



“Best Practices” Newsletter Volume 23, January 2005

About This Issue - This January 2005 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 services. Robert Dunn, C.P.M. & Mark Trowbridge, C.P.M. are principals in the firm who lead teams of professionals in supporting leading procurement organizations. More information can be found at www.StrategicProcurementSolutions.com.

Easing the Pain of MRO Buying, by Mark Trowbridge, C.P.M.

Strategic sourcing personnel in manufacturing companies usually try and avoid Maintenance, Repair & Operating (“MRO”) categories like the plague. This is because many MRO categories are a painful conglomeration of OEM-specific parts and user-specified brands, linked with a myriad of inventory ramifications.



So how can procurement ease the pain of MRO buying? This article will provide several methods that supply management can use to Generate Savings...Simplify Ordering...and Provide Greater Value for the users we support.

First, let’s understand what falls into this spend category. MRO spending is a subset of a broader spend segment, “Indirect”. “Indirect” spending can be easily defined by what it is not. *“Direct” spending is what goes directly into a manufactured product. “Indirect” spending is everything else* (i.e. that which does not become part of the marketable product).

For example, three of Strategic Procurement Solutions’ 2004 customers are Fortune 500 manufacturers with worldwide production operations (two make automotive, and one personal care, products)...and their “Direct” materials are those that enter the production line and end up as marketable products. Their “Indirect” expenditures are those that support their worldwide operations...i.e. those supplier expenses that support the companies’ operations...like Premises, Personnel, Professional Services, Non-Professional Services, Infrastructure Hardware & Software, Marketing/Advertising, etc.

“MRO” is that portion of Indirect spending which directly-supports production-line equipment and operations. Examples of MRO commodities and services include: *Repair parts for capital equipment*; Consumable fuel, lubricants, & supplies used in production; *Maintenance services*; Wiring & electrical components; *Fasteners*; etc.

**So why is MRO spending more “painful” than some other sourcing categories?
Here are some reasons:**

- **Sole Source Limitations** - Much of MRO spending is for repair parts for production-line equipment. Due to the proprietary nature of much equipment, the replacement parts must come from the Original Equipment Manufacturer (“OEM.”)...thus making those parts “sole source” without competitive options. This can severely limit procurement’s options.
- **Distribution Obstacles** – Since much MRO spending is necessitated by the breakdown of equipment, the ability to receive replacement parts in a rapid manner is very important. Local distribution is sometimes necessary for key product groups. To complicate matters, some brands of parts & supplies have tight distribution controls placed upon them by the OEM. This may prevent buying organizations from using a single distributor as the source for disparate operations.
- **Lack of SKU Commonality** – Even when there are generic alternatives available for MRO products, the internal users rarely use descriptions that easily allow brand comparisons. For example, if an electrical part fails, the maintenance staff will probably request the same part they last used (by manufacturer name & part number). The lack of generic descriptions makes it difficult to cross-reference another manufacturer’s comparable product.
- **Freight Costs** – Many MRO products are just costly to ship due to weight or size, and thus require a local source. For example, a 10% savings on the unit price of fastener hardware can easily be eclipsed by an increased delivery cost.

Here are some tips to make MRO sourcing & buying easier:

Tip 1 – Plan for Life Cycle Issues When Buying Capital Equipment

The best time to negotiate discounts on ongoing purchases of replacement parts or maintenance services is at the time you are buying the Capital Equipment. If these parts or services are sole source from the OEM, negotiate ongoing price protections that will last for the useful life of the asset. Ancillary products and services are giveaways for the salesperson trying to land a capital equipment sale. Once you have committed to the initial purchase, you are at the mercy of the OEM for ongoing purchases....unless you have protected your firm for the life of the asset.

<p>Tip 2 – Control Part Numbers Centrally</p>	<p>It's bad enough to cross-reference part numbers of various manufacturer's MRO products...and the problem is exponentially-worsened if the buyer's own company has different part numbers for the items at its various inventory locations. Take time to harmonize part numbers and descriptions across all locations...the effort will pay for itself very quickly.</p>
<p>Tip 3 – Leverage Supplier Knowledge</p>	<p>The best source of information about your own MRO purchases may be your suppliers. They can provide very accurate information about your historical purchases, OEM part numbers, etc. If faced with challenging data capture problems about inventory or purchase patterns, contact key suppliers for that information. They can easily provide itemized details about everything your purchases.</p>
<p>Tip 4 – Use eProcurement Technology</p>	<p>Once a master contract has been negotiated with an MRO supplier, there is <u>Zero Value</u> in having procurement personnel involved in each transactional purchase. Use catalog-driven eProcurement technology to automate as much MRO buying as possible.</p>
<p>Tip 5 – Negotiation Can Be a MRO Buyer's Best Friend</p>	<p>While many MRO categories can be sourced effectively using Reverse Auctions or eSourcing, negotiations are still a key tool to use in driving down costs in this spend category. A recent study performed by the Institute of Management & Administration, Inc. (IOMA) shows that contract renegotiation is the <i>best practice</i> most-utilized by leading procurement departments.</p>
<p>Tip 6 – Don't Assume the OEM is the Only Source</p>	<p>Even though an OEM may be the primary source for proprietary replacement parts & supplies, there may be alternative products that offer better value. This is especially true for generic MRO components that are available through distributors...for example...fasteners, electrical components & wiring, etc. Just be careful that any generic substitutions don't void your warranty with the OEM, or infringe upon any of their proprietary rights.</p>

Is MRO buying a “Pain”? **Definitely**. But with the right planning & execution, this category can provide *remarkable benefits*... Visit our website for more information about improving all your Indirect Spend Categories.

Writing a Statement-of-Work (SOW) To Be An Effective Strategic Procurement Tool (Part 1)... by Robert Dunn, M.B.A., C.P.M.

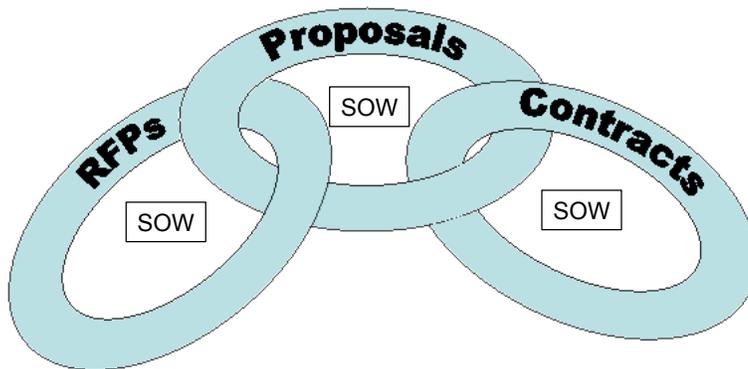
In today's Supply Management environment, an increasing amount of focus is being placed upon *increasing* the value received through strategic supplier relationships.



This article will discuss techniques that leading Procurement groups are using in contracts to properly define and manage suppliers in delivering superior products & services.

The Statement-of-Work (SOW) is that portion of a good contract which outlines the specific services a supplier will perform in fulfilling its contractual obligations. The SOW generally indicates the type, level, quantity, and quality of service, as well as the time schedule required. Not only is the SOW a critical component of any good agreement (because it expresses the desired output of the contract in legally-enforceable terms), but it is often the heart of a good Request-for-Proposal (RFP)...AND the successful bidder's proposal. This makes the SOW a key component in three of the "links" that make up the acquisition process:

The Acquisition Chain



Strategic Procurement Solutions is often hired by clients to perform a "risk assessment" on their existing supplier contract portfolios to identify Additional Saving Opportunities, Contracting Process Efficiency Improvements, Supplier Performance Enhancements, & Legal/Business Risk Exposures (the latter being significant Sarbanes-Oxley [SOX] concerns). We frequently find the SOW portion of the agreements to be a primary weak link.

A poorly-written SOW will invite disaster, including:

- Production of poor-quality products or services
- Wasted time & money
- Unfavorable pricing
- Contractual disputes and litigation
- Uninvited scrutiny by protesters, attorneys, shareholders, and in some instances, government officials.

On the other hand, a well-written SOW permits:

- Effective planning and communication among the organizational groups involved in sourcing and acquisition
- Solicitation of high-quality competitive proposals
- Minimization of ambiguities that might otherwise arise during the term of a supplier agreement, due to clear definition of the buyer/seller relationship and expectations of both parties
- Clear description of which party will perform which actions

Although any contract must describe the ancillary services to be performed by the supplier, whether providing products or services, a comprehensive SOW is essential in agreements like the following:

Consulting Services	Equipment Maintenance	Environmental, Health & Safety
Construction	Technology Services	Audit & Legal
Facility Management	Contingent Staffing	Non-Professional Services
Creative Agency	Research & Development	Complex Purchases

The majority of SOW's fall into one of 4 basic types:



Performance SOW – Describes everything wanted by the buyer. This SOW is broken down into defined tasks and the required outcome of each task. An example would be defining the output of a generator, whereby the buyer provides the output requirements but the seller is allowed to provide the solution that best meets those requirements.

#2

Functional SOW – Defines what the buyer “is trying to do”; but leaves the supplier free to come up with the most efficient means to do so. An example would be a buyer who hires a marketing creative agency to gain them 15% better penetration into a particular market segment. It is left up to the creative agency what media to use, how to design the campaign...

#3

Design SOW – This is the most-detailed type of Statement-of-Work. It is used mainly in projects for the construction or production of structures, goods or equipment. Design Statements-of-Work often incorporate plans, blueprints, CAD files, or detailed specifications.

#4

Level-of-Effort SOW – This is a specialized version of the Performance SOW, generally used in Research & Development (R&D) or studies agreements.

The following chart illustrates key differences between these 4 types of SOWs:

HOW STATEMENTS OF WORK DIFFER					
SOW Type	Purpose	Planning	Requirements	Deliverables	Progress & Compliance
Performance	Describes performance attributes (capabilities) of end product; leaves design up to contractor.	Deliverables define performance.	Describe performance attributes.	Attributes specified; but content unspecified.	Test performance attributes.
Functional	Describes problem to be solved; leaves best method and design up to contractor; does not specify attributes.	Objectives define the problem to be solved.	Describe the problem to be solved.	Unspecified.	Verify that the problem has been solved.
Design	Describes both method and design; does not specify performance attributes.	Tasks help form the design.	Describe the design.	Specified.	Check product against design.

Level-of-Effort	Describes performance attributes of a means to an end product; can specify method and design; does not detail end product; allows for development to proceed when end might not be achieved.	Skills help frame the means.	Describe the means and the desired end.	Unspecified.	Phasing and peer review.
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Take time to develop good Statements-of-Work (SOWs). Without them, superior supplier performance won't be achieved...regardless of how many signed agreements are in your organization's contract portfolio!

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.