Strategies for Successful Procurement Partnerships
Part 3 of a 4-part series

Total Cost of Ownership

Unite Cross-Functional Teams

KEY TAKEAWAYS

Assess Where You Are

- Look honestly at where you are, balance cost and quality.
- Learn from successful industry best practices.

Determine What Key Stakeholders (Actually) Need

- Ask the right questions to build an effective picture of total cost of ownership.
- What do cost savings look like to stakeholders?
- What financial pains are caused by vendor / supplier products and services?

Total Cost of Ownership (TCO) Criteria

- 4 high impact criteria for TCO.
- Place more responsibility with key suppliers to achieve better TCO.

By Joe Williamson
Senior Director of Global Sales and Customer Operations

"Real savings not only require a change in source, but a change in behavior."

-Paul Rogers, MCIPS

Procurement expert Paul Rogers tells a simple story that captures the value of Total Cost of Ownership (TCO). Paul's story takes place when he worked in procurement for a major hospital. As a healthcare facility, all employees were frequently required to wash their hands. The common purchasing practice was to buy the cheapest paper towel – and buy a lot of them. The problem? Because of the inferior, thin-ply product, hospital employees grabbed three or four paper towels instead of just one or two.

Upon closer analysis, Paul decided to buy a higher quality of wipes – twice the cost – and in the end, usage eventually fell an impressive 300%.

The two big lessons here are:

1. Value is not just about price – it's about usage

2. Real savings require teamwork within an organization

Let's take a closer look at lesson #2: Paper towel usage didn't decrease right away. What happened is that even after the new, higher-quality hand towel was purchased, employee behavior remained the same. They kept taking three or four towels. It was Procurement's responsibility to get everybody across the company on board with procurement's mission. In this case, to **inform and instruct** employees to take fewer of the new, high quality paper towels. Shortly afterwards, hospital employees recognized the change and adjusted their behavior.

This is when usage fell 300%.

Paul Rogers states the essence of including your own team in executing a strong Total Cost of Ownership process: *"Real savings not only require a change in source, but a change in behavior. You can't claim a price savings if you don't manage the change in user behavior as well."*

Changing User Behavior Means Getting Key Stakeholders – Including Your Boss – to Recognize Their Vital Contributions to Total Cost of Ownership (TCO)

Years ago, it was simple. As long as purchasing found and chose the lowest-priced product or vendor – they were doing their job. TCO as a smart business practice has grown steadily since the late 1980s when IT industry analysts first began to discuss the differences between computer system prices vs. long-term computer system costs.

Today, most companies recognize the value of TCO decision-making tools. That's the easy part. Putting it into practice – that's the hard part. The challenge is to implement TCO analysis systematically across a company – which requires you to gather input and apply it to the TCO analysis model that represents everyone's best interests.

Strong Procurement Leadership Will Result in the Best TCO Model

The first part of a successful TCO practice is developing the right model. This criteria addresses goals *across your company.* Your research, experience and insight – including your deep, well-informed discussions with your company's key stakeholders – will result in the best overall TCO analysis model.

It will require strong, organized, proactive leadership – a real serious mission to convince your own company's key leaders that your approach to procurement represents *their* goals and the *overall corporate mission, too.*

The idea of procurement leadership in seeking input from colleagues in legal, engineering, quality assurance, manufacturing and even the CEO might seem self-defeating. Here's an approach that inspires success: Team up with buyers, purchasing agents and others on your team with the enticement that they're part of something bigger and better – actions that lower cost, reduce risk, and create efficiency by consolidating suppliers. Build credibility for your colleagues. Make them heroes!

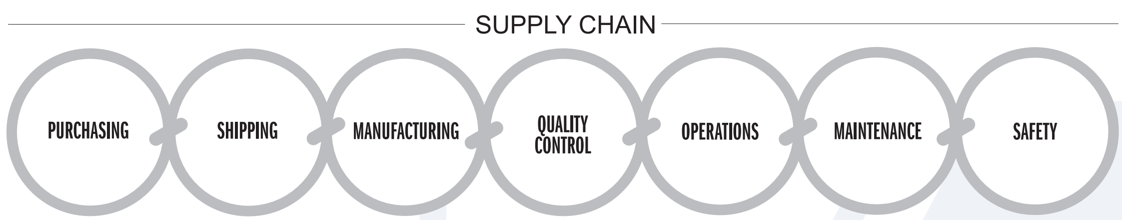
> **Reaching out in partnership to other areas of the organization is not just a smart move in optimizing procurement practices. Bringing these other stakeholders with you is a great career positioning step!**

Primary Benefits of Understanding and Implementing TCO

1. Procurement is liberated from being pigeonholed into a process that just goes cheap. The long-term consequences of "going cheap" will be costlier as a result of other problems such as inferior quality, longer lead times and even legal consequences.

2. Create wins across the organizational chart, with procurement driving future, sustainable success.

It is common SRM wisdom to build strong strategic **relationships with suppliers**. It's often overlooked that the pathway to good SRM (and great suppliers) is **building strong strategic relationships with key stakeholders** in your own company.



Your own part of the supply chain includes input and sign-off from your fellow company stakeholders

It is no easy task to gather and allocate **data and expectations from each of your stakeholders.** It requires vision and leadership – organization and dogged determination. But the result is worth it.

As a manager in a company that is a longtime supplier to clients across many industries, I have witnessed firsthand how companies benefit from great TCO processes. Not only did we enjoy rewarding partnerships with such companies, but their procurement leaders enjoy **great relationships with their own internal stakeholders.**

To forge internal strategic partners as part of your TCO, procurement must take the lead in these **three main steps:**

1. Assess Where You Are (establish your baseline)
2. Determine What Key Stakeholders Need (your discovery phase)
3. Establish TCO Criteria (develop supplier criteria and questions that addresses key stakeholder concerns)

1. Assess Where You Are

Your baseline and launching pad for a valuable discovery phase.

To understand where you are headed, take stock in whatever high-level procurement processes (or lack) you practice now. This will help you discover your current efficiencies and inefficiencies, including areas where you can improve communications. It will serve as a baseline for what new practices you adopt.

Begin the process by researching to determine your criteria for TCO. Reach out to key stakeholders in your company and identify what their supplier needs are. Accept any initial data they have to help you get started. This will not be your only encounter with these stakeholders – but it is a good start.

Remember – TCO best practices are the sum total of many departmental best practices.

How do you lead the effort to find the most important information from each aspect of business in your company? The NIGP Business Council, from the Institute for Public Procurement, recommends addressing these topics when integrating TCO into internal processes – including key questions to ask your internal stakeholders. Here are some essential categories of information to research:

- **Actual purchase price**. Even if you've been getting discounts, it is important for the procurement team to know what the actual end price is.
- **Consistent shipping**. Are complete shipments being received? Is there a waiting list for backfilled items?
- **Contract issues**. Understanding current contracts (and challenges) will help you understand your legal obligations as they stand – and provide a basis for renegotiation in the future based upon your new TCO initiatives.
- **Cooperative purchasing agreements.** These agreements often use a variety of TCO guiding principles to evaluate both supplier proposals and RFPs. Know what valuable criteria are present, and what is missing.

- **Direct and indirect costs.** It is essential for all stakeholders to inform procurement of direct and indirect costs – including fuel, freight, shipping, maintenance, labor for support teams and more.

- **Product quality.** It begins with price vs. longevity – and what's the best solution for your TCO purposes.

- **Supplier support**. Do they understand our company and how to manage a project from start to finish? Do they learn well? Can they train? How, overall, will they support your mission?

2. Determine What Key Stakeholders Need

This is your discovery phase.

Discussing the list of topics in section 1 shows your fellow stakeholders how vital procurement is to the overall TCO process. This reality helps motivate other stakeholders to fully participate in the discovery phase.

For each leader and area of business, develop questions to discover:

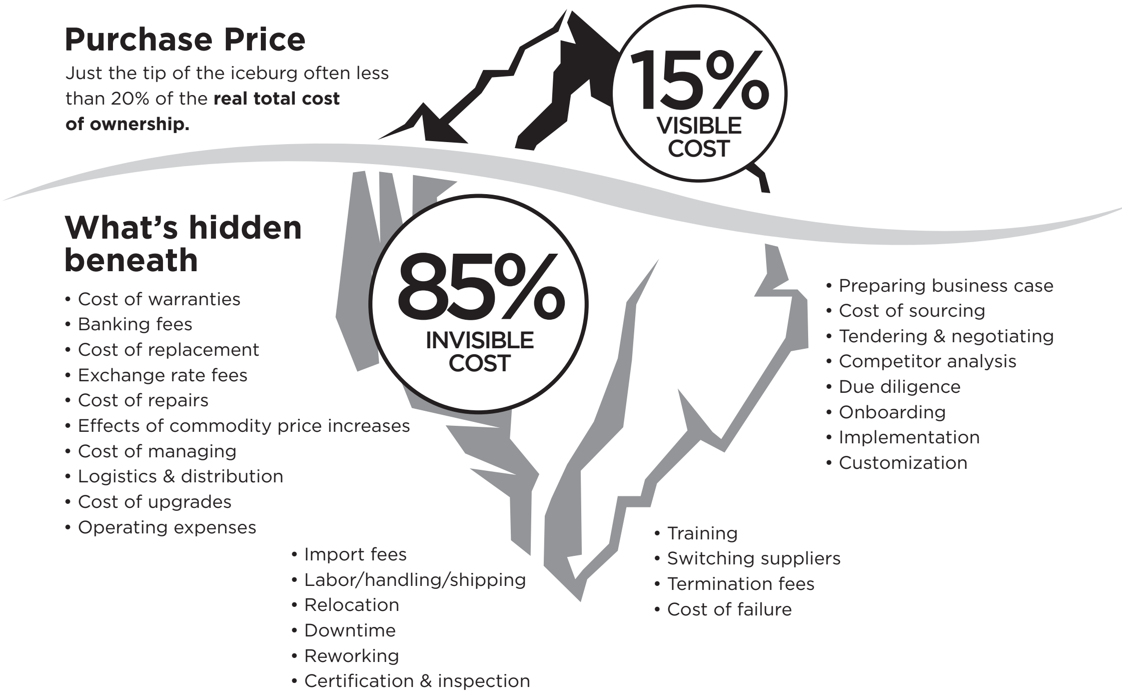
1. *What do cost savings look like to each of them?*

2. *What costs/pains are caused by vendor/supplier products and services?*

3. *Evaluate their operational needs and purchasing history.*

Beyond basic discovery

As you visit decision makers in shipping, product development, manufacturing, quality control, safety and other areas, you will discover how procurement decisions in the following areas will affect one business more than the others. Nevertheless, be sure to understand the basic subject areas and discuss each of the topics with everyone.



3. Total Cost of Ownership Criteria

Develop supplier criteria and questions that address key stakeholder concerns.

Formulating a well-defined list of goals and objectives for an organization-wide focus on total cost of ownership is not easy. Understanding where the organization is in terms of understanding TCO, then determining what key stakeholders need, is essential to get started.

Focus next on relevant criteria for a strong TCO model. Forward thinking companies have a strong grasp of TCO by first understanding a supplier's manufacturing capabilities. A proactive supplier, eager to partner with you, will ask you to consider outsourcing more of the work. Give this supplier your attention. Ask for their case study samples that demonstrate to your satisfaction just how capable the supplier is in providing TCO solutions for you.

Look to the big picture in order to receive the greatest Total Opportunity Cost value. Bring together all of the supply chain components that you can. See if you can consolidate them among fewer suppliers – and hopefully the result is that the product is made at lower costs. That's why it's important to understand a supplier's manufacturing capabilities. You may not be aware of them – and the work they do for other customers.

> **Consider outsourcing, but find out first. The details and numbers will speak for themselves. Evaluate this proposal to see if the savings matches your criteria for quality. If so, the supplier might be able to manufacture your product for less. Get numbers also on the invisible costs in the process, including electricity, maintenance and machine costs and upkeep. Could handing off a larger share of the product manufacturing save you money?**

Quality control standards

Quality Control means different things to different people in your organization. This is the chance for your fellow stakeholders to tell horror stories – success stories, too – and for you to learn from them. Ask them to create a list of questions they'd ask a supplier. Then walk through the rationale for their question selection. They will likely give you questions on these topics:

1. Ethical credentials
2. Certificates of quality initiatives such as ISO 9001 and ISO 13485
3. Capacity limitations
4. How fast they can respond to changes in demand?
5. What do they understand about our business?
6. What are the *supplier's* QA processes
7. Does the supplier ever outsource work – Where? Why?

Ask them to provide ideal answers to these questions, too, so that you can keep your fellow stakeholders' priorities high in your TCO process.

The idea is to create criteria that helps you vette suppliers with everyone's best interest in mind – and their past horror stories will go a long way in helping you nip problems in the bud.

Logistics priorities

Your intake from everybody involved in shipping, receiving and warehousing and inventory will give your TCO more perspective and depth. Develop questions to discover:

1. Are they satisfied with current analytics/benchmarking tools?
2. Can shipments be consolidated or clustered?
3. Are lead times long enough to accommodate late shipments?
4. Are they confident that all activities adhere to requirements in the Customs-Trade Partnership Against Terrorism (CTPAT)?
5. Do we have suppliers also capable of managing orders and inventory?

Point #5 is a great way to discover supplier capabilities. Here's a case study that began with a problem and resulted in a stronger relationship between OEM and supplier.

A major orthodontic equipment manufacturer needed to greatly reduce inventory replenishment lead time. As their supplier, Kent Elastomer Products (KEP) produced (to order), then shipped. For KEP, condensing that entire process required a new, just-in-time inventory system that will benefit other customers as well.

KEP demonstrated an eager willingness to partner in the client's grow by changing its procedures for storing, handling, and labeling products. The result? A just-in-time inventory process that allows KEP to receive orders and ship the same day to the OEM.

Green initiatives and sustainability

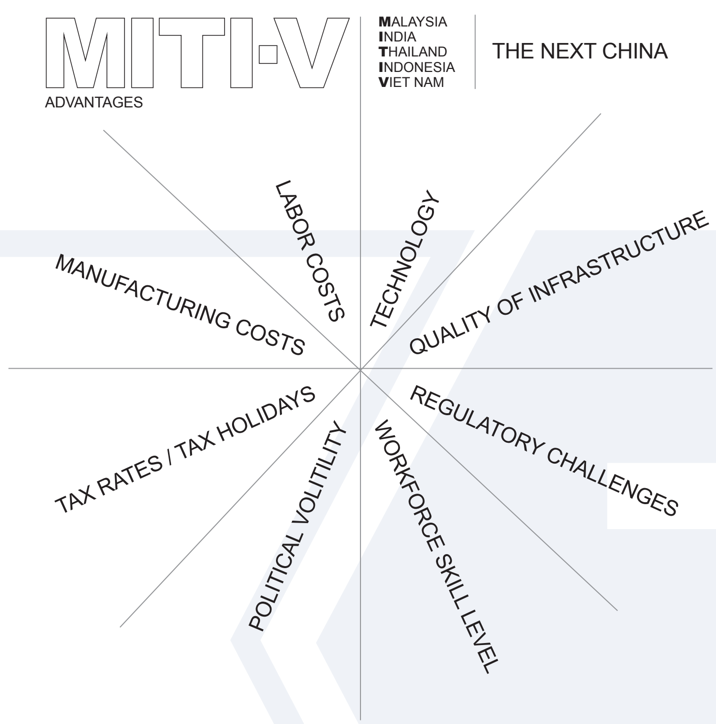
Many companies have statements and policies on corporate social responsibility (CSR), and the activities of the supply management organization certainly should be included in those policies.

Sustainability may be very important to your corporate mission – especially to specific parts within your organization. Learn all you can about their priorities and go into your discovery phase with the knowledge that you are not necessarily caught in a tug-of-war between sustainable and low-cost procurement.

Forward-thinking suppliers, trying to stay ahead of the game, have adopted lean practices in manufacturing and embraced sustainability in sourcing – and are very competitive. One such supplier is Kent Elastomer Products (KEP), where lean practices have earned EPA recognition for greatly reducing waste and energy-usage. Plus, KEP's certified lean manufacturing fulfills criteria required in many CSR policies.

Geopolitical and other conditions from overseas suppliers

The old high-level debate was: *Buy American or Buy Overseas?* The situation is now much more nuanced. Before you discuss "low cost" manufacturing overseas, be well-versed in basic details. One such scenario is "the Mighty Five" – or MITI V – the acronym standing for Malaysia, India, Thailand, Indonesia and Vietnam. Deloitte's 2015 Global Manufacturing Competitiveness Index (GMCI) names these countries as among (or soon to be) the top 15 most competitive manufacturing countries in the world by 2020. The nations are judged by various measures such as labor costs, education and skill-level in workforce to the condition of infrastructure and stability of government.



Understanding their basic strengths and weaknesses in conversation with your fellow procurement stakeholders will result in vital information from your discovery phase.

By comparison, the 2016 GMCI contends that by 2020, the United States is expected to be the number one competitive global manufacturer.

A renewed TCO process and viewpoint will most likely lead you to ask suppliers to step up their game – and I hope you achieve similarly great results to KEP's.

The Total Cost of Ownership is a big task that ultimately brings out the best in your relationships within your company and with external suppliers and vendors. It also reveals weak links – but that gives you a great opportunity to fix or replace them.

In the end, you will lead your company to develop a sound, well-informed TCO approach in which procurement becomes the guardians of quality, brand and reputation – combining everyone's best interests into a strong, unified success story.

Endnotes & Recommended References

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About Kent Elastomer Products

Kent Elastomer Products, Inc. (KEP), a subsidiary of Meridian Industries, Inc., was founded in 1960 and is a leading U.S. solutions provider for the global medical market, as well as dental, food and beverage, sports/recreation, laboratory, and industrial markets worldwide.

KEP is one of the world's largest manufacturers of precision-engineered, natural rubber latex and thermoplastic tubing. The company emphasizes continuous improvement, lean leadership training and communication. We stand alone as the only manufacturer of latex tubing in the United States.

Our headquarters, latex and custom-dip operations are located in Kent, Ohio. Extrusion operations are located in Mogadore, Ohio. Assembly, quality and shipping operation are located in Winesburg, Ohio.

Kent Elastomer Products publishes *Leader Views*, examining the best practices in global competition, lean manufacturing, sustainability and high quality values in production and services. It is available at KentElastomer.com.