Procurement can often suffer from a lack of exposure in some organisations. It is sometimes seen as a ‘back end’ or administrative function that simply processes purchase orders. It is too cost focused and is a stickler for following policies and procedures meticulously. This has only been reinforced by measuring P&SM professional’s performance predominantly on cost savings.

Driving down costs time and time again is not sustainable and even if it were, there are often consequences for doing so. So yes, you can achieve you 20% savings target but at what cost? P&SM professionals need to start looking at value propositions rather than just cost savings. Forward thinking procurement teams align their targets to the corporate strategy or their stakeholder’s goals in order to deliver true value. The problem is that the board and shareholders often still want to see a difference to the bottom line and savings for them is a way of achieving that; yet paradoxically long term investment in supplier relationships is more likely to deliver sustained shareholder value – just not in the short term.

Beating suppliers up on price is not a bad strategy, but it is also not one that can be applied to all situations. Negotiation is about power and influence. What P&SM professionals need to establish is which way the scales of power and influence are swinging and choose their appropriate strategy. Gung-ho P&SM professionals often boast of dramatic cost savings but what have they sacrificed as a result? Will that supplier be as willing to help them out in a crisis next time? Will they even be interested in applying to tender the next time the contract is awarded? Or even worse will they cease to exist as a supplier as a result of falling margins? What was the full cost of that achievement? It’s about selecting the most appropriate sourcing strategy to suit your organisation and ensuring the right techniques are implemented.

Professor Paul Cousins of Manchester Business School highlights this point in his paper ‘To be or not to be – the dilemma of strategic supply chain management’. Cousins uses a UK retailer case study to demonstrate the pitfalls of using a heavy handed approach with suppliers when the sourcing strategy is a more collaborative approach.

“The supply function in a large UK retailer spent over a year negotiating long-term agreements with suppliers following an aggressive re-sourcing programme. After the negotiations were complete and the contracts were running, the suppliers each received a letter from the CEO demanding a 10 per cent price reduction across the board. This letter was sent without the knowledge of the supply function.
The result was mayhem with suppliers refusing to supply and threatening legal action. The supply function became very demoralised and disillusioned with senior management and a great deal of money was wasted setting up deals that were not going to be realised. In order to survive the firm needed to reduce costs – that is, follow a cost-focused approach. Conversely supply was implementing long-term strategic collaborations. There was a mismatch between what the firm needed to do and the role supply adopted. This occurred because the strategic priorities of the firm were not communicated to the supply function (until too late)."

There has been a significant movement from focusing on a price tag to assessing the total cost of ownership (TCO) when making a purchase. Spreading the message to other business disciplines about the difference between cost and price has been an uphill battle for years. Maybe this was the wrong message? Or maybe we just omitted one piece of detail – risk. Total Cost of Relationship (TCR) strategies look at TCO plus risk. From a sales perspective this has been around for years. By bundling service elements into a product, you are increasing the attractiveness to the client and increasing the perceived or actual benefits. For example, nowadays when you book your car in for a service there are drop off, collection and valet services included. Software companies will offer implementation and maintenance programmes reducing the risk factor for the client. So we need to not only measure our suppliers on these benefits, but start measuring procurement teams on obtaining them.

‘Procurement has grown up’, says Professor Lynette Ryals from Cranfield University, in her paper ‘Holding up the mirror: The impact of strategic procurement practices on account management’. A shift from short term price reductions to long-term relationships with our suppliers is delivering more sustained shareholder value. Yet the vast majority of relationships (approx 70%) are still at arms length. She goes on to say that many organisations suffer from supplier delusion as they may believe they are in a partnership arrangement with a customer however, the buying organisation has a very different picture. Suppliers and P&SM professionals often pour time, money and effort relentlessly into relationships with customers that will never be anything more than ‘arms length’.

Ryals lists the following as major success factors for relationship management and supplier measurement. These factors are also key for measuring a procurement team’s performance.

- Trust and commitment; relationship continuity
- Investment in the relationship
- Dependence on the relationship
- Communication
- Personal relationships
- Reciprocity and fairness
- Shared benefits

1 Download this paper and podcast at www.scmrg.com
Forward thinking procurement teams look to add value to their organisation and not just cut costs. CPO’s and managers need to change their mind set on how they measure their team and their supply base in order to steer P&SM professionals away from being too cost focused. This will require investment in relationship management and a fresh approach to dealing with suppliers. Individuals, their attitudes, methods of communication and behaviour, all have an impact on relationships and no policy or process can steer every individual down the same path. Decide what is important to your organisation, design a strategy to meet that objective and deliver it!