



A guide for CEO's, CFO's and purchasing leaders on Surviving the Tough Times though Procurement Excellence

Introduction:

With the global economic slowdown hitting businesses hard, many businesses have been caught with high debt ratios, lower asset prices and significantly lower demand for their products. These businesses are being forced to, cut capacity and reduce staff to cut cost to survive in the short term. So what's your cost management strategy?

Economic downturns are typically accompanied by large inventory build ups and cut backs in orders which cascade down the supply chain, often having a devastating effect on unprepared suppliers. In such a climate businesses large and small cannot afford to simply stand by and do nothing. A typical response might be that sales are good and costs are bad, followed by a financial crack down, to limit the damage to the company's market capitalisation and the level of shareholder dividend payments? In other words, get back to financial basics.

At Purchasing Practice, we don't believe this is the right solution. We believe in a more strategic approach to cost reduction. Some costs are actually good because they are a vital component that drives current and future growth. Cutting these too far or in the wrong places can have catastrophic impact on a business. It is the role of strategic cost management programs to consider all types of cost, good, neutral, and bad. This assessment can then be used to target cost more effectively and reinvest any savings back into the business. By taking a more strategic approach we believe, businesses can actually create opportunities to outmanoeuvre competitors who carry on with business as usual or are unable to adapt quickly, except by wielding the axe and cutting staff.

So how does Purchasing Excellence help?

There is now a body of evidence to show that Procurement Leaders consistently outperform their peers across business and economic cycles as measured by widely accepted financial metrics. Excellence in procurement is therefore a clear indicator of a high performance company which can survive and thrive



through repeated economic and market cycles. The financial markets know this and factor this into company ratings.

We know from previous downturns that procurement plays a key role in any cost reduction initiative. At Purchasing Practice we believe procurement leaders must use this opportunity to not only cut cost but also build sustainable competitive advantage:

Know your business:

Procurement staff must understand the company's objectives and what's important in order to gain a better understanding of its strategic imperatives and business drivers. Purchasing must take the lead whilst creating close alignments and alliances with key stakeholders across the company.

Stakeholders:

Procurement must focus on the issues that are most important to the company. It is no use asking stakeholders, 'How can I help you?'...they may not know! Procurement must lead and as successful procurement leaders know one of the biggest mistakes procurement can make is trying to be all things to all people. By considering how the wants and needs of *stakeholders* align with what the *organization* wants and needs from its stakeholders, procurement can examine its relationship with each stakeholder. Procurement can then assess the strategies, processes and capabilities that are needed in order to satisfy these two critical sets of wants and needs.

The battle for talent:

In the end, transforming procurement into a competitive advantage depends on winning the battle for talent.

Procurement talent is in short supply across all sectors and major organizations globally are finding it a significant challenge to recruit and retain highly skilled experienced procurement staff. So overzealous cutting can be detrimental to employee morale and increase turnover, sending top performers into the hands of competitors and can leave your organization in a weakened position. With both the shortage of talent and increased internal financial constraints during a downturn, companies cannot depend on hiring to fill the talent gap; businesses have to develop the skill levels of their existing staff.



Invest in Training

One lesson from the 1990s downturn is the threat to staff morale caused by lay-offs and redundancies among the remaining employees. This syndrome is often called “survivor guilt”, and those survivors are often less productive and preoccupied with the short term. Consequently, their behaviour becomes highly risk averse and innovation is stifled. Surveys have found however, that companies that increased their training after announcing lay-offs were twice as likely to report improved profits and productivity as the firms that did not invest in expanded training. Training and development recognises and values employees, and helps survivors move on and respond to the new environment.

Review the staffing mix

World-class procurement executives build organizations that have a much more strategic staffing mix than typical companies. According to past research from Hackett, world-class procurement executives build organizations with 63% fewer clerical staff and 31% more professionals. The staffing model plays a key role in enabling world-class procurement organizations to perform very differently than typical companies. World-class procurement organizations spend 20% less on operations than peers and have about half of the overall staff.

Suppliers:

A prolonged industry downturn is typically accompanied with increased supplier instability. Unfortunately, it is still true to say that many organizations do not know enough about their suppliers. This becomes particularly important in a downturn as supply risk can have an even greater impact on a company’s success. Organizations require a proactive and predictive strategy towards supplier risk management to understand the realities of their suppliers, partners and the supply chain as a whole, to determine the impact on the organization if they cannot fulfill their obligations. *So how do you manage the risks of procurement?*

Collaborate for success

In order to benefit from collaboration, it must be managed both effectively and selectively. The wrong approach to collaboration may increase costs instead of cutting them, create confusion instead of clarity and drive suppliers away.

Examples of collaboration include, joint training and development in such areas as lean processes, data analysis, common systems and aligned metrics. Cost reduction targets, warranty claim reduction and continuous improvement activities.



Collaboration requires sharing information freely and transforming this information into knowledge, and then creating value from that knowledge. The ability to create value from knowledge depends on relationships.

Supplier Relationship Management:

Profitability and efficiency is increasingly being driven by good supplier relationship management, working closely with suppliers to achieve corporate objectives. Managing supplier relationships is vital because it allows companies to create value from their intangible assets. Strong supplier relationships can also help drive innovation as it is often the supplier that can identify opportunities for improving processes or providing new materials.

More strategic approaches are needed

For the buying organization, the purpose of investing time in a relationship with a supplier is to ensure the performance of that supplier always operates at its peak, or if it hasn't been performing satisfactorily, to instigate improvement measures.

Supplier relationships can be categorized depending upon their strategic importance to the organization. This then sets a clear framework by which to determine the appropriate intensity of the relationship and how much time and resource is committed to managing the relationship. A relationship for example could be deliberately kept at a distance but still remain good; this could be because it is deemed that there will be no immediate business benefit from having a closer relationship. This may be the case when the goods or services being supplied are relatively low value, infrequently required and pose very little risk to the organization should the security of that supply ever break down. Moving to the other extreme is the long-term close relationships that may be operated as a partnership. This will often be the case when items are high risk, high value and critical to maintaining the organizations operations.

Visit the **Buying Magician Blog** to read: **"Building the foundations for preferential treatment from your suppliers"** <http://purchasingpractice.com/building-the-foundation-for-preferential-supplier-treatment/>

Examine supplier finances

A general economic downturn may put some of your suppliers at risk of financial problems. A review of the financial condition of all key suppliers should be conducted, along with closer monitoring of the financial status of these suppliers through the downturn.



Renegotiate contracts

A downturn in your business will reduce your requirements for goods or services. Review your volume commitments to suppliers under longer-term agreements, especially take-or-pay type agreements, and be proactive in discussing changing requirements with suppliers. Also, be alert to potential changes in inflation when drawing up contracts.

Working with suppliers to mitigate risks and insulate against the negative impact of a downturn helps everyone. Share the pain to survive, get serious discussions moving with critical suppliers to share risks and rewards, reduce cost and improve efficiencies in a downturn as well as to prepare for the next growth phase.

Strategies:

Manage Your Cost Structure and External Spending:

Care must be taken when cutting cost. Too often companies focus on short-term cost reduction, which can result in higher costs over the long term. Common mistakes include:

- Cutting costs in areas critical to future growth and success
- Eliminating costs without addressing root cause issues, such as inefficient business processes
- Cost cutting decisions based on assumptions rather than fact based data.

Any business must incur costs to remain competitive. Sound cost management is not only about reducing short-term costs and increasing efficiencies, it is about achieving sustainable competitive advantage. Timely, accurate information makes the difference between a decision and a guess. Supply executives who have a thorough knowledge of their organization's cost structure and third party expenditure are better positioned to make informed decisions about cost management.

Strategic Cost Management Strategies in Procurement

Structuring for strategic Cost Management requires understanding the Cost Drivers, and laying down clear guidelines for how to proceed when first embarking on a cost management program. As you move forward the task becomes more complex as easy targets have been identified and executed and more difficult cost opportunities present themselves.

Typical stages of cost management in procurement are; price drift, price down, cost down, cost out and value add. As companies progress they move from focusing on reducing cost to removing cost and to



adding value, and to be successful they must employ increasingly sophisticated tools and techniques. This includes selecting appropriate supplier relationships and then managing the relationship effectively. Typical tactics may involve simplifying specifications and cutting process waste.

Launch a Strategic Sourcing Initiative:

Since the early 90's, we've heard many examples of the large and sustainable benefits that can accrue when strategic sourcing is applied to attack supply cost.

What is strategic sourcing?

Strategic sourcing is a collaborative and structured process for dramatically reducing external spending. It is a high reward, low risk alternative to traditional cost-reduction initiatives.

Strategic sourcing starts by meticulously defining the requirements for a product or service, and continues through the contracting process, followed by ongoing monitoring of the supplier's performance against the defined requirements. By definition it is very straightforward and common sense, in practice it requires skilled leaders to manage the shift in the organization from a traditional procurement organization to a world class procurement organization.

The benefits of strategic sourcing

It benefits the entire organization by reducing cost, optimizing resources, drives standardization and supports compliance, whilst improving quality, internal processes and lowering total cost. Once realized, savings are sustained through benefits tracking, supplier relationship management and stronger purchasing capabilities.

Manage Inventories:

Business downturns are typically accompanied by significant build-up and subsequent write-offs of inventories. Take this opportunity to review materials-planning policies, reduce existing inventories, and re-examine prescribed inventory parameters.

Manage Working Capital:

Companies striving to improve the way they manage working capital are often handicapped by paper-based, manual invoicing processes that result in lengthy invoice cycle times, which in turn makes it difficult to qualify for and capture early payment discounts. Because these companies allocate so much



time and energy to simply processing invoices, they are unable to devote the resources needed to strategically identify and work with suppliers.

Multiple groups, including treasury, finance, AP and procurement, impact an organization's ability to manage working capital effectively, but often work in silos. While each of these groups has its own goals, the entire organization must be aligned to gain maximum working capital efficiencies. For example managing Days Payable Outstanding and paying suppliers early to capture discounts, must be carefully balanced if an organization is to make optimal working capital decisions.

Procurement Excellence

Does excellence matter?

Excellence is no accident.... World-class organizations operate and perform very differently than their median peers, reports Hackett. They found that World-Class Procurement Drives 133% greater return than typical companies but cuts cost of procurement by 20%. They calculated returns by dividing spend savings (spend reduction attributable to procurement practices) by the total cost of procurement operations. This advantage translates to \$3.6 million to the company's bottom line for every \$1 million in procurement operations costs.

Leverage the Power of Technology:

Many companies have purchase expenditure of up to 60% of their overall annual turnover and in some cases even higher. By deploying e-procurement, companies can better manage this spend by creating significant process savings and lowering the absolute cost of the goods and services by ensuring compliance with strategic procurement initiatives.

Benefits:

- Improved procure to pay processes resulting in increased compliance with strategic procurement contracts and reduced maverick spending
- Increased spend visibility
- Improved working capital management
- Improved contract management and supplier relationship management resulting in improved monitoring of the suppliers performance

Delivering these benefits may involve a combination of technologies, such as an e-marketplace for ordering goods and procurement cards for their payment, e-auctions for sourcing initiatives and automated contract management systems etc.



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Achieving the benefits of e-procurement will require the updating of current practices towards best practice. Change management is, therefore, critical to the success of e-procurement.

Drive compliance and track savings:

During a downturn preventing maverick spending and leakage from negotiated contracts becomes even more important. One key performance indicator is whether an organization is on track to achieving their procurement savings initiative goals gained from strategic sourcing and other purchase cost reduction initiatives. The information associated with these initiatives is critical input for annual savings reviews and management reports which communicate savings data to company executives and financial analysts. Unfortunately, most organizations face problems in being able to consistently track the transactions associated with each savings initiative, and have the necessary information available for immediate analysis to take any necessary corrective action. A savings tracking solution which integrates into an organization's sourcing infrastructure can deliver the necessary data associated with each initiative to help drive compliance and cut maverick spending.

Conclusion

Company executives and Procurement leaders should be proactive in developing strategies for how they might meet the challenges of managing through a downturn.

Whilst smart businesses are prepared to take defensive measures that will limit the short-term damage, best in class businesses turn the challenge of a downturn into long-term advantage by building stronger customer and supplier relationships. Best in class companies therefore understand that superior performance requires preferential treatment from both customers and suppliers.

On the supply side, this means investing in procurement to win the battle for talent, develop world class organizations and business practices and deploys technology to support them.

The Opportunity:

Purchasing Practice can work with you to develop strategies to maximize your company's ability to operate profitably in a downturned economy through effective procurement practices. By developing these capabilities your organization will be better placed to:

1. Gain market share from competitors unable to adjust to shifting market conditions.
2. Maintain strong cash flow throughout the downturn, in contrast to other companies that may have liquidity problems.
3. Become a leaner, more cost-effective and more efficient operation, better positioned to do well when the market improves.



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Purchasing Practice –*Corporate Procurement made simple*

Purchasing Practice works with clients on the complexity and barriers associated with implementing world class procurement practices; enabling our clients to gain more control over their third party spend management, processes and supply chains, resulting in enhanced capability to deliver innovative cost effective solutions to their own customers.

We drive superior and sustainable financial performance through top line growth, free cash flow and margin improvement (in private sector companies), and best value and service excellence (in public sector organizations).

We can help your organization “*make change happen*” in procurement. Our services include:

Transformation Management: We will act as a change agent by working with you to articulate and communicate the need for change, develop an enterprise wide procurement blue print and support you through the implementation process.

Opportunity Analysis: By working directly with those staff responsible for committing expenditure, or managing suppliers, we will carry out a rigorous review and present our recommendations

Sourcing Management: Using our strategic sourcing service enables clients to realize full value from their supply base through leveraging our proven processes

Category Management: We work with clients to analyze spend data, define suitable categories then working on a category by category basis to deliver significant benefits

Supplier Relationship Management: We will carry out a rigorous review using proven tools and methodologies to present our recommendations.

Call us on 778 988 1052 or email us at info@purchasingpractice.com to schedule a consultation.