



6 SIMPLE PRACTICES FOR PERFECT PURCHASING

A tough economy and competitive markets require every company to pay less, but get more. Here's how to do it

Chances are you don't pay much attention to procurement. Yet, taking a strategic approach to buying the goods and services needed for your operations can substantially improve your business results.

One SME that took such an approach, including consolidating its purchasing and building strong relationships with key suppliers, reduced costs by 5% and boosted profits by almost 30% in just six months. This is a typical return on the modest investment of time required to buy smarter.

The benefits of a smart procurement strategy go beyond the bottom line. Securing preferred treatment from your most important suppliers can allow you to deliver high-quality products and services more consistently, take your new offerings to market sooner and gain preferred access to suppliers' hottest new products. The ultimate reward is twofold: higher cus-

tomers satisfaction and sales.

None of the following steps to implementing an effective procurement strategy requires inordinate effort or specialized skills. If these steps strike you as being straightforward, that's because, for most firms, there's plenty of low-hanging fruit. And even if you carry out only some of these steps, you can generate significant gains in profitability and client satisfaction.

► **Use spreadsheets to spot where you can save money:** It's striking how many firms have no clear idea of what they buy. Yet, all it takes to turn up substantial cost savings is an exercise requiring basic spreadsheet skills.

First, create a spreadsheet listing every

purchase by your company over the past 12 to 18 months, including the good or service bought, supplier, cost and product category. Use the "Sort" function to group together purchases that fall into the same category, then sort again by supplier. Next, look for opportunities to save money by consolidating your procurement.

These opportunities come in two types. The first exists if you're buying the same or equivalent items from various suppliers at different prices. It's common to discover that you're purchasing, say, pens for 50¢ each from one supplier and equivalent ones for 75¢ from another. My experience in working with clients to develop a smart procurement strategy shows that you're almost certain to save at least 5% to 8%—perhaps even 15% to 20%—by switching to the lower-cost supplier.

Most firms that carry out this exercise also discover a second type of opportunity. This exists if you realize that there's a supplier that could provide various products that you now purchase from multiple suppliers. In return for giving this supplier more business, you can obtain lower per-unit rates that typically reduce your total outlay by 4% to 6%.

► Create a framework for buying decisions:

Most SMEs don't have a set of criteria on how to handle procurement; instead, they just buy stuff. Rather than let your people wing it, you should provide direction to ensure that they follow best practices. This doesn't mean burying them in procurement rules; just adopting a fairly brief set of guidelines.

These should include clarifying which purchasing process your employees should use depending on what they're buying. If they're not sure what they want to buy and want to test the market, a Request for Information works best.

If they know what they want and simply want the cheapest price, a Request for Quotation is the best option. And if they know which outcome

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they want to achieve but not the best way to achieve it, they should craft a Request for Proposals. Your guidelines should specify that when a purchase is small or urgent enough, the employee can skip these documents and simply contact one supplier.

Your guidelines also should specify a minimum above which a more formal process kicks in. You might state that for purchases

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of at least \$50,000, the employee responsible must obtain three written quotes that include information about X, Y and Z. You also should specify how you'll evaluate these quotes, such as departments will have input into buying decisions that will have the most impact on themselves.

► **Focus on suppliers that truly matter:**

As outlined below, you can achieve business-building results by working closely with key suppliers. But first you have to identify the five who are worth spending a lot of time on.

Exclude those from which you solely buy commodity goods, such as office supplies, because in these categories you should simply seek the best price. Then, compile a list of your most important suppliers, based on two criteria: those you spend the most with, which usually offer the most scope for cost savings; and those most crucial to the success of your business. A company that provides something vital to keeping your business running and your clients happy counts as a key supplier even if it doesn't rank highly by dollars spent.

► **Brainstorm and bargain regularly with key suppliers:** Meet with them two to four times per year in order to build close partnerships. Use these meetings to review their performance and any challenges that have arisen. And tap into their expertise to find ways to work together better. Most suppliers have plenty of good ideas that you're unlikely to hear unless you ask.

One way to uncover such ideas is to ask suppliers about their best customer relationships, what makes these relationships so strong and how you can emulate them. Also ask what they need from you in order to improve in areas such as delivery times. If, for instance, you're developing a new product, providing the supplier of an essential component with key specs sooner may let you to get to market more quickly.

As well, you should use these meetings to negotiate better terms. And don't assume you have no bargaining clout if the supplier is a much bigger company than yours. You also bring a lot to the table. If your firm is growing fast, you represent higher future purchase volumes; you could provide referrals to potential clients; or you might be an industry leader that other companies want to be associated with. In return, ask for benefits such as bigger volume discounts, extended warranties, better payment terms, preferred access to new products or even input into product development.

► **Put it in writing:** One measure of a wise procurement strategy is the percentage of total spending covered by formal contracts. Typically, a best-in-class company will have 80% to 85% of its spending under contract—with the rest consisting of small, one-time or emergency purchases that aren't worth negotiating contracts for.

As a legally binding document, a contract helps you manage the risk of dealing with a supplier, holding it accountable for service levels such as delivery times, upgrades and system availability. In return for making a commitment to buy a specified amount, you can secure access to preferred pricing and service guarantees. But be careful not to sign a contract that is inflexible, such as a deal to buy exclusively from a supplier that locks you in even if you're unhappy with its performance.

► **Calculate both kinds of ROI:** Procurement is about far more than obtaining the best price. It's also vital to measure something that most firms don't: the value generated by a purchase, both financial and non-financial. Gauging the former requires making a return-on-investment calculation—although there's no single formula that applies across all sectors—to assess the savings and/or sales boost against the purchase price. You may achieve a good ROI because, say, what you're buying allows you to produce your product or service for much less or because a lower defect rate on a key input increases client loyalty.

Sometimes, non-financial benefits are more important, even if you can't express them numerically. Here, you need to ask yourself how the purchase will make your company better off. Buying new software may free up more time for your salespeople to talk to prospective customers. An HR consultant's training sessions on employee feedback may help your firm retain more top-notch people. And developing a strong relationship with a highly reliable supplier of an essential input may provide a benefit that's tough to quantify but worth a great deal: reducing stress levels for you and your entire workforce.



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