

The Rest of the Story

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In my April 2009 post entitled “**Take A Long Term View**”, I described a client facing a sourcing dilemma. They were purchasing materials from a distributor who had installed “free” equipment in exchange for a commitment to buy the related supplies. They had previously solicited bids every two years and believed their “supplier partner” was competitive. They couldn’t imagine a way to save money given the high switching costs, so they were unwilling to diligently source this requirement.

This sole source situation raised a number of red flags so we continued our examination. We realized that prices for a third of the buy should track a feedstock index. Using this index, we demonstrated to the client that they had been paying a 10%-15% premium for these materials, versus what the index would have predicted, over the 2 year life of the contract! This finally convinced them to take action!

With the contract expiration and the holidays quickly approaching we needed to take quick but diligent action. We engaged the client by taking a tour of their facility. We interviewed them to fully understand their CTQs (Critical to Quality requirements). We requested detailed material specifications, as the existing specs were often the incumbent’s unusable short-hand descriptions.

Before reaching out to potential bidders, we obtained the client’s agreement on several important points:

- They would move business if best value was available from a non-incumbent supplier,
- They would consider alternatives to the “free” equipment and related supplies if the alternative was comparable and the switching costs were covered, and
- They would allow a multi-source award if the savings warranted.

An important first step was a pre-bid meeting with the incumbent supplier and prior unsuccessful bidders. We felt it was critical to signal a change in the sourcing process. Prior bidders responded favorably to this. They acknowledged that the routine RFQs were not taken very seriously. They perceived the specs as biased and/or incomplete, and they knew the incumbent always won. Therefore, they had not bid aggressively in the past.

After the pre-bid meetings, we used a two step sourcing process. First we issued an **electronic RFI using lasta's SmartSource solution**. The purpose was to determine potential suppliers' capabilities, to gather information on various alternatives, and to collect feasibility level pricing. We cast a wide net to over 20 potential suppliers, and through this process eliminated all but six. We then issued an electronic RFQ with final lots and detailed, accurate item descriptions. Responses allowed us to evaluate bidders against non-price criteria and to determine total best value.

Interestingly, the incumbent "partner" dropped their pricing by almost 20%! We had a 20% savings "in the bag" with no change. We seriously considered an alternative to the "free" equipment which offered a huge additional savings. However, upon investigation we determined the solution was not really comparable and we also had concerns about the service level of this bidder. After abandoning this alternative, we were still able to award over half the business to a non-incumbent supplier who could use the equipment that was already in place. (It turned out that the equipment was owned by the manufacturer, not the distributor!)

At the end of the day, this sourcing initiative delivered a 24% savings with future price movement for many items tied to an index. We included contract language that gives our client the ability to easily monitor suppliers' performance. Contracts also provide for quarterly reviews including discussions about potential non-price cost savings. The new agreements clearly define the Scope of Services, and determine how cost increases for both indexed and non-indexed products are justified and approved. Additionally, the award entails minimal disruption since the existing equipment will be utilized. Of paramount importance, this award signals to all involved that the client will move business when warranted. We anticipate competitive proposals when these new contracts expire.

The lessons: In the absence of competition, our supplier "partners" become complacent and margins creep upwards. A perfunctory RFQ will likely not deliver best value. Our client did not have the staffing to conduct this rigorous sourcing project. By engaging consultants on a gain-share basis, our client was able to achieve a significant savings with no up-front cost or risk and a minimum of employee time.

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