



# “Best Practices” Newsletter Volume 18, January - 2004

**About This Issue** - This January 2004 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](http://www.StrategicProcurementSolutions.com).

We also invite readers to attend one of our upcoming public presentations:

- February 5<sup>th</sup> & 6<sup>th</sup>, 2004 – **Advanced Procurement Negotiations Seminar**, Ramada Inn - Ft. Myers Marina. Sponsored by the N.A.P.M. Florida Suncoast chapter for nationwide attendance. Contact Ms. Meliza Colon at [meliza\\_colon@pall.com](mailto:meliza_colon@pall.com) for information.
- April 27<sup>th</sup> 10:20 a.m. – **Strategic Contracting** and April 28<sup>th</sup>, 8:00 a.m. – **Greater Saving Through Supplier Management** – I.S.M. International Conference, Philadelphia, PA.

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## **Selecting “The Best” Sourcing Strategy...** by Robert Dunn, M.B.A., C.P.M.

Selecting the best sourcing strategy to maximize cost reductions must be based upon the characteristics of the target commodity. One must determine which strategy to use by first considering the following commodity characteristics:



**Commodity Type**  
**Internal Customer Requirements**  
**Market Conditions**  
**Supplier Base**  
**Business Risk**  
**Expenditure Level**  
**Technical Complexity**

True procurement professionals don't use the same approach for the purchase of Office Supplies as they do to license Sole Source Application Software. And it's interesting to note that if you're a buyer working for a large office supply distributor, you don't use the same approach to contract for Hewlett-Packard toner cartridges that is used by end consumers. **Every commodity must be sourced differently depending upon two variables...Category Criticality and Buyer Power.**

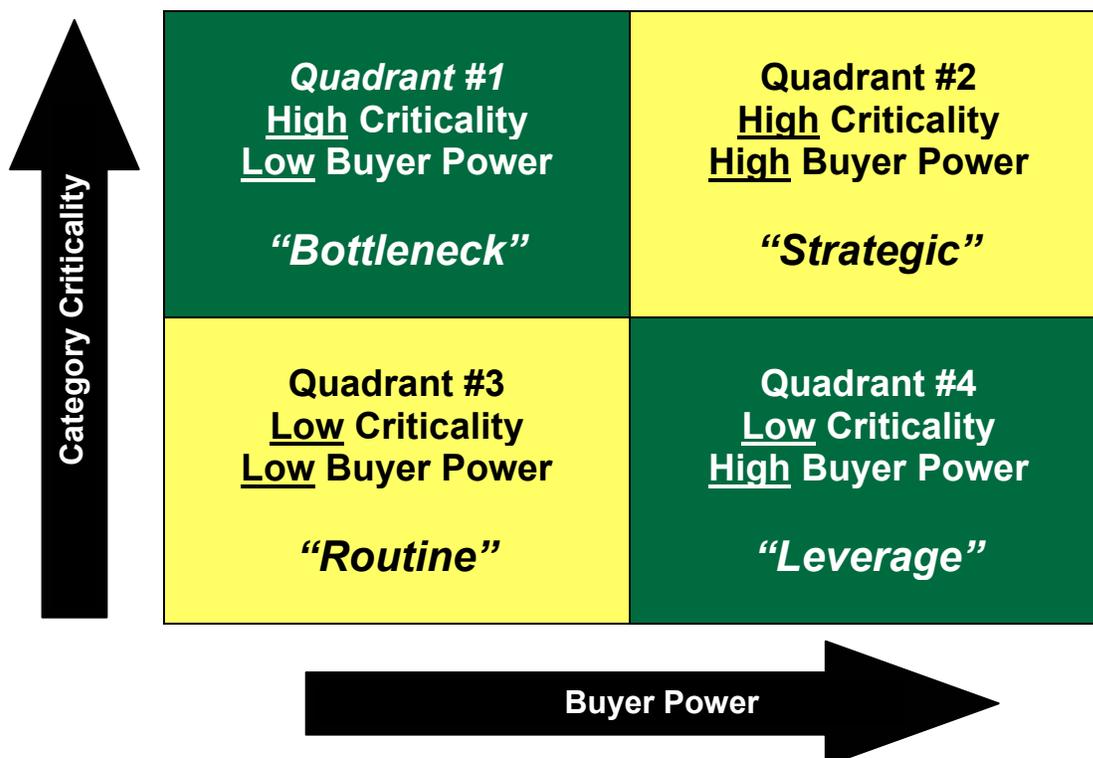
**Category Criticality** is determined by the degree of:

- Percent of a Buyer's Total Expenditures
- Visibility & Value of the Commodity to the Buyer's Operations
- Availability Risk
- Technical Complexity of the Commodity
- Price Volatility
- Quality Risk
- Capacity of Supply Market

**Buyer Power** is determined by the degree of:

- Supply Market Concentration
- Threat of Substitution
- Buyer's Spend as a Percent of:
  - Supplier's Business
  - Market Demand
- Value of the Buyer's Account to Suppliers
- Possibility of New Suppliers Entering Market

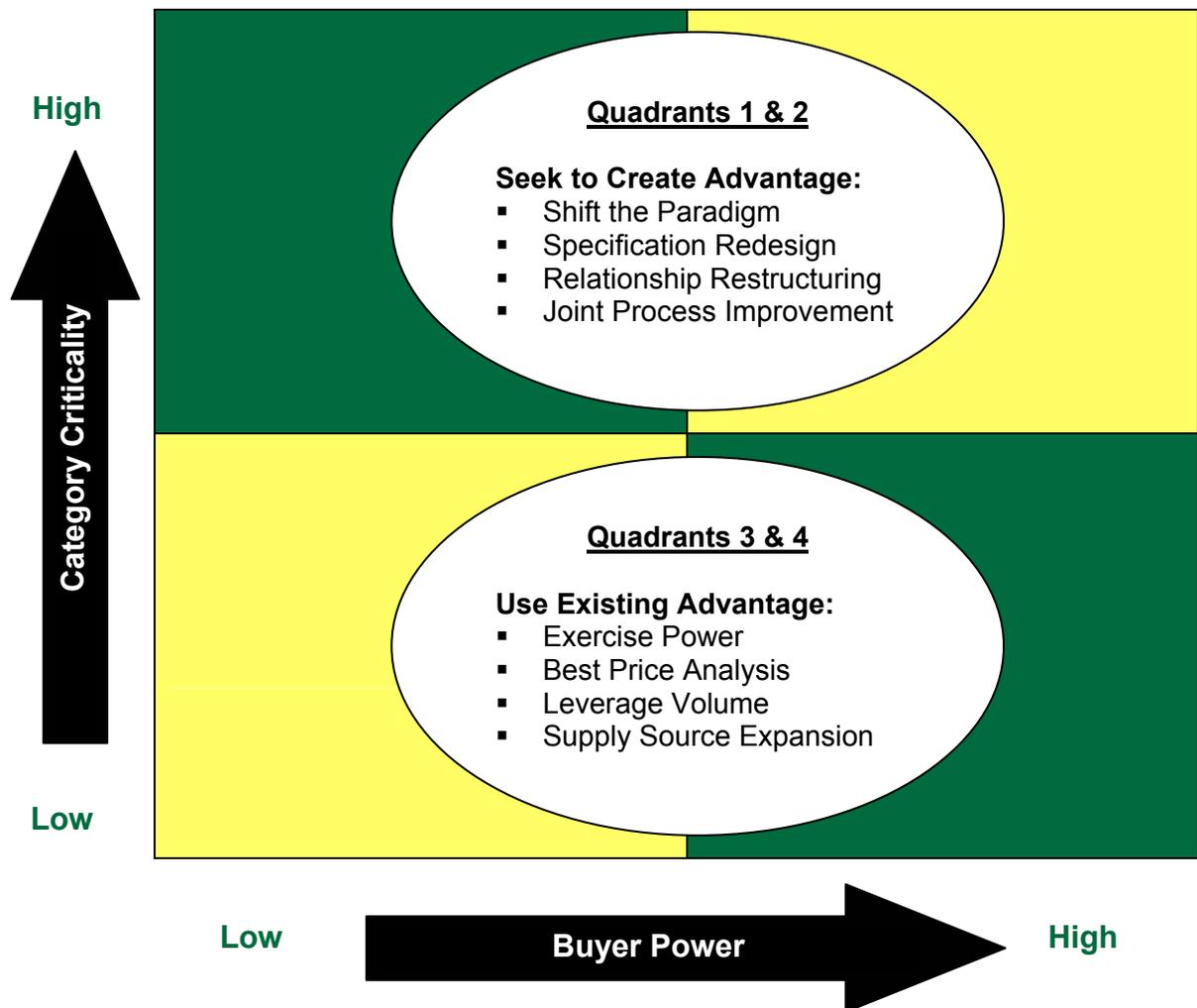
The following *Commodity Category Positioning Matrix* can be helpful in evaluating the degree to which Category Criticality and Buyer Power are factors in determining the best sourcing strategy...



The sourcing strategy selected will differ by quadrant. Strategic sourcing strategies that support Quadrants #1 and 2 are more “Qualitative” in nature, and require *redefinition of the Commodity Category Requirements, Total Cost of Ownership, Company Boundaries, and Supply Base Relationships*.

Those strategies supporting Quadrants #3 and 4 are more “Quantitative”, and may involve Aggressive Negotiations, Volume Leveraging, and Expansion of Supply Base Options.

Sourcing strategies are driven by the commodity location on the Commodity Category Positioning Matrix...



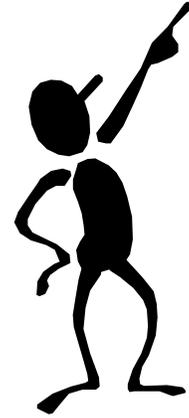
Some very complex commodity categories may require the utilization of more than one sourcing strategy; some being **Power Driven** and other more **Support Driven**. The goal is to optimize the total cost saving opportunity by matching the sourcing strategy to the commodity characteristic.

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**Group Purchasing Organizations...Told You So...** by Mark Trowbridge, C.P.M.

In the March 2002 edition of this publication, an article appeared titled “**Myths About Consortium Buying**”. In that article, Strategic Procurement Solutions identified five “myths” about GPOs (Group Purchasing Organizations).



In this issue, we’re re-visiting this subject because of the recent release of a study by the U.S. General Accounting Office (GAO), focused upon the industry that leads others in using consortium purchasing...hospitals. **That study is titled “Pilot Study Suggests Large Buying Groups Do Not Always Offer Hospitals Lower Prices”.**

In Strategic Procurement Solutions’ March 2002 article (which can be downloaded at [www.StrategicProcurementSolutions.com](http://www.StrategicProcurementSolutions.com)), we suggested that five *myths* exist about GPO purchases. Three of our observations have been supported by recent studies, as set forth below:

**Consortium Myth #1 – Prices offered by a supplier to a consortium always represent the combined volume of consortium member purchases.** Last year, Strategic Procurement Solutions observed that suppliers quote consortium pricing at levels slightly better than the level justified for the *average consortium member alone*. This is because suppliers need to have an acceptable profit margin for all sales to a particular consortium. Suppliers who operate in “consortium rich” industries may even standardize the price levels offered to various consortium groups (irrespective of volume). *Finding #2 in the GAO’s study observed that for a particular commodity: Four small hospitals always did better with a GPO contract...Eleven medium-sized hospitals did better with a GPO contract for only 40% of the products...Three large hospitals rarely did better with a GPO contract.*

**Consortium Myth #2 – All members of a consortium receive more beneficial pricing than they can qualify for individually.** Strategic Procurement Solutions said that actually, larger members of a consortium can usually directly negotiate better prices & terms with suppliers based upon the lower cost of doing business with them. Some consortiums are even beginning to negotiate “tiered” pricing levels on behalf of their members to reflect varying member volume. *Finding #1 in the GAO’s study was that “GPOs did not always obtain better prices for member hospitals”. They further found that median GPO-negotiated prices ranged from 1% to 5% higher for one product commodity group, and between 26 % lower to 39% higher for another. The GAO summarized this finding by stating that “Hospital using contracts negotiated by large GPOs often paid more than those buying on their own.”*

**Consortium Myth #3 – All of a buyer’s volume should be focused through consortium relationships.** Strategic Procurement Solutions said that actually, the optimal mix may be to have direct provider relationships for a buying firm’s high volume commodities, coupled with consortium pricing for lower volume acquisitions. *Coincidentally, in May 2003 a study was sponsored by the Health Industry Group Purchasing Association (HIGPA) titled “Assessing the Value of Group Purchasing Organizations”. That study, conducted by the Lewin Group, contained the following admissions: “Hospitals can and do sometimes purchase goods outside of GPO contracts at prices that are as low as, or lower than, the GPO contract prices” and “The degree of reliance does vary somewhat, with smaller and independent hospitals more likely to depend on GPOs than larger and system-affiliated hospitals”.*

So what does all of this mean for supply management groups in other industries where Group Purchasing Organizations are available? We offer the following recommendations:

Tip  
#1

The hospital industry is by far the most-aggressive user of consortium purchasing. While other industries share GPO procurement opportunities (good examples are Public Sector Entities, the Energy Sector, etc.), procurement professionals need to consider the evolutionary stage of their own industry...before committing volume to a consortium.

Tip  
#2

Consortium groups can still be very beneficial, especially when your organization’s volume is small/medium in comparison to that of other consortium members. If you do utilize consortiums, though, you still must systematically identify your high volume supplier relationships and “source” them periodically in comparison to the consortium.

Tip  
#3

A great draw for some GPOs is the purchasing technology they offer to members. It becomes very easy to place an order with the GPO rather than having to place an order directly with a manufacturer...but don’t let this ease lull you into placing all volume with any GPO.

Tip  
#4

Consortiums generally offer best price levels for “consumable” items...not capital items, labor services, or technology. For example, Strategic Procurement Solutions has recently helped two healthcare groups directly save > \$35 Million on nursing registry, temporary labor, and digital output devices. Don’t buy “non-traditional” spend categories through a GPO...you can usually do it better yourself.

Tip  
#5

If you do utilize a consortium group for some procurement needs, don’t blindly select the GPO without competition. Larger organizations often use *more than one* GPO relationship to leverage prices. Consider performing a *Strategic Sourcing* event as the best means of selecting any consortium relationship.

GPO's can provide members with solid benefits. They should not, however, be trusted with all category purchases. Smart buyers incorporate consortiums as part of their larger sourcing strategy. Maximum savings can be achieved by leveraging key opportunities, while relying upon consortium discounts for non-core commodities.

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## **Today's Procurement Professional...by Dan Raatjes, M.B.A, C.P.M.**

*In many instances no other organization can have a greater impact on the financial health of a company than the team of people responsible for sourcing and managing the company's suppliers. Today's procurement professional often manage Cost-Of-Goods-Sold ("C.O.G.S.") figures that exceed 70% of total sales. Today's procurement professionals are managing critical supplier relationships that can "Make" or "Break" the entire enterprise.*



Much is expected of today's procurement professional, and the capabilities of the past are not sufficient. Organizations must now hire the best and brightest to source and manage their supplier relationships, and they must constantly nurture this talent. **In this article we will explore three critical traits required to be a successful procurement professional in today's business environment:**

### **Trait #1**

**Dollars & Cents** - First and foremost, the procurement professional must think and act like a Chief Financial Officer. The hard reality is that it's all about *increasing shareholder value*. Everything else is a means to this end. And Yes this is true for Private Companies, Public-Sector Agencies, as well as Not-For-Profit organizations. The shareholders just look different. If the procurement organization is not having a positive impact on shareholder value, they are a burden to the company and will eventually be outsourced. The ability to understand exactly how sourcing decisions impact the organization's financial statements *is vital*...and the ability to develop sourcing and supply management strategies that have a positive effect on those statements is even *more vital*.

Procurement professional must know how to break down a product or service into its detailed cost elements, analyze those elements and implement a plan to optimize all of the critical cost factors. They must understand the financial cost of inventory and know how to design and execute build-to-order processes in order to increase asset velocity & reduce expensive inventory levels.

**The bottom line is that we must focus on the bottom line.** We must clearly understand how every decision, process, and strategy impacts the organization's financial statements.

Trait  
#2

**Influencing** – This skill might arguably be the most critical skill of all. We're not talking about the kind of aggressive emotional expression one might experience from a touting televangelist, but rather influence based on sound logic and intelligent data. This is the ability...

- To influence a supplier to change the direction of their product roadmap;
- To influence a supplier to enter into a long-term contract favorable to you; or
- To influence your internal customer to outsource a critical service.

These are all scenarios that today's procurement professionals must be able to positively impact.

If you want a leading edge procurement team, you **must** have members with the ability to gather critical information from various sources, evaluate that information, develop a plan of action, and subsequently articulate a position that changes someone's mindset to achieve support of the plan.

Trait  
#3

**Execution** - Everyone is talking about strategy and quantum change management. *But unless you translate missions or strategies into concrete steps for action, they're worthless.* We must become workers that focus on execution... on getting things done. Meaningful change comes only with execution. Dell Computer Corporation beats the competition not because they assemble a better product, nor because they have better television commercials. Dell Computer Corporation beats its competition because they execute the supply chain process meticulously, from customer order to final supplier payment.

**Today's procurement professional cannot afford to have a gap between "Results Promised" and "Results Delivered".** In order to deliver the required performance results expected from today's CEO's, we must hire people with the ability to execute. We must create a culture where execution is valued, practiced and rewarded.

**Conclusion** - Globalization, outsourcing, dynamic product cycles, and information technology advances have driven us to a point where we must have the "Best" and the "Brightest" talent involved in sourcing and managing our critical suppliers. Not many job categories have experienced the rapid changes and scope expansions like that of the procurement profession.

We must hire the right people, and we must purposefully develop this talent.

**Maintaining a Financial Mindset. Polishing our Influencing Skills. Focusing on Execution.** These are three critical traits today's procurement professional must have to be successful.

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**Cost Savings Through “Float” Management...by  
Mark Trowbridge, C.P.M.**

For years, the supply management profession has preached the need to focus upon the Total Cost of Ownership (“T.C.O.”) in evaluating various buying options. An often-ignored portion of the T.C.O. is the cost of funds experienced by either the buying or selling organization.



When either organization must expend funds prior to receiving the promised value (“consideration”) from the other party, they will suffer financial loss of some sort. Bankers refer to this time delay as “float loss”. More-timely compensation is “float capture”.

**Float capture can work to a buyer’s advantage if we understand the benefit to suppliers by being paid in a timely manner.** Too often, a company’s finance executives will extend payment timing to suppliers...sometimes taking 45 to 60 days to pay an invoice. They fail to recognize the cost imposed upon the supplier by this practice.

Strategic Procurement Solutions often helps firms to take advantage of discounted payment terms linked to particular spend categories. “2% 10, Net 30” payment terms are readily-available in certain commodity groups, for example Paper Products, Commercial Printing, Packaging, Moving & Storage, etc. **The trick is to realize that most suppliers don’t count payment discounts against net revenue from your organization.** A 2% or 3% payment discount usually won’t impact their sales force’s booked revenues. In fact, the best way to secure payment timing discounts is often just to ask the supplier’s Accounts Receivable VP for preferential terms.

We helped one Fortune 100 corporation capture \$980 Thousand in additional yearly savings...just by taking advantage of discounted payment terms. Don’t assume payment timing doesn’t matter to your suppliers. It does, and can save you money if properly-addressed.

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**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](http://www.StrategicProcurementSolutions.com) for more information about our services, or if you do not wish to receive this newsletter in the future.