Avoiding a false economy

A paper on commercial sourcing and supplier relationship management

DAV Management Limited

http://www.davmanagement.com

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Even today, as the economic outlook continues to improve, organisations tend to look more closely at bottom line costs rather than value delivered and in their quest to reduce costs and timescales, sometimes lose sight of the end goal. Many businesses will have gone through comprehensive contract renegotiations with their suppliers to reduce costs, but without necessarily considering whether or not this will enable the organisation to deliver its underlying business objectives. DAV Management has years of wide-ranging commercial, sourcing and supplier relationship management experience and has played a lead role in a number of high profile contract awards, helping customers formulate the right dealings with suppliers, from selection through to negotiating contracts and creating the foundations that foster successful, long-lasting relationships. Here, we take a look at the challenges of managing supplier relationships successfully and explain what organisations should consider and how to avoid some of the most common pitfalls.

1. Cost versus value-add

The last UK recession has had an impact on two levels when it comes to supplier relationships. First, many organisations are now reliant on supplier performance when it comes to the quality of their own execution. However, this is frequently undermined in the way that the business and procurement functions communicate and the way in which business objectives are interpreted by each party. A procurement function mandated to get the best price from a supplier may act in good faith and deliver on this objective, but the impact this has on the supplier's approach may well yield an outcome that is not aligned with the strategic imperative of the business.

When it comes to hiring external help there can be the tendency to look at the day-rate alone, rather than the value-add that those individuals might be able to contribute to the business. However, buying on price alone, more often than not presents a false economy. Potentially two people may be hired for the price of one depending on rates, e.g. £1000+ per day, but if it takes those two people three times or even twice as long to achieve a less beneficial result then ultimately they are the more expensive option. Similarly many organisations also fail to recognise that one more expensive, but more experienced person could save the company millions of pounds whereas someone of a lower rate may not even begin to recognise or generate such savings, irrespective of the number of days spent.

Of course, it is not easy to put an absolute value on the qualities that one individual is able to bring into an organisation, such as drive, leadership, experience and judgement. These are less tangible deliverables, but there is no truer saying than 'you get what you pay for' and if people have been priced low it usually means that they won't have the prerequisite skills or experience the company may be looking for. Similarly, self-employed contractors hired through agencies that provide no value added services are unlikely to have the support of an organisation to fall back on.

Over the years we have seen that with the wrong resources, projects or programmes that should have been relatively straightforward often take much longer than necessary to deliver and cost significantly more into the bargain.

The second trend that we are seeing is that customers would rather approach external suppliers or contractors and ask them to take a rate-cut rather than incentivise them in a positive way, or assess the return on investment, even when customers recognise the quality and value to the business of the service delivered. A blunt instrument of rate comparisons without taking into account the value delivered can be a short sighted approach. The effect is that, regardless of how well they perform or the business benefits they deliver, the best suppliers are rewarded in the same way as mediocre or poor suppliers - with a rate cut. Sadly for those organisations, the best resources are likely to go where their services are properly valued and rewarded accordingly.

2. *Common sense no longer prevails*

There is a huge amount of pressure on contract renegotiation. Admittedly some suppliers have enjoyed maximum return for minimum of effort in the past and are now finding that they have to be a lot more accommodating. They may find that they are forced to take less from a contract than they were used to in the years of corporate excess.

Customers have not been blameless in arriving at this situation, as they have, in many situations, taken no assertive corrective action in the face of supplier underperformance or failures under the auspices of maintaining the “relationship”. The pendulum has arguably swung too far in the opposite direction with many suppliers subject to the same blunt and, in some cases, draconian cost comparisons, irrespective of experience, knowledge, skills and overall value/cost savings that are being delivered to the business.

In the past many suppliers may have experienced a very relaxed arrangement with their customers; purchase orders were signed off with relative ease and budgets were easily accessible. However, this is no longer the case. All contracts are under the microscope and this has both positive and negative ramifications. Even as we enter better times, so corporate fat has been trimmed right out of the business and prudence is still being applied, but within many organisations common sense appears to have gone by the wayside. For example, in an attempt to cut costs, we have seen some organisations mandate a ban on travel even where that travel is funded separately by the customer and is necessary to honour the contract obligations.

3. *Rushing ahead*

In the new business environment that we all now find ourselves operating in, there is a tendency and often a political necessity to execute with pace. The attitude of many organisations seems to be: “We’ve got to get on the train so we’ll just get on the first one we see regardless of the end destination.” People think that they have to react quickly, time is of the essence; however, our advice for a higher quality outcome is more reflection and less speed.

One company we came across had been struggling with a particular programme of work around which they had failed to secure a sensible contractual relationship with their suppliers. With a number of important business deadlines looming they rushed into an alternative strategy that not only compounded the poor relationship they had with existing suppliers, but also doomed the new relationship they were trying to develop to ultimate failure. Needless to say, the business deadlines were missed and a significant amount of money was wasted. All of which could have been avoided with a more considered approach. Perhaps even more bizarrely, we had a situation recently where a client asked us to lead the renegotiation of a high value contract, just 24 hours after it had been signed in haste.

4. Outsourcing issues

The nature of outsourcing has changed in recent years as customers have become disillusioned with the lack of value for money over the longer term, particularly in the light of the rate of technology change and obsolescence in the market. Instead of a customer going to one supplier to provide a 'one-stop shop' for 10 years or more, there are now more engagements with multiples of suppliers involved, more layers of providers in the outsource and shorter contract durations. As a strategy this is perfectly viable. However, all too often the customer underestimates how much management and other effort this will require of their internal organisation, or does not assess the risks inherent within this approach and has therefore no effective mechanisms in place to manage such risks and thereby derive the benefits they are seeking. Consequently, the inevitable interdependencies between the multiple suppliers transform what could have been a perfectly cost effective and workable arrangement into a hotbed of disputes, claims and counterclaims, with the default position being that the customer accepts responsibility and incurs additional cost in order to avoid complete gridlock.

5. Fostering relationships

We have worked for organisations where the contract structured for the arrangement was diametrically opposed to what the customer was trying to achieve. In one instance we were faced with a very draconian and inflexible contract when what the organisation really needed was a completely flexible arrangement. Many customer organisations don't give enough thought to the nature of the contract and the strategy they want to evolve for the supplier relationship, or how they want to work with a particular supplier. Often organisations either negotiate supplier relationships in advance of winning customer business (so that they are able to move more quickly to the point of contract delivery) or negotiate customer contracts without having secured the underlying subcontractor commitment. Ahead of any engagement with a supplier or sub-contractor, the customer should not simply focus on the deliverables but should look more holistically at the whole relationship and in the context of both organisations' business objectives. The customer needs to be clear about the type of relationship they need to deliver the business benefits they are seeking. They then need to set the strategy to reflect the required relationship and business outcomes.

Often senior management doesn't think through how much time and effort is going to be required to get the briefing right for suppliers, enabling them to set the right baseline for the desired solution. Frequently they don't place enough emphasis or value on taking up references or talking to other customers of potential suppliers – too much is done in haste in a quest to get the contract signed and started in order to get a particular programme of work underway.

This inevitably results in an unbalanced relationship creating a "lose:lose scenario" that benefits neither party and a commercial vehicle that mitigates against the best interest of the business. The whole process can become a bureaucratic nightmare. If you want the flexibility to change quickly you must have a commercial agreement that supports this. In our experience if you want lowest cost then you must accept a very rigid contract that doesn't support this flexibility, other than for the supplier to take a huge amount of risk. This may sound acceptable from a customer perspective, but it's not if it impacts the supplier's ability or willingness to flex in response to specific requirements, other than to revert to potentially expensive change control.

We have also come across organisations that are dealing with lots of different suppliers but without the benefit of an effective central procurement organisation or other control mechanism. As a result, many departments were simply going off and doing their own thing, thereby minimising the opportunity for economies of scale and best value for money.

Conversely other organisations suffer from "analysis paralysis" whereby the desire to consider too many options and avoid making a decision means the opportunity for benefits realisation is at best diminished and at worst exhausted.

6. Aligning agendas

Partnership is one of the most misused terms in business today. Nowadays everyone claims to be a partner. In the environment we work in, the IT provider is supposed to be the client's "partner". However, despite the best of intentions the two agendas of client and supplier are not always in line. Most service providers want to engender a solid, long lasting relationship with their clients, but at the end of the day they also need to maximise their profits. It is in the best interest of the customer to structure the arrangement so that supplier profitability is contingent on delivery of service improvement and business benefit to the customer and thereby aligning the agendas of both parties. The misalignment of customer and supplier agendas is the main reason why the partnership concept will not work in practice.

Often there are no consequences of suppliers, or partners, not delivering and the customer does not seek any redress from the supplier for falling short on commitments. So what is the incentive for suppliers to deliver? Similarly, if the customer is open to the point of naivety then the supplier is likely to exploit this. Being overly secretive with no openness is equally unhealthy and unhelpful. It is all about getting the balance right so the customer has the instruments in place to drive the right level of performance and the supplier does not feel exploited.

7. Understanding the gatekeepers

Procurement is increasingly powerful in most organisations and in many cases is often the standalone gateway controlling the supply chain, with a standardised approach and associated contractual templates. This can be very effective for certain types of purchase but for others, such as professional services, the reverse is often true, where a 'one size fits all' approach isn't always the sensible or best approach. For example, procurement can sometimes take the same approach to a commodity purchase as they do to complex business change programmes. When it comes to hiring external expertise, it is not uncommon to find that the procurement process is overly focussed on process accreditation and cost and fails to recognise the value of experience, proven track record, leadership and relational attributes, which complex change initiatives demand in management professionals.

However in those organisations where the procurement organisation's influence is on a par with the commercial, finance and the business functions, all of whom are required to meet common business objectives, then the organisation creates a formidable and effective team that is best placed to derive maximum supplier value at optimum cost to deliver those business objectives.

8. Conclusion

Ultimately there is no substitute for experience. If you are wrestling with a complex business change programme or major contract negotiation, you need someone at the helm with the requisite levels of skill and experience in order to achieve the desired results. In most organisations, the people who can lead and deliver this type of work are in extremely short supply and this is where experienced external resources can really pay dividends. But in hiring this kind of expertise it's imperative to evaluate 'delivered value' and not simply incremental cost. This goes against the grain of a growing trend in the industry, whereby a procurement mind-set is becoming increasingly fixated with process related accreditation and lowest day rate, or perceived cost, as the only determinants when hiring much needed external expertise. Organisations that do this might find their supplier is overly reliant on process and following a bureaucratic plan to achieve results, when what is needed is creativity and practical hands on experience to circumvent obstacles and achieve results.

When faced with a high profile business change programme, a strategic supplier selection or complex commercial contract negotiation, our advice would be to bring in people that have the expertise not only to reduce your costs but also secure the outcome that your business needs. When engaging with suppliers:

- Be realistic about what you are trying to achieve and make sure that you and the supplier have a common view.
- Be realistic about what your organisation is and isn't capable of. Failure is the inevitable outcome if success is dependent on a specific experience profile that your internal resources don't have.

- Beware the siren call of collaboration and cooperation in the context of layered contractual relationships and obligations. It usually means no one takes responsibility for anything.
- Make sure the contracting vehicle that you choose supports the business objectives and doesn't conflict with where the business wants to be.
- Be firm but fair, in other words don't let your supplier off the hook if they are not performing, but at the same time don't be deliberately obstructive or confrontational. Typical questions that you should ask before you engage include:

  - What will the contract deliver and when?
  - Who are the team and what are their responsibilities?
  - What are the expected service levels?
  - What are the consequences of late-or non-delivery?
  - How will project success be measured?
  - How often will the contract itself be reviewed?
  - What happens if there is a disaster?
  - How will the contract be terminated if needs be?
  - What support will we receive if we need to migrate to a new service?

- Foster a win: win relationship with your supplier and really walk the talk as you go through the programme of work with them.
- Set the tone, strategy and base for the relationship upfront and stick to this approach throughout.
- Reward the right behaviour. Too many customers put up with poor performance and don't take any positive action to remedy it. What incentive has a supplier to change if you keep rewarding bad behaviour? But remember to get the balance right, most suppliers will perform well in a relationship that is underpinned by a fair and equitable contract.

If you get these things in place then you're well on your way not only to a mutually rewarding contractual relationship with your suppliers, but also a successful outcome for the business. Spending a little extra money up front to bring in the right people will repay itself over and again, in respect of the long term value they will deliver to your organisation.