



“Best Practices” Newsletter Volume 16, September - 2003

About This Issue - This September 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 “world-class” client organizations. More information can be found at www.StrategicProcurementSolutions.com.

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

- *N.C.M.A. Sacramento Valley, Lunch Presentation, Wednesday – September 10th*
- *I.S.M.. Denver, Evening Presentation, Thursday – September 18th*
- *I.S.M. Arizona, Evening Presentation & Day Seminar – October 16th and 17th*

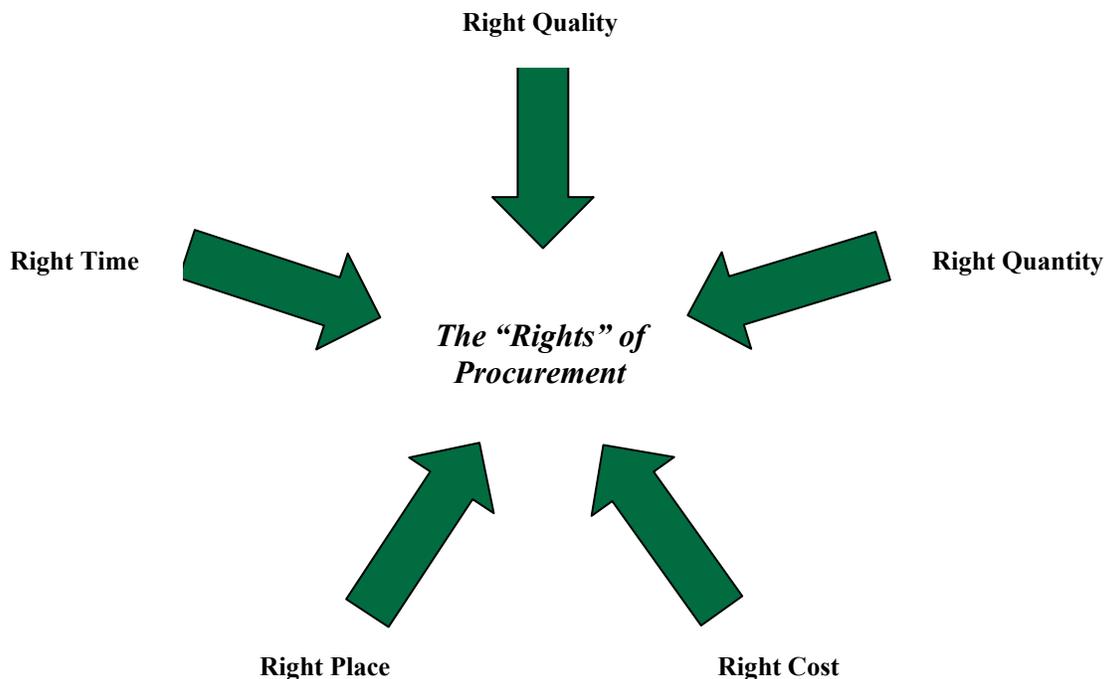
The Procurement “Safety Net”...by Mark Trowbridge, C.P.M.

*Let's face it...*the primary theme in today's supply management arena is the *capture of cost savings*. Without proving their continual contribution to financial performance, today's procurement organization finds it difficult to gain support from executive management.

But cost reduction sometimes becomes so emphasized that supply professionals can lose track of the *most important* part of their job...ensuring the availability of products & services needed for their employer to efficiently conduct business. This article will discuss “safety net” protections that “world class” procurement groups are using to ensure continued supply-chain performance.



An old procurement motto is that procurement professionals must understand the “Rights of Procurement”, whereby they are responsible for delivering the Right Quality, in the Right Quantity, at the Right Time, to the Right Place, for the Right Cost. Notice that only when we manage the entire supply-chain process, can these be achieved.



As I write this article, I'm sitting in an airport while electrical power grids fail in New York, Cleveland, Detroit, and Toronto (fortunately my flight is unaffected by these disruptions...). In the Eastern U.S. millions of people are stranded as lights, traffic signals, subways, airport ground support, elevators, etc. are non-functional.

With more core operations being performed by external suppliers, it is essential that procurement build "safety nets" to ensure continued performance during similar times of transition, instability, and emergency. One day of stoppage due to a supply-chain failure will wipe out any "savings" claimed for a particular procurement action...and can decimate the reputations of procurement personnel associated with the failure.

During times of emergency and shortage, suppliers are also placed into a position of advantage. Without secure supplier relationships, buyers can often be forced to pay "premiums" to continue ongoing supply-chain performance...or can be left without any source of supply.

In the '80's, I was a buyer for a national airline. Part of my job involved acquiring technical materials used in the repair of our Boeing & McDonnell Douglas aircraft. The procurement organization had an "alert" system for out-of-stock materials that consisted of four levels:

- **Level C** = Needed within 72 hours;
- **Level B** = Needed within 48 hours;
- **Level A** = Needed within 24 hours; and
- **A.O.G. = A \$100 Million Jet Plane Is Sitting on the Tarmac Because You Goofed ("Aircraft on the Ground")**

Needless to say, the hypothetical 15% cost reduction captured on 6061-T6 aluminum extrusions doesn't matter much when the company president is on the phone demanding to know why flights are being cancelled for lack of those extrusions...

The following concepts are worth considering as you build supplier networks to support key areas of organizational performance:

COP & BDRP Plans

Companies and public agencies today recognize that they need a plan & resources to resume operations during times of emergency. These plans are typically called Contingency Operating Plans ("COP") or Business Disaster Recovery Plans ("BDRP"). These plans provide a written procedure for how operations will be resumed in the event of a failure. For key suppliers, it is imperative that their contracts require them to have a valid COP or BDRP plan acceptable to the buying organization.

Source Diversity

When sourcing a commodity, often the "greatest" savings can be secured by awarding to just one supplier. Greedy investors also may put all their funds into one stock with the "potential" of significant increases. But what if a problem occurs with that one supplier or investment? Take a hint from wise investors and "diversify" the sources which provide "business-critical" products and services. Utilize primary/secondary relationships to ensure continued supply-chain performance.

"Most Favored" Emergency Treatment

Do your key supplier contracts contain language that requires them to divert resources to your account during times of emergency, prioritized equal to (or better than) their "most favored" customers? If not, you can bet that some of their other customers do...meaning that their services will be resumed more quickly than those provided to your organization.

Carefully-Written Force Majeure Language

Force Majeure ("Major Force") language is standard in most contracts, and excludes one or more parties from performance when events occur beyond their reasonable control ("Acts of God", wars, labor strikes...even "Nuclear Detonation"). This language is good to have in order to protect the parties, but if too-broadly written...may exclude the supplier from performing during emergencies when their performance is most needed. As with all other legal language, have your counsel carefully-a good Force Majeure clause.

Emergency Performance Standards

Mission-critical contracts must contain language defining how the parties are to perform during key times. This is especially important for outsourced service bureau relationships, but can apply equally to suppliers which supply important direct materials. The contract Statement of Work (“S.O.W.”) should define problem resolution, emergency contact procedures, alternative production sites, and also incorporate each firm’s C.O.P. or B.D.R.P. procedures.

Collaborative Supplier Relationships

In this day of “e” sourcing, it is easy to *bid* and *rebid* commodity production materials on a frequent basis. Savings will often result in fluctuating markets, by shifting short-term acquisition volumes to low-cost providers. “Competitive” supplier relationships work great for standard products when supply is plentiful, but the “tactical” buyer can be without recourse if a shortage occurs...caused by a fire in one of the three U.S. production facilities for a particular web paper...a terrorist disruption of international air traffic...or a national increase in fuel prices... In these instances, the procurement groups with “Collaborative” supplier relationships will take first priority from the industry suppliers, and the tactical buyers will be left with any remaining capacity.

Does your organization have a good procurement “safety net”? Supply-chain risk is an important part of the Total-Cost-of-Ownership (“T.C.O”) that must be evaluated for each supplier relationship. “World-class” procurement groups are eager to secure savings...but not at the risk of stopping operations. **Don’t wait for a supply-chain failure to find out...**

Laws of Agency – “Buyers Beware”...by Robert Dunn, M.B.A., C.P.M.

The “Laws of Agency” have a significant impact upon negotiations for the supply management organization. While most procurement professionals have general knowledge of the “Laws of Agency” as they relate to signing contractual documents, we sometimes fail to apply proper “checks and balances” in all stages of negotiation.



Hopefully when signing a contract, each party has a signatory with full authority to bind their organization. They signify by title or position that they have capacity to contract. In fact, many prudent buyers have language in their contracts that says “The undersigned representatives of each Party hereby represent and warrant that they have the authority to bind their Party to the terms and conditions hereof”.

But what about the persons who represent their employer in negotiating elements (for example, terms & conditions, rate schedules, Statements of Work (S.O.W.), performance criteria, etc) that become an integral part of a supplier relationship?

To illustrate, let's turn to an example that many of us have experienced when buying a vehicle for personal use. We start to negotiate with the car dealer's Sales Representative. The details are worked out, back and forth, until we think we're going to proceed with the purchase. Only then, do we find out that the Sales Representative is incapable of making any major concessions without obtaining approval from the Sales Manager. At this point, we either leave the dealership in frustration or have to begin again with the Sales Manager. The trick often works with unsuspecting buyers, because they are emotionally vested in the purchase...and will accept higher costs or additional options upon which they would not have originally agreed.

In a commercial environment, procurement professionals and sales representatives are typically acting on behalf of their employers, rather than for themselves, in making contractual commitments. The legal term for this is an "Agent", leading to historically-popular procurement titles like "Purchasing Agent". ***An Agent can be described as "One having been granted the authority and responsibility to act on behalf of another"***.

Procurement professionals are usually classified as "general agents", while salespeople are usually classified as "special agents" having somewhat restricted authority. Consequently, a sales representative may not have the authority to bind their company to a sales contract. Courts have often held that, unless otherwise delegated by an authorized company officer (i.e. Sales Director, etc.), special agent sales representatives have authority only to "solicit orders".

General agent authority can also vary for the procurement professional. In practice, the amount of authority delegated to buyers varies significantly among organizations. Hence, it is difficult to know the precise limits of a particular buyer's authority. **Consequently, under the law, a procurement professional operates under two types of agency...**

"Actual" Authority =
The authority actually delegated by the employer to the employee that allows them to commit contractually. Example: a signature delegation allowing a Contract Negotiator to sign contracts worth up to \$200,000.

"Apparant" Authority =
The implied authority for an employee that can be reasonably assumed by another party. Example: a Marketing Vice President might be assumed to have authority to sign a contract, even if their company only grants actual authority to the procurement organization.

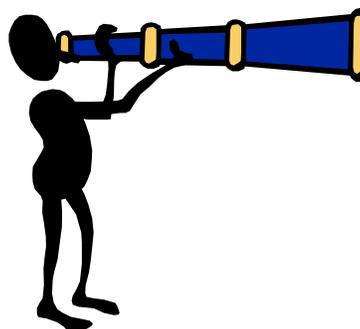
Procurement negotiators must continually verify their own actions as an Agent for their employer, and simultaneously question the authority of sales personnel to act as Agents for theirs.

In most business relationships, agents on both sides negotiate the conditions on behalf of their principals. Skilled negotiators place great emphasis upon preparing for their negotiations with Strategy Development, Orchestration, and Detailed Planning. Part of this preparation process is to develop a line of communication with the supplier before the formal negotiations commence. Concerning this issue of “Agency”, a helpful tool is the meeting agenda that ensures the participants from each party has the authority to commit.

Don't allow a negotiation to proceed if the negotiating teams don't have Actual Authority to commit their organization...

As with all topics of law, readers should check with their own legal counsel for proper application to their organization's circumstances.

Supply Management's Contribution to Strategic Planning...by Patrick Soller, M.B.A.



Finance, Marketing, Human Resources, and Operations have long-been responsible for delivering comprehensive strategies that contribute to the overall success of the organization. *As the role of the supply-management organization escalates in visibility, the procurement strategy must too becoming an important part of enterprise-wide strategic plan.* More thorough planning is required as both private and public sector organizations desire their supply management groups to accomplish *more*, using *fewer* resources.

This article will describe how Chief Procurement Officers can achieve greater recognition from executive leadership, by contributing to enterprise-wide strategic planning.

A comprehensive Supply Management Plan should address five aspects of future performance:

- 1. Procurement Operational Performance*
- 2. Supply Chain Optimization*
- 3. Market Trend Forecasting*
- 4. Sourcing Efficiency*
- 5. Financial Contribution*

1.

The **Procurement Operational Performance** portion should answer the following questions:

- What products & services are being acquired and how much is spent on them? This portion of procurement's strategic plan should describe how an expenditure analysis tool can be used to gather data from the organizations key legacy systems (General Ledger, Accounts Payable, eProcurement, pCard, etc) to "drill down" to derive meaningful understanding of spending sorted by major internal clients, suppliers, product categories, transactional volumes, supplier diversity, etc. The plan should describe the current situation in a meaningful level of description. Be careful not to assume "one-off" expenditures will be "recurring".
- How does the last year's expenditure compare with the projected spend? The report can summarize your marketplace research & interaction with key internal clients to identify increasing or decreasing trend information. The strategic plan should document changes in the pattern of expenditure, the causes, and recommended actions. It should then benchmark future acquisition volumes against staffing & technology resources necessary to adequately manage the volume.
- How are products & services currently being acquired? With a solid understanding of transactional volumes and supplier expenditures, the report can evaluate the use of tools like pCard and eProcurement for high-volume transactions, monitor cycle times for solicitations, contract actions & transactional purchases, measure the spend outside of the procurement department's control, and estimate the amount of maverick spending that could be controlled through more pro-active supply management involvement.
- How effective is the procurement organization in servicing internal clients? The results of ongoing internal customer surveys should be summarized here. Solicit feedback from major stakeholders on the value-added reputation of the procurement group with whom they interact. The plan should identify targets for improvement and opportunities for training.

2.

The **Supply Chain Optimization** portion should answer the following questions:

- How consolidated or fragmented is our category spending among suppliers? The plan should identify measurable objectives to attain in consolidating the supply base.

- How appropriate are products & services to the actual needs of the enterprise? The plan should seek to identify objective steps to standardize requirements, rightsize demand, and determine actual need. Many organizations find they are buying certain products or services which they don't really need and the strategic plan should discuss the present situation and identify demand management approaches to be followed by procurement to limit such demand.
- How secure is the supply-chain for products & services critical to the operation of the enterprise? This portion of the plan should discuss stability of supply for products & services essential to operations. It should identify the degree of difficulty to secure stable sources of supply. What is the general level of risk associated with each purchase category based on product, organizational, supplier, or market? Risk increases with complexity, limited sources of supply, specialized knowledge, rapidly-changing market, safety and environmental concerns, or when a specific quality or service is needed

3.

The **Market Trend Forecasting** portion should answer the following questions:

- What changes are expected in critical portions of the supply-chain stream? This portion of the plan should review recent market changes and forecast trends that can affect organizational profitability or financial stability. It should focus on high expenditure and difficult-to-secure-areas of the market. The depth of analysis should be consistent with the importance of the good or service, and provide executive management with visibility to future exposure. Lastly, this portion of the trend should outline steps to be taken by procurement to limit marketplace exposure...such as futures buying, hedging, long-term contracting, escalation/de-escalation limiters, etc.

4.

The **Sourcing Efficiency** portion should answer the following questions:

- What portion of enterprise spending is being strategically sourced & managed? This portion of the plan report upon the current state of spend management...using measurements like “% of Spend Influenced by Procurement”, “% of Spend Under Strategically Sourced Long-Term Contracts”, % of Spend NOT Strategically Sourced”.
- What spend opportunities will be addressed in the upcoming reporting period? At a high level, the report should outline major areas of opportunity for procurement-driven cost reduction. It should describe the general actions to be taken, and measurable results to be expected by executive management.

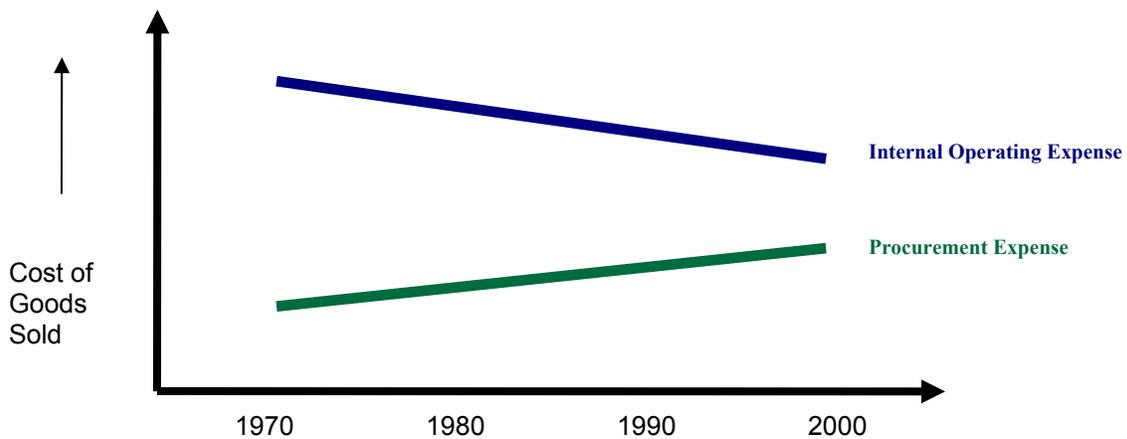
5.

The **Financial Contribution** section is where the CPO identifies targeted savings expected to result from the supply management group's strategic performance. This section answers the following:

- What financial benefits will procurement deliver to the enterprise? This section should discuss savings to result from Strategic Sourcing, Supplier Performance Enhancement, Improved Cycle Times, Reduced Inventory Holding Costs, Procurement Staffing Efficiencies, and other beneficial changes.
- What investments are needed to secure the financial benefits? Clever CPOs often use this portion of their strategic plan to identify new technologies, staffing adjustments, and organizational changes they will require to deliver the pledged financial benefits. This is a good place to incorporate a Return-On-Investment ("R.O.I.") calculation that helps executive management understand the benefits to be received from the pre-requisite changes.

As companies become more efficient in their internal operations, including manufacturing, the importance of the supply management organization has become more critical to ongoing financial performance. In an article titled "What's In a Name?" in Purchasing Magazine, David Nelson (then at John Deere, now at Delphi) is quoted as explaining this shift, "Twenty years ago, 70% of the spend was in manufacturing and 30% in procurement....With the trend toward outsourcing over the past decade or two, though, the numbers have reversed for many organizations, with 70% of the spend being in procurement and 30% in manufacturing."

Increasing Financial Contribution of Supply Management



This observation, made back in 2000, is even more valid in 2003. With shrinking budgets and greater supplier dependency impacting them, even governmental and service sector companies are now seeing a higher portion of their total budgetary performance impacted by external supply costs.

Failure to incorporate procurement into the strategic planning process can negatively impact the enterprise and the potential success of the procurement organization.

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.