



Checkmate News

Winning Approaches for Cost and Resource Productivity

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Strategic Sourcing can rapidly identify immediate cost reductions through relationships with suppliers which leverage an organization's buying power.

In order to maximize the benefits that procurement management offers it is critical to implement the procurement process effectively across all levels of the workforce.

The first article in this issue, "Making Sourcing Savings Stick" provides actionable advice in 3 critical areas: communications, change management and measurement of results.

The second article, "Stopping Contract Leakage" elaborates on specific steps to identify and fix implementation problems: measuring contract leakage, identifying root causes and developing a correction plan.

Paladin Associates wishes you success in 2010 and is ready to assist with data-driven solutions to these common challenges.

Best Regards,

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Making Sourcing Savings Stick

Barb Ardell, Vice President, Paladin Associates Inc.

[Click here](#) to listen to the podcast on this topic.

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% leakage¹. Small companies experience up to 40% savings leakage². Net, there is a huge payout for improvement.

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.
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. See article below for tips on "Stopping Contract Leakage". 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.
- 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.

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.). Be sure to get agreement on the weighting of the various criteria.
- 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.

- Develop the RFP including survey questions which address the "must have" decision criteria. 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.
- 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. We recently followed this process at a client where there was great reluctance to formally source a spend category. The business owner valued their "partnership" with the incumbent and projected huge switching costs and disruption in order 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!

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! ■

[Click here](#) to read a more comprehensive article on this topic.

¹ Aberdeen Group. "The Advanced Sourcing & Negotiation Benchmark Report. January, 2007.

² Aberdeen Group. "Sourcing Challenges for SMB". August, 2007.

Stopping Contract Leakage

Barb Ardell, Vice President, Paladin Associates Inc.

You've invested countless hours and completed your strategic sourcing process. The resulting award will deliver significant and important savings to your company's bottom line. You're a hero, at least for now. But how do you ensure that the award is implemented as contracted so that the savings, in fact, accrue? And how will you know?

Contract leakage is your enemy. It includes things like:

- Buying from a non-contract source.
- Buying non-contracted items.
- Buying through the wrong channel (in store purchase or retail website versus "punch out" catalog)
- Paying a total delivered price different from the contract (including payment terms, freight, duty, etc.),
- Incorrect or missing contract reference which results in non-contract billing.
- Not getting rebates or other volume price reductions.

Most sourcing professionals face these challenges and have a difficult time plugging all the holes. This is particularly true for today's awards which often span vast geographical regions and numerous business units. 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% leakage¹. Small companies experience up to 40% savings leakage². The risk and the opportunity are huge!

To address this challenge, one needs to do the following for each potential leakage point:

- 1. Measure the leakage rate.**
- 2. Understand the root cause.**
- 3. Fix the problem** – either the user behavior, vendor behavior or change the definition of "right".
Most people don't even try to do #1, don't understand #2 and, therefore, are in no position to fix the problem. Let's examine each point in a bit more detail.

1. Measure The Leakage Rate

There is an axiom among business gurus that states: "What gets measured, gets done." So if it's important that our award gets implemented correctly, then we first need a way to track actual purchases and get visibility into all of the potential leakage points listed above. Also, measurement must occur on a timely basis so that any required corrections can be made before additional savings are lost, perhaps forever. You wouldn't drive your car by looking in the rear view mirror. You can't effectively manage your expenditures that way either. Fortunately, today's spend analysis solutions provide the functionality we need to efficiently monitor the various components of our business awards so that we can take the necessary action to forestall contract leakage.

For this purpose, it is critical that data be refreshed very frequently – at least monthly. A quarterly data extract leaves erroneous spend unchecked for 3 months draining savings that may never be recovered. Monthly extracts are actually more efficient. Once the queries are defined, they get put into a monthly schedule and can happen automatically. They become part of the routine. A monthly review becomes part of the sourcing manager's routine as well. With an effective spend analysis solution, he/she can quickly review contract performance. Some tools (such as BIQ) provide an interactive tool that facilitates period-to-period comparisons and highlights outages by magnitude. This makes it easy for the buyer to prioritize efforts to reign in maverick spend.

2. Understand The Root Cause

Now that you've identified the outages, what do you do? First, you need to understand the root cause(s). As stated in the article above "Making Sourcing Savings Stick", there can be several reasons including: communication, inconvenience, fear of the unknown, lack of trust and others. Quality tools such as "5 Whys" or a Fishbone Diagram can help you get to the root. Fixing symptoms alone results in unnecessary rework.

3. Fix The Problem

After identifying the root cause(s) you want to develop a correction plan. The plan should address management support and must involve stakeholders. It should include detailed actions with names and dates and, importantly, a means of accountability.

Accountability is key but can be tricky, particularly in situations where purchasing is seen as more of a support organization rather than a leader on the path to improved profitability. You must re-double your effort to sell your sourcing plan to corporate management as well as to internal customers. To do that effectively you must:

- Understand and explain the link to business objectives. How will contract adherence help stakeholders achieve their goals?
- Refine business processes to make doing the right thing easiest. Human nature follows the path of least resistance. How can you make it easy to comply?
- Speak like a CEO. The language of management is numbers. What is the impact of leakage on profitability and other financial goals?
- Be opportunistic. Look for "pain" you can relieve. What short or long term pain can be alleviated through compliance?

The preferred approach is the "carrot". Convince your constituency that compliance is in their best interest. Reward positive behavior. Publicize successes and share the glory! However, you must also be prepared to escalate if necessary. As Teddy Roosevelt advised: "Speak softly and carry a big stick". Most importantly, don't get discouraged. You must continually monitor the situation through your monthly reviews, and seek continuous improvement over time.

As sourcing professionals, our job is not done when the contract is signed. We must continually monitor and measure actual spend, identify root causes of leakage and implement effective fixes so that we don't leak 15% to 40% of our hard-earned savings. Spend Analysis solutions provide an effective and efficient means to achieve this. ■

¹ Aberdeen Group. "The Advanced Sourcing & Negotiation Benchmark Report. January, 2007.

² Aberdeen Group. "Sourcing Challenges for SMB". August, 2007.

Do you believe that your organization has a savings opportunity? If so, don't hesitate to contact us. In less than a few weeks, Paladin can provide a comprehensive assessment of the types of savings opportunities that your company might be missing. Since we are willing to work on either a contingency or gain-share basis, there is no cost or risk to your organization. Contact us today:

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About Paladin Associates, Inc.

With over 800 years of collective financial and operating experience, Paladin Associates executives bring a unique perspective to productivity and profitability improvement. Founded by former GE executives with extensive experience working with middle market organizations, Paladin delivers hard dollar cost savings to companies of all sizes. Clients have nothing to lose in our relationships— if a company fails to realize savings or value creation, they pay nothing. In addition to providing world-class consulting and advisory capabilities in the Strategic Sourcing and eSourcing areas, Paladin also offers services in Telecommunications Sourcing, Financial Management, Marketing & Sales Productivity, IT Management, HR Productivity, Manufacturing Efficiency,

Energy and Utilities Management, Mergers & Acquisitions Support, and Interim C-level Management.
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