STRATEGIC
PROCUREMENT
SOLUTIONS

"Best Practices" Newsletter
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<u>About This Issue</u> - This July 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 who lead teams of professionals in supporting our clients. More information can be found at **www.StrategicProcurementSolutions.com**.

You are invited to upcoming presentations we're making at:

- *N.A.P.M. Orange County, Evening Presentation, Thursday – August 21st ("Navigating Through Mergers, Acquisitions, & Re-Organizations").*
- *N.A.P.M. Denver, Evening Presentation, Thursday – September 18th ("Building Internal Customer Relationships")*

<u>Stages of Successful Negotiations (Part Three of a Series)</u>…by Robert Dunn, M.B.A., C.P.M.

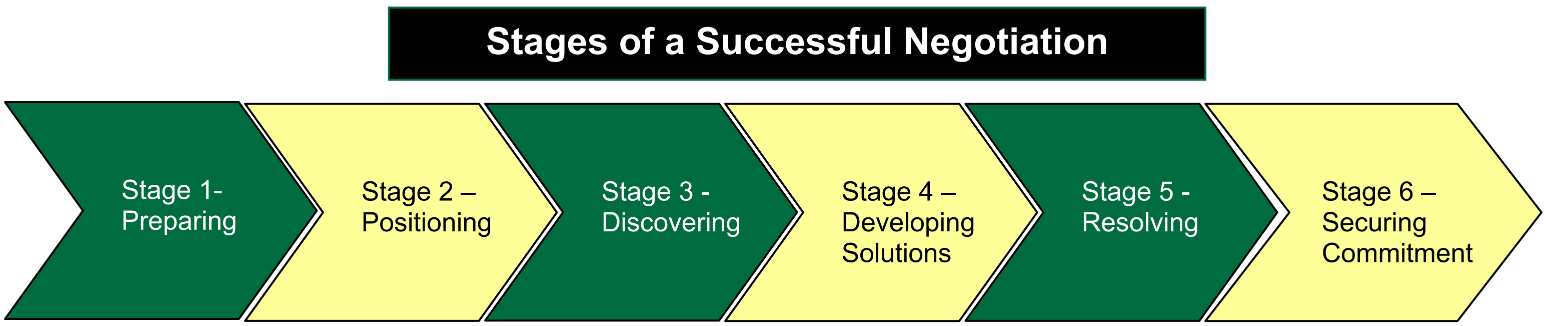
The last two editions of our newsletter presented ways to prepare for negotiations in articles titled "Negotiation Strategy Development" (March 2003) and "Negotiation Preparation/Planning" (May 2003).

Research we've performed shows that *great negotiators* place considerable emphasis upon preparation, strategy development & detailed planning…but there's much more…

Successful negotiators must also understand the **Stages of a Negotiation** in order to execute the plan they've put together.

We must remember that negotiation is a process by which two (or more) parties attempt to reach acceptable agreement upon issues & needs which satisfy their objectives. Both parties may compromise to reach their overall objectives and the negotiators must be able to understand, at any given point, where they are in the negotiation process in relation to securing commitment.

The following stages in the negotiation process are very similar to the sales/marketing cycle employed by salespersons. Each negotiator must identify the issues & needs of the other, while seeking to achieve concessions that will result in an agreement. When initial commitment is not reached, the skilled negotiator will re-trace the process stages to determine what went wrong…and develop a revised plan.



Negotiation Stage 1 – Preparing: As previously discussed, good preparation is critical to the success of any negotiation. The preparation stage before & during the negotiation should represent approximately 85% of the total negotiation time spent. Also keep in mind the principle that "Knowledge is Foundational to Power".

Our first priority then, should be to gain a fuller understanding of the needs & issues (i.e. requirements) of the supplier with whom we will be negotiating. Key activities in the preparation stage include:

- Situational Analysis;
- Formation of Objectives (Issues & Needs);
- Development of General Negotiation Strategy; and
- Anticipation of the Supplier's Probable Negotiation Strategy.

Negotiation Stage 2 – Positioning: The positioning stage is the opening stage of the interaction, and it will set the tone for the entire negotiation session. A good positioning statement will identify a purpose, show the value of a positive interaction, & establish a basis for trust. Key accomplishments in the positioning stage include:

- Description of the Desired Outcome;
- Mutual Agreement to the Negotiation Guidelines; and
- Clear Understanding of How Both Parties May Benefit By Reaching Agreement.

Negotiation Stage 3 – Discovering: The discovery stage of a negotiation is used to better understand the supplier's motivations & objectives. Use questions to understand the needs of the supplier, and share information to aid them in understanding your perspective. Activities in the discovery phase include:

- Reviewing the Business Situation;
- State Your Issues & Needs;
- Gain Greater Understanding of the Supplier's Position; and
- Identify Initial Points of Agreement & Conflict.

Negotiation Stage 4 – Developing Solutions: This stage of the negotiation process is where the parties identify a range of solutions that may satisfy their needs & issues. Discuss the "pros" and "cons" of all available options, and determine the solutions that best match each party's requirements. Strive to obtain acceptance by involving the supplier in the decision-making process. Key activities in developing solutions include:

- Initiate Problem-Solving;
- Develop & Evaluate Options;
- Agree Upon Action Plan for Accepted Issues (Acceptance); and
- Identify Remaining Points of Disagreement (Rejection).

Negotiation Stage 5 – Resolving: The supplier may have concerns that are preventing satisfactory resolution of the remaining issues. You must resolve these concerns before they become obstacles by first understanding what they are, providing needed information or evidence, and/or by modifying available options. The negotiator's goal is to resolve the supplier's concerns without minimizing the achievement of the desired objectives of the negotiations. Key activities in the resolving stage include:

- Restatement of Obstacles & Gaps;
- Invitation of Proposals & Concessions;
- Evaluation of "Pluses" & "Minuses"; and
- If Resolved, Agreement Upon Next Action Steps; or
- If Not Resolved, Agreement Upon a Follow-up Plan to Return to Previous Stages.

Negotiation Stage 6 – Securing Commitment: In this stage, both parties need to reach agreement upon decisions that will satisfy their respective needs & issues. All obstacles must be resolved and requirements clearly-defined. Key activities in securing commitment include:

- Summarization of All Points of Agreement;
- Assignment of Roles, Responsibilities, & Schedule;
- Summarization of Benefits to Both Parties ("Win-Win" Decisions Achieved); and
- Documentation & Approval of Final Agreement.

Once proper preparation has occurred in Stage 1, a skilled negotiator will be positioned to take the supplier through Stages 2 - 6 of the negotiation process. We start by establishing a purpose, then we mutually-define the needs & issues, develop options, and explore best solutions. After resolving all concerns, the end result will be mutual commitment in the form of agreement.

<u>Moving "Upstream" For Better Cost Savings</u>…by Mark Trowbridge, C.P.M.

In today's *strategic sourcing* environment, we continue to be surprised at how many procurement practitioners limit their concept of "sourcing" to just competitive bidding & negotiating.

After the initial round of sourcing, these persons are *sometimes* achieving cost reductions in the single digit percentage range, rather than double-digits available by spending more time "upstream" in the supply chain.

The term "sourcing" can be summarized to be "the intentional selection of the best source from which to acquire needed products or services". This "source" includes every *customer requirement, designer, supplier, producer, and distributor* that influences the item before it is delivered to your organization.

Supply management groups that are aggressively "sourcing" today, do far more than bidding…they are also:

- **Re-engineering the products & services to reduce Total Cost of Ownership (T.C.O.);**
- **Working to reduce production & logistics costs several levels "upstream" of their position in the distribution channel;**
- **Developing alternative suppliers to compete in fields of monopoly or limited supply.**

This article will discuss each of these "best practices" techniques in greater detail.

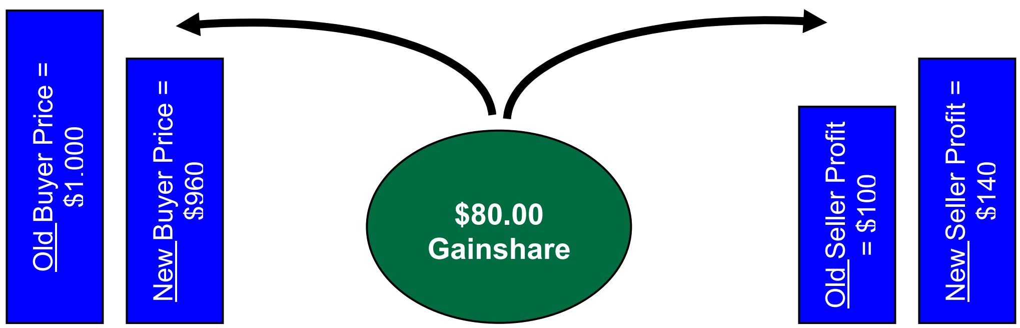
<u>Upstream Technique #1</u> – Re-engineer Products & Services to Reduce T.C.O.: A product or service can be competitively bid a hundred times, but if the requirements are inaccurate or overbuilt, the Total-Cost-of-Ownership (T.C.O.) will still be too high for the buying organization. World-class procurement groups are working creatively to reduce specification complexity through standardization, make production easier for suppliers, and minimize their own costs.

Two “best practices” approaches frequently used today by commercial-sector firms are those of “gainsharing” and “performance-based” contracting. These approaches establish motivational factors for suppliers that encourage cost reduction:

- “Gainsharing” provides financial benefit to suppliers who reduce costs for the customer, by allowing the supplier to retain a defined portion of any cost reduction that positively impacts the customer.

  For example, let’s say that a contracted product is priced at $1,000…a level at which the supplier makes a 10% profit of $100 (based on a production cost of $900). A hypothetical “gainsharing” clause might say that the parties (buyer & seller) will reduce the contracted selling price by ½ of the amount of any cost savings implemented by the supplier.

  If the supplier can reduce its cost of production by $80 (to $820), this gainsharing arrangement would divide the savings between the parties and set the new selling price at $960. Both the buyer and seller would benefit equally from the seller’s cost reduction…with $40 in buyer savings and $40 in additional seller profits.



- “Performance-based contracting” builds quantifiable performance objectives & criteria into strategic supplier contracts. Innovative firms are now including the provision of cost reduction suggestions, concepts, and technologies as part of the normal “scope of work” for key suppliers.

Upstream Technique #2 – Working to Reduce Production & Logistics Costs Several Levels “Upstream”: Unsophisticated buying organizations often incorrectly assume that they must “buy” at the level of distribution placed upon them by the provider. Creative buyers, however, are breaking out of this mindset and *challenging* the supply chain.

Two examples come to mind of how to look “upstream” to reduce costs:

1. **Strategic Procurement Solutions** was approached several months ago by the C.P.O. of a Fortune 100 energy provider. Their firm is considering the use of our services to help their supply management organization with training services. In addition, however, they are planning to refer us to several of the energy firm’s key suppliers who might benefit by improving their own procurement processes. The energy firm rightfully-understands that by reducing the costs upstream, they may reduce their own expenses. This C.P.O. is known for *thinking outside the box.*

2. Several years ago, a large financial institution sought to reduce its costs for acquiring a digital output device. They were buying the device at the lowest-tier prices available in the preferred manufacturer's distribution channel. Due to the bank's centralization of internal resources, the procurement group realized that the firm's own technicians were performing certain services similar to those performed by a distributor in the manufacturer's distribution channel (i.e. warehousing inventory & supplies, installation & maintenance). The organization contacted the manufacturer and established the firm as an "authorized dealer" with better pricing than any available to their other top tier customers.

<u>Upstream Technique #3</u> – Developing Alternate Suppliers to Compete in Fields of Limited Supply: If there are not sufficient suppliers to *compete*, it is difficult to leverage volume. In "sole" or "single" source circumstances the aspect of competition drives advantage to the seller.

Many shortsighted buyers have even cut off volume provided to a secondary supplier that has slightly-higher pricing or a less beneficial product…only to have them disappear from the marketplace. Then the leader has a monopoly and prices begin to escalate...service levels deteriorate…etc.

At the recent I.S.M. International Conference in Nashville, I ate breakfast next to the C.P.O. of a large firm that manufactures one highly-specialized product. More than 30% of his company's expenditures are for one raw material for which just a single domestic provider dominates the U.S. market.

Not only does this type of situation minimize leveraging opportunities, but for this firm it creates an unreasonable business risk...i.e. they might be unable to stay in business if the sole supplier ceased to produce the necessary raw material.

His firm's primary "strategic sourcing" effort for 2003 will be to embark on a multi-year initiative to develop alternate sources of supply. His firm has assigned three top executives to nurture and mentor closely-aligned U.S. manufacturers and International providers to see if competition can be developed. As well, they are investigating the creation of a subsidiary to produce the raw material…something that is really a "core competency" for them.

This *upstream* technique also can incorporate the old "make or buy" assumptions made by the buying organization. "Make or Buy" is a concept largely used by manufacturing firms, but applies equally to all public and private sectors. This concept captures the decision between acquiring a product or service from an external supplier or building/performing it internally. World class procurement groups are actively challenging past decisions to build something in-house, when the resources necessary to outsource it may be more cost-effective externally. In other cases, moving production internally can reduce costs.

These techniques can help purchasers to move "upstream" and make significant impacts upon company expenditures. *Strategic Sourcing* takes time to evaluate the entire supply chain as various approaches to sourcing are planned & implemented.

If you ever feel like you're paddling without making significant progress, consider taking the canoe out of the river and re-launching at a different point farther upstream.

<u>Procurement Enhancement through Process Improvement</u>… by Patrick Soller, M.B.A.

With the advent of Six Sigma, Total Quality Management (T.Q.M.), Lean Manufacturing, and the PDCA (**P**lan, **D**o, **C**heck, **A**ction) cycle concepts, supply management organizations are increasingly exposed to process improvement concepts. The ability to understand, analyze, and improve a business process can bring great value to the procurement organization…whether applied internally to its own operations or externally to the supply chain.

Process improvement is a basic building-block of quality management and a fundamental competitive weapon. Processes in today's business environment are complex, and many are inefficient and wasteful. Between 5% and 15% of an organization's total work effort may be wasted through ineffective processes. Systematic process improvement can dramatically improve quality, reduce costs, interest employees and delight customers.

Benchmarking a process is simply comparing one process to another more effective one in order to find ways to improve the first. The comparison can spur rapid learning and change and can be made an integral part of organization-wide learning and improvement. Benchmarking can be done both internally and externally. It is often wise to benchmark within a company before looking outside. External benchmarking is used to compare oneself to those considered world-class or best-in-class. You may want to look for a partner outside your industry. Search for *Best Practices* regardless of the nature of the business.

Benchmarking follows a series of ten steps:

1	**Prepare as a team;**
2	**Map the existing process using a visual method such as flowcharting;**

3	**Search for pertinent benchmarking data through organizations like the Center for Advanced Purchasing Studies (C.A.P.S.), National Contract Management Association (N.C.M.A.), National Institute of Governmental Purchasers (N.I.G.P.)… *Links to these and other sites can be found on the "Research" page at www.StrategicProcurementSolutions.com .***
4	**If published benchmarking data is insufficient or unconvincing, research competitors, markets, other industries, to find a benchmarking partner(s);**
5	**Establish the partner(s) relationship;**
6	**Observe and collect pertinent data (only ask for what you would be willing to give);**
7	**Debrief and analyze the data. Search for breakthrough points where you can leapfrog the competition and/or improve your own process;**
8	**Eliminate/modify redundant or unnecessary steps in the process and adapt what you learned to suit your needs;**
9	**Pilot the new process; and**
10	**If it proves successful, implement the new process.**

The tools used in each of the above steps include:

- **Brainstorming** – building a list of potential problem areas or causes of problems;
- **Affinity diagram** – group-brainstormed ideas quickly and intuitively;
- **Flowchart** – map the flow of a process;
- **Cause & effect diagrams** – chart ideas in logical chains of causality, finding root causes; and
- **Data analysis** – gather and analyze process data

Process improvement becomes even more important when procurement automates aspects of the supply chain. Implementing a bad process is similar to *putting lipstick on a pig*…not a wise investment. It is also more difficult to alter a process that has been incorporated into a technology solution.

Benefits are often found by focusing upon the following*: Variation in the process; Misuse of technology; Non-value-added activities; Poorly-coordinated activities; Poor communication flow; Non-standard information & operations; or Poorly-defined responsibilities.*

As an example, Strategic Procurement Solutions worked with a large regional bank to strategically-source their commercial printing expenditures. The process resulted in a remarkable 48% savings. Of equal importance to the client, however, were the results of a process-improvement initiative related to the design & development of the print artwork. By following the tips in this process, we were able to reduce a 33-step review process involving Marketing, Legal, Retail Banking, Commercial Banking, Private Banking, and Procurement. The firm now follows a 14-step process that achieves a greater degree of review & protection.

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 bi-monthly 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.