



“Best Practices” Newsletter Volume 13, March - 2003

About This Issue - This March 2003 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 advanced Strategic Sourcing, Training, and Organizational supply management services. 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.

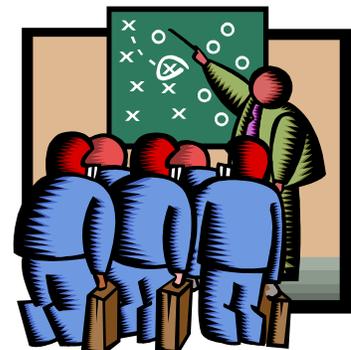
Mark your Calendars - Readers are invited to a free educational Web Seminar entitled “**Innovative Concepts in Strategic Procurement**,” co-sponsored by our firm, and Sofiface, the Procurement Intelligence Company. The online presentation will be at 11:00 a.m. Pacific Time (USA) on Wednesday March 26th, and last 45 minutes. Act quickly, as a limited number of user seats are available. For more information and to sign up for this free presentation, please visit: www.softface.com/solutions/demos.html (Note: If you have multiple people at one site, please share one log-in to allow others to participate).

You are also invited to an upcoming presentation we’re making at the I.S.M. International Conference in May – Nashville TN (“Navigating Through Mergers, Acquisitions, and Re-Organizations”). We’d also enjoy meeting you in person in our booth at the Educational Exhibit Hall (Booth #727).

What is Strategic Procurement?...by Patrick Soller, M.B.A.

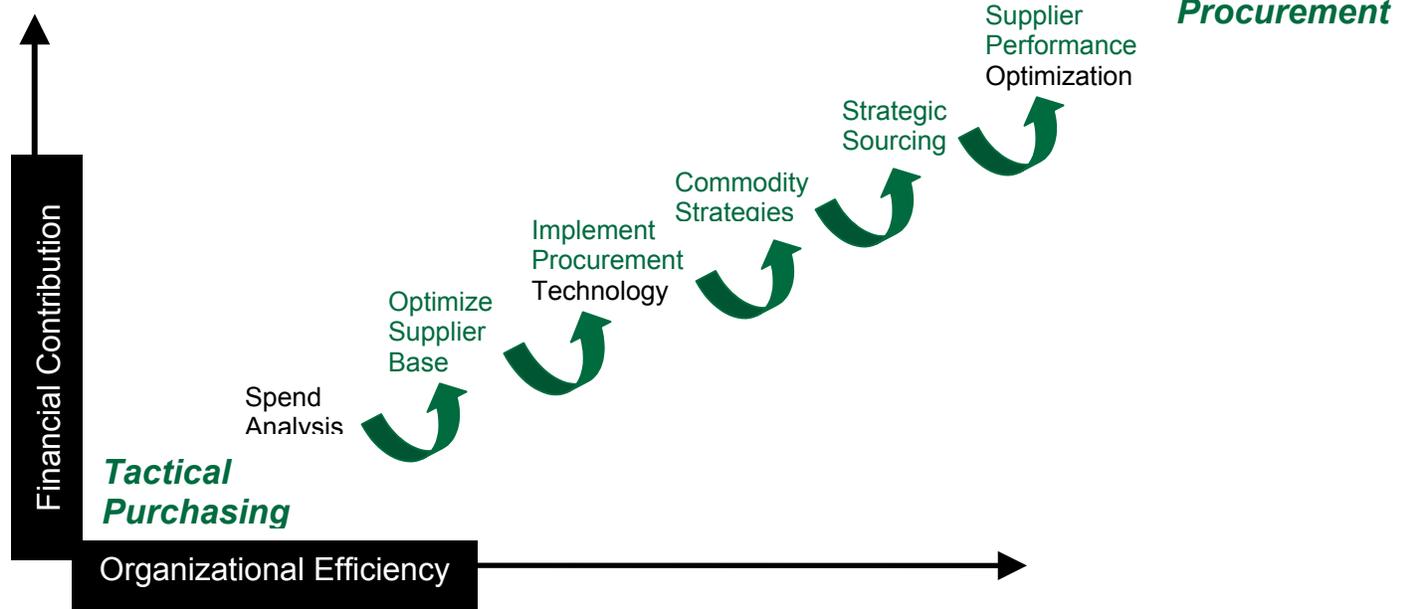
During the last 15 years, leading supply management organizations in both the public & private sectors have begun to transition from “tactical” towards “strategic” activities.

This transition has been accelerated as executive leaders have recognized the “bottom line” impact that results when procurement is done “strategically”.



The expression “strategy” is often associated with terms like “**long range**”, “**value-added**”, “**intentional**”, “**pro-active**” and “**planned**”. When applied to supply management, the expression “Strategic Procurement” can be summarized as the development and implementation of a long-term plan to procure the appropriate goods & services needed to support organizational operations, at the lowest Total Cost of Ownership (T.C.O.). **So what characteristics identify Strategic Procurement organizations?**

The following illustration reflects several key milestones along an organization's progression from "Tactical Purchasing" towards "Strategic Procurement":



The transition towards "strategic" and "value added" activities can often be measured by an entity's successful migration through these levels of performance:

Tactical Purchasing – This is the "Beginning" point for the transformational journey. Leading entities no longer allow a majority of their procurement actions to be "tactical", i.e. "three bids and a cloud of dust", many fragmented suppliers, manual ordering and settlement processes, "reactive" purchases, etc. Although great activity levels are generated through multiple and redundant bidding actions, little value results from this approach to procurement.

Spend Analysis – It's difficult for an army to plan a "strategy" without ever seeing the battlefield. Why do procurement groups think they are doing "strategic sourcing" when they don't have detailed knowledge of their organization's spending? The steps involved in "strategic procurement" require detailed information about the enterprise's spending habits...i.e. How many suppliers? Dollars spent...by supplier/commodity? Fragmentation of commodity spending? Who's spending the money? Potential leveraging opportunities? Opportunities for product/service standardization? "Maverick spending" patterns? Spend analysis is prerequisite to the steps to follow.

Optimize Supplier Base – An initial step in the progression towards value-added procurement is usually a consolidation of the supplier base. Organizations that buy from many fragmented sources are not positioned to achieve savings by leveraging enterprise volumes. Nor can they orchestrate quality supplier performance. Having too many suppliers creates "tactical work" (placing orders, settlement processing, etc), negates quality, increases delivery risk, dilutes leverage, and burdens the procurement

workforce. pCard processing of low-impact items may fit here too. The rationale inherent in initial supplier base consolidation is similar to that of “ABC” analysis...i.e. streamline low “value add” transactions to allow the supply management organization to focus upon high return opportunities.

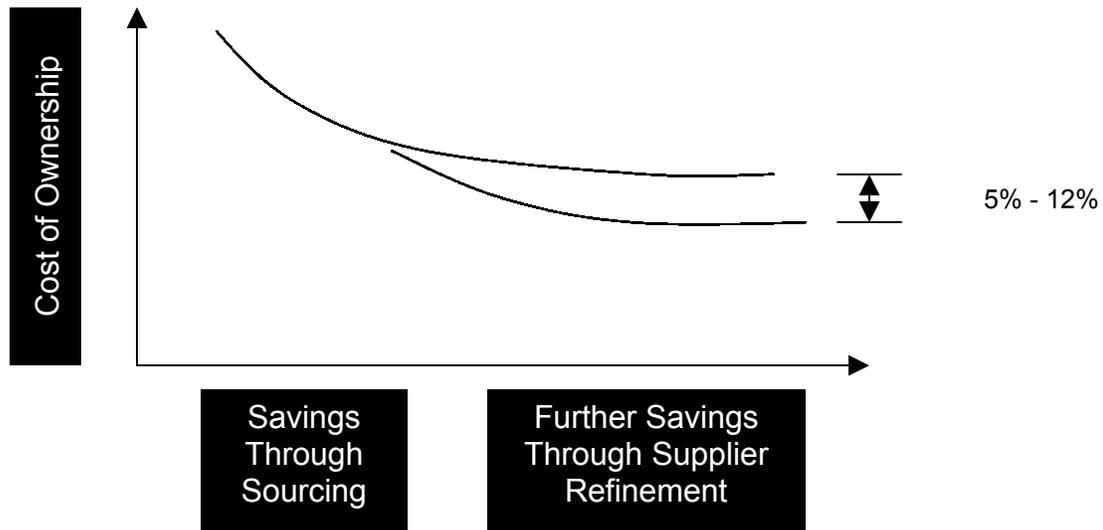
Implementation of Procurement Technology – With the consolidation of the supplier base, organizations can free resources to automate procurement transactions. Expenditure analysis, electronic routing of requisitions, eRFx sourcing actions (including reverse auctions), eProcurement online transaction processing, and electronic settlement are all benefits of supply chain consolidation. pCard automation can also be part of the eBusiness solution. Electronic commerce is a framework to reduce tactical activities, because of its efficient paperless process, self-service ordering for contracted products, automatic approval workflow, less expediting, and fewer exceptions.

Commodity Strategies – An important step in the transition towards Strategic Procurement is the sequential development & implementation of strategies for the acquisition of various expense areas. Having commodity strategies is foundational to strategic sourcing. This stage of development also takes organizations from a position of buying in the best manner possible, to identifying ways not to buy at all through demand management & forecasting.

Strategic Sourcing – This characteristic is looking at an enterprise’s total volume to select optimal sources of supply. Strategic Sourcing is not getting three bids, and choosing the lowest price supplier. Instead, it is a sophisticated process of performing market analysis, soliciting proposals from qualified suppliers, evaluating total-cost-of-ownership, entering into long-term & performance-based agreements, and ensuring quality performance management. In the public sector, Strategic Sourcing also includes evaluation & leveraged selection of an optimal balance of governmental and commercial sources of supply. Strategic sourcing may include other innovative concepts, like consortium purchasing, bartering, and supply-chain partnering.

Supplier Performance Optimization – With a consolidated supplier base that has been selected through a “best value” process, performance metrics can be applied to improve and further streamline the supply base. Interestingly, the optimization of supplier relationships is the final frontier to achieve further savings on non-commodity acquisitions. Leading procurement groups now understand that repeatedly “going to market” will not always achieve the lowest total cost of ownership. The final frontier of cost reductions can often be found by further leveraging a strong supplier relationship (shared cost reductions, product customization, supply chain streamlining, long-term strategies, etc.). We call this phase of Strategic Procurement “Value Management” (see our prior newsletter edition for more information).

This frontier of further savings through Supplier Performance Management is illustrated by the graph below:



How far is your organization on its progression towards “world-class” Strategic Procurement?

Stepping Into Their Shoes...by Mark Trowbridge, C.P.M.

Supply Management professionals should be well-versed in legal principles that apply to the contracts we manage. One helpful concept that all procurement professionals should understand is that of **Indemnification**.

In contract documents, we often find sentences like the following:... *“Each party indemnifies and holds harmless the other, from and against direct damages that result from the action, inaction, or negligence of the indemnifying party”*.



Corporate agreements usually contain the concept of “indemnification” with regards to several subject areas. One of the most common found in contracts dealing in the transfer or use of Intellectual Property Rights (i.e. software licenses, purchase agreements, professional service agreements...) is a clause titled Patent, Copyright, & Trade Secret Indemnity.

So what does it mean to “Indemnify” someone? The simplest definition is *“to step into their shoes”*.

When we *indemnify* another party, we agree to assume their place with regards to the risk being discussed. Indemnification is broader in scope than “hold harmless”, which simply means we will not hold the other party responsible ourselves. In fact, the term “indemnify” can be argued to implicitly encompass “hold harmless” protections. Indemnification means that not only will we not pursue a claim against the other party, but that we will also protect them if they incur loss as a result of another third-party.

This concept is especially important to purchasers, when our firms bear risk exposure to third-parties...i.e. persons or companies with whom we have not directly contracted.

Case Example: Patent, Copyright & Trade Secret Indemnity. A large financial institution had acquired several million dollars worth of a technology product from a well-known technology provider. Through an oversight, the technology firm had neglected to document ownership of a proprietary part of their technology from a subcontracted software developer.

The developer filed a lawsuit against the financial institution, even though he had never had any direct dealings with them (look for a future article about the legal strategy of “deep pockets”). The suit sought damages from the financial institution based on the value they had received from the developer’s software code.

Did the software developer have rights in the software code? The court ruled “yes”. Did the financial institution receive value from the developer’s software code? The court ruled “yes”.

Fortunately, the financial institution’s contract with the technology provider contained a clause titled “Patent, Copyright & Trade Secret Indemnity” whereby the technology provider indemnified the financial institution from damages incurred if a third-party’s rights in the product were infringed upon. The technology provider had to “step into the financial institution’s shoes” and bore the damages awarded by the court against the financial institution.

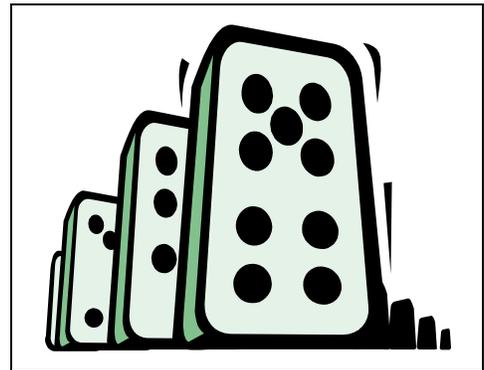
It is not enough to be protected against the other party in a transaction. Sometimes, they also need to become responsible for “stepping into your shoes”.

Readers should consult with their own legal counsel on the correct use of indemnity language.

Preparing for Negotiations (Part One)...by Robert Dunn, M.B.A., C.P.M.

No matter how many new tools are utilized (eSourcing, Reverse Auctions, GPO's, etc.), supply management professionals still need excellent negotiating skills.

One of our firm's most-requested on-site training programs is titled "Advanced Procurement Negotiations". When we first began to develop this offering, we were challenged to determine what skills qualified as "Advanced Negotiations".



Our research into the skills demonstrated by successful negotiators reflected a sophisticated utilization of the basic methods & techniques used by many practitioners. The real difference, however, was largely found in the amount of preparation, strategy work, and detailed planning demonstrated by these experts. They matched their preparation to the level of complexity & scope of the negotiated action.

Taking the time to identify and analyze all the factors is critical to developing an advanced negotiating strategy. Areas to consider include the following:

- **The Team** – Who will be involved in the negotiation process, in a (A) Leadership, (B) Support, or (C) Advisory capacity? What will their roles be? How will their involvement help to achieve the negotiation objectives?
- **The Location** – Where will the negotiations be held? How will the team be arranged to support the negotiation objectives? (see also the article titled "Setting the Stage for Successful Negotiations" – Volume 10, September 2002)
- **Business Risk** – What is the risk if a negotiated agreement cannot be reached? Is there a viable alternative if negotiations fail?
- **Market Conditions** – What are the current & projected economic conditions? Is a stable or unstable supply availability predicted for the product or service?
- **International Dynamics** – International sources of supply often require a sophisticated approach to negotiations due to cultural, language, and geographical dynamics. Negotiation of a simple acquisition takes on great complexity when cultural dynamics are involved.

- **Supplier Base** – “Sole” or “Single” source negotiations are much more challenging than those in openly competitive markets.
- **Total Cost Model** – Advanced negotiations address all aspects of cost, not just unit price. Many times complex negotiations are like touching a strand of a spider’s web, when one strand is moved all the others change shape too.
- **Mind Set** – How much time do we set aside to prepare “mentally” for a negotiation? Advanced negotiators often spend time alone beforehand, reviewing the strategy and preparing mentally for what must occur.

Preparation consumes 85% of the time required for an “advanced” negotiation. The more “what if” questions are posed in preparation, the further we move towards an advanced level of negotiation.

Next edition, this series will present some advanced techniques used by skilled negotiators.

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.