Take a Long Term View

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I am a sourcing professional and my husband is a sales executive. This has made for some interesting dinner conversations over the last 30 years. I am currently working with a client on a sourcing event. The client's sole source vendor (a distributor) has wisely placed significant "free" equipment on site which, of course, uses proprietary materials. The client doesn't want to incur the significant switching costs nor the disruption to its operation by changing vendors. The requirements include other standard products which could easily be purchased elsewhere, but the client also wants a sole source. The distributor manages inventory for stock items on a kanban basis making the lives of the buyer and his internal customers very easy.

Over coffee, my husband acknowledged that this is a sales rep's dream situation! The customer is "locked in" with high switching costs thereby eliminating competition. He further admitted that this situation would most likely result in higher than normal profit margins for the vendor. Conversely, this situation is a buyer's nightmare! How does one realistically introduce competition given the circumstances? A couple of possibilities come to mind. First, we can potentially create competition among various distributors who can supply the same equipment and proprietary materials as well as the standard items. However, that could require changing out the equipment, and it remains to be seen whether the distributors will bid against one another. Another option is to take the proprietary materials off the table and bid out the remaining standard products. However, this would violate the sole source objective, and one should only pursue this if there is a sincere willingness to split the business assuming the savings justify. Bluffing with potential bidders will only damage any long term potential for competition.

It's unclear at this point which option we'll take. Bidding the non-proprietary products will potentially allow the client to see the premium he's paying for the standard supplies in order to maintain a sole source. The risk, however, is that the incumbent distributor will subsidize pricing on the stock items to maintain this business and make his profit on the proprietary products. Not an ideal situation.

As sourcing professionals, our best approach is to avoid these situations to begin with. We need to help our internal customers understand that there is no such thing as “free”. We need to look at not only the short term savings for “freebies”, but also consider the long term effect on competition and the resulting impact on pricing. Without competition, we’ll never know the true cost for the “free” equipment.

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