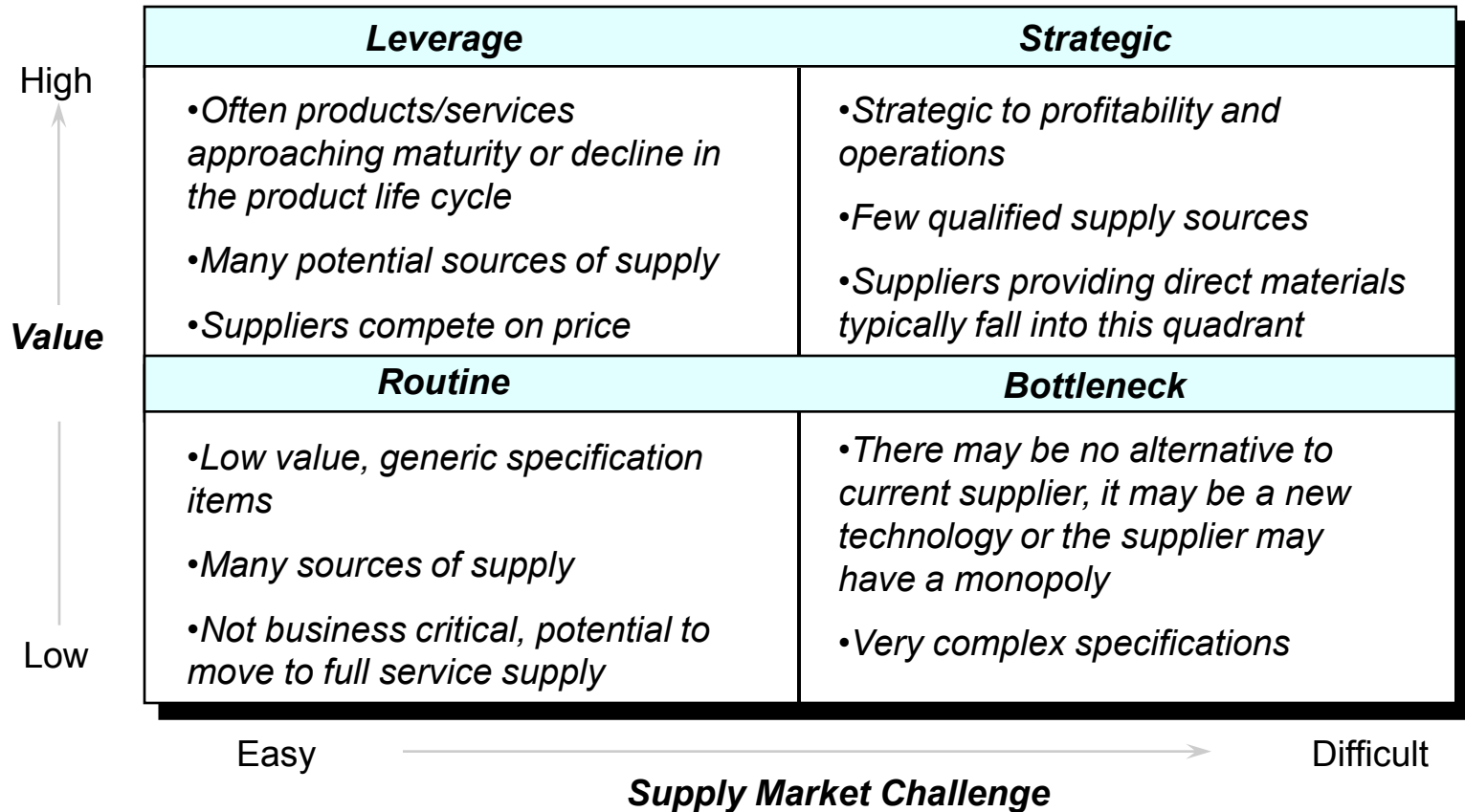
to value engineering..



What are the activities of Supplier Management?

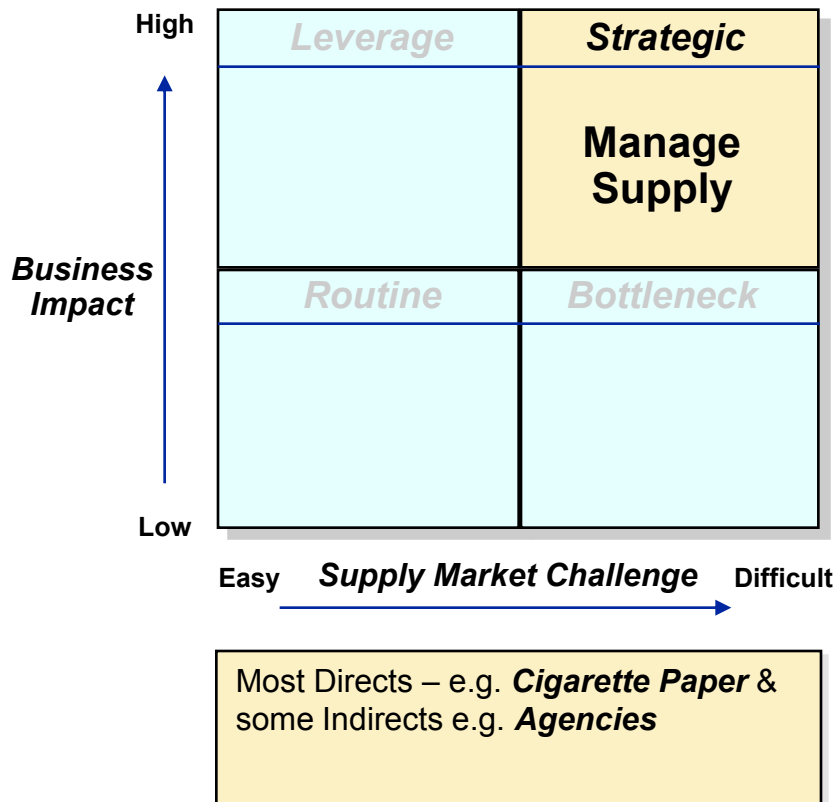
- Ensuring that we are dealing with **Best Suppliers**
- Ensure **right number of capable suppliers**
- **Analyzing supplier performance and potential**
- **Regular Supplier Review**
- **Transferring leading practices**
- Defining and ensuring **ongoing & improving performance**
- Ensuring **sustainable benefit** for customer and suppliers

The importance of a supplier drives the “Procurement Positioning”



The type of relationship drives our Supplier Management approach

The approach for **Strategic** suppliers is to very **actively manage** the relationship

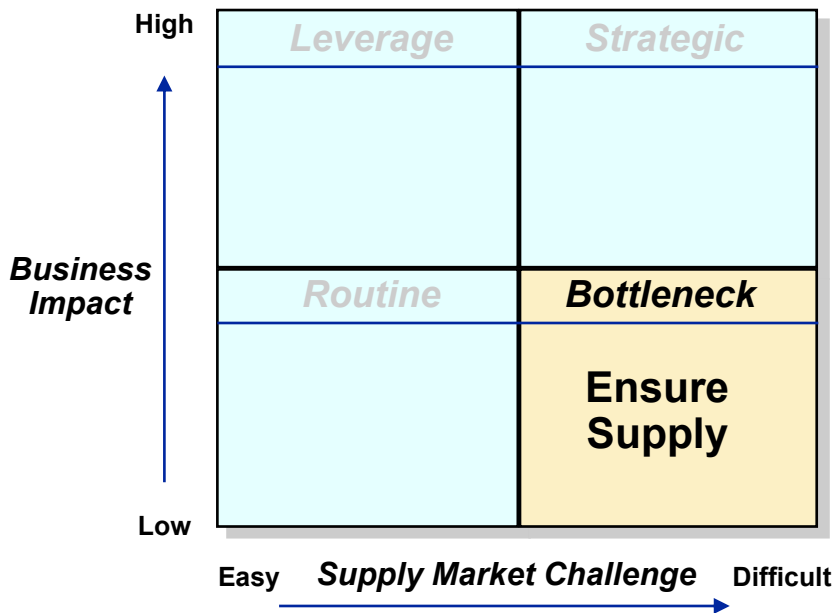


Action Plan

- Consider **long-term** contracts or service-life agreements
- Work closely with suppliers in product **innovation**, design & **continuous improvement**
- Joint product/process design and planning
- Integrated systems
- Supplier manages product / service
- Consider on-site representation

Strategic relationships should be partnerships with mutual benefits

The approach for **Bottleneck** suppliers is to **ensure supply** of critical items



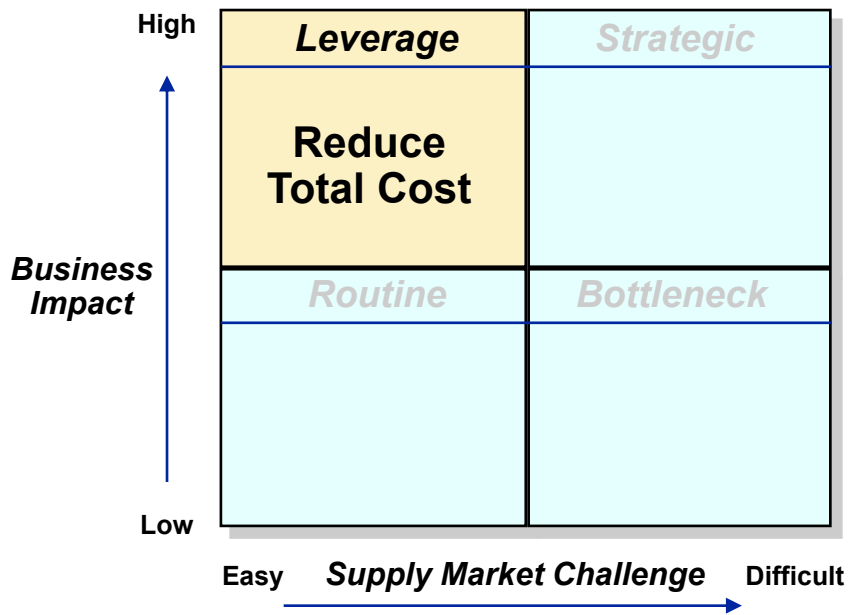
Directs: e.g. **Adhesives & Flavours**;
Indirects: e.g. **Monopoly Utilities, Spares, DOHS**

Action Plan

- **Long-term** contracts
- Move to **generic specifications** where appropriate
- Ensure supplier is **motivated** to provide quality service
- Look at developing new & **alternative suppliers**
- Consider buffer stocks for additional security
- Identify and plan for potential interruptions to supply

Bottleneck suppliers should ultimately be transitioned into another quadrant, i.e. routine

The approach for **Leverage** suppliers is to **cut cost** using innovation and competition



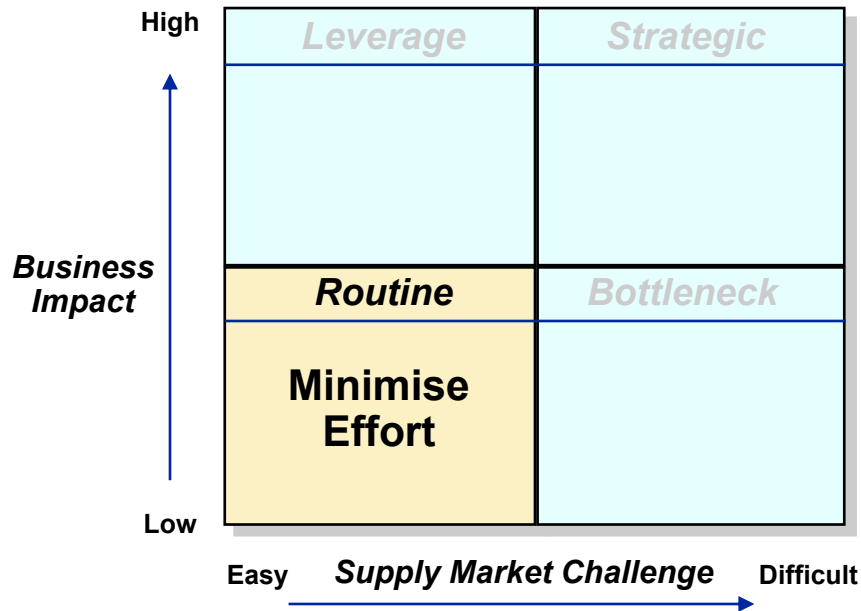
Directs: e.g. **Chemicals**
 Indirects: e.g. **Travel, Canteen, other contracts**

Action Plan

- **Short-term** contracts
- Focus on **price**
- Consider the use of **eAuctions** & other leverage opportunities
- Pursue a very active sourcing policy
- Look for continued cost-reduction
- Reduce stockholding
- Pursue value add services from suppliers who reduce total cost

Leverage relationships are built primarily around price

The approach for **Routine** suppliers is to **minimise management attention** and investment



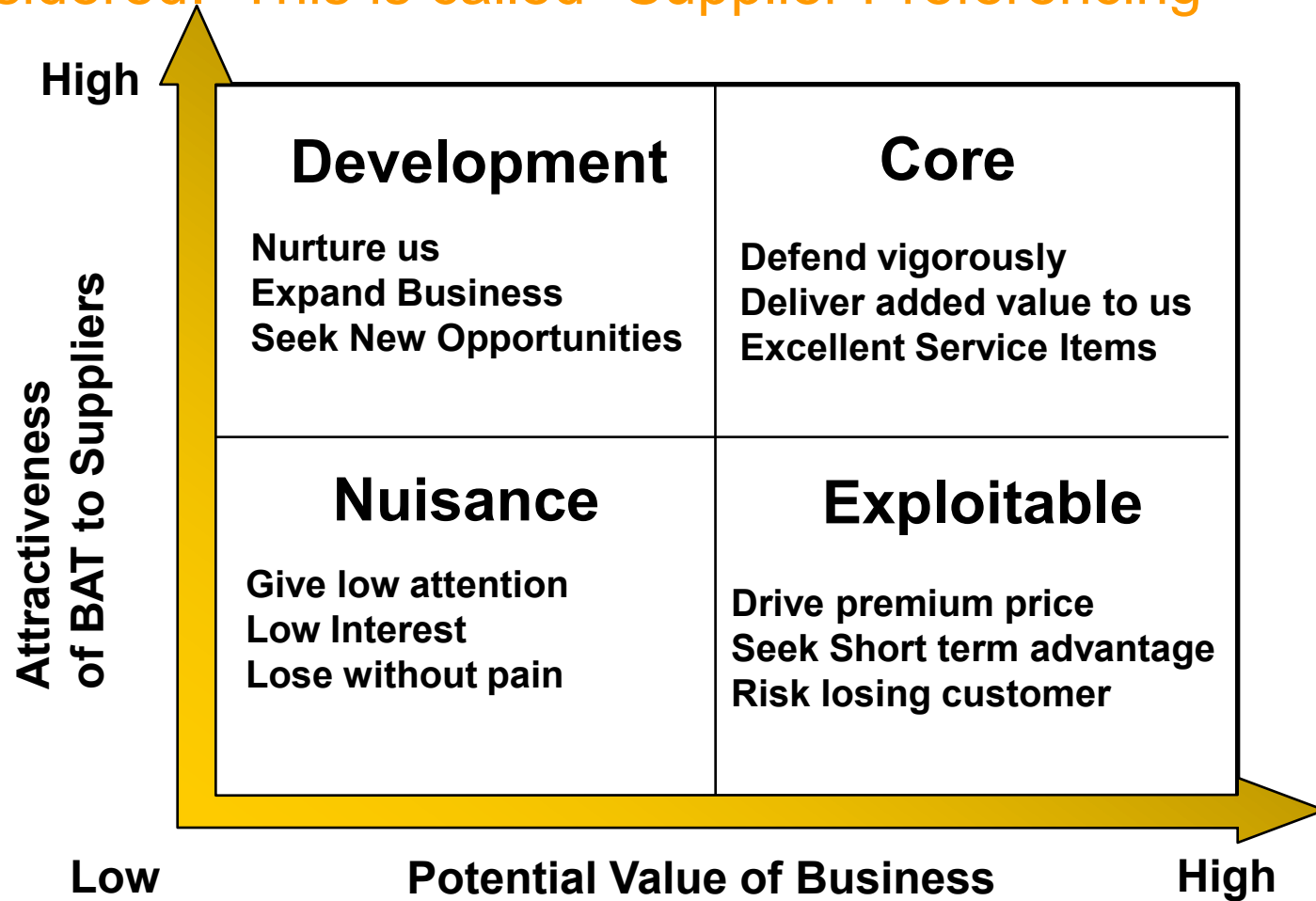
Directs: e.g. **Packing Tape**, Indirects:
e.g. **Stationary**

Action Plan

- Aggregate requirements wherever possible
- Consider a wholesaler
- Alternatively, use **supplier's own specifications**
- Reduce inventory – supplier managed
- Very simple performance measurement process with focus on reliability

Routine relationships should take up minimal time and effort

It is also critical that the suppliers perspective is considered. This is called "Supplier Preferencing"



We must aim to do business with suppliers whose perspective is compatible with our requirements

The *type* and *frequency* of supplier review meetings depends on the relationship

Routine		
Leverage		
Bottleneck		
Strategic		
1. Operational Review Meeting	2. Strategic Business Review	
<ul style="list-style-type: none"> ▪ Periodic checks / reviews ▪ Frequency will vary from weekly to annual ▪ Review performance using agreed criteria ▪ Review data requirements 	<ul style="list-style-type: none"> ▪ Quarterly or half yearly review meetings ▪ Held with a more senior representation from the supplier ▪ Review appropriateness of KPI's ▪ Review relationship ▪ Address long-term risks and issues 	<ul style="list-style-type: none"> ▪ Focus on strategic initiatives to improve performance and to innovate ▪ Identify additional business opportunities ▪ Not usually held for routine suppliers

The more important the relationship the more attention that is needed!

More strategic supplier relationships require more frequent reviews and involve more senior stakeholders

What are the benefits?

*Effective Supplier Management offers significant benefits to **both** company and Supplier*

Company Benefits

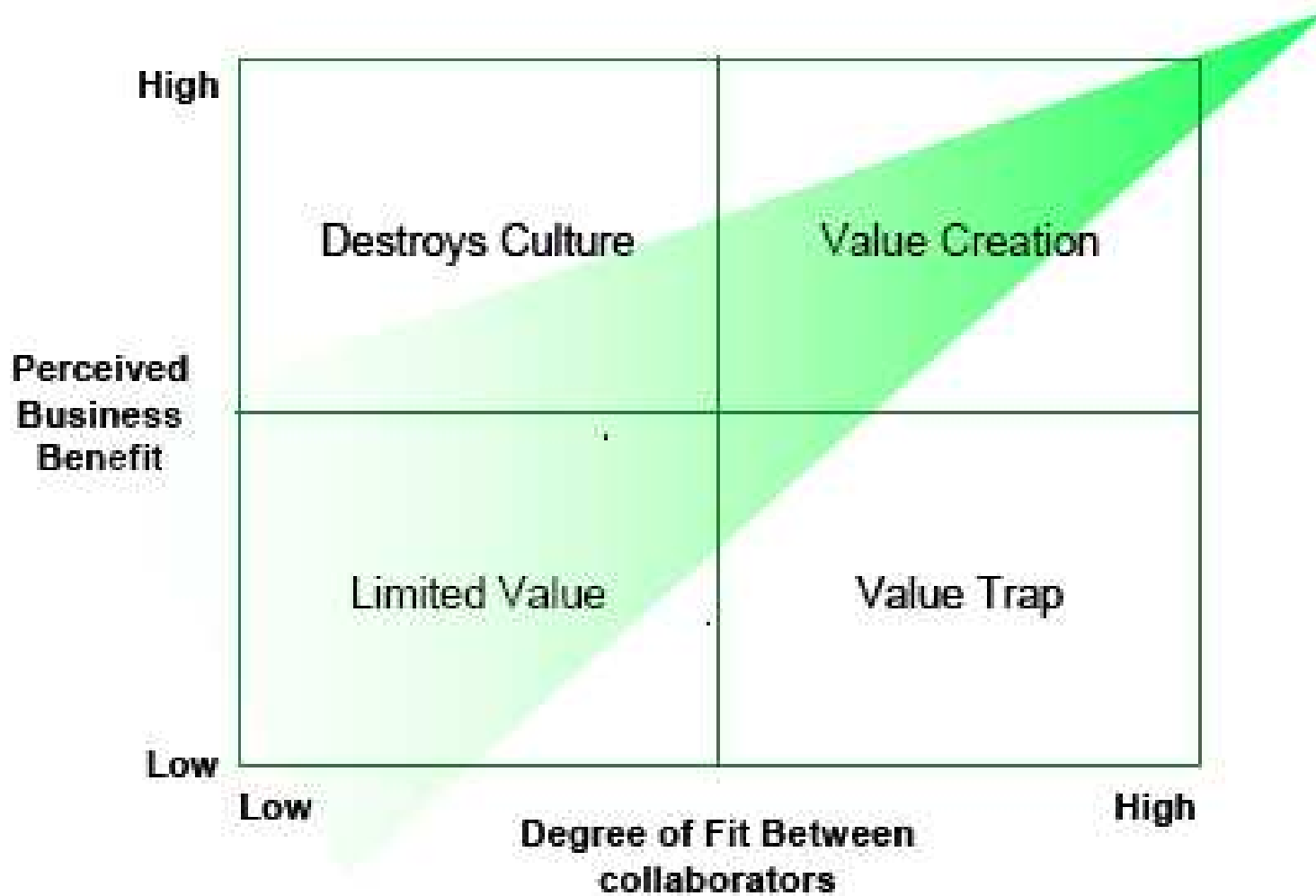
- Improved level of performance leading to supplier **meeting or exceeding** company expectations
- Better performance from suppliers means staff spend **less time** being distracted from other activities
- Relationship building towards **preferential treatment** (customer of first resort)
- Suppliers becoming **pro-active and collaborative** rather than reactive and confrontational

Supplier Benefits

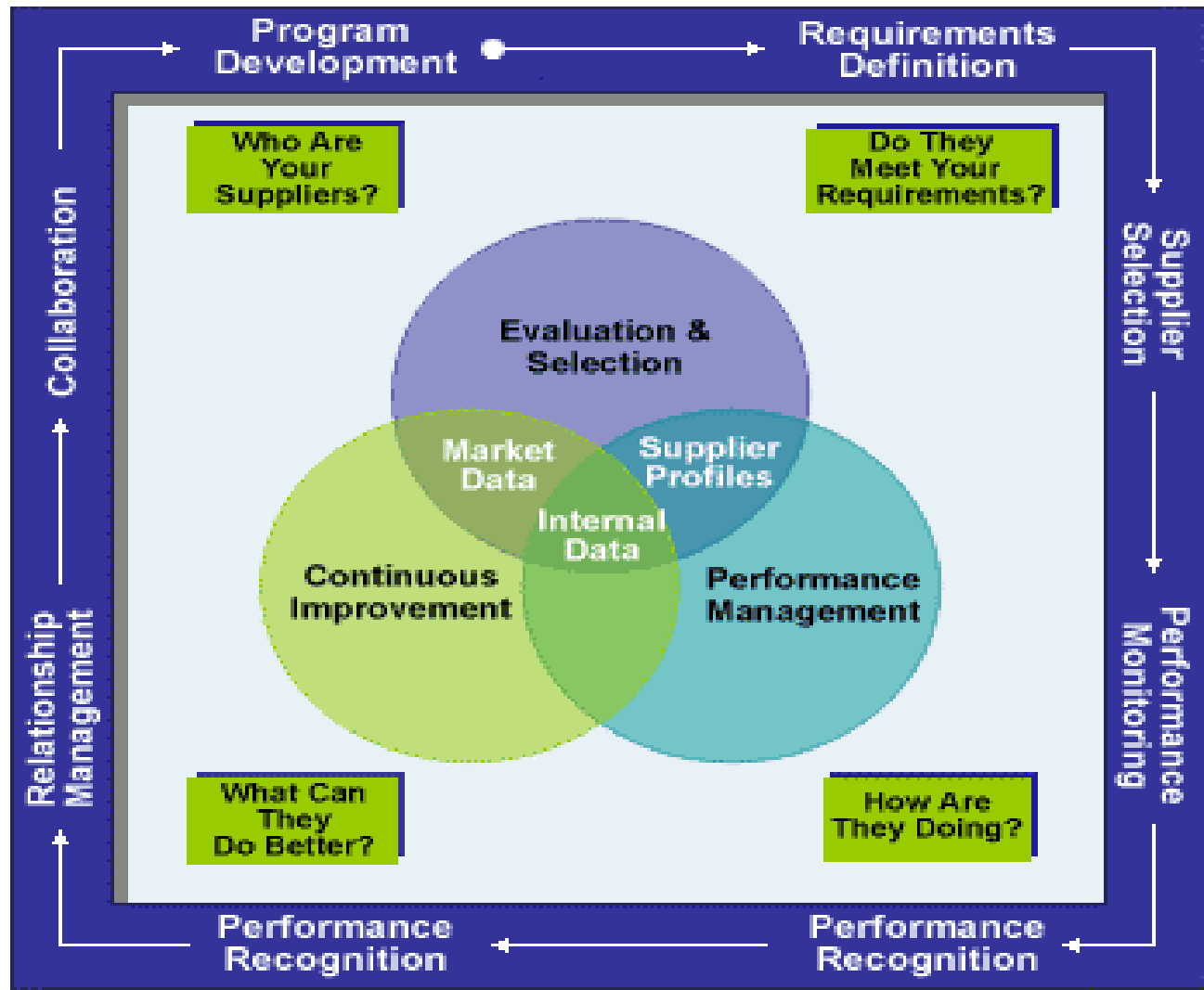
- Clear understanding of customers objectives & expectations – allowing the supplier to **focus** resources on value-adding activities
- Better performance (in the customer's eyes) improves **opportunities for additional sales**
- Customer becomes a good credential for marketing purposes
- Re-selling to customer is more **cost effective** than winning new business

Often we need the **best** supplier (not necessarily the cheapest)

	Quality	Manufacturing	Information	Management
Tomorrow's Suppliers	Zero defects. Total quality management. Capable processes	Flexible manufacturing systems. Synchronous capable	E-business Bar coding. Open access	Demonstrable willingness to work with customers. "Star Trek".
Today's Suppliers	ISO 9000 Acceptable quality levels	Economic batch quantities. MRP and MRPII	Limited E-commerce Limited access.	"Me too" culture. Mismatch between intent and actions.
Today's Monopoly Suppliers				No "burning platform". No customer culture. No desire for change.
Yesterday's Suppliers	Consistent failure to meet specifications	Inflexible. Consistent failure to meet lead time requirements.	Directed channels for information	Stale and predictable. Change resistant.



In Summary...



Strategic Sourcing - Summary

