"Best Practices"

Supply Management Journal...

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New articles in this Edition:

- **"Extracting *Superior* Supplier Performance"** - by Robert Dunn, M.B.A.
- **"BPO - The Ultimate 'Make vs. Buy'"** - by Mark Trowbridge, CPSM, C.P.M.

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Strategic Procurement Solutions, LLC is a niche professional services firm dedicated only to the advance practice of Supply Management. **Key Services include**...

- **Procurement Staffing Services (Temporary, Project, Contingency Search)**
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- **Expertise in Strategic Sourcing of High ROI Spend Categories**
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- **Outsourcing Project Expertise (LCC & BPO).**
- **Supply Management Consulting Services**

Strategic Procurement Solutions' clients range from Fortune 100 to Russell 2000 in size; and include numerous Global enterprises as well. We also work with leading Public Sector supply chain groups.

Robert Dunn and Mark Trowbridge will each be making two presentations at the ISM International Conference in Charlotte, NC on May 3rd - 6th. Our firm will also have a booth in the Exhibit Hall, so please drop by to say hello.

An article by Mark Trowbridge will appear in the March edition of **Supply Chain Management Review Magazine.**

"Extracting *Superior* Supplier Performance" - by Robert Dunn, M.B.A., Principal

World class supply management organizations manage their supplier's performance in a pro-active manner. Score carding of key metrics is one way a procurement group can track the value being added by each supplier relationship.

But just tracking performance won't increase the value we receive, unless that information is used constructively to change a supplier's future actions. This article will discuss several important elements in relaying score card information to an important supplier:

- **Factor #1 – Metrics Must Be Meaningful**: For the last decade, a theme in leading businesses is "metrics that matter". Metrics, otherwise known as Key Performance Indicators (KPI), needs to reflect something of real importance. *I heard about one company whose procurement group reported several metrics to its key suppliers. One of those metrics was "on-time delivery". The problem? The buying company arbitrarily put due dates into their purchase orders, without taking time to calculate the delivery dates with which their suppliers had contractually agreed to comply. So the metric really had no meaning to the suppliers.* So it is important to choose metrics which (i) really matter to your own firm, and (ii) are recognized by the supplier as having meaning.

- **Factor #2 – Communicate, Communicate, Communicate:** Most of us would not have tried nearly

Another article by Mark Trowbridge will appear in the March ISM **eSide Supply Management** publication.

as hard in school, if a report card hadn't shown up every quarter. Meeting with a supplier once a year to discuss performance also is not nearly as effective as providing them with a score card every month (or quarter) and sitting down to review their performance regularly. The amount of attention we put into the communication is commensurate to the amount of attention the supplier places on the communication.

- **Factor #3 – Be a Good Supplier Manager:** A good supplier manager is really a mentor or coach who helps each supplier succeed. A good coach is someone who:

  - Is knowledgeable and confident in the subject matter.
  - Communicates clearly and logically.
  - Recognizes their own limitations.
  - Supports others and helps them succeed.
  - Has the ability to see things from other's point of view.
  - Is fair, and willing to make time for people.
  - Treats suppliers with respect.

- **Factor #4 – Give Constructive Feedback:** Performance reviews with suppliers should provide a two-way dialog to discuss positive and negative aspects of the buyer/seller business relationship. Constructive feedback can be provided to the supplier in the following ways:

  - Issues are more-meaningful if brought to the attention of the other party quickly. If several months have gone by following an incident, the issue will have less meaning.
  - Take time to agree on the facts surrounding the issue (if there is variance concerning facts, take time to research the truth).
  - Ask and listen. Relationships are two-way.
  - Criticize the action, not the person.
  - Take time to explain why an issue is important to your firm. The "why" is often as important as the

"what".

- Agree on any remedies.
- End on a positive note.

- **Factor #5 - Recognize Superior Performance:** The old analogy says there are two ways to motivate performance; one is with a "carrot" and the other a "stick". Too often procurement professionals try to run supplier relationships only with a "stick". *Procurement professionals often threaten to cancel a contract, give business to the supplier's competitor, or withhold payment.* Don't get me wrong, these can be valid ways to motivate a supplier. But we should also remember to use a "carrot" with our suppliers.

Visit www.StrategicProcurementSolutions.com if you'd like information about Strategic Procurement Solutions' onsite training workshop titled Supplier Performance Management™. It teaches leading techniques to procurement personnel and their internal customers who manage key supplier relationships. We'd be happy to work with your team to ensure a top-performing supply chain.

"BPO - The Ultimate 'Make vs. Buy'"...by Mark Trowbridge, CPSM, C.P.M., Principal

In the manufacturing sector, a key element of procurement success has long been determining which products should be produced internally and what elements should be acquired from outside suppliers. **This has traditionally been known as a "Make vs. Buy" decision.** As supply management has progressed, the lines which once had clearly differentiated internal manufacturing from supplier production have become blurred. Today, it's all part of the supply chain.

But the role of the supply management professional has also expanded to include responsibility for sourcing of services. Anything (products or services) acquired from an outside supplier is now impacted to achieve cost savings. **The business principle of keeping only "core competencies" internal has enabled procurement groups to achieve significant savings by outsourcing "non-core" business activities. This is known as Business Process Outsourcing (BPO), and is the ultimate form of "Make vs. Buy".**

I've been a part of many BPO projects *(the largest being the outsourcing of 1,100 jobs for a Fortune 100 company).*

especially for the employees who are affected. But if done well, the outsourced associates can often find great fulfillment working for a supplier in performing a job that now is a “core competency” of an outside firm which will support many different customers with their expertise.

Too often, though, procurement’s involvement is stymied by internal management and their political barriers; limited down to what is already procured from suppliers…and we fail to challenge the status-quo by evaluating internal operations which might be performed at a lower price on the outside. **Some supply management groups simply bury their heads in the sand, and never risk becoming involved in evaluating BPO opportunities.**

Top performing supply management are ones who find innovative ways to challenge the status-quo by quantifying potential benefits from Business Process Outsourcing. This is the ultimate extension of the manufacturing sector’s “Make vs. Buy” analysis, because this technique forces a true business case to be evaluated by senior management…rather than just continuing the current operational status. BPO often yields significant benefits (sometimes being combined with Low Cost Country [LCC] sourcing, which takes advantage of global human capital cost variances).

To be successful in Business Process Outsourcing, the procurement team should consider the following eight techniques:

- **Technique #1 – Time the Project for Success:** BPO projects often become a possibility only within narrow time windows. Other events trigger the possibility of outsourcing, and must be acted upon to seize the prize. Examples include: *timing of supplier agreement expirations; upcoming need to replace capital equipment/technology/assets; loss of key personnel; renegotiation of labor/union agreements; aging technology tools; facility lease expirations; etc.* Sometimes the procurement team needs to identify potential “candidate” projects, and then wait for the right events to line up. When the time is right, we can become pro-actively involved in these decisions.

- **Technique #2 - Analyze All TCO Components:** It is a very strong temptation for department owners to “hide the ball” when their areas are being considered for outsourcing. A client of our firm was a Fortune 1000 sized financial services company. Our firm’s review of their operations identified an internal print function (reprographics and printing) which cost them several million a year to operate. When asked, the client's management insisted that a "thorough" analysis had been performed to evaluate potential savings from outsourcing the function to printing supplier…and their evaluation had resulted in a cost higher than their current expense for people, equipment, paper, and ink.

Only when our consultant inquired further, did we learn that the premises (facility) costs had never been included in their "thorough" analysis. The client's rationale was that since the print shop only occupied half of the facility, they wouldn't be able to move out and the ongoing depreciation costs related to the facility shouldn't be factored into the BPO analysis. Only through discussion with the client's CFO was it agreed that future analyses should include the market value of the facility (or expected revenue through leasing the space to another business), and incremental cost to house the remaining department elsewhere.

Whenever you do a BPO analysis, make sure no one is "hiding the ball", and that <u>all</u> Total Cost of Ownership (TCO) elements are fully reflected. Key cost elements to consider include: *Salary, Benefits, Training, Premises Costs; Telecomm & Network Expenses; Turnover; Productivity; Quality; Capital Investment (Technology, Equipment, Supplies & Maintenance); Investment Cost, Depreciation and Disposal; Cost of Funds/Interest Expense; Freight/Transportation Costs; Technology Software & Hardware; Taxation Factors; Import/Export Fees; etc.*

- **Technique #3 – Focus on High Labor-Content Functions:** Ideal spend segments for outsourcing are often those which involve a large number of people, performing non-strategic repetitive tasks, with a large degree of standardization. The more complex the tasks, the better-suited internal operations are to handle them. Expense can be significantly reduced by migrating work to regions (domestically or internationally) where human resources are available at a lower cost. *Classic targets for BPO are functions like call centers, inside sales, collections, manufacturing of specialized subcomponents, mailroom operations, food service functions, technology help desk services, printing/reprographics functions, billing operations, payroll operations, etc.*

Labor savings are a large motivator in off-shoring, as the difference in wages between major consumer nations and LCC regions can be significant (sometimes referred to as “labor arbitrage”). Consider for example the average annual wage for a manufacturing employee in the following regions, as documented in a 2007 international compensation study by the U.S. Bureau of Labor Statistics (* Note: ranges for China and India are estimated here due to lack of reliable governmental indexes) :

	Norway	$39.14/Hr (USD)
	Germany	$33.00/Hr
	Netherlands	$31.81/Hr
	United	$25.65/Hr
	Kingdom	$23.65/Hr
	United States	$21.76/Hr
	Japan	*$13.65/Hr*
	Korea	*$ 6.38/Hr*
	Taiwan	*$ 6.11/Hr*
	Czech Republic	*$ 5.65/Hr*
	Hong Kong	*$ 4.54/Hr*
	Poland	*$ 4.09/Hr*
	Brazil	*$ 2.63/Hr*
	Mexico	*$ 3.90/Hr*
	*India**	*$ 2.05/Hr*
	*China**	

Differences in national benefit factors compound these variances, since certain countries provide a “social” working environment where the government provides many benefits paid by employers in the US and other western countries (China for example).

But compensation variances are changing quickly, as labor costs are increasing in countries like China and India (the latter dramatically for professional levels of workers). Countries that were considered *underdeveloped* a decade ago are catching up to their Western counterparts. The burgeoning “middle class” in these countries is requiring rapidly-increasing compensation, and the cost of produced goods and services is rising proportionally.

Freight costs are also increasing in parallel with crude oil prices, and thus many leading firms are actively moving manufacturing closer to their home bases. “Near shoring” is a trend we’ll all be hearing in upcoming years, as transportation costs continue to change the formula. Near shoring is resulting in many

European companies turning to Eastern Europe suppliers (and US firms turning to Latin America) rather than Asia. These companies are also building internal production capacity in the near shore countries, thus bringing manufacturing back in-house.

- **Technique #4 – Don't Assume "Off-Shoring "is the Answer:** Very significant compensation differences may also exist between regions of our own country. For example base salaries in the United States can vary by more than 18% for similar jobs, depending upon where they are located. Surprisingly low wages are paid to high-quality workers in rural areas in the southern USA, and outsourcing to those regions has become quite competitive with off-shoring. The procurement team leader should also keep quality in the forefront of their mind, remembering that supplier relationships are difficult to manage at a distance.

- **Technique #5 – Don't Think "Outsourcing" Must be Physically Distant:** Often outsourcing is achieved by having a supplier take over onsite services at the buyer's location. If the function continues to be closely linked to your own operations, physical proximity can make the transition work better. Many BPO deals also involve the supplier buying or leasing facilities back from the customer organization.

- **Technique #6 – Remember the "Make" Part of "Make vs. Buy":** Never forget that all suppliers add a profit margin onto their own cost of providing services. In certain cases, it is better to in-source rather than paying a premium to a supplier for activities the buyer can perform efficiently. In-sourcing may also produce savings on services which have been produced externally on a start-up basis…but can now be performed internally at lower cost. Many firms have outsourced core functions, and suffered at the hands of a supplier which took advantage of the situation. *One well-known example was a top-tier supply chain consultancy, which decided to outsource their own procurement function to a third-party. The transition was badly-executed, and key parts of the function had to again be internalized by the consultancy (note – they sell outsourcing services to their own customers!).*

- **Technique #7– Be Careful About Outsourcing a "Core Competency":** There are certain elements of any operation which distinguish it from its competition. An organization's "core competencies" are those which provide it with market advantage. Outsourcing these can provide short term savings, but can prove to be a strategic error if not done prudently. *In many market segments, technology and manufacturing firms are now finding themselves to be competing directly against suppliers to whom they had previously outsourced production or programming operations.* Your sourcing team needs to honestly appraise the risks of any BPO project. And if the benefits are marginal, it may be wiser to keep proprietary "core competencies" internal.

- **Technique #8 – Don't Be "Outgunned":** Supply management groups often are "straight-armed" by internal stakeholders if we don't thoroughly understand the marketplace and affected operations where BPO might be successful. *In a corporate procurement position I held with a Fortune 100 company early in my career, my sourcing team had achieved great success in securing more than a quarter-billion dollars in savings across the enterprise's various global operations. The one area that we had not been able to touch was HR Benefits, and this was a weak spot among the dozen negotiators on my team. Our lack of knowledge was enthusiastically used by the HR group to keep us out of sourcing projects…until I added a "hired gun" to our team. This person was a licensed benefits specialist, who had negotiated customer health and dental care agreements on behalf of several major medical insurance providers. Our team coached her on the "procurement" methodologies we used, but her expertise got us in the door and allowed us to score large gains with HR.*

Strategic Procurement Solutions provides skilled "hired guns" who help clients make good BPO and sourcing decisions. Please email us at Info@StrategicProcurementSolutions.com if your organization would like skilled assistance with a BPO project.

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