



“Best Practices” Newsletter

About This Issue

This September 2002 edition of our newsletter contains more techniques to help our clients & colleagues accomplish their strategic procurement objectives.

Strategic Procurement Solutions is a consulting firm specializing in Strategic Sourcing, Training, and Organizational issues related to supply management. Robert Dunn, C.P.M. & Mark Trowbridge, C.P.M. are senior partners in the firm, and lead teams of professionals in supporting our clients.

Visit our web site at www.StrategicProcurementSolutions.com for more information or to contact us about our consulting & training services.

“Setting the Stage” for Successful Negotiations ...by Mark Trowbridge, C.P.M.

How meaningful would “Phantom of the Opera” have been if the “Phantom” pranced out on a bare stage wearing blue jeans and a t-shirt, without an orchestra, and without his white mask...and began to sing? In order to achieve a desired effect, Broadway Theatres expend extraordinary effort to “set the stage” for their productions.



Many negotiation sessions fail because the procurement team *failed to properly “set the stage”*. Here are some tips you can use to make your next negotiation successful:

The Cast – Great actors can make the play. Poor actors can ruin a production. Similarly, negotiations can be optimized by involving the right people. *Make sure your negotiating team members are each (A) Empowered to make decisions, (B) Prepared to respond to all negotiation issues, (C) Capable of playing their assigned roles, and (D) Unified in their understanding of the negotiation objectives.* Also, don't have too many actors on stage...only those personnel who are critical to achieving the negotiation objective.

Staging - The location selected for negotiations, conveys to the supplier how much their business matters. We observed one firm try to negotiate a multi-million dollar transaction in a warehouse conference room, with record storage cartons stacked at one end of the conference table...and the interchange was interrupted by warehouse personnel trying to get their lunch out of a refrigerator in the adjoining room. Needless to say, the interaction failed to achieve all the desired objectives.

At the other end of the spectrum, I once chose to host a multi-million dollar consumable products negotiation in a mahogany-walled private executive dining room...that achieved significant concessions from a key supplier. Their Sales Director later confided that, "this is an account we had to have".

Don't underestimate the effect of the location. Consider introducing the supplier's negotiating team to your CPO before the negotiations begin...that person can certainly spare 10 minutes in their upscale corner office to "sell" the supplier on how important an opportunity this is for each of your firms. With the "staging" set, then proceed with the negotiations.

The Set – Negotiating at the supplier's location puts a variety of factors under their control. Access to your computer files/email is more difficult. Private phone conversations with your advisors/customers are constrained. Sidebar conversations are restricted. It is recommended that negotiations occur at the buyer's site. If not possible, try a neutral location like a hotel conference room. If you must use the supplier's facility, make sure in advance that you will have flexibility, by discussing your requirements with the host.

Cue Marks – Arrange both firms' representatives on opposite sides of the conference table, not mixed together. This allows comfortable "sidebar" conversations between your team members, keeps notes & computer screens out of the other party's sight, and prevents accidental sharing of confidential information.

The primary negotiator should position themselves, not at the head, but near the middle of the table. This enables them to communicate with their entire team, hear everything said at both ends of the table, and maintain direct eye contact with everyone on the opposing side.

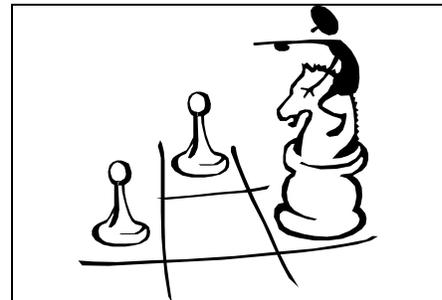
Intermission – If the meeting exceeds two hours, arrange refreshments for the participants (even the toughest attorney becomes human when offered a cookie...). In advance, let everyone know where the "Bio" facilities are located. Tough negotiations can be softened when personal necessities are provided for, in a caring manner.

The Program – The timing, content, and sequence of negotiations is critical. By controlling the agenda, with input from all participants, you can influence the content and outcome of the negotiation. For more information, see the article titled “Momentum in Negotiations in the Volume 5 - August 2001 edition (free download at www.StrategicProcurementSolutions.com). In addition, make sure to schedule breaks to keep everyone fresh, allow for team decisions, and to permit communications with each firm’s offsite corporate players.

If the “stage is set” properly, your negotiations will achieve great success. Just ask the Phantom...

Strategic Staffing in a Short-Sighted World...by
Robert Dunn, C.P.M., M.B.A.

The term “strategic” implies visionary & long-term actions. In the current economic downturn, however, many senior managers have failed to focus upon the value of their most important resource...procurement personnel.



The backbone of any supply management organization is the personnel who perform strategic sourcing, manage suppliers, support customer departments, and transact acquisitions. During the present economic times, however, some organizations are eliminating jobs, constraining salary growth, and curtailing professional development.

While necessary in certain circumstances, too often these actions are “knee jerk” reactions to reduced corporate revenue....and cost the employer “far more” than a strategic approach to personnel issues.

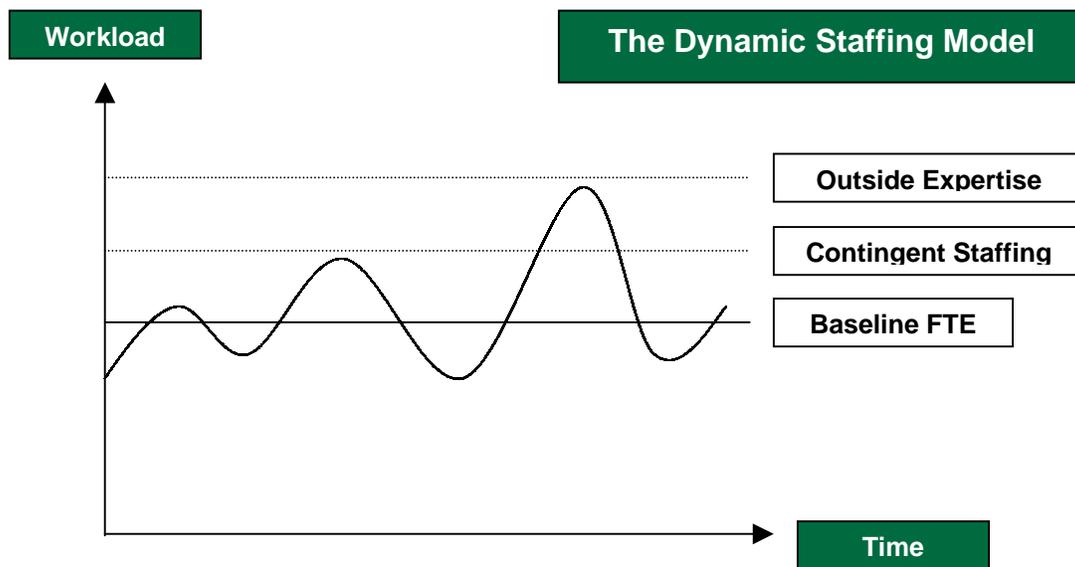
Here are several tips that will help a procurement organization to strategically maximize its human resources, even during the times of economic expansion and contraction that our country seems to cycle through every 7 – 10 years:

- **Tip #1 - Use a Dynamic Staffing Model** to solidify & enhance employee resources. This concept was explained more fully in an article titled “Flex Staffing in Procurement” in our first newsletter (free download at www.StrategicProcurementSolutions.com). A Dynamic Staffing Model allows flexibility to rapidly enlarge or decrease procurement staffing levels in keeping with revenue growth, and keeps top quality human resources available to the Chief Procurement Officer:
 1. **Baseline FTE** - Begin by developing a base of strategic and transactional full-time equivalent (FTE) employees. Choose qualified individuals able to handle the “baseline” departmental workload in a pro-active and productive manner. Don’t staff for the “peaks”, but rather maintain FTE levels to handle the average transaction volumes in a quality manner, **plus:**

2. **Contingent Staffing** - Add a contingent source for temporary staff that provides consistent quality and timely support. These are persons with solid procurement skills who are available during times of high workload (special projects, year-end, key contract renewals/expiration). Contingent staffing should not exceed 15% - 20% of an organization's total workforce. Sources for contingent staffing include temporary labor providers, specialty contingency providers for supply-management professionals, retirees from your procurement group willing to work for specific periods, or contracted labor recruited for a fixed term, *plus:*

3. **Outside Expertise** - Use outside consultants for key projects where it is not cost effective to build your own workforce, or where outside knowledge/capability will achieve greater impact. Niche consultants can cost-effectively provide additional resources for important initiatives. Although more expensive than baseline and contingent staffing, they are **far less costly** than doing nothing, or failing in a key initiative. Your CFO uses skilled consultants to maximize the corporation's financial performance. The CIO hires technology consultants to learn about new technology concepts. Marketing uses professional agencies to create & deliver new advertising initiatives. *In the same way, leading supply management groups also use professional service providers to implement strategic endeavors.*

The Dynamic Staffing Model allows timely increases and decreases in the personnel base, and enables the strategic CPO to meet enterprise demands in a timely and budgetary manner.



- **Tip #2 - Continue Investing Into Professional Development** to raise the performance of the procurement staff. Leading supply management organizations invest in personnel...expanding their capabilities through exposure to innovative concepts & new techniques.

Mediocre purchasing groups, however, rely upon “on the job” training. Or they send just the most senior personnel to offsite seminars. What results, however, is “inbred” ideas and processes.

During the lean times, continue to support professional development. Encourage employees to earn degrees and certifications (like APP, CPM, or CPCM). Support employee membership in professional associations like the Institute of Supply Management or the National Contract Management Association (who facilitate many educational speakers at dinner meetings). Consider bringing quality training to your company site to present new concepts to your staff.

- **Tip #3 - Minimize Turnover** – According to a recent study by the *American Management Association*, each time an employer replaces an employee, the transition costs more than 30% of their annual salary. Significant costs are incurred from lost productivity, recruiting expenses, and training expense. Related personnel issues often arise from other staff members “covering” for the departing employee during the transition. When procurement personnel change, negotiations can falter, supplier relationships suffer, and customer department trust can be damaged.

Recently, we have seen several procurement organizations with annual “churn” rates above 25%. Consider the cost of this. What drives a good employee to change jobs? Lack of attractive career options? Limited advancement opportunities? Inadequate compensation? Overwork? Boring workload? Factors far less than 30% of a person’s salary can be applied to “retaining” rather than “replacing” good employees. The answers must be strategically addressed so as to minimize turnover.

During tough economic times, leading companies focus upon their “core competencies”. In the same manner, leading supply-management organizations should focus resources upon their most important strength...their employees.

Leaping into eSourcing – Part 1...by Michael Zirkle, M.B.A.

Over the past five years, Internet-based sourcing (“eSourcing”) has become more and more popular as a means of matching demand with supply. Driving this popularity are the potential benefits of reduced costs, cycle times and manual labor, and improved process repeatability.



In this brief article, we would like to discuss Internet-based reverse auctions, a subset of eSourcing, and explore how they might work for you. In future editions, we will discuss other eSourcing technologies.

What is an Internet-based reverse auction? A reverse auction is a dynamic event, covering a specific period of time, during which a select group of suppliers competes for a buying company's specified demand for a defined good or service. In a reverse auction, the buyer initiates and establishes the rules for the event and invites select suppliers to compete for their business. The core work associated with the event is in many ways similar to the work done in a traditional RFP process, with the primary change being the use of technology to streamline the process and enable real-time, iterative competition.

There are two types of reverse auctions. An "open" auction allows visibility of competitors pricing...with varying degrees of propriety. A "closed" auction event protects the unique aspects of each bidder's proposal, but still makes each participant aware of their standing through the various stages of the competition.

During open reverse auctions, bidders can see their bids compared with those of their competitors and can submit later and better bids as they seek to win the business. At the end of the event, per the pre-defined rules, the buyer can select the best performing supplier(s) for award of the business or for entry into the final stage of negotiations.

It is critical to note that reverse auctions do not eliminate the need for sound, strategic sourcing capabilities. In fact, the very success of a reverse auction depends upon excellent requirements definition, market analysis, supplier qualification, sourcing strategy and supplier evaluation and selection. All of this work is still needed for a reverse auction, but it is done up front as preparation for the event.

What are the benefits of reverse online auctions?

The primary benefits are the price and/or total cost of ownership ("TCO") savings. These savings are achieved through dynamic, real-time price and/or TCO discovery as compared to that achieved through traditional, non-iterative, and non-dynamic sealed bid processes. Many of the auction software tools available today allow the buyer to specify the use of the output of multi-variable TCO formulas as the comparable bid value instead of simply focusing on aggregate purchase price. This ability allows suppliers to use other capabilities such as delivery, service, support, etc. to differentiate their offerings, even during an online event. This iterative, real-time competition drives discovery of available supply and value that is usually not made visible in traditional bid processes. In instances *where aggressive strategic sourcing was not used in the past*, the dynamic aspects of this bidding process combined with introduction of sourcing best practices in event preparation and process automation, have shown savings of 15% or better over historical pricing. Where strategic sourcing *was aggressively employed historically*, the process automation and dynamic pricing elements of the auction process have been seen to yield savings of 5-7% over historical pricing.

Of secondary benefit are the process efficiencies. Online reverse auctions can significantly reduce overall process and negotiation cycle times. Setting up an effective online reverse auction takes careful pre-event planning that includes issues such as clear requirements definition, market analysis, supplier qualification, supplier preparation, lot structuring, defining means of bid comparison (single or multivariable), defining event rules, legal considerations, and exception management procedures. The

quality of this pre-event work is not only critical to the success of the event but can greatly reduce the time traditionally required for post bid negotiations.

There are also significant learning curve effects. In general, the more auctions you run the more efficient you become in setting them up and getting results. Especially for specific products and services, once you have executed one successful reverse auction, much of the work and lessons learned from the first event can be used to compress the cycle time for the next event.

When does using an online reverse auction make sense?

Anyone that performs competitive sourcing can consider using reverse auctions to engage, evaluate and help select suppliers. However, not all types of spend or market conditions are favorable to successful use of auctions. Typically, only 5-15% of a firm's spend is a good fit, at any point in time, for sourcing via reverse auction. Buyers must review their sourcing needs by spend category to identify spend and market conditions that best fit with the strengths and weaknesses (and costs) of the available reverse auction tools.

Typically an item is a good candidate for sourcing via reverse auction only if it satisfies ALL of the following criteria:

- There are three or more strong suppliers qualified to meet the requirements;
- The business opportunity is large enough to be sufficiently attractive to the qualified suppliers to motivate participation and competition;
- There is room in the market for price or TCO compression sufficient to outweigh the cost of the event and possible switching costs;
- The requirements for the product or service can be clearly defined and reflected in the bidder's proposal.

Expenditures that you are currently taking to market through a bid process are often a great place to start looking for reverse auction candidates. *Spend categories that contain a high degree of intangible value, however, aren't good candidates for reverse auctions, such as those with (A) significant aspects of Intellectual Property content (examples, professional services such as Legal or Consulting), (B) large "human element" such as Creative Advertising services, (C) highly complex analysis that does not fit a standard bid model (example, HR Benefits), or (D) subjectively different performance levels across a limited number of suppliers (example, Customized Application Software).*

What are the technology requirements?

Currently online auctions have gained in popularity due to increasing supplier access to the Internet, new software capabilities, increased user friendliness, and decreasing costs.

There are several approaches to conducting a reverse auction. One approach is to engage a full service auction service provider with its own hosted software and experienced sourcing and auction professionals to help you setup and execute the auction. This requires no purchase or licensing of software by you or your suppliers and takes away most of the “heavy lifting” work that you would typically need to do internally to strategically source the category. In this case the experienced sourcing and auction professionals show you how to plan and execute the event and avoid costly and unpleasant “first timer” mistakes. This is a useful approach when you don’t have the internal capacity to do the up front strategic sourcing preparation yourself or you want to learn from others who may have sourced the category many times. The downside is that you pay a significant fee for that expertise and use of software and are not always given full access to the market analysis and other pre-event information that helps make the event successful.

Another approach is license the auction software and to run your own events. You or a third party can host this software. This can significantly reduce your external costs per event. In this approach however, your internal resources will need to do the event associated strategic sourcing work and develop the auction expertise to setup and execute the online event. For firm’s that have the strategic sourcing expertise and capacity and knowledge of the reverse auction process this can be a very efficient way to go.

Many companies start-off with a hybrid approach. In this case they learn about auctions by working, for a few events, with a full service provider and then, once the process is better understood and skills are developed internally, begin to conduct auctions on their own using licensed software. For “first time” categories, particularly challenging events, and/or for times when internal resources are unavailable, they may selectively use the full service provider but for all other appropriate categories they setup and run the events themselves.

How should my investment be prioritized?

Successful reverse auctions combine strategic sourcing capabilities and expertise with process automation and dynamic price discovery. While all three elements deliver benefits, the largest benefits are driven from excellence in strategic sourcing. Additionally, while reverse auctions can be effectively applied only to a small portion of a firm’s categories and spend, strategic sourcing capabilities are almost universally applicable and valuable. For these reasons we recommend that a firm’s first investments should focus on building internal strategic sourcing capabilities. With this foundation in place, additional investments in process efficiency and dynamic pricing can really pay off.

So how do we get started?

Our recommendation would be to develop a vision for the role auctions should play in your sourcing, do some pilot events, learn from experience, and once you have demonstrated auction’s value, to build with intent. Like doing any new thing, this change will require determination and hard work. The biggest challenge is not the technology, not the suppliers, and not the size or risk of savings, it is simply getting people to change from the “familiar and proven” to the “new and different”.

Editor's Note: **Strategic Procurement Solutions'** objective is to provide top quality supply management services to client organizations in the private & public sector, and to enable those clients to exceed their internal users' expectations regarding promptness, price, and quality. One means of doing this is through this educational newsletter, which provides quarterly articles about "Best Practices" in procurement. Contact us at www.StrategicProcurementSolutions.com for more information about our services, or if you do not wish to receive this newsletter in the future.