

From Hammer to Handshake

The Power of Purchasing

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18% at DuPont.
22% at Compaq.
25% at Fleet Bank.
20% at IBM.

What are they reporting? The savings generated through the application of improved procurement.

Purchasing, strategic sourcing, procurement, or just plain buying – the function goes by many names but results are always the same – adding value to the bottom line.

Some Things Old, Some Things New

“Negotiate with our suppliers as aggressively as our customers are negotiating with us!” That’s been the challenge from CEOs to their procurement staffs for the past decade. Purchasing organizations have met this challenge by introducing best practices that have generated huge savings. The best practices range from standardizing specifications, to evaluating total life cycle costs, to sourcing from the global marketplace, to decomposing supplier costs, to developing quality suppliers. Savings of 10 percent and greater have been routinely realized through a combination of hammer and handshake best practices. The emergence of e-procurement has added new tools (e.g., reverse auctions, aggregated volumes, fast/inexpensive communications) that enable more companies to implement best practices and save money.

Best Practices “Triple Benefits”

The starting point for implementing best practices focuses on contracting

with practices ranging from leveraging all volumes to aggressive fact-based negotiations.

Contracting Best Practices Checklist

- Leverage all volume and suppliers
- Negotiate aggressively from a fact base
- Ensure competition
- Evaluate total cost
- Source from global marketplace
- Develop strategic suppliers
- Pursue continuous shared cost elimination

Source: Norbridge, Inc.

Many companies have launched initiatives to consolidate supplier relationships and focus spending with strategic sources. These efforts yield triple benefits according to William Schaefer, Vice President of IBM Global Services’ Procurement Services division:

- Lower unit costs (from 5 to 25 percent reductions)
- Improved quality, availability, and collaboration with suppliers
- Reduced administrative effort

Paul Box, Compaq’s purchasing head, echoes the need to consolidate suppliers. “Compaq has 33,000 active suppliers; 2000 account for 80% of our spend. Our goal is to rationalize the total supply base to drive meaningful, incremental spend toward our core of preferred suppliers.”

At the other end of the spectrum is the challenge of sole-source buying. In this case, more suppliers are needed to ensure a competitive environment. One powerful source, Thomas Register (TR), the “buyers’ yellow pages,” provides 72,000 product and services headings and lists more than 173,000 companies. “We

list both large and small manufacturers, and you can search all of them by company name, product or service, brand, and location. It’s an immense array of potential suppliers, available to the buyer in a fast, easy-to-use fashion,” states Alisa Fogel, Director of Marketing for Thomas Register.

Strength – and Savings – in Numbers

Global sourcing is emerging as a very powerful best practice in the contracting arena. Tapping the worldwide marketplace is allowing companies to:

- Find additional suppliers
- Access leading-edge technology
- Reduce total costs
- Meet localization requirements

Continental Airlines gets its small-plane engines repaired by Volvo in Sweden and gets its DC-10s repaired in Tel Aviv. One of the reasons Continental finds this attractive is that offshore companies often take a longer-term profit perspective, which provides better capital investment, resulting in greater efficiency.

These global sources are also introducing new ways to do business. Chuck Wodehouse, President of CSX Technology, reports that an Indian firm remedied 50 million lines of code for Y2K. The quality of the effort was terrific with an error rate below 2 percent. The time difference allowed 7 x 24 coverage and the cost benefit exceeded 25 percent.

Procurement – A Lifetime Event

The discussion of contracting best practices is incomplete without introducing total life cycle costs. Most purchasing executives are focused on minimizing the total expense of materials and services, not first costs. At Peabody Energy Corporation,



> mining equipment is purchased based on a total cost approach that includes the initial price of the equipment and the projected cost of maintaining it throughout its useful life. Ron Osborn, who heads Peabody's purchasing function, has successfully negotiated full life cycle costs of equipment at the time of initial purchase, when leverage is greatest. Continental Airlines also focuses on purchasing as a support to the revenue-generation side of the business. Jun Tsuruta, Sr. VP of Purchasing & Materials states, "Our objective is to minimize aircraft downtime and optimize use.... Purchasing's role in this is to buy the best quality product at the most reasonable price."

To be blunt, purchasing executives also have a hammer at their disposal. Through aggressive negotiations, introducing new competitors, and consolidating volume, companies have achieved 10 to 20 percent cost reductions largely through suppliers reducing margins.

"The first wave of pain is the supplier's," says Tariq Hassan, Managing Director, Global Procurement at Fleet Bank. "In the second wave, where we focus on requirements planning practices, the pain is the user's." The requirements planning best practices focus on product specifications, the use of generic products, and collaborative planning.

Requirements Planning Best Practices Checklist

- Standardize products
- Review specifications; participate in design
- Share forecasts with suppliers
- Evaluate outsourcing
- Optimize usage
- Participate in all purchases
- Obtain vendor input

Source: Norbridge, Inc.

Collaborating with suppliers about requirements is a powerful practice that helps purchasing professionals reduce costs. Linwood Stockwell, who leads supply management at National Grid, explains. "It represents a commitment from the vendor," he says, "to hold specific production capacity awaiting our instructions each month. In return, rather than allow the day-to-day demand to drive periodic

replenishments, we combine our needs into a single monthly order." The theme of these practices is the handshake – buyer and supplier working hand in hand to reduce costs.

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– Norbert Litzkow
Head of Procurement, Finance,
Controlling & Information Technology
Mercedes-Benz España

Take It Outside

Outsourcing is a hot topic for procurement heads and general management. The rationale for outsourcing includes:

- Focus management attention on the core business
- Tap outside expertise
- Adapt quickly to changing business conditions
- Avoid investment costs
- Reduce expenses
- Turn fixed costs into variable costs

DuPont's outsourcing of its out-bound logistics and import/export business on a global basis illustrates the reasoning. "We realize," says Henri Irrthum, DuPont's Vice President of Global Sourcing and Logistics Services, that "we can't be smart on everything worldwide – we have to rely on people who [import/export] as their core business."

The E-Procurement Boost

E-procurement has become an enabler for many of the best practices as well as a best practice in its own right. The power of the Internet is used to:

- Improve communications with suppliers
- Eliminate "maverick" buying
- Lower the costs of goods or services purchased by:
 - Supply base rationalization
 - Collective purchasing power
- Lower inventory levels and order lead times
- Shift the focus of purchasing personnel from tactical to strategic activities

Automate and Control with mySAP E-Procurement

Company: Mercedes-Benz España produces 90,000 Vito and V-Class vans per year – and demand is rising.

Situation: The procurement process for indirect materials at the Spanish auto-maker's Vitoria plant was cumbersome. For every requisition, employees completed a form, obtained their manager's approval, asked the controlling department to check account assignment, then handed it over to the purchasing department. No wonder they often bypassed this route. Maverick buying was rife. The result: the plant purchased nonproduction goods and services from 1,500 different suppliers. "We really needed a much leaner process," says head of procurement, finance, controlling and information technology Norbert Litzkow.

Goals: Automation and control were the twin goals of the e-procurement project. The company wanted to use automation to streamline the entire process – from requisition through invoice checking. It also wanted to tighten control by centralizing supplier relationship management and enforcing optimized purchasing strategies: bulk buying and long-term agreements. A further objective was to integrate with the Covisint electronic marketplace, intended as the platform for the majority of the company's procurement transactions.

Process: Mercedes-Benz España opted to implement mySAP E-Procurement, which integrated effortlessly with its existing SAP ERP system. The new, intuitive workflows have reduced the standard procurement process to just one or two steps. The solution's integrated analytics reveal purchasing trends and behaviors, forming an ideal basis for effective procurement strategies. And it provides direct links to online business-to-business (B2B) exchanges.

Results: The number of suppliers has plummeted to around 200 – a far more manageable figure. The smooth interplay between back-office and e-procurement functions has cut purchasing lead times. Reduced routine work allows purchasing staff to concentrate on more strategic tasks like assessing suppliers and negotiating long-term agreements. Mercedes-Benz España plans to use online auctions to reduce the time and resources needed for contract negotiation.

The project is expected to yield a big return on investment. "Mid- to long-term, electronic procurement will save us \$1.5 to \$3 million a year," predicts Litzkow.

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Hurst Boiler Turns Up the Heat on a Hull of an Idea

Company: Hurst Boiler & Welding Co. of Coolidge, GA, manufactures wood, gas, coal, oil-fired steam, and hot water boilers for a variety of industries.

Situation: The Bolivian government was looking for an efficient way to produce electricity for several villages when engineers realized they could create fuel by burning the hulls of Brazil nuts. But to do it, they needed new boilers.

Goal: The government wanted to conserve the nut hulls, which are usually discarded in nearby rivers, as a natural source of energy. A waste-fired system would not only slash the cost of dumping the hulls, it would eliminate the need to drag hull-clogged rivers periodically to keep them flowing.

Process/Tools: Hurst Boiler gained \$1.5 million in new business when the Bolivian government found them on www.ThomasRegister.com. The company broke into the international market about three years ago, and most of its international business since then has come through the Thomas Register Web site. Hurst has also expanded its business domestically by adding CAD drawings of its product line to Thomas Register's PlantSpec® CD-ROM. This CD allows potential customers to easily import CAD drawings directly into blueprints.

Results: Vice President of Sales Jeff Hurst sums it up: "Within our first six months of being on the Internet with Thomas Register, we made over \$6 million in sales. I don't think we could ask for a better result."

In addition to supplying China and the entire Pacific Rim, Hurst Boiler, with customers throughout the U.S. and Canada, is one of the fastest growing boiler companies in America. "We give a lot of credit to Thomas Register," says Jeff Hurst. "It's helped us get into many new markets... and get a leg up on our competitors."

HERE ARE TWO UPCOMING SECTIONS OF RELATED INTEREST:

"Supply Chain Visibility and Collaboration: The Results Are Beginning to Show" a logistics special advertising section appearing in the October 8 issue.

"Industrial & Economic Development: The Strategic Emergence of Location" a corporate location special advertising section appearing in the December 17 issue.

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> Electronic administration frees time for high-value activities. "By automating and distributing the transaction processing into the hands of employees," says Paul Box of Compaq, "we freed up our procurement team to do more value-added work.... We began realizing savings as soon as the first order was processed through the system."

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Reverse auctions are a powerful negotiating tool allowing multiple sellers to bid and sell to individual buyers, hence greatly increasing the competitive landscape and improving purchase price for buyers. DuPont uses reverse auctions on a selective basis, "as a tool to drive purchase costs down to the lowest possible price," states Irrthum.

Sustaining the Gain

One of the most frequently asked questions by executives with regard to purchasing is: What is the magnitude of

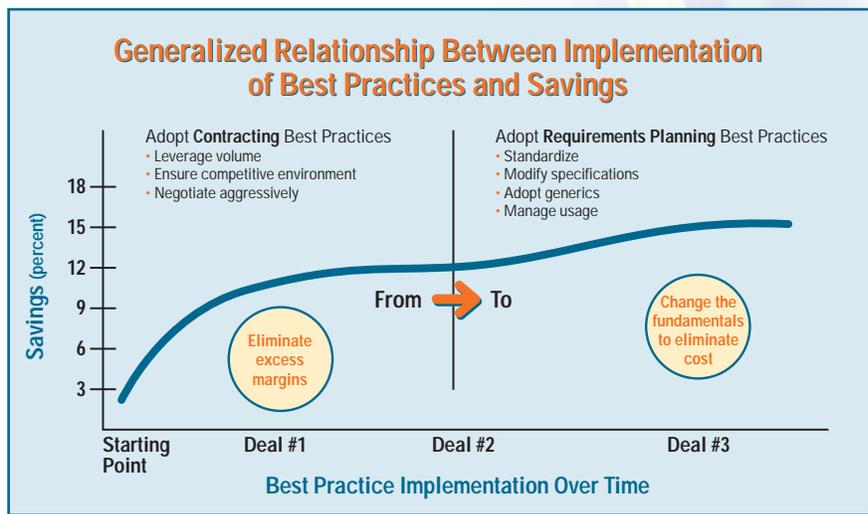
savings potential, and can purchasing continue to deliver additional savings year after year? The answer is that the application of best practices will typically deliver 10 to 20 percent savings or more and, yes, the savings can continue to follow deal after deal after deal.

Continuous cost elimination programs that create savings throughout the life of the relationship with the supplier are essential. Eastman Kodak Company's SOLID (Supply Online Idea Database) system encourages its suppliers to submit ideas. "We are trying to eliminate barriers to change," states Timothy Smith, Worldwide Purchasing Strategy Manager. "The 2,900 ideas so far submitted have already resulted in \$119 million in savings!," echoes Richard S. Morabito, Purchasing Chief.

Fleet Bank is a firm believer in the concept of sustained cost reduction. Hassan states that "strategic sourcing is not considered successful unless the cost reduction and organizational purchasing efficiencies can be sustained and institutionalized over the long term."

The Journey Continues

The purpose of this article is to whet the appetite. The sources of best practices abound. Smart-Purchasing.com provides a comprehensive online guide to purchasing best practices. In summary, "There are always more savings. You just have to look, ask, and act." ■



Source: Norbridge, Inc.