institute for supply management
Materials Management Group

March 2014

MATERIALS MANAGEMENT NEWS

Inside this issue:

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Going to ISM's 99th Annual International Supply Management Conference?

Don't Miss Session FH

Resistance Recovery — The Key to Effective Resilience

Tuesday, May 6, 2014
3:00 – 4:15 PM

Resistance Recovery—The Key to Effective Resilience consists of three sections – foundations, implementation, and Q&A.

In foundations, we begin by identifying the importance of Resilience through examples. Next, we define the notion of resilience - the ability of a supply chain to both resist disruptions and recover operational capability after disruptions occur. Critical to resilience are the two properties of resistance (the ability to delay a disruption and reduce the impact once the disruption occurs) and recovery (the ability to recover from a disruption). How these two properties are implemented and used is influenced by whether the supply chain is dealing with risk or uncertainty (both of which are discussed in the session). The session then identifies and explores the eight major types of investments that help build resilience (e.g., indirect, buffers, information sharing, discovery, supply chain design, operating flexibilities, security, preparedness).

In the second section, implementation, the session draws on a panel of practitioners drawn from the MMG and Risk Management SIGS. This panel, drawing a set of prepared questions, explores various implementation issues.

In the final section, we open up the session to the general assembly.

This presentation is jointly sponsored by the Materials Management Group and the Supply Chain Risk Management Group.

Who Should Attend and Why?

Any person who is interested in resilience should attend because this session will explore most of the issues associated with resilience, from theory to practice.

* The Speakers *

Steven A. Melnyk is Professor of Operations and Supply Chain Management (Ph.D. – The Ivey School, University of Western Ontario, 1981) at Michigan State University. He has co-authored 16 books on operations and supply chain management.

Terry Volpel currently holds three volunteer positions within ISM. He is Chair of the Materials Management Group, President of ISM-Canada and serves on the Accreditation Committee of ISM. His career has spanned over 35 years in Supply Management.

Rose Kelly-Falls, Senior Vice President, Supply Chain Risk Management. As a supply chain professional and industry practitioner, Ms. Kelly-Falls has extensive management experience within small divisional startups and global corporations including Ford Motor Company and Rolls Royce North America. Her areas of expertise include supply chain risk management, supply chain strategic planning, contract management and global sourcing. □

"The Board of the Materials Management Group would like to recognize our members who work in all industries and aspects of Supply Management around the globe. The Materials Management Group more than doubled its membership in 2013 (111% increase) as others are coming to understand our value. The Board would like to welcome the new members to our group and extend an invitation to all others who wish to further the field. Join us, and together let us all make Supply Management a profession of choice and pride for those who follow in our footsteps."

Replenishment Battles — Us vs Them

Terry R. Volpel, CPSM, C.P.M., SCMP

Once upon a time, buyers fought battles against a common enemy. Evil suppliers were seen as villains who raised our prices and laughed at us behind our backs. Our only weapon was our ability to refuse to buy and that was problematic because we needed the goods for our factories. So we developed strategies around inventory management and replenishment theories to make sure we bought the absolute minimum that we needed to keep the factory running. "We have met the enemy and they are ours". (Commodore Perry 1813)

Then a brave buyer somewhere thought "I'd wonder if my supplier can actually help me." Of course, the supplier laughed, twirled his moustache and ran his fingers through his thinning, yet slicked back hair and said, "Sure thing, just tell me what you need ...".

Thus the whole supplier/buyer relationship management field was hatched and they lived happily ever after…

Of course this is a satirical tale of how suppliers and buyers' relationships have evolved over the last couple of decades. I'd like to examine some of the basics in how replenishment practices have changed as a result of the new supplier relationship models.

When suppliers were evil and we were valiant warriors protecting our employer's checkbook, the responsibility for ordering and maintaining an inventory in our factory fell to the Materials Manager. Various strategies were developed to control stock. ABC Analysis and cycle counting were developed to keep our attention on the important components most of the time. Production planners worked far enough out that Buyers had time to push orders out or pull orders in to suit manufacturing schedules. Master Schedulers shuffled production to suit material flows.

Then the magic moment happened and we thought, "Hey, let's see if we can work together". From this the <u>Collaborative Planning, Forecasting and Replenishment (CPFR)</u> model was introduced. ISM defines the CPFR as:

A collaborative process between buyer and seller involving the exchange of jointly developed sales forecasts, inventory replenishment schedules and promotion plans. Both parties benefit from these co-managed processes and shared information. (ISM Glossary of terms)

This was a huge leap forward in trust. A Buyer had to give some power (information) to the supplier and the supplier in turn co-managed the replenishment of inventory. They became partners. This was seen as a radical idea to many, but it worked and it worked quite well. As both sides became more and more used to the idea and tested it out on smaller commodity groups, the trust grew and both sides saw benefits from this renewed alliance.

Eventually this was so successful that Materials Managers thought that certain suppliers should be able to self manage certain commodity groups. This idea became known as <u>Supplier Managed Inventory (SMI)</u>. ISM defines this as:

Inventory management system that holds a supplier responsible for ensuring that stock is maintained at appropriate levels in the purchaser's facility and for replenishing items when these levels drop. Sometimes referred to as vendor-managed inventory (VMI). (ISM Glossary of terms)

The first commodities to be tested were hardware (bolts, nuts, washers, etc.) and MRO commodities such as WD40, shop towels, floor dry, etc. From this was born the vending machine phenomenon we see today where everything from Safety personal protective equipment (PPE) to drill bits and tools are dispensed from token or card activated vending machines. Suppliers make sure the machines never run out. Often the machines report usage over the internet directly into a supplier's facility. Note that while these are all used in production, few were actually "Direct" materials. The reason was that these were relatively low cost fast moving items that were essentially consumables in nature and that left the important "direct" production components in the hands of Buyers.

The most recent innovation came when Suppliers of "Direct" materials became more and more involved in forecasting, planning and inventory management. The first of these collaborations became widely known as <u>Just In Time (JIT)</u>. JIT works really well as long as we have full control of all aspects of the supply chain. Forecasting, production planning, warehousing, pick/pack, logistics…if there is a hiccup at any stage, the production line stops. Now even auto manufacturers carry (or force their suppliers to carry) a buffer inventory in case a delivery truck gets a flat tire on the way to the plant. Many suppliers built facilities (essentially warehouses) a short distance from the customer's plant so that they could carry this buffer stock.

From this concept, it was not a large leap to introduce "consignment" stock. ISM defines this as:

An agreement with a supplier to stock goods at a customer's location with the goods remaining the property of the supplier until used or sold. (ISM Glossary of terms)

There are many benefits to a Materials Manager to have consignment stock on hand but there are some things to consider before embarking on such as course.

1. It's not your stock. This seems self evident but your warehouse people, shippers, receivers and others need to know that the stock is not yours. Many suppliers will require a separate space in a warehouse (sometimes enclosed) to clearly delineate ownership. You may need to adjust your insurance to cover this inventory and allow the supplier access to inspect and count the stock periodically.

2. The agreement is a contract and needs to have an exit strategy if terminated. Does the supplier pick up the goods? Do you agree to buy the whole inventory? How much inventory is appropriate? What about damage in transit? What about pricing protections? When does the Warranty start?

Consignment works really well if both parties have a good relationship. This takes work on both parts as there are always situations that arise that can cause stress. Are you prepared if your supplier comes over at short notice and picks up half of the consigned inventory for another customer or a competitor? Remember, it is their stock, not yours. What if your supplier goes into bankruptcy or receivership and a bailiff arrives to lock up the consigned stock under a court order?

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Successful Partnerships in a JIT Environment

David Van Valkenburgh, CFPIM, CPSM, CFIM CSCP, C.P.M.

JIT's goal is to reduce or eliminate waste and improve productivity and quality by delivering on-time product, with you and your supplier acting as partners

Just-in-time (JIT) is a philosophy of manufacturing based on planned elimination of all waste and continuous improvement of productivity. It encompasses the successful execution of all manufacturing activities required to produce a final product, from design engineering to delivery, and includes all stages of conversion from raw material onward.

The primary element of zero inventories is to have only the required inventory when needed. You must reduce material movement, by having operations as close together as possible. To help improve quality to zero defects; you need to decrease lead times by reducing setup times, queue lengths, and lot sizes. It will also be necessary to revise incrementally the operations themselves; and create U-shape work cell when the process allows and to accomplish these things at minimum cost.

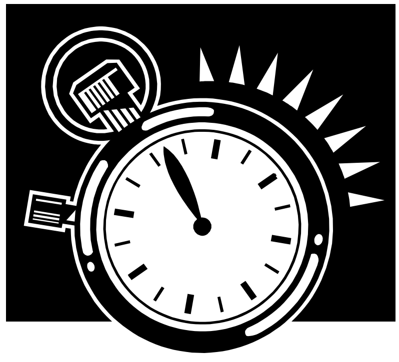
In the broad sense, it applies to all types of manufacturing: job shop and process, as well as repetitive.

What Environment Is Best for JIT?

JIT strives to reduce or eliminate waste and improve productivity and quality by delivering product on time. It has a proven track record of success for many small and large organizations around the world.

The first consideration is the supplier's performance and commitment levels to the partnership venture to deliver on time with reliable quality materials. JIT inventory control diverts the attention of the complicated work order toward concentrating on the review of the supplier.

In JIT, remember your supplier is your partner; if you expect success you must be able to depend on him/her. In addition, the successes of JIT will not be established unless you pay attention to the supplier's resource management. Communicating, performance measures, and demand requirement need to be addressed. If you don't continually record feedback and keep your supplier's performance ratings at a high satisfaction level, JIT will probably fail.



Under a traditional supplier-rating system — once you've selected you optimum supplier — begin meeting with the supplier to develop the JIT requirement. Before the supplier-selection phase of JIT implementation is finalized, a commitment from both parties must be established. A long-term relationship is essential to maintain a successful JIT environment. Reducing cost through lowering inventory, increasing quality, and, at the same time, decreasing lead time, is not guaranteed.

Engineering changes should not be the responsibility of the supplier. The commitment is long-term, not short production runs, with various changes over a long period of time. The supplier profit usually does not materialize until after 50 percent of the order is produced and shipped. If continuous changes in tooling and setup are needed, the supplier must be reassured and compensated for it.

Some suppliers probably will produce the full production run but ship on an "as needed" basis. This will eliminate excessive setup and enable the supplier to manufacture the next product or handle the next production run.

The supplier must continue to give the best possible price while making a profit. Meanwhile, the purchaser must not trade off the relationship if he/she receives a different quote for a few cents lower from a different supplier. The partnership is long term, and this is why supplier selection is one of the most important aspects in controlling the success of purchasing in a JIT environment.

The suppliers must work as hard as we do to reduce their lot sizes by giving the same close attention to setup times that we do.

Education in JIT must be accepted by the employees who will be affected by its use. Concepts of inventory reduction, quality acceptance, and customer-service levels need to be understood and the benefits of the project continuously reviewed and measured to assure its effectiveness. Feedback from the employees will help achieve the goal you are trying to reach.

Advantages and Disadvantages

Remembering that JIT is a philosophy for reducing waste and improving quality, so it must be treated as such. It can easily be controlled with minimum cost and still be rewarding. The majority of the cost includes initial labor and time to maintain the process. There is no real set-up cost to purchase software, nor is there a need to hire a consultant.

As for disadvantages, many suppliers do not want to commit to a long-term relationship where they are "married" to only one customer. The supplier is at jeopardy if something should happen to the organization. The risk will be substantially higher when supplying one product to one customer.

Another concern is quality assurance. Tolerances and standards are incorporated in the beginning and must be maintained. If closer tolerances are required after production has started, additional cost will be incurred by the supplier.

Most deviations can't be predicted precisely. If they are expected during manufacturing, they must be reviewed with both parties involved to eliminate any doubt or concern of failure.

Continue to review feedback and measure performance levels, and keep the basics in mind when you try to implement a JIT system: Deliver the right part at the right time and at the right price.

David Van Valkenburgh has over 25 years experience in the manufacturing/production industry, David has worked as a Design Engineer, Manufacturing Manager and is currently employed as a Materials Manger for Oceaneering International, in Baltimore Maryland. David holds a B/S degree in Manufacturing Engineering from the New Jersey Institute of Technology. He is also Certified Fellow in Production and Inventory Management from APICS, Certified Professional in Supply Management and Certified Purchasing Manager from ISM and Certified Federal Contracts Manger from NCMA. David currently serves on the Board of Directors for Baltimore ISM affiliate and also serves as Materials Management subject matter expert for Institute for Supply Chain Management International.

David can be reached at d.vanvalkenburgh@oceaneering.com for questions or comments. □

Welcome to the Post-Sourcing Era

David Clevenger, Corporate United

HOW PROCUREMENT CAN REMAIN RELEVANT IN THE POST-SOURCING ERA

In a recent article in Barron's on corporate earnings trends, Thomson Reuters earnings analyst Gregory Harrison is quoted as saying, "…profit margins are holding up better than analysts thought, likely because companies are still cutting costs to make up for the lack of revenue growth. The question is how long can they keep doing that?"

That same question is no doubt also being asked inside companies. With the slow global economy still constraining corporate revenue growth, procurement executives are under pressure from top management to continue to identify savings and cut costs.

Companies have successfully trimmed their operational budgets through such proven initiatives as strategic sourcing, right-sizing their workforces and shifting production and back-office work to emerging markets. However, most of these programs have already been optimized, and further returns will be diminishing at best.

Will procurement be able to continue to deliver?

Welcome to the Post-Sourcing Era

The procurement function has increased in importance in most corporations over the past two decades as a result of the savings delivered through strategic sourcing. However, that easy to grab, low-hanging fruit has already been harvested at most companies. When you get to the third, fourth or fifth generation of a strategic sourcing initiative on the same category, any further gains will be unlikely to offset the cost of the sourcing effort or even justify the disruption of changing suppliers. And yet, strategic sourcing is where many procurement departments continue to focus their time and energy.

This needs to change.

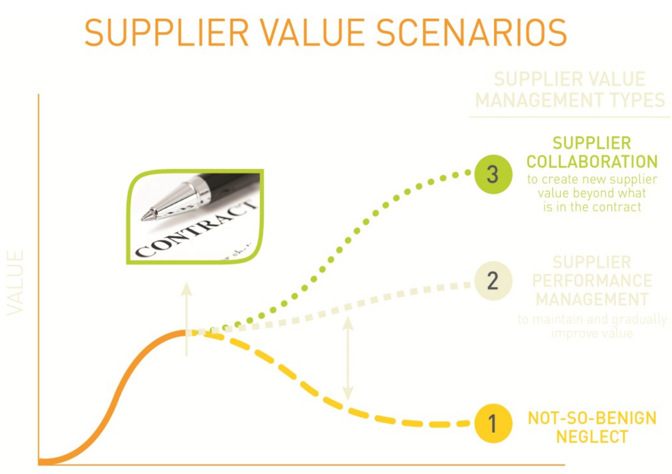


Image Cutline: As shown by Geller & Company, strategic sourcing savings can quickly erode if contract management and supplier collaboration are neglected. For example, with a category such as office supplies, 20 to 40 percent of the covered products will change each year. A specified product is no longer available and with no alternative at the same price point, so a more expensive option is substituted and the savings revert to the supplier.

As the supplier value scenarios chart above illustrates, there's a limit to the value that strategic sourcing alone can deliver. Without rigorous supplier performance management, 75 percent of sourcing savings can disappear within just 18 months. And creating value beyond what is in the contract will require new levels of supplier collaboration.

So welcome to the post-sourcing era.

THE CHALLENGE

Many companies do a reasonably good job of contract management and supplier collaboration in direct sourcing, but this is definitely not the case with indirect goods and services. According to the Aberdeen Group, the average organization only realizes and implements 22 percent of negotiated indirect cost savings.

LEVELS OF INDIRECT PROCUREMENT ACHIEVEMENT

Definition of Maturity Class	Mean Class Performance
Best-in-Class: Top 20% of aggregate performance scorers	• 83% of spend under management • 82% rate of procurement contract compliance • 70% of identified/negotiated savings are realized and implemented
Industry Average: Middle 50% of aggregate performance scorers	• 68% of spend under management • 63% rate of procurement contract compliance • 22% of identified/negotiated savings are realized and implemented
Laggard: Bottom 30% of aggregate performance scorers	• 28% of spend under management • 13% rate of procurement contract compliance • 3% of identified/negotiated savings are realized and implemented

Image Cutline: Aberdeen Group uses three key criteria to distinguish best-in-class from industry average and laggard organizations: rate of spend under management, rate of procurement contract compliance, and the percentage of identified and negotiated savings that are actually realized and implemented.

Procurement Obstacles

Corporate procurement would seem to be the logical function to bring indirect spend under management. But too often it's involved in just a handful of traditional indirect categories, and the involvement typically ends when the contract is signed. Other corporate budget holders generally perceive procurement as a tactical support function, not a strategic partner, and keep it at arm's length.

This view is not without justification. The reality is that the indirect procurement function often has limited resources, lacks market knowledge and technology resources and is reactive and time-pressured. No wonder it has limited buy-in from functional heads and senior management.

Additionally, most companies don't have the diverse skill sets necessary to source and then adequately maintain contracts, which are truly two different roles. And there's a chance that they have adversarial, or at best, unengaged relationships with their indirect suppliers. True collaboration is essential in realizing added value beyond the contract. You want suppliers to work with you and not always feel they need to protect their profit.

Many chief procurement officers acknowledge this. In a 2012 NelsonHall study, nearly a third of respondents ex-

(Continued on page 5)

pressed very high dissatisfaction with their indirect sourcing capabilities. Nearly one quarter (24 percent) were highly dissatisfied with their category management capabilities.

The Solution

The good news is that some procurement departments have successfully tackled the indirect procurement challenge and become business partners within their organization. According to the same Aberdeen Group study, approximately 20 percent of companies stand out as best-in-class performers. These companies on average report 83 percent of spend under management, 82 percent contract compliance and have realized 70 percent of identified and negotiated savings.

And these categories are not static. In a 2013 survey of procurement executives by Corporate United, 87 percent said the percentage of indirect spend under management by procurement in their company has increased over the last three years.

HOW TO REMAIN RELEVANT

If procurement professionals are to remain relevant in the post-sourcing era, they must find a way to advance to best-in-class performance and seize the tremendous savings opportunities in indirect procurement. To do this, they must think differently about their internal and external relationships and how the indirect procurement function is structured.

1. Sell your value. Internally, procurement professionals need to assume their responsibilities more aggressively and sell their value from a position of confidence if they are to expand their influence into areas outside the traditional indirect categories. Touting better buying skills, procurement's standard approach, is rarely effective. Every function believes they are skilled buyers in their own space.

2. Build solid relationships. By focusing on building relationships with functional spend owners and understanding their priorities; procurement can extend their influence beyond the traditional categories. For example, the HR department wants to see added value and best-in-class solutions, not a mediocre contingent labor provider who happens to come at a lower price. And most marketing departments are not motivated by cutting costs, but would be delighted to be able to free up budget dollars they could redeploy elsewhere.

The other critical internal relationship is with the finance department. The challenge is in quantifying non-sourcing savings: continuous improvement and the impact on total cost of ownership. Procurement needs to work with the CFO in the planning and budgeting phases to help create realistic, achievable numbers—and help them understand how those numbers were determined.

3. View suppliers as partners. Externally, the way procurement thinks about suppliers also has to change. Companies must show they are serious about treating suppliers as partners, not adversaries. Over and over we see that trying to squeeze more from suppliers is ultimately counterproductive. They will either find ways to protect their profit, walk away from the relationship, or be driven out of business. Value comes from having best-in-class suppliers working jointly to find savings opportunities, simplify processes and improve utilization.

4. Organize for success. In addition to improving relationships, procurement officers also need to ask if they have the best organizational structure in place to address indirect spend, see below graph. A centralized structure will only be effective if it has the necessary resources – broad category management expertise and tools to:

- Analyze spend
- Manage contracts
- Track compliance
- Measure performance
- Execute continuous improvement

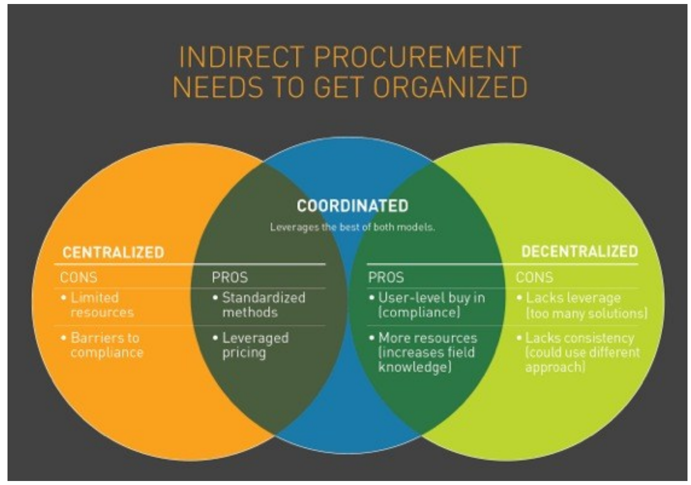


Image Cutline: A coordinated indirect procurement structure is more effective in leveraging indirect spend than either a high-cost centralized system or a decentralized structure that fails to leverage best practices and best suppliers across the organization. It takes the pros and avoids the cons from each model.

Most procurement departments don't have those resources and are unlikely to get them. Consequently, the most effective structure tends to be a coordinated one—neither centralized nor decentralized—that balances local requirements and aggressive corporate targets.

READY TO THINK DIFFERENTLY? CHOOSE YOUR OPTION

Of course, indirect category management expertise and analytical and management tools are still required. That's why the decision to pursue the untapped savings opportunities in indirect procurement often leads to a search for external assistance.

Companies can choose from a variety of strategies to maximize the indirect spend value proposition.

The primary external options include:

1. Engage a management consulting firm,
2. Replace internal capability with a business process outsourcer (BPO), or
3. Join a group purchasing organization (GPO).

Consulting or custom sourcing options are best suited to one-off projects where a depth of subject matter expertise is critical.

But they are very expensive and rarely provide any ongoing management support.

BPO options represent a greater risk due to the expense, longer lead time to results and more comprehensive nature of the engagement. Once a company has replaced its internal resources with a BPO, it is very difficult to go back.

Many are finding just the right balance with a GPO.

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THE UNIQUE APPEAL OF A GPO

The modern GPO is unique among the various leveraged approaches. A GPO is not a supplier, consulting firm, software provider or procurement outsourcer. It does not serve as an outsourced provider of transactional purchasing services. It is designed to supplement, not replace, existing procurement personnel.

The GPO concept of providing cost savings to members by aggregating purchasing power has been around for years. Some large, well-funded (mostly vertical) purchasing consortia arose back in the dot.com era (for example, Covisint and the O'Hare Group), but fell short of being adequately collaborative with either their members or their suppliers. Lessons learned from those failures helped a new generation of organizations reinvent the GPO concept for the post-sourcing era.

In line with the Geller model referenced earlier, today's GPO is based on the application of leverage to all aspects of the procurement process, from sourcing through supplier management and supplier collaboration. GPOs are generally compensated by participating suppliers based on a flat, predetermined administrative fee applied to the gross sales. Members of course benefit from hard-dollar savings through their participation in pre-negotiated agreements, but there are important additional benefits:

1. Speed to market. Because the leveraged supplier contracts are pre-negotiated, members are able to quickly realize the savings identified in the assessment process. The members benefit from the GPO's built-in analysis, implementation and account management support functions and completely bypass the request for proposal and sourcing processes. Consequently members avoid sourcing exercises, which can take up to 500 hours to complete, not including implementation.

2. Expanded spend under management. The broad array of pre-negotiated, relevant agreements that GPO members have access to can prove to be a valuable tool in internal efforts to expand spend under management. They give procurement a reason to open a meaningful dialogue with colleagues in HR, IT and other functional groups and become a strategic business partner across the organization in areas outside traditional categories.

3. Resource flexibility. By taking advantage of multiple category agreements in the GPO's portfolio, members gain the flexibility to redirect their own limited internal resources toward other strategic initiatives or spend categories, potentially generating more savings.

4. Contract management. A GPO works closely with all of its suppliers on an ongoing basis to ensure that the terms of the contract are being followed and to seek out opportunities for improvement and potential savings. It conducts thorough market intelligence assessments of quantitative and qualitative factors across the portfolio of agreements. The category-specific expertise it has developed enables more active and productive management of offerings.

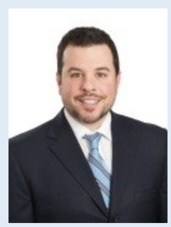
5. Purchasing power. Even large member companies realize the enhanced purchasing power of a GPO. This leverage not only impacts pricing, it also positions members as "customers of choice" who command higher service levels and responsiveness from portfolio suppliers. The collaborative relationship also facilitates continuous improvements and enables functional alignment.

6. Sharing of expertise. An effective GPO structure creates a transparent atmosphere that facilitates meaningful networking and sharing of knowledge and best practices among members. GPOs are home to a tremendous amount of procurement expertise readily accessible to their members.

AN EMERGING HYBRID SOLUTION

As CEOs and CFOs look to procurement to generate additional cost savings, chief procurement officers should seize the opportunity and think big. There are significant savings to be had in indirect procurement, but they are not low-hanging fruit. Capturing those savings means changing how procurement operates internally and how it leverages outside resources.

The modern GPO has emerged as the ideal outsourced indirect spend solution. It offers a combination of speed to market, lower cost and risk and ongoing value creation that is best suited for the post-sourcing era. It delivers what senior management is looking for, and it supports the procurement officer's objective of becoming integrated as a business partner in the corporate value chain.



David Clevenger
Vice President, Corporate United

David is responsible for strategy and organizational development at Corporate United, previously directing strategic sourcing and supplier management functions, as well as operations, category management and marketing.

Since joining Corporate United in 2004, the company has grown from 40 to more than 200 member companies.

David is a seven-time recipient of Supply & Demand Chain Executive magazine's Executive 100 award and has been named one of their "Pros to Know" for seven consecutive years.

Prior to joining Corporate United, David spent four years leading the global MRO and services sourcing practice at FreeMarkets, Inc., a leading software and service provider. There he developed widely adopted strategies for functional alignment and assisted in developing total-cost bidding technologies, for which he holds a patent.

David is an expert in indirect spend management and functional alignment and has extensive experience in e-sourcing and supply-chain consulting.

David is a regular writer, contributor and presenter. Topics include the relevance of group purchasing, his vision for the advancement of the procurement discipline, indirect sourcing and functional alignment.

10 GPO MYTHS, DEBUNKED

1. **If GPOs are so great, why haven't even more companies signed on?** GPO participation may be higher than many realize. A 2011 study by the research firm Spend Matters found that 15 to 20 percent of the Fortune 1000 currently uses a horizontal buying consortium, and 85 percent of the time they are seeing real savings of more than 10 percent. Those percentages have almost

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certainly increased since 2011, but a GPO isn't always right for every company. Some may not be a good fit due to a less collaborative culture. In terms of industry type, though, there are few that could not benefit from a GPO arrangement.

2. **A GPO cannot accommodate my unique requirements.** In fact, GPOs operate within a flexible framework that allows participants to enjoy all the benefits of leverage while retaining the ability to negotiate adjustments and incorporate options that address specific needs. GPO members participate fully in the structuring of the supplier agreements and understand the need for flexibility.

3. **A GPO will lock me in.** Participating members are not obligated to utilize a GPO holistically. Members leverage the category offerings and other services based on their unique needs and where the most value can be driven.

4. **We can realize greater savings on our own in some of these categories.** This point actually illustrates an important advantage of GPOs. In the engagement process, new GPO members determine which of the 25 to 30 pre-negotiated agreements they will participate in based on their estimate of the savings. There is no requirement that a member participate in all or even most of the categories offered.

5. **Let's say a company identifies five categories that are clear choices and five more where the savings are good but not quite as high.** It will still make sense to shift all 10 categories to the GPO. This is because in addition to the hard savings, the company is bypassing the time-consuming RFP and sourcing processes and gaining the flexibility to impact other areas of spend and focus on more strategic initiatives.

6. **GPOs are compensated through supplier rebates but the customer can't see the amount.** Not true. Most GPOs operate on administrative fees applied to gross sales that are incorporated into the pricing offered to members. The compensation is transparent to participants.

7. **GPOs are geared to encourage more purchasing, not less, which is the best path to savings.** Not so. Successful demand management strategies are not developed by procurement in a vacuum. Functional spend owners work with their supply partners to better understand the needs of their end users and create approaches that satisfy their requirements while reducing excess usage. GPOs facilitate these discussions by providing benchmarks across their membership so that individual members can establish achievable metrics.

8. **A GPO is going to come between my team and our suppliers and seem like a threat.** GPOs are sensitive to the perception that they are going to be viewed as an impediment or a competitor. That is simply not the case. The participants control the GPO, not vice versa. Think of the GPO as extra hands who are taking on selected non-core categories, thereby enabling your team to focus on higher-value strategic sourcing.

9. **A GPO means switching suppliers and that is always painful.** Corporate procurement initiatives are about saving money, so yes, some changes will be necessary. But in our experience, companies tend to be happy with their new suppliers. A GPO will have processes that smooth supplier rollouts to new customers. My internal departments won't be happy about having low-bid suppliers imposed on them. Because of the total cost philosophy, a good GPO's preferred suppliers are likely to be best in class, not corner-cutting low bidders. Members don't have to worry about contract enforcement; the GPO provides that service. If you think you will have less leverage with your new GPO suppliers, you are wrong. Because of a GPO's buying power, you will be regarded as one of your suppliers' largest, most important customers.

10. **Why would I want to risk reducing my own relevance by outsourcing procurement?** As a hybrid outsourced solution, a GPO actually addresses this concern rather than creating it. By partnering with a GPO, the procurement function expands the scope of its control and enhances its relevance to the organization.

This one's not a myth.

GPOs don't provide a comprehensive procurement outsourcing strategy. The GPO model is not about covering every one of the 150 to 200 different areas of indirect spend. Rather, a GPO focuses on driving value on a broad set of categories that can have a meaningful impact for a large number of participants. Partnering with a GPO not only generates hard-dollar savings in the selected categories, but also enables corporate procurement to redirect freed-up resources to focus on other,

Replenishment Battles — Us vs Them (continued)

All of these can be worked out when the contract is drafted. Each side must be honest about what they expect and require out of the deal. Only then can it work both ways. Legal advice is recommended as well as there may be local or state laws that need to be examined.

What's next? Logically the trend should continue, allowing our suppliers more and more control over design and production until they take it over completely. Our functions would involve Branding, Marketing and Distribution. We could close our factories and still sell our products…wait a minute…could it be? "*We have met the enemy and he is us?*" (Walt Kelly for Pogo 1970) Just a thought…□