Making Sourcing Savings Stick

As a sourcing professional, my most difficult negotiations aren't with suppliers but rather with internal customers. Based on conversations with my colleagues, this experience is *not* unusual. One measure of this challenge is "savings leakage" (savings negotiated but not realized). Aberdeen Group reports average leakage rates of 21% as Purchasing strives to implement its sourcing decisions. Best In Class companies experience about 14% leakage whereas All Others see 24% leakage (1). Small companies experience up to 40% savings leakage (2). Net, there is a huge payout for improvement.

Let me provide a couple of personal examples. During a particularly volatile market, I sourced corrugated containers every six months, and typically negotiated significant savings. However, we often got to the end of the contract period without having qualified the new supplier. Despite verbal agreement, the using location was not on-board with the change. The supplier qualification dragged on for various reasons and savings were never realized. In another instance, I was coaching an eSourcing client through a polybag sourcing event. There were a couple of dozen using locations which were aggregated into about 5 regional groups to leverage volume. The reverse auction netted an impressive double digit savings, but the using locations refused to cooperate. The deal fell apart and the savings was never realized.

There can be many reasons for leakage:

1. *Communication.* The using organization is unaware of the award and continues buying from the incumbent.
2. *Inconvenience.* The new supplier's process is inefficient providing a negative incentive to change (e.g. a travel reservation website which is difficult to use).
3. *Fear of the unknown.* There may be a long-standing, positive relationship between the supplier and the user. Alternately, the internal customer may not be thrilled with their current supplier, but at least the incumbent is "the devil they know".
4. *Lack of trust.* The internal customer organization doesn't trust the buyer to properly address non-price criteria when making sourcing decisions.

Regardless of the reason, this leakage represents innumerable hours of wasted effort and, more importantly, millions of dollars in missed bottom line profit improvements.

Communication breakdown is relatively easy to address, particularly with the use of eSourcing, eProcurement, Spend Analysis and on-line contract management systems. The other three reasons require a deliberate process and up-front planning. It's all about effective change management! Successful sourcing managers don't wait until *after* the award to sell their internal customers. This is particularly critical in companies where business units are relatively autonomous, and not subject to corporate edicts.

Effective sourcing professionals follow Stephen Covey's advice: "Begin with the end in mind". What does that mean? It means involving key stakeholders throughout the entire sourcing process so they will support implementation of the ultimate award decision.

Specifically, what does this entail?

1. *Ensure upper management support for sourcing initiatives and savings goals.*
    - Review your corporate and/or business unit objectives, and be sure your sourcing initiatives support them. At Procter & Gamble, diaper raw material costs have a huge impact on profitability. As a result, sourcing savings enjoy high visibility and support from management. Conversely, shampoo packaging material costs are much less impactful. Purchasing brings value by working with suppliers to identify new technologies and to reduce time to market with new/upgraded products and promotions. Therefore, cost savings are a lesser priority.
    - Communicate to leadership how your savings priorities support business objectives. Be sure to quantify and communicate specific goals and results. Enlist your management sponsor. Partner with Finance. Learn to talk like a CFO. Linda Peyton, former Director of Procurement Technology at Blyth, compared a $1.6 million savings opportunity to an equivalent $3.6 million increase in Sales to gain project approval. [3]
2. *Initiate a comprehensive and methodical change management process early on.*
    - Identify Key Stakeholders. If the number is very large, look for the "thought leaders". These are the people who influence the rest of the pack.
    - Identify potential areas of resistance and develop a plan to address. People resist change for a variety of reasons. Therefore, it is necessary to identify the issues and address them.
    - Research customer business objectives and pinpoint those that can be fulfilled through your sourcing initiative.
    - Have your project sponsor pre-sell the initiative to his/her peers, being conscious to link to customer business objectives.
    - Develop a project plan that incorporates specific actions to ensure customer influence in the decision process. Communicate your objectives and project plan to internal customers highlighting their involvement.
3. *Work with stakeholders to clearly define decision criteria with appropriate measures.*
    - Survey stakeholders to identify concerns, and to begin defining savings goals, award strategy (e.g. single source, co-source, etc.) and decision criteria. Decision criteria should include things like projected switching costs and non-price criteria (e.g. quality, service, etc.). Get agreement on the weighting of the various criteria.
    - When defining decision criteria, be sure to probe your stakeholders on the following:
        - What criteria will truly disqualify a supplier from participating in our business? What is the measure above or below which a supplier would be disqualified from participation?

    - What are the reasons you might want to keep your incumbent suppliers? What is it that they do or don't do that make you want to keep them?
    - What are the biggest problems you've experienced with this product/service over the last year?
  - Summarize measurable decision criteria, and seek feedback from key stakeholders. If working with a subset of stakeholders, broaden the group for this step. Also, have your sponsor communicate this information to his/her cross-functional peers.

4. *Conduct the RFP/RFQ with stakeholder input and involvement.*
  - In most cases, a two step process is ideal. Phase 1: The RFP gathers market and supplier capability information and screens potential bidders against "must have" criteria. Phase 2: The RFQ solicits bids from pre-qualified suppliers and evaluates them against non-price criteria.
  - Develop the RFP including survey questions which address the "must have" decision criteria. Survey questions should be limited to 20 or 25 questions that allow you to isolate those who will move forward in the process. Identify survey evaluators. Validate the survey with key stakeholders. Listen to and incorporate feedback.
  - Have evaluators score the surveys. Meet with stakeholders to discuss and resolve discrepancies, to identify the bidder "short list" and to determine how the RFP responses will be incorporated into the RFQ.
  - Create the RFQ incorporating the RFP data and appropriate non-price decision criteria. Validate the RFQ with stakeholders. Confirm decision criteria and savings goals.
  - Collect supplier responses and bids. If you're conducting an auction, invite stakeholders to participate in a practice auction and/or observe the live event. There is nothing like the excitement of a live auction to build enthusiasm and buy-in.
  - Develop award recommendation consistent with pre-agreed decision criteria. Review with key stakeholders.
  - Management sponsor should share the approved award decision, projected savings and implementation timing with his/her peers.

5. *Gain stakeholder support for a comprehensive implementation plan and enforce accountability.*
  - The plan should include actions, names and dates. Manage the plan holding people accountable for meeting commitments. Escalate outages through the project sponsor, if necessary.
  - Work with Finance to change user budgets by the expected savings amount. Nothing ensures compliance and usage of a new, lower cost supplier than a formal change in the budget. GE effectively used budget to drive sourcing savings to the bottom line.
  - When the implementation is complete, CELEBRATE and share the glory! Acknowledge, publicize and recognize the cross-functional success.

6. *Monitor expenditures over time to identify any leakage.*
  - You can't improve what you don't measure.

- Ideally, use a spend analysis solution to facilitate this process.
- Look for “root causes” of any leakage.

Sound like a lot of work? It is. However, it often eliminates months of wasted effort on sourcing decisions that don’t stick. Why is it that we never have time to do it right, but we always have time to do it over? We recently followed this process at a client where there was great reluctance to formally source a spend. The business owner valued their “partnership” with the incumbent and projected huge switching costs and disruption to move business. Why bother!?! By following this process, we identified important decision criteria and enlisted support of the business. They were 100% behind the ultimate award that delivered almost 25% savings with virtually no switching costs!

It is critical to communicate, communicate, communicate up, down and across the organization throughout the entire process. Bring people along with you in the process and make sure there are no surprises. Listen to your stakeholders. Learn from your mistakes and pursue continuous improvement.

Is this formal process necessary for all savings initiatives? No, but the thought process should be applied to all situations. Thinking through this process allows you to determine the extent of the effort required. One size does not fit all.

Addressing stakeholder fear, lack of trust and potential inconvenience through a comprehensive change management effort and improved communication will have a tremendous impact on savings leakage. Yes, it requires an upfront time investment, but it also delivers a huge back-end payout!

(1) Aberdeen Group. “The Advanced Sourcing & Negotiation Benchmark Report. January, 2007.
(2) Aberdeen Group. “Sourcing Challenges for SMB”. August, 2007
(3) Teague, Paul. *Purchasing.* “How to Speak Like a CFO.” May 4, 2006.

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