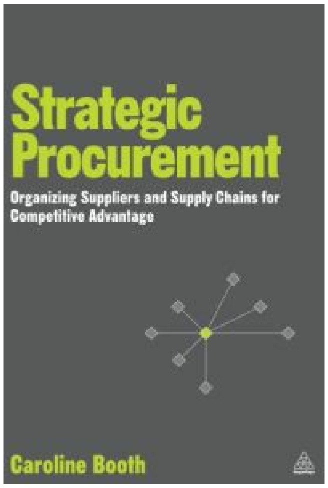

Book Strategic Procurement

Organizing Suppliers and Supply Chains for Competitive Advantage

Caroline Booth
Kogan Page, 2010
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Recommendation

Believe it or not, logistics can be exciting, especially when presented in a flowing, concise essay spiced with case studies and examples from the author's experience. Procurement specialist Caroline Booth makes her points clearly through great organization, vivid stories and effective charts. While some chapters would benefit from some refined editing, readers can appreciate and implement her message about the importance of procurement. Managers can easily follow Booth's suggestions on using third-party providers to complement their businesses' core activities. *BooksInShort* considers this valuable reading for senior executives and supply chain managers who want to elevate the role of procurement and make their firms more profitable.

Take-Aways

- A supply chain is a sequence of activities that delivers a product or service to a recipient.
- Most senior executives have no idea how much they spend on their suppliers.
- Few managers know how to evaluate the service their suppliers provide or the service they give to their customers.
- Once you understand why your customers like your products or services, you will know your value proposition.
- The farther suppliers are from the end of the supply chain, the less they understand your customer's needs.
- Optimizing the supply chain requires that everyone – product engineers, marketers, plant managers – takes a role in coordinating and managing suppliers.
- Articulating organizational strategy unifies employees, customers and suppliers.
- Managers who assess supply chains should know what they want.
- Supply chain managers who demand value-saving explanations may uncover overpricing, underperformance and mismanagement.
- Procurement is a crucial task that cannot be left to the procurement department alone.

Summary

Know Your Suppliers

A supply chain is a sequence of activities that delivers a product or service to an internal or external recipient. In some cases, suppliers assist other suppliers. Procurement is a big part of most companies' budgets, but many senior executives have no idea how much their suppliers cost them. When asked how much his bank spent on vendors, one executive replied that the figure could not be much since the bank did not manufacture anything. He was wrong. In the late-1990s, his bank spent £2 billion on check printers, automated teller machine mechanics and other suppliers crucial to the bank's operations.

“Procurement isn’t order-taking or even order-placing any more: It is a key business competence.”

Many firms outsource services they once handled in-house to mitigate potential risk to their reputations in case of error. This tactic fails because, in the event of mistakes or mishaps, customers and the public will always blame the corporation, not an anonymous supplier.

Executives must know how much they spend on third-party providers in three areas:

1. **“Direct expenditures”** – The cost of buying the goods needed to make or support the product or service a firm sells, including all manufacturing materials.
2. **“Enabling expenditures”** – The expenses covering the goods and services that enable a company to meet its commitments to customers, such as sales and marketing expenditures or delivery trucks. These costs do not include items sold directly to customers.
3. **“Indirect expenditures”** – The costs derived from supporting the business and its employees, including travel, entertainment and facilities management.

> “Company leaders need to recognize supplier relationship management as a key business lever and to reskill and reshape their organizations to manage their third-party spending and sources of supply.”

Few managers know – despite significant expenditures on suppliers – how to evaluate the service they or their customers receive, or whether the services they purchase are necessary now or in the future. The reverse is also true: Research indicates that the farther a supplier firm is from the end of a client’s supply chain, the less it understands that client’s needs.

> “I can’t think of any business that does everything for its customers any more – some hardly do anything at all.”

Managers who assess supply chains should know what they want. They must develop new assessment skills and think strategically about procurement. Ideally, third-party providers can be sources of innovation, scalability and new markets. For example, Dell and Procter & Gamble work closely with their clients to improve their customers’ inventory management and satisfaction.

“Supply Chains”

Supply chains are made up of various businesses engaged in a variety of activities. Each business produces a service or product that is delivered to a customer. Supply chains move across different organizations and cross through different departments – operations, IT, marketing and human resources. In large, complex organizations, outsourcing a service that supports core departments can disrupt performance.

> “For the last 20 years, one of the most enduring mantras for modern business has been ‘focus on the core’.”

Optimizing the supply chain requires that everyone involved – product engineers, marketers, plant managers – take a role in coordinating the process and managing suppliers. Classify suppliers according to their relationships with your business. “Tier one suppliers” have a “contractual relationship with the owner of the supply chain,” while “tier two suppliers” provide materials to tier one suppliers. These relationships are most effective when a tier one supplier creates an all-star team of other vendors to add knowledge to the supply chain and reduce costs. Specify your company’s needs, or “functional requirements,” and its required results, or “outcome specifications,” in the vendor’s contract. These factors will drive the fee structure and the final deliverable.

> “Understanding your customer value is fundamental to...your company’s continuing existence.”

To assess your supplier relationships, examine the account teams serving your business. If they keep trying to sell you new products or services, beware. Supply chain managers who demand better value-based information may uncover years of overpricing, underperformance and mismanagement. To establish quality service and pricing power, your company should manage your suppliers collectively and involve every department they serve.

Customer Needs and Resource Allocation

Learn why your customers like your products or services. If you know what they value, you can improve your service and make wiser decisions about resource allocation. Accordingly, you and your third-party suppliers can deliver what your customers want – which usually is to meet their own goals faster or cheaper.

> “There are likely to be various organizations involved in delivering your customer value propositions.”

To withstand inroads made by competitors or changing technologies, develop a value proposition that articulates your company’s larger purpose. Understanding your value proposition means knowing what your firm can outsource and what it should provide. Based on your goals, evaluate every necessary task. Do you have the ability to perform each one? Are they all important to your core business? Determine how each task affects profitability, customer satisfaction, market share, costs, operational integrity and overall reputation. Properly executed, this evaluation yields four choices: Form a partnership with a supplier, eliminate a service, sell a service to another entity or maintain the service in-house as a core activity for which you possess staff expertise.

Communicate Your Strategy

A clearly articulated organizational strategy unifies employees, customers and suppliers around a single purpose. Strategy differentiates your company from your competition. For example, if you present your firm as innovative, suppliers will propose product or service improvements. Suppliers are often part of complex organizations and have relationships with other service providers who could be useful to your company.

Evaluating Attractive Suppliers

To choose quality suppliers, establish a formal requisition process using criteria that evaluate costs, quality and social responsibility. Consider indirect costs. For instance, suppliers may charge for travel or consulting services that have no direct impact on your business. Such indirect costs can be significant, so delineate and evaluate them.

> "The decision about what you...ask of your suppliers is one of the most strategic you will ever need to make."

Negotiate contracts that reward suppliers for providing the services you need. Designate senior staffers to manage and improve key relationships by acting as "intelligent buyers" of your suppliers' services. Grant suppliers contractual incentives to improve their products or services.

Seek suppliers who understand the importance of corporate responsibility. Your company's good reputation sustains your brands and your customer relationships. Hire ethical suppliers who share your firm's social responsibility agenda and practice environmentalism, employment equality, fairness, and sustainability. Examine suppliers to see if they are using sustainable resources and following good labor practices. Include social responsibility criteria in your suppliers' contracts. Include union visits to monitor work practices at factories in developing nations.

> "The more clearly you can articulate what you need to your suppliers, the greater the chance they have of fulfilling it."

Many pro-environmental business practices either reduce costs or are cost-neutral. For example, one UK nonprofit works with companies to reduce their carbon emissions and improve their packaging to eliminate waste. As a responsible organization, include minority-owned companies among your suppliers to "play a part in growing new businesses and supporting the regional economy."

Controlled Delegation

Procurement is too essential to leave to the procurement department. Key individuals in other departments should share responsibility. Corporate culture affects procurement department practices. During the 1990s, IBM suffered because of its poorly managed supply chain. It established a new system that everyone in the company had to accept. IBM said it would fire anyone who racked up three violations of its new procurement policies.

> "One of the key ways a supplier manages its customers is to divide and conquer."

Other organizational models for procurement follow the principles of "subsidiarity" and "federalism." Subsidiarity means granting decision-making power to those outside the central command and putting responsibility in the hands of people closest to ordering and customer demand. In a federal system, people work together when it is in their mutual interest. Procurement managers engage in federalism to achieve the benefits of bulk purchasing or to manage companywide suppliers. Both approaches give managers organizational leverage and bargaining power. They empower people to act individually and collectively to achieve procurement goals. The desired result of any procurement improvement program is to lower supply and service costs over the long term, and to assure that managers work inside established procurement channels.

Building Supplier Relationships

Strengthening relationships with suppliers requires that both parties understand the mutual benefits of their connection. Smaller companies are better at fostering strong supplier relationships than larger companies, perhaps because suppliers respond to appreciation.

> "Sharing information on strategies, priorities and process will encourage suppliers to participate in your projects."

An annual North American Automotive OEM (Original Equipment Manufacturers) study examines tier one relationships between suppliers and major car manufacturers. The survey acknowledges the value of being a top supplier's preferred customer and thus receiving lower prices and better service.

Good supplier relationships must start with a clear understanding of the supplier's responsibilities. Generally, a company requests bids, and suppliers submit proposals showing how they can meet the company's needs. Companies then select the best fit. The next step is developing a contract between suppliers and supply chain managers. Contracts spell out the nature and expectations of the relationship, deliverables, rewards, penalties, timelines, technical conditions, required outputs, service levels, payment structures, dispute resolution processes and exit strategies for both parties.

> "There is little point in outsourcing an activity... if it is going to be more expensive and of poorer quality than in-house provision."

Once a contract is signed, the supplier works with the firm's client services manager, who knows the delivery requirements. Some supplier relationships are purely transactional: The supplier delivers the specified product, commodity, or service at the right time, quantity, and quality. In more complex relationships, suppliers provide more expensive, critical materials, and a partnership evolves. In such cases, managers must verify that the supplier has constant access to provisions and can sustain pivotal deliveries. Managers should build collaborative relationships with their most important suppliers. Joint ventures and cooperative R&D projects can leads to "continuous improvement" of processes. For example, Microsoft and Intel work closely to support their mutually linked products.

"Gainshare"

Many contracts specify that both suppliers and managers must work on continuous improvements, but this seldom occurs. Continuous improvements take time to develop. Japanese automakers traditionally work with their suppliers to improve productivity, while US automakers' adversarial relations with their suppliers impede improvements.

> "The journey through both good and bad times is taken hand-in-hand with your suppliers."

In practice, continuous improvement provisions that cut production costs enable companies to pass savings along to their suppliers. Known as "gainshare," this spells out potential revenues a supplier receives when the company reduces costs. Chrysler implemented a successful Supplier Cost Reduction Effort in the late-1980s. The company reaped significant benefits because it benchmarked its costs against Honda's. Chrysler gained by accepting suppliers' suggestions about components and processes. In 1996 alone, the auto maker reduced costs by $1 billion. Chrysler abandoned this effort when Daimler bought the company and then went back to the traditional procurement bidding process. By 2010, Chrysler ranked last in the North American Automotive OEM’s tier one study.

About the Author

Procurement specialist **Caroline Booth** has worked internationally for Shell and Ernst & Young.