



## “Best Practices” Newsletter Volume 19, March - 2004

**About This Issue** - This March 2004 edition of our newsletter contains more techniques to help our clients & colleagues accomplish their strategic procurement objectives.

Strategic Procurement Solutions is a consulting firm specializing in advanced Strategic Sourcing, Training, and Organizational services. Robert Dunn, C.P.M. & Mark Trowbridge, C.P.M. are senior partners in the firm who lead teams of professionals in supporting “world-class” client organizations. More information can be found at [www.StrategicProcurementSolutions.com](http://www.StrategicProcurementSolutions.com).

We also invite readers to attend one of our upcoming public presentations:

- April 26<sup>th</sup>, 9:20 a.m. and April 27<sup>th</sup>, 10:20 a.m. EST – **Strategic Contracting** – I.S.M. International Conference (Philadelphia, PA).
- April 28<sup>th</sup>, 8:00 a.m. – **Greater Savings Through Supplier Management** – I.S.M. International Conference (Philadelphia, PA).
- May 6<sup>th</sup>, 11:00 a.m. PST – **Is Your Procurement Organization Re-Active or Pro-Active?** - Webinar presentation hosted by Noosh, Inc. Please contact them at (888) 286-6674 x6029 to view this free lunchtime web-based seminar.

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### **Strategic Contracting ...by Mark Trowbridge, C.P.M.**

One of two topics that Bob Dunn and I will be presenting at April’s I.S.M. International Conference is that titled above. Apparently, it has generated much interest, as the I.S.M. folks just asked us to present it twice. **Why the interest in “Strategic Contracting”?**



Perhaps it is because a sophisticated approach to contracting management is still one of supply management’s unconquered frontiers. Consider the following quotes:

- **“The average Fortune 1000 company has between 20,000 and 40,000 active contracts, up 20% in the last 5 years”** (Institute for Supply Management)
- **“Contract management is where finance was 30 years ago”** (Oracle)
- **“ERP solutions only cover 20% - 30% of the needs of most organizations...”** (Goldman Sachs)

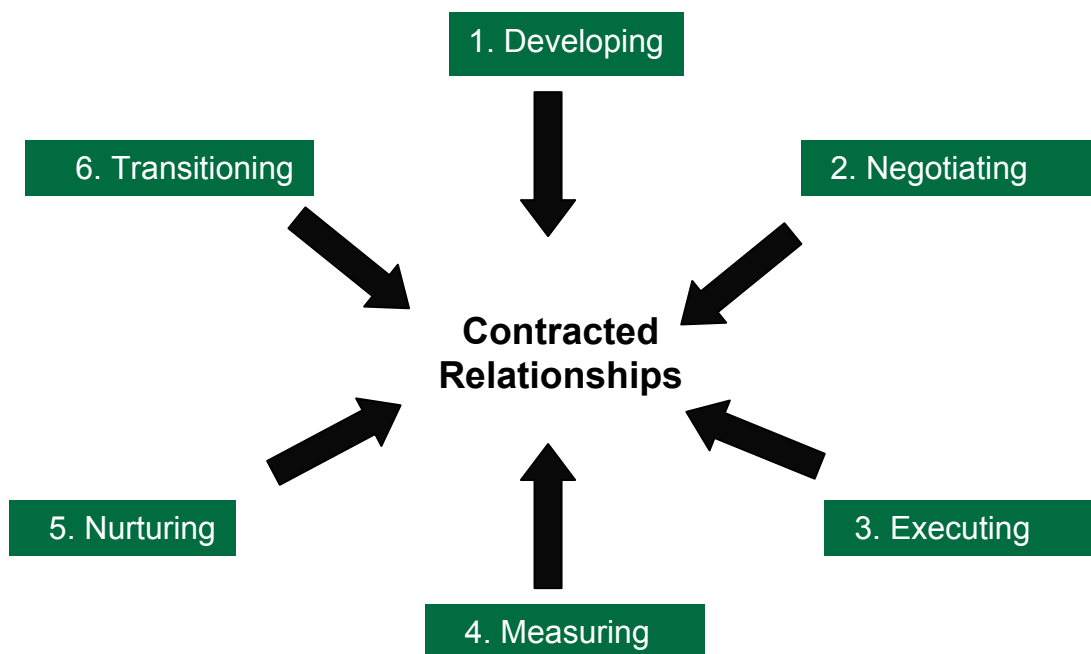
- **“It is estimated that 10% of contracts across all industry sectors are lost. Many companies say they regard this as inevitable, and that dealing with the consequences is simply a cost of doing business. They are wrong. This is a cost of poor business.”** (PriceWaterhouseCoopers)

World-class supply management organizations are placing much greater emphasis upon their contracting strategies & portfolio management techniques. With large scale “Strategic Sourcing” trends passing the 10 year anniversary mark, a much higher percentage of the typical Fortune 500 organization’s expenditures now fall under long-term supplier contracts. Organizations without a comprehensive contracting strategy are falling behind.

**Another reason for the recent focus upon the contracting process is the Sarbanes-Oxley Act that holds senior corporate officers more-responsible for the financial integrity of their firms (see the article later in this newsletter for information about this Act’s impact upon procurement groups).** Without a good methodology for tracking, managing, and reporting upon external contractual commitments, companies and their senior officers may be held responsible by shareholders.

*So just what is Strategic Contracting?* At a high-level, it’s the difference between the concepts of “Contract Administration” vs. “Contracting Management”. The former is just ensuring that terms & conditions of contracts are fulfilled. The latter is a strategic approach to the entire contracting process that enhances the overall sourcing strategy.

*Contracting Management* is the pro-active process of **Developing, Negotiating, Executing, Measuring, Nurturing,** and **Transitioning** contracted supplier relationships to *Maximize Shareholder Value.*



#1

**Phase 1 is that of “Developing”** the contract. Advanced supply management groups are using pre-approved Pro-Forma Templates, Document Management Technology, & Project Management Tools to shorten the cycle time needed to prepare written agreements. They are also including their preferred terms & conditions in RFP solicitations in a manner that positions them for Phase 2.

#2

**Phase 2 is “Negotiating”** the agreement. Using Revision Tracking technologies, this part of the process is being significantly-shortened. Building upon the use of Pro-Forma Templates, legal support costs & time delays are being minimized.

#3

**Phase #3 is that of “Executing”** the contract. Suppliers are much better than procurement folks at getting signed, and keeping alive and active, contracts. Use of Streamlined Executive Approval Processes, Strategic Renewal Clauses, Master/SOW Agreement Formats, and Innovative Pricing Methodologies is helping large procurement groups simplify this phase. This phase also includes an *Implementation* project plan to get the supplier relationship up and running.

#4

**Phase #4 is “Measuring”**. A big theme of business in 2004 is building “Metrics That Matter”. Value-managing contracted supplier relationships requires measuring & improving their performance. There are some great techniques & technologies becoming available to strategically manage contract portfolios, but this arena is still not highly-sophisticated.

#5

**Phase #5 is “Nurturing”**. Many contracts go into a file folder until they are about to expire. This is often because they are so complex and overwritten that the stakeholders don’t care to modify or improve them. Strategic procurement groups, however, now treat contracts as “living documents” that need to change along with the supplier relationship. Just because the ink is still wet, doesn’t mean it can’t be re-negotiated or improved.

#6

**Phase #6 is “Transitioning”**. Every contract comes to an end. This sometimes surprises the procurement team, and causes them to extend a bad deal or make a rushed sourcing decision. The time to plan for the end of a contract is before it is signed. Language must be incorporated into every supplier agreement to deal with the transition back to the buyer...or a new supplier. We also recommend to clients that when they perform initial reference checks on a potential supplier, that a “past customer” is included to determine the professionalism of the supplier in supporting a transfer of responsibility.

Strategic Procurement Solutions has recently worked with one Fortune 500 client that has *never* had any organized process for managing their contracts. It is safe to say that they have been at the mercy of the supplier community. Until a centralized process and methodology was developed (by Strategic Procurement Solutions), widespread strategic sourcing of their \$300 Million in expenditures could not occur. Once we gathered their 700+ agreements and identified key data elements for each contract, however, systematic cost reductions have begun.

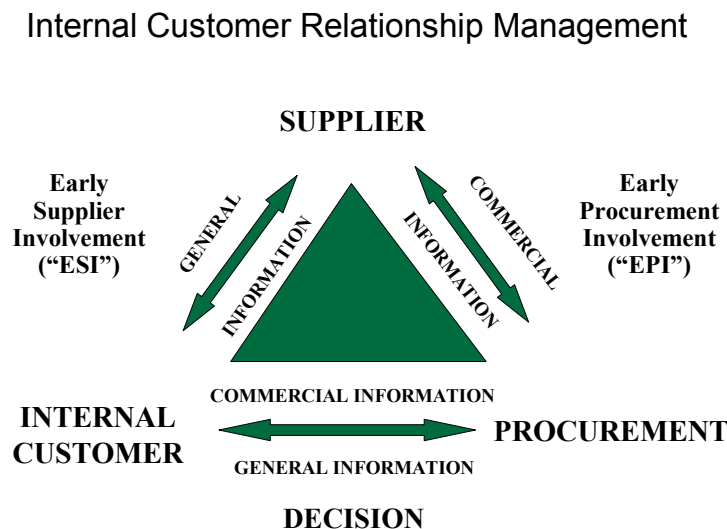
**A strategic approach to Contracting Management empowers many remarkable things.** *Senior management will be impressed* by the security of a well-run business. *Internal customers will be pleased* by reduced cycle times and improved supply-chain performance. And the *supply management group will have an easier job* of managing enterprise expenditures.

**Early Procurement Involvement & The Strategic Sourcing Process...** by Robert Dunn, C.P.A., C.P.M.

The success of any Strategic Sourcing initiative depends largely upon Early Procurement Involvement (“E.P.I.”). If we convince internal customers of the need for our services, the Procurement organization can be engaged at the front end of the process where greater savings can be achieved.



Procurement’s early involvement is based upon developing an internal customer relationship program that can deliver Supply Chain Value in response to the internal customer’s needs. *The Internal Customer Relationship Management Model below illustrates the communication linkages between Procurement, our Internal Customer, and the Supplier:*



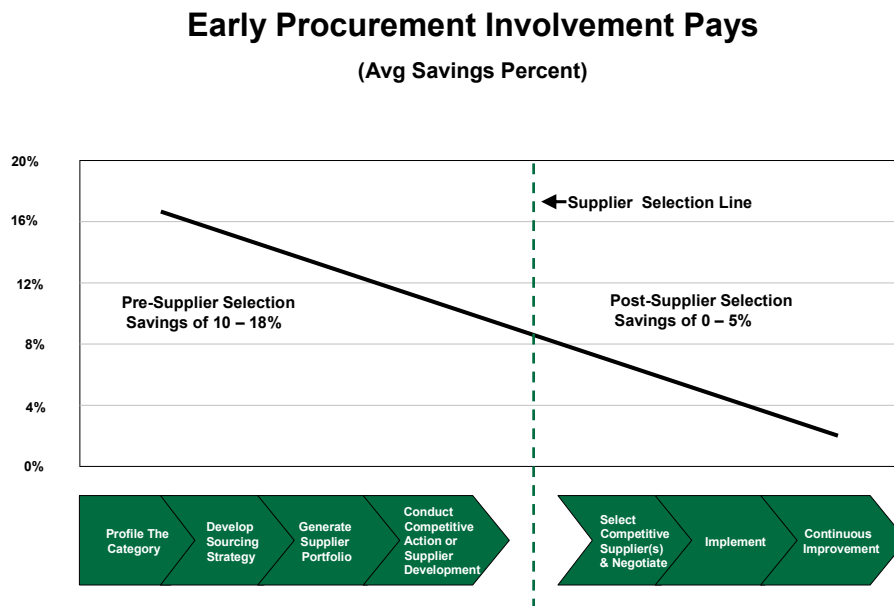
Communications involve both a sharing of General Information about a specific commodity category and Commercial Information related to pricing, terms, & conditions, which together will form the future business relationship.

Dialog about General Information can be healthy for suppliers and customers, but often leads to sharing of Commercial Information where procurement needs to be involved. Supply management groups that have the greatest impact, are usually those that have formed strong relationships with both suppliers and internal customers. Without Early Procurement Involvement, however, this is often not the case....because internal customers and suppliers transition from *General Information* to *Commercial Information* without procurement input. That leads to lost objectivity and increased acquisition costs.

**So how does Early Supplier Involvement (ESI) work?** ESI is the controlled and value-added involvement of suppliers in helping a buying organization understand what their industry can offer (rather than sending out a RFP for Oranges to the Apple Industry). ESI is having suppliers participate in the design process to reduce the overall cost of the final product. It's having strong-enough relationships with a key supplier that they call the Commodity Manager when an internal customer tries to bypass procurement to place an order. It's creating a balanced involvement with suppliers.

**How does Early Procurement Involvement (EPI) work?** EPI is developing procurement's relationship with internal customers so we are part of planning an acquisition. It's helping the customer to identify their requirements, and proceed through the Strategic Sourcing Process. It's being on the train from the beginning, rather than trying to leap onboard after it's already left the station.

**The following chart illustrates the cost benefit of EPI in the Strategic Sourcing Process before supplier selection and contract negotiations...**



The ideal situation is to have procurement involved from the start, supporting such activities as:

- Profiling the Category
- Developing the Sourcing Strategy
- Generating the Supplier Portfolio (i.e. Bidders)
- Conducting the Sourcing Process
- Negotiating the Acquisition
- Choosing the Implementation Path

***Building internal customer relationships will drive Early Procurement Involvement (EPI). But remember, strong customer relationships take time to nurture. They are earned, not mandated.***

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### **The Sarbanes-Oxley Act ...by Mark Trowbridge, C.P.M.**

**Numerous corporate scandals have shattered the confidence of investors.** Accounting fraud or leadership failures were linked to companies like Worldcom, Tyco, Enron, Xerox, and Global Crossing.



The Securities and Exchange Commission (S.E.C.) implemented the Sarbanes-Oxley Act in 2002 to require that corporate managers ensure their firms have operational systems of internal accounting controls that accurately reflect the financial well-being of the company. Sarbanes-Oxley put in place higher levels of responsibility for the leaders of publicly-traded corporations.

The impact of Sarbanes-Oxley is even beginning to cascade down to *other types* of organizations. Whether or not directly impacted by the Act, senior officers across many industries are taking notice. Stricter accounting rules & processes are beginning to be implemented with some Pre-IPO Organizations, Not-For-Profits, Privately-Held Companies, and even Governmental Agencies.

**Question** - *So what can this mean for today's procurement leaders?* **Answer** - *Supply management must also manage its business with "operational" internal accounting controls. So don't be surprised if your executive board begins to ask you things like...*

- ***Can we identify all external supplier commitments (i.e. dollars committed)?***
- ***Can we track key data elements about contract obligations (Effective Date, Expiration Date, Evergreen Renewals, Annual Dollar Value, Tiered Pricing Factors, Volume Obligations, Insurance Policy Certifications, etc)?***
- ***Do we have good controls in place to ensure capture of lowest-available-cost?***

- ***Where are all our supplier contracts located?***
- ***How do we track savings?***
- ***Do we have controls in place to ensure full value is received for every dollar spent?***
- ***Can we accurately track supplier expenditures?***
- ***Is all procurement data aligned with organization legacy systems (i.e. G/L, A/P, F/A) to ensure accurate financial reporting?***

If these types of questions can't be answered quickly and accurately by Supply Management, senior executives will turn elsewhere for the answers. *And with their own jobs on the line, they will no longer be satisfied with incomplete answers.*

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**Editor's Note:** **Strategic Procurement Solutions'** objective is to provide top quality supply management services to client organizations in the private & public sector, and to enable those clients to exceed their internal users' expectations regarding promptness, price, and quality. One means of doing this is through this educational newsletter, which provides bi-monthly articles about "Best Practices" in procurement. Contact us at [www.StrategicProcurementSolutions.com](http://www.StrategicProcurementSolutions.com) for more information about our services, or if you do not wish to receive this newsletter in the future.