



## “Best Practices” Newsletter Volume 27, November 2006

**About This Issue** - This November 2005 edition of our newsletter contains more techniques to help our clients & colleagues accomplish their strategic procurement objectives. This issue will be the first highlighting a series of contributions from our firm’s various subject matter experts.

Strategic Procurement Solutions provides advanced Strategic Sourcing, Training, and Supply Organizational Improvement services. Robert Dunn, C.P.M. & Mark Trowbridge, C.P.M. are principals in the firm who lead teams of professionals in supporting our procurement clients. More information can be found at [www.StrategicProcurementSolutions.com](http://www.StrategicProcurementSolutions.com).

**Note to Readers:** We are currently scheduling onsite training & consulting with clients for Q1 & Q2 - 2006. Please contact us if you would like to reserve space in our schedule.

### **Calendar Notice:**

- December 1<sup>st</sup> & 2<sup>nd</sup> - I.S.M. Services Conference, Tempe, AZ – Along with a client executive from Limited Brands, Mark Trowbridge is making a presentation titled **“Building the Procurement Superhero...Innovative Practices in Professional Development”**. Please drop by our exhibit booth if you attend that conference.

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### **Selecting Products for Outsourcing to Low Cost Countries (LCC’s)...** by Geoffrey Greene, C.P.I.M.

**When was the last time you read “Made In Japan” on a product label?** While outsourcing to Japan was very frequent a decade ago, much international outsourcing has moved to other Low Cost Country (LCC) regions...China, Eastern Europe, Latin America, India, Indonesia, etc.



Today, even companies like Honda and Yamaha are now having some of their motorcycles manufactured at facilities in China.

**Outsourcing to Low Cost Countries has become a strategic initiative for many sourcing personnel. The lure of low cost labor and Multimillion Dollar Annualized cost savings generates attention at the highest level of the organization. *This article will provide guidelines on how to select products for outsourcing to LCC’s.***

Many U.S. manufacturing companies have successfully outsourced components and finished goods to an LCC by carefully matching the high demand in the West with the low cost labor in the East.

**Two key factors for outsourcing success include: (1) Understanding the total cost of manufacturing; and (2) Selecting products that are a good fit for outsourcing to an LCC. The following table provides an overview of significant LCC factors and regional costs:**

<b><u>Cost Factors</u></b>	<b><u>USA</u></b>	<b><u>China</u></b>	<b><u>Indonesia</u></b>
<b>Labor Rate (USD)</b>	\$18.00/Hr	\$1.40/Hr	\$0.80/Hr
<b>Labor Productivity</b>	1	1.2	1.3
<b>Material Cost</b>	Similar	Similar	Similar
<b>Shipping (Note: Ocean Freight)</b>	0%	4%	5%
<b>Customs/ Duties</b>	0%	5%	4%

The opportunity to capitalize on low cost labor savings for your organization’s products does not come without inherent risks. Manufacturing in a Low Cost Country will introduce new dynamics to the supply chain and this will require a revised strategy to successfully manage the transition. In essence the trade-off is low cost labor vs. inventory and logistics.

The lead-time for products manufactured overseas typically runs 12-14 weeks. This translates into higher inventory levels through out the supply chain to ensure product availability for the end customer. Increased inventory levels generate higher carrying costs and can increase the potential for excess and obsolescence. The logistics cost increases include ocean freight, customs duty and ground transportation to and from the port of entry.

A second major factor for successfully manufacturing in an LCC is selecting components or products that will be a good fit for your LLC manufacturing partner. The following table highlights several factors that will have a direct impact on the success of your strategic outsourcing initiative:

Selection Factors	Good "LCC" Candidate	Poor "LCC" Candidate
Production Volume	High Volume	Low Volume
Labor Content	Labor Intensive	Low Labor Content
Forecast Accuracy	Accurate	Volatile
Product Design	Stable	Frequent Change
Documentation Accuracy	Well Documented	Poorly documented
Intellectual Property	Low (Non-Proprietary)	High (Proprietary)

1. **Production Volume** – LCC’s are an ideal fit for products that are high volume and low mix. LCC manufacturers maximize their manufacturing efficiencies with longer production runs and minimal sets-ups and changeovers. Many manufacturers will have minimum production run requirements. Selecting high-volume products for outsourcing will maximize the cost savings potential.
2. **Labor Content** – The main advantage of moving production to an LCC is to capitalize on the low cost labor. Material costs overseas are similar to material costs in the United States. Products selected for manufacturing in an LCC should have a high labor content to maximize the cost savings potential.
3. **Forecast Accuracy** – The lead-time from an overseas LCC is typically 12-14 weeks. It is critical to have a closed loop forecasting process that results in a high degree of accuracy at the SKU level. If your company’s sales and operations planning process is inaccurate, the result can be product stock outs and slow moving finished goods inventory. Consider products for outsourcing that have an established demand history and a high degree of forecast accuracy.
4. **Product Design** – The stability of the product design will have a direct impact on the success of your outsourcing initiative. Products that are subject to frequent design changes are not the best fit for manufacturing in an LCC. Design changes that are not properly coordinated or communicated to your manufacturing partner can result in excess and obsolete inventory.
5. **Documentation Accuracy** – The LCC manufacturing partner selected to manufacture your product will be dependant of the accuracy of your product documentation. They will build your product to the manufacturing specifications

provided. If your documentation is inaccurate, you will receive product that is not to the latest revision. A thorough review of the product and manufacturing specifications will prevent future headaches.

6. **Intellectual Property** – The concept of intellectual property is different in most LCC's than in the United States. This is a fundamental cultural difference that needs to be understood prior to selecting products for outsourcing. Many LCC's don't recognize the concept of a person or company owning an idea. Selecting products that have low intellectual property content will protect your company from potential issues.

Can your company be successful manufacturing products in a Low Cost Country? Yes, but you will need to understand the total cost of manufacturing and you will need to identify your company's products that best position you and your manufacturing partner for success. You will also need to modify your supply chain strategy to accommodate the dynamics of manufacturing product in a Low Cost Country.

More information about our outsourcing services can be found on the "Outsourcing Specialists" page at [www.StrategicProcurementSolutions.com](http://www.StrategicProcurementSolutions.com).

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### **Controlling Spending With Limited Procurement Resources...** by Mark Trowbridge, C.P.M.

Many procurement groups today are being asked to "Do More With Less". **Yours may be one of them.** Executive management (in their wisdom) sometimes limits the supply management organization's budget to achieve a "perceived" cost savings. This isn't new, but the constraints of a limited departmental budget do create challenges for supply management professionals who are trying to control enterprise-wide spending.



**This article will discuss some innovative ways for procurement groups to make a deep impact upon organizational spending, even when operating with limited staffing & budget levels:**

#1

**Focus Upon Key Expenditures** – To be "strategic", any procurement groups must focus its best efforts upon the products and services which make up a majority of total spending. The Pareto Principle provides a very useful guideline here, as the "A" and "B" items which may account for 80% of total spending probably represents only 20% of transactional activity. But how can procurement ignore the "C" items which take so much time?...Here are some ideas:

- **P-Cards.** Use corporate credit cards with defined controls to automate low-dollar transactions that can't be impacted by the procurement

organization. Link card use to companywide discount agreements to the extent possible. *Examples include: Travel Expenditures, Decentralized Fuel Purchases, Fleet Maintenance, Utility Payments, Field MRO Purchases, etc.*

- **Consortiums.** Small and medium sized buying organizations can utilize Group Purchasing Organizations (GPO's) to standardize and leverage their non-strategic purchases. An example of this is the hospital industry, which utilizes GPOs extensively for high-volume transactional purchases. *Note: Use of a consortium can be a bad practice if your organization is a large member of such GPO. For more information, read our previous newsletter articles titled Myths About Consortium Purchasing (Volume 8) and Group Purchasing Organizations...Told You So (Volume 18), which can be downloaded without charge from our website.*

#2

**Utilize “Alternative” Resources** – With limited staffing, innovative procurement groups are partnering with their internal customers to accomplish supply management objectives. This can be accomplished in various means:

- **Empower Internal Customers** - Despite achieving millions in annual cost savings, one of **Strategic Procurement Solutions'** clients (a large banking institution) had its annual department budget reduced by senior management. The VP of Procurement elected to empower internal customers to handle low-dollar contract negotiations by establishing procedures to manage the contracting process, and a pro-forma contract template to document the transaction. These steps allowed the procurement professionals to fully-focus on higher-dollar negotiations where they continue to achieve significant cost savings and mitigate risk.
- **Leverage Supplier Capabilities** – Consider having your contracted suppliers perform tasks currently-handled by the procurement staff members. *Examples might include Customer Service, Project Requirements Definition, Inside Delivery, Quality Inspections, Management Reporting, etc.* While you certainly don't want to incur additional supplier costs in outsourcing these support activities, some costs may be acceptable if enough procurement organization resources are made available by the action. And there may be no additional costs incurred if these types of services are outsourced during a contract renewal period, at a time when the supplier's start-up costs have already been fully-absorbed.
- **Matrix Organizational Relationships** – Procurement groups in diversified companies are achieving remarkable cost reductions by matrixing their working relationships with internal customer organizations. In a “matrix” organization, formal reporting lines are abandoned in exchange for a blend of “formal” and “informal” accountabilities. Together, the matrixed groups work to achieve aggressive cost reduction objectives.

- **Train Key Business Partners in Non-Sourcing Procurement Tasks** – In order to enable their personnel to focus upon sourcing activities which yield higher savings, some groups are training internal customers to be more proficient in Managing Supplier Relationships, Non-Key Negotiations, and Preparing Contract Documents. One of our client companies is a Top 10 U.S. Energy Firm, and they asked **Strategic Procurement Solutions** to train their field engineers in how to draft a good Statements of Work (SOW) and then manage associated supplier performance. We trained more than 120 of this firm’s personnel, and were later told that the organization estimated that each month they are saving *an additional \$2 Million* due to better management of their supplier relationships!



**Make Procurement More Efficient** – This option is often overlooked by procurement managers overwhelmed with organizational demands, but the best way to “Do More With Less” is to be more efficient with the resources we have. Ways to increase supply organization efficiency include the following:

- **Automate High-Volume Purchase Transactions** – A best-practice tool which should be employed by every high-volume procurement group is catalog driven eProcurement. Once set up, requisition submission/approval, purchases from internal catalogs, and purchases from external catalogs (“punchout”) transactions can be completely automated within enterprise contract controls.
- **Automate High-Volume Billing Transactions** – eInvoicing software tools are now available which can be linked cost-effectively to just about any ERP system that automate supplier invoice submission and PO matching...and feed approved voucher transactions into the firm’s accounts payable software for settlement. As well, features like evaluated receipt settlement (non-invoice payments) can be enabled to eliminate the entire invoicing process.

*Note: eProcurement and eInvoicing technologies can pay for themselves within 12 to 15 months, based on a selection process **Strategic Procurement Solutions** recently completed for a large financial services client organization.*

- **Consolidate Suppliers** – It’s much more efficient to manage a smaller number of suppliers. It requires more staff & resources to do business with a greater number of suppliers. So how can the supplier base be reduced? Through strategic sourcing, contract consolidation, and elimination of non-value-add supplier interaction.

- **Train Procurement Employees** – This goes without saying, but employees don't improve their efficiency unless taught how to do so. In addition to procurement skills training that must be continuously enhanced, invest in efficiency skills training that will improve employee productivity. *Example 1...Advanced User Training on the Organization's Purchasing System. Example 2...Time Management Training (for example, Franklin Covey) to help employees efficiently accomplish their objectives.*

**Is it easy to achieve savings when we're forced to work with fewer resources? Of course not. But these and other creative techniques can help procurement groups to make aggressive accomplishments without the financial support of executive management.**

For support in achieving aggressive procurement goals, please feel free to contact **Strategic Procurement Solutions**.

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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.