

SUPPLY CHAIN MANAGEMENT

MOVING PROCUREMENT FORWARD

Slowly but steadily procurement is moving forward from a function focused on three bids and a contract to a function that enables innovation and delivers value to the organization.

Moving Procurement Forward, a special digital edition for December, will offer the best of *Supply Chain Management Review* on how you can move your procurement organization forward.

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welcome

Moving Procurement Forward

BACK IN THE DAY, people described Ohio State's offense as "three yards and a cloud of dust." Purchasing, as we used to think of it, could be described as "three bids and a contract." While cost is still important, procurement is moving forward. At many organizations, the focus is turning to the digitization of purchasing, innovation and even predictive analytics. But blocking and tackling, like how to get the most from your indirect spend, still counts.



In this special digital edition from *Supply Chain Management Review*, we're bringing together the best of our recent stories on procurement, ranging from a new framework for indirect procurement to contracting in China to getting innovation from your supply base. We hope you'll find them useful as you move your procurement organization forward.

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Procurement is getting its digitized act together

While supply chain managers have been slow to integrate digitization in the procurement function, the trend may finally be gaining traction, says a new report.



“The Future of Digital Procurement,” a new report released by Accenture, maintains that many supply chain managers are seeking to modernize this function, but may not have the tools to get started.

“The digital revolution has largely overlooked procurement,” the consulting firm declares. In its report, analysts examine how artificial intelligence (AI) and analytics add to the equation, thereby expediting digital procurement to produce better informed buying decisions, open new channels for engaging suppliers and drive new efficiencies through smart automation.

Art Nourot, vice president of Carrier Procurement, at UNYSON, notes that as the industry becomes increasingly digitized, new demands are being made on the suppliers and service providers, such as 3PLs in North America, that interact with the procurement function. “More transparency leads to greater efficiencies,” he says. “But at the same time, we must all be building better firewalls and find ways to keep our data secure.”

Stepping up

In today’s economy, many companies are racing to embrace digital to transform key areas of their businesses. These include “customer-facing” functions such as marketing, sales and service. To date, procurement hasn’t commanded the same kind of attention or investment, according to Accenture. “True, companies have enthusiastically embraced eProcurement systems and even cloud-based procurement tools,” writes Managing Director Kristin Ruehle. “But it’s time to move beyond simply replicating the same tedious procurement processes with new software. Leading companies are taking the next step to create a true digital procurement organization.”

According to Ruehle, a true digital procurement organization automates repeatable tasks to boost

efficiency and potentially drive down costs. It equips stakeholders across the business with real-time access to easy-to-use online tools. It deploys new and smarter ways to infuse data models to enrich daily operations and decision-making. And it transforms how buyers interact with suppliers and other third parties by serving as a platform for new levels and types of collaboration.

New upstart

Accenture is not alone in identifying the need for new levels and types of collaboration. Adrian Gonzalez, president of Adelante SCM, argues that today’s businesses expect the same experience that consumers get from their online vendors with full visibility in real time, regardless of mode. “The need to convert data into actionable insights is more important than ever,” Gonzalez says. “Industry business networks, which enable trading partners to connect, communicate, and collaborate in more scalable and efficient ways, are responding by innovating their platforms with machine learning, artificial intelligence and predictive analytics capabilities.”

Gonzalez and other analysts have recently identified Elemica as a new upstart in this arena, having

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recently introduced real-time predictive visibility from customer order to supplier delivery and the complete order-to-cash and procure-to-pay process.

In essence, digital procurement enables the “Amazon-like” experience employees now want—but currently aren’t getting—in the workplace. “This is easier said than done,” observes Rich Katz, chief technology officer of Elemica. Katz notes that Amazon has a relatively closed system—it controls the majority of the process from search to delivery—and where it doesn’t have direct control it can dictate how partners will interact with their customers. Procurement organizations are in a very different spot—they deal with thousands of suppliers and carriers operating in their own unique ways.

“Digitization provides a path to get there,” he says. “By fronting the supplier ecosystem with a common user interface (UI and) backing that up with real time information exchange with suppliers and logistics providers, procurement can create a sort of ‘virtual’ Amazon for their users.”

In other words, while supply chain visibility is not new, the ability to gain deep visibility with embedded predictive analytics is. “Gleaning historical data from disparate enterprise systems including the customer, supplier and logistics providers is what businesses have been needing for a long time,” Katz says.

Elemica, a leading business network for process industries, recently introduced an extended end-to-end supply chain visibility service called “Elemica Pulse” for the procure-to-pay function. Accenture maintains that this trend, too, is gaining traction.

Stakeholders expect the ease and elegance from the “procurement” tasks they do at home as consumers on Sunday to apply to the work they do for the company on Monday. But current procurement policies and tools are geared toward driving a process—with a lot of rigor and controls—versus an experience or outcome.

So it’s not a surprise that stakeholders find the procurement process too cumbersome, slow and rigid. In their minds, procurement is an obstacle to be avoided rather than a useful tool.

Conversely, digital procurement is defined not by a rigorous process but by deep and rich data. It assumes business controls are built into AI models so users can do what they want to do without having to go through many painful steps.

Embracing the process

By streamlining and simplifying how people make and execute buying decisions, digital procurement encourages stakeholders to “embrace the process” instead of circumventing it in favor of the experience they prefer. In other words, users aren’t necessarily fully aware of procurement’s influence and guidance, and they don’t feel like they’re “going through a process.” They simply see valuable information presented that they can act on. Compliance and controls are inherent and embedded in the model instead of being visible obstacles to be overcome.

“It’s critical to increasing the procurement organization’s influence over the half of the company’s spend it doesn’t control—and, by extension, increasing the effectiveness of how that spend is managed,” says Accenture’s Ruehle.

“Gleaning historical data from disparate enterprise systems including the customer, supplier and logistics providers is what businesses have been needing for a long time.”

—Rich Katz, chief technology officer, Elemica

She concludes that “digital is the foundation of procurement 3.0,” whereby digital procurement isn’t just the next phase in IT’s evolution, but rather the genuine step-change—a dramatic departure from both procurement’s use of technology and its operating model of the past few decades.

Today, the vast majority of companies have what Accenture calls “a Procurement 1.0 organization.” This is characterized by a focus on using technology to automate processes and record what has happened: a transaction executed, an invoice paid, an item purchased, a contract signed. And, unfortunately, it’s also marked by systems of record that generally have made the procurement process overly complex.

The encouraging news, add analysts, is that some leading procurement organizations are making strides toward 2.0, in which they’re using technologies to dig deeper to get much more contextual information about what happened and why.

Such information is critical: It’s foundational to building AI-enabled predictive models that help improve future decision making, and are at the heart of a Procurement 2.0 organization. The next advance will represent a true digitized “revolution.” •

A holistic view of procurement leads to efficiency

Making changes to other procurement processes can lead to fewer resources and cost allocated to tactical activities.

BY BECKY PARTIDA



When organizations think of the areas in their supply chains on which to focus to deliver cost reduction, they often select the procurement function. This is understandable because it is easy for an organization to incur extra costs in procurement due to inefficiencies in ordering and purchasing activities. In fact, when looking at its Open Standards Benchmarking data in procurement, APQC has found that organizations have the largest group of their procurement full-time equivalent employees (FTEs) assigned to ordering materials and services (Figure 1).

The data indicates that just over 36% of procurement FTEs work on this process. Over the last nine years, APQC has seen this percentage decrease among organizations taking its benchmarking survey, but the process still retains the largest share of FTEs within procurement. The fact that many procurement staff members are dedicated to completing what is largely a tactical activity that provides little strategic value to the organization is a motivation for finding ways to shift procurement staff to other processes.

Related to the amount of staff needed for ordering materials and services is the breakdown of the cost organizations incur for this activity (Exhibit 2). Nearly half of an organization's cost for ordering materials and services goes toward personnel. By comparison, nearly 24% of the cost related to ordering materials and services goes toward overhead, and nearly 16% of the cost is devoted to outsourcing.

An organization looking to reduce the number of FTEs needed to order materials and services, and thus drive down its personnel costs for this activity,

could start by identifying ways to simplify activities and save employee time. APQC recommends that organizations also look beyond the actual ordering procedures to identify factors that can influence the amount of staff, and the personnel cost, required for this process. Two of these factors are the ability of the procurement function to provide input on the materials and components used within products manufactured by the organization and the practice of regularly measuring supplier cost reductions or total cost of ownership.

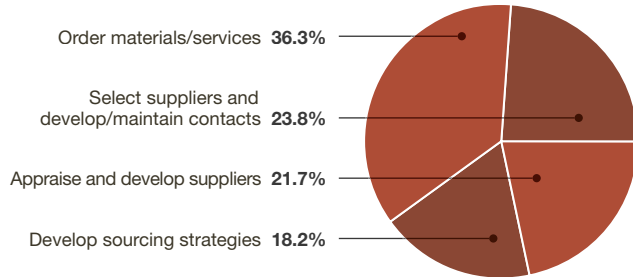
Product design and production considerations

When an organization manufactures a product, the materials or components selected for that product can affect how much the organization spends to order materials. Components that are in high demand or that are only available from specialized suppliers can increase the complexity of the purchasing process, driving up the need for staff and the cost associated with personnel.

By Becky Partida, Senior Research Specialist, Supply Chain Management, APQC

FIGURE 1

Allocation of FTEs by procurement process



Source: APQC

Some organizations address this through efforts to control the cost of products and their components during the design phase for a new product. In a survey conducted by APQC, nearly three-fifths of responding organizations agree that they use teams during the product design process that always involve experts from different functions to ensure the best balance of cost, function and quality. And 74% of responding organizations indicate that members of their procurement staff provide input within these teams, accounting for one of the most involved functions.

Involving members of the procurement function in the management of product and component costs can result in changes to a product's design so as to use a less expensive material or one that can be easily sourced from an existing supplier. It can also result in the procurement group being better prepared for sourcing materials for a product. Earlier awareness of materials or components that would require identifying new suppliers would give procurement staff more time to consider their options and establish more valuable contracts with suppliers that could simplify purchasing efforts.

Measuring supplier cost reductions

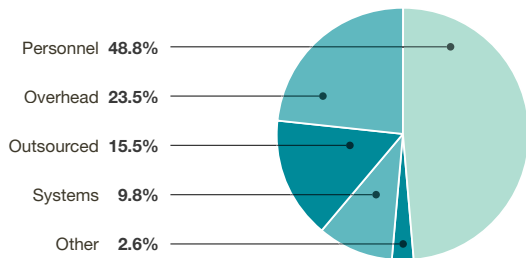
Another factor that can impact the cost of ordering materials and services is the regular measurement and recording of cost reductions or the total cost of ownership for suppliers. Among organizations responding to APQC's Open Standards Bench-

marking survey in procurement, about 57% indicated that they regularly measure and record this information. At first glance one would expect the measurement of cost reductions for suppliers to only affect the purchase prices that an organization incurs. However, APQC's data shows that organizations regularly measuring this information need fewer FTEs for ordering materials and have lower costs associated with this activity (Figure 3).

At the median, organizations that regularly track cost reductions or the total cost of ownership for their suppliers need nearly 16 fewer FTEs to order materials and services. As a result, at the median these organizations spend \$0.57 less per \$1,000 in purchases on the personnel needed for this activity and \$1.14 less per \$1,000 in purchases to complete this activity overall. For an organization making \$1 billion in purchases annually, this would translate into spending \$570,000 less on personnel costs related to ordering materials and an overall savings of \$1.14 million simply for the activity of ordering materials.

FIGURE 2

Cost breakdown for ordering materials and services



Source: APQC

Organizations that measure supplier cost reductions also spend less on the procurement process overall. At the median, these organizations spend \$10.80 per \$1,000 in purchases on the procurement process, or \$2.77 less than their counterparts that do not track reductions. These results are interesting

given the effort involved in regularly measuring and recording information on supplier cost reductions. Even more time intensive is measuring the total cost of ownership, which involves tracking the purchase cost as well as costs related to shipping and inventory maintenance. Simply obtaining this information can be a challenge due to the fact that it must be compiled from different functions within the supplier organization. Then, once the information is compiled, staff must actually calculate the total cost.

APQC's data suggests that organizations measuring and recording supplier cost reductions, or the total cost of ownership, have developed more mature relationships with suppliers that have allowed them to eliminate unnecessary effort from the ordering process. These organizations recognize that developing mature relationships can have a ripple effect that enables them to not only get the best purchase value, but also reduce the cost of tactical processes. It may also be that these organizations have made measuring and recording cost reductions or total cost of ownership part of an overall effort to improve the efficiency of their procurement efforts that also includes taking steps to reduce the amount of staff needed for ordering materials.

Take a holistic view

For organizations in APQC's data, the largest group of procurement FTEs is dedicated to ordering materials and services, and the largest share of the cost associated with ordering materials is allocated to personnel. That such a large amount of resources is dedicated to what is, for the most part, a tactical process should raise concern for procurement leaders. However, APQC has found that organizations can take action to modify processes during the product design stage or during the monitoring of suppliers and ultimately reduce the amount of staff needed for ordering materials.

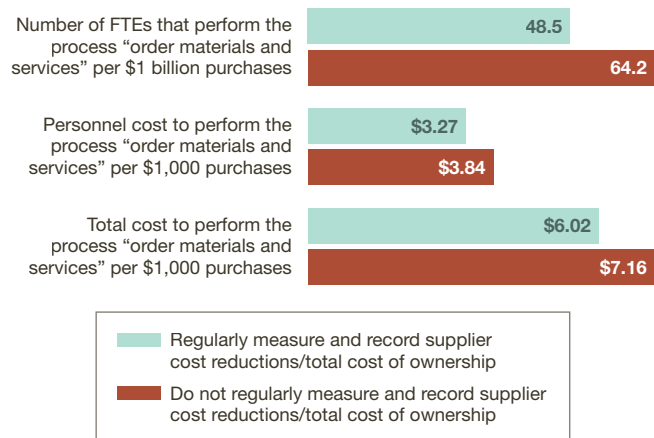
This big-picture thinking reflects the shift that the procurement function has made over the years to a

more strategic function that provides greater value not only through its sourcing efforts and the relationships it creates with suppliers, but also through the practices it adopts. APQC recommends that organizations look at the entire span of procurement processes to see how improvements in one area can lead to improvements in other aspects of sourcing and purchasing. By taking a holistic view, organizations can identify previously hidden opportunities to drive down procurement costs.

FIGURE 3

Impact of measuring and recording cost reductions for suppliers

(Median)



Source: APQC

Organizations can also reallocate resources freed up through their efficiency efforts to more valuable activities such as developing sourcing strategies or working to create and maintain the more mature relationships with suppliers that can lead to innovation and benefits for all parties. •

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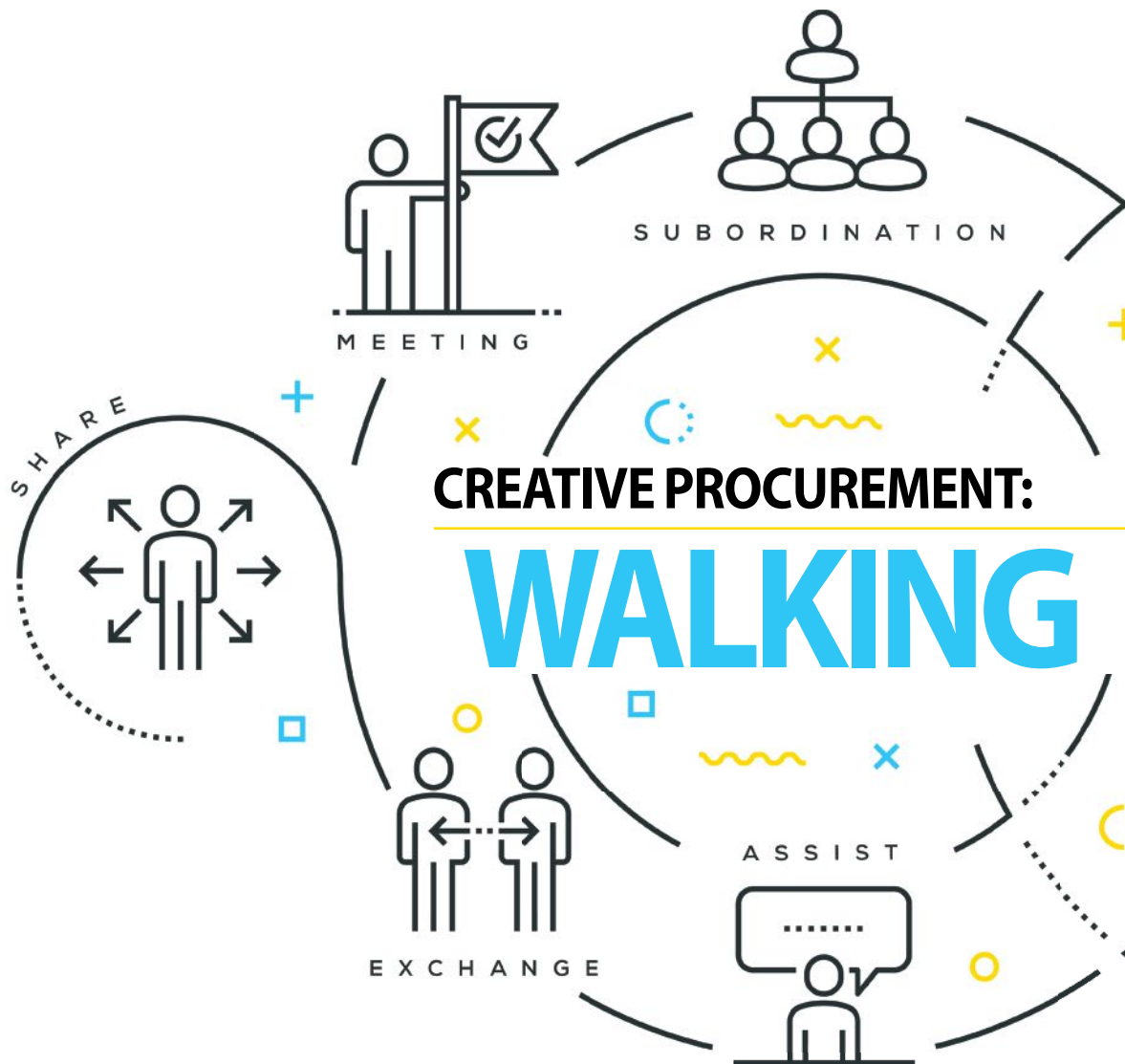
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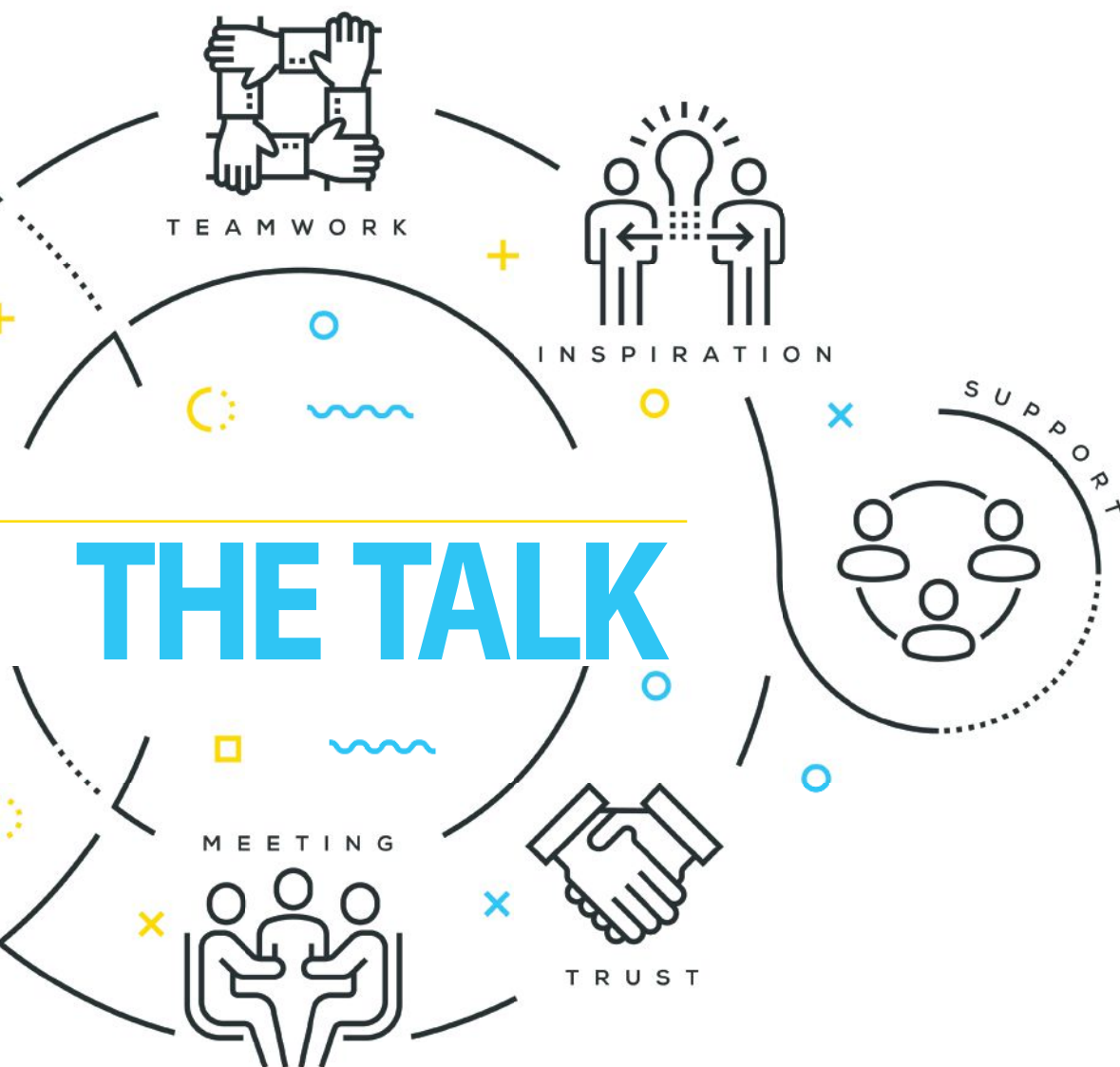
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Procurement is changing from a focus on cost savings to creativity and innovation in a talent rich supply chain. That's the talk. The question is whether organizations are walking the talk when they recruit, and, if not, how do we recruit for creativity.

BY SRIRAM NARAYANAN, CARLOS MENA AND RIYAJ GILANI



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As a profession, procurement is experiencing a dramatic change in philosophy. In “Charting the course: Why procurement must transform itself by 2020,” the consulting firm Deloitte noted significant shifts already underway. From savings and strategic sourcing (called yesterday’s

paradigms), to category leadership and managing procurement systems in a global environment (called today’s paradigm), to a radical approach to thinking about procurement as a creative endeavor, generating new ideas and innovating in a talent rich supply chain (called future paradigm).

In our interactions, senior procurement leaders often emphasize “out of the box thinking” in their supply chains. That shift is certainly on the agenda of supply chain conferences and publications. But we wondered: When it comes to recruiting new hires in their procurement departments, are companies “walking the talk” with reference to recruiting for innovation and creativity? Or are they stuck in “yesterday’s paradigm?” That question motivated this article.

Procurement professionals are problem solvers. First, the level at which they solve problems and the issues are likely different across strategic, managerial and tactical hierarchies. What are these issues? Do they have any bearing on innovation? Second, what are the dominant thinking approaches that firms stress in hiring for procurement positions? These dominant thinking

professionals were engaged in. Next, we focused on the type of cognitive skills demanded from these managers by focusing on specific words that the job advertisements used, that is, what skills companies told the market they were looking for. To do this, we compiled a “word dictionary” across the different levels of Bloom’s taxonomy.

We identified the core topics that form the domain of procurement—the problems that procurement managers solve. In studying the topics, we divided our firms into those that have been recognized as innovative in top supply chain rankings (called *innovative firms*), and those that were not ranked as leading innovators (*mainstream firms*). Rather than discuss company names, we will focus on the key findings and learning points that emerged from our investigation.

First, we found that a number of skills and activities

When it comes to recruiting new hires in their procurement departments, are companies walking the talk with reference to recruiting for innovation and creativity? Or are they stuck in yesterday’s paradigm?

approaches have a bearing on the person they are likely to hire and consequent activities.

To answer those questions, we drew from a popular education planning tool called Bloom’s Taxonomy that focuses on the structure of the cognitive process. These processes are classified as follows in increasing order of cognitive intensity: *remember*, *understand*, *apply*, *analyze*, *evaluate* and *create*. To *remember*, one needs to recall or recognize situations; to *understand*, one needs to interpret, infer, summarize and explain; to *apply*, one needs to implement/execute; to *analyze*, one needs to differentiate, organize and attribute cause and effect; to *evaluate*, one needs to check and critique; and to *create*, one needs to produce, plan and generate ideas; this is to innovate.

To explore whether firms put an emphasis on innovation we went to the first step in the process of hiring procurement professionals—job advertisements. We analyzed the text of job advertisements across more than 150 procurement openings that were categorized at tactical (buyer, senior buyer); managerial (commodity manager, category manager); and strategic (director, vice president, and higher, including CPO) looking for patterns for more creative companies. (For more, see About our research).

Our text analysis was comprised of two stages. First, we examined the emergent topics in these advertisements. Those allowed us to focus on the activities that procurement

were emphasized by both innovative and mainstream firms, including: communication skills, understanding of market dynamics, monitoring compliance, category management, cost analysis, contract management and negotiation. However, there were some notable differences. For one, our analysis suggests that innovative firms require procurement professionals to engage in planning, visioning and a forward-focused thinking—elements that were absent among mainstream firms. In contrast, mainstream firms emphasize control, gate keeping and firefighting. Do planning, visioning and forward thinking lead to innovative procurement departments? Common sense suggests the answer is: Yes, it is likely. Does this mean that in innovative procurement groups managers don’t control, gate-keep and firefight? Common sense suggests the answer is: No. It is only practical that managers do both in every firm. It is the relative emphasis across levels that is likely to make the key difference.

Second, our results on the type of cognitive thinking process sought among procurement professionals suggests that the dominant thinking sought is *apply*, followed by *create* and *evaluate*. Surprisingly, hiring advertisements place much lower emphasis on *analyze*. Presumably *applying* subsumes *analysis*. An alternative explanation could be that the emphasis on action and creation without solid analysis underpinning it could

perpetuate a fire fighting culture that struggles to move beyond urgent day-to-day problems.

Finally, *remembering* and *understanding processes* also had low emphasis, and deservedly so. While we expected the relative emphasis on the “thinking process” to vary across the different managerial levels, surprisingly, our analysis revealed that the distribution of keywords across the six thinking processes was very similar across the different hierarchical levels of procurement – tactical, managerial and strategic. We believe this is encouraging, given that high-level activities within procurement are broadly similar across different firms. This also leads to an important question: If procurement wants to emphasize creativity in hiring, should it be using terms that reflect the need for creativity and creative skills in job advertisements?

Of interest is that in none of these job announcements did we see corporations asking for creative individuals who focused on out-of-the box solutions, even though certain keywords were being picked up. Clearly, this shows that despite the talk, procurement is not dominated by creative endeavors. Yet, the focus on issues that emphasize creative endeavors needs better definition and alignment. Should one even ask for them? Is this a reflection on what is happening in procurement departments across firms? While these are provocative questions, we believe that it is important to reflect on these issues to move us to a domain of superior creativity in problem solving. We now detail our results. The approach is relegated to the Appendix for interested readers.

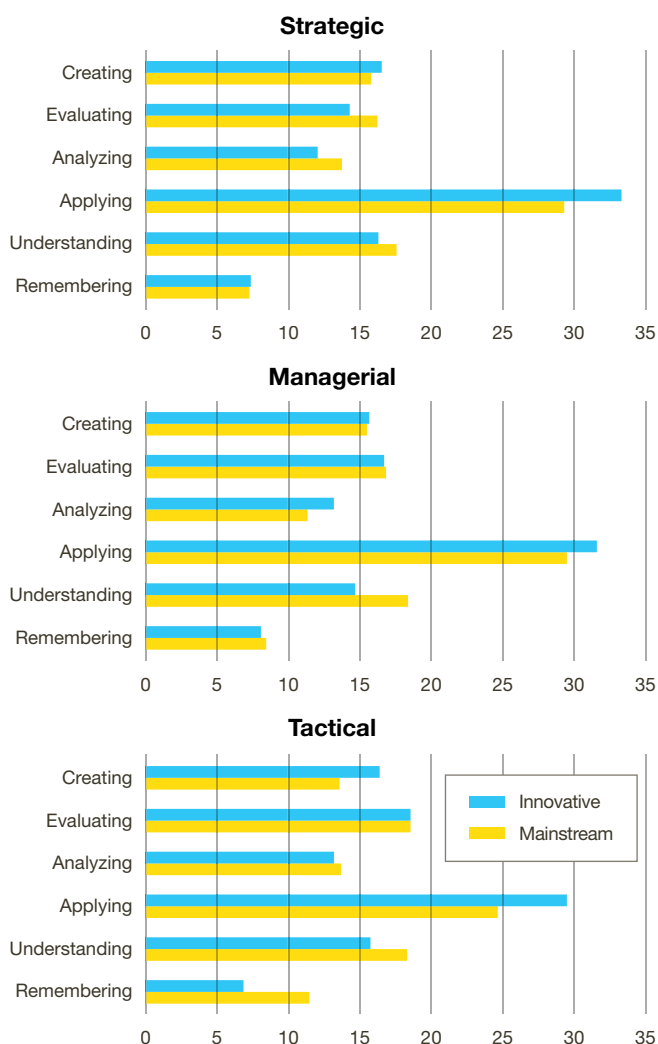
Key takeaways

Let’s first look at the results of our word count analysis. These are summarized for innovative and mainstream firms in Figure 1. The percentage of words in the creating category is slightly higher among innovative companies compared to mainstream firms at tactical and strategic levels. It is almost the same in the managerial level. Firms in the mainstream category appear to place more value on evaluation and understanding compared to firms in the innovative category. Of interest is that the firms that we derived from the innovative category appear to have a substantial tilt toward application.

What we found most interesting is that the

highest stress is not on *analysis, evaluation, or creating*—rather it is on *application*. Clearly, this lines up well with our anecdotal observation that procurement professionals often tend to apply policy decisions. Of greater interest is the fact that the distribution of keywords is quite similar across the levels of the organization. Two key questions are relevant here. First, do managers have the onus to be creative as they grow within the organization? At the corporate level what leeway do procurement organizations have to be creative? If organizations spend 50% to 70% of their revenues on

FIGURE 1
Keywords found across different types of cognitive processes under Bloom’s taxonomy



Notes: Table based on order of cognitive intensity from first row to last row based on Bloom’s taxonomy. Certain words used spanned across multiple cognitive processes in our dictionary, and we let them be counted on both processes for clarity.

Source: Authors

suppliers, this appears to be an imperative question based on our analysis.

We now move to the discussion of the key activities that procurement managers engage in. These activities are presented in Table 1. The results come from a topic analysis of all of the procurement activities that emerged from our text data of job advertisements. We translated the topics from our text analysis into activities for procurement managers. At face value, the activities appear reasonably comprehensive. While the list itself has some value, we are more interested in the scope activities that are different across innovative and mainstream firms.

Table 1 shows that the activities across strategic, managerial and tactical levels are different. Specifically, we show the order of responsibility of the different

positions on that activity. For example, “Influencing, managing and executing change” was a category that was found in the innovative firms but not among the mainstream firms. Focusing on the innovative firms, the activity was more prominent among strategic and managerial procurement professionals in that order and least prominent among tactical procurement professionals. Similarly, other activities can be interpreted across innovative and mainstream firms.

What then are the key takeaways from this table of activities? First, we focus on activities that are common across both innovative and mainstream firms:

- “relationship management” is important in both, but there appears to be more strategic involvement in the innovative companies compared to the mainstream group in this activity;
 - both type of firms emphasize “understanding market dynamics,” however, this aspect is more dominant in strategic positions in innovative companies as compared to managerial positions in mainstream companies;
 - in both cases “managing quality and delivery,” “managing P/O,” “compliance and standards” and “relationship management” is relegated to tactical positions and to some extent managerial, as one would expect;
 - “category management” is key at the strategic level for mainstream firms, but at the managerial level for the innovative firms; and
 - focus on “cost analysis and management” is higher at the tactical level for innovative firms, but at the managerial level for mainstream firms.
- There are some activities that only appear in innovative firms, and not in the topic analysis of mainstream firms. These firms look for:
- people who are influencers and change managers;
 - initiative taking;
 - generating recommendations based on analytics;
 - product life-cycle approach to procurement; and
 - strategic portfolio management.

It is interesting that in each of these activities there is a dominant component of senior

TABLE 1
Key activities executed by procurement professionals

ACTIVITY	EMPHASIS ON LEVEL	
	Innovative	Mainstream
Influencing, managing and executing change	S M	N/A
Initiative taking	M S	N/A
Strategic portfolio management	S M	N/A
Generating recommendations based on analytics	T S	N/A
Setting, monitoring and managing targets	N/A	S M
Efficiency and resources management	N/A	S M
Problem solving	N/A	T
Setting policies and procedures	N/A	S M
Managing purchase orders	N/A	T
Relationship management	M T	M T
Managing quality and delivery	T M	T M
Understanding market dynamics	S M	M T
Contract management	S M	M T
Managing product life-cycle	M S	N/A
Compliance and standards	T S	S M
Category management	S M	S M
Cost analysis and management	T M	M T

S Strategic
 M Managerial
 T Tactical
 N/A Activity was not emphasized by a group of companies

Source: Authors

About our research

We first collected job postings from several websites including LinkedIn, Monster and Indeed. The job titles drawn from the openings were then categorized into strategic (director, senior director, vice president, CPO); managerial (procurement/sourcing manager, category manager, sourcing senior manager); and tactical (buyer, senior buyer). We then prepared a comprehensive data dictionary for each thinking type of Bloom's taxonomy that covered all of the keywords related to the different thinking types. This was done by identifying all possible synonyms for keywords within the Bloom's taxonomy keywords by generating more than 1000 words across all the Blooms taxonomy keywords. Using this data dictionary, we focused on building a count of the keywords that appeared across categories for both innovative and mainstream firms. Some of our keywords spanned across all of the cognitive categories, and we counted them for every category they fell into (this is a caveat that required judicious judgment). We then used the collective set of advertisements to delineate the key topics that emerged in these postings to extract our insights. In general, we divided the mainstream company positions into 30 advertisements across each level. For innovative companies, we had 25 each in tactical and managerial positions and only 12 in strategic positions. This recognizes the limitation of having to pull advertisements for a targeted set of firms that were identified as innovative in supply chain.

procurement leadership involvement. Furthermore, these also require a significant degree of creativity-based skills in addition to application and evaluation. Finally, mainstream firms also had areas of emphasis that are intuitive, yet not found in our topic analysis of innovative firms. These are:

- target setting, monitoring and management

emphasized at the strategic level;

• issue resolution and problem solving is dominant at the tactical level;

- policy setting and procedures; and

- emphasis on managing P/O.

In these settings, it appears that problem solving and transaction management get more emphasis. Clearly, individuals performing these activities are more focused in a "getting the job done" approach and the level of creativity involved in these jobs is debatable.

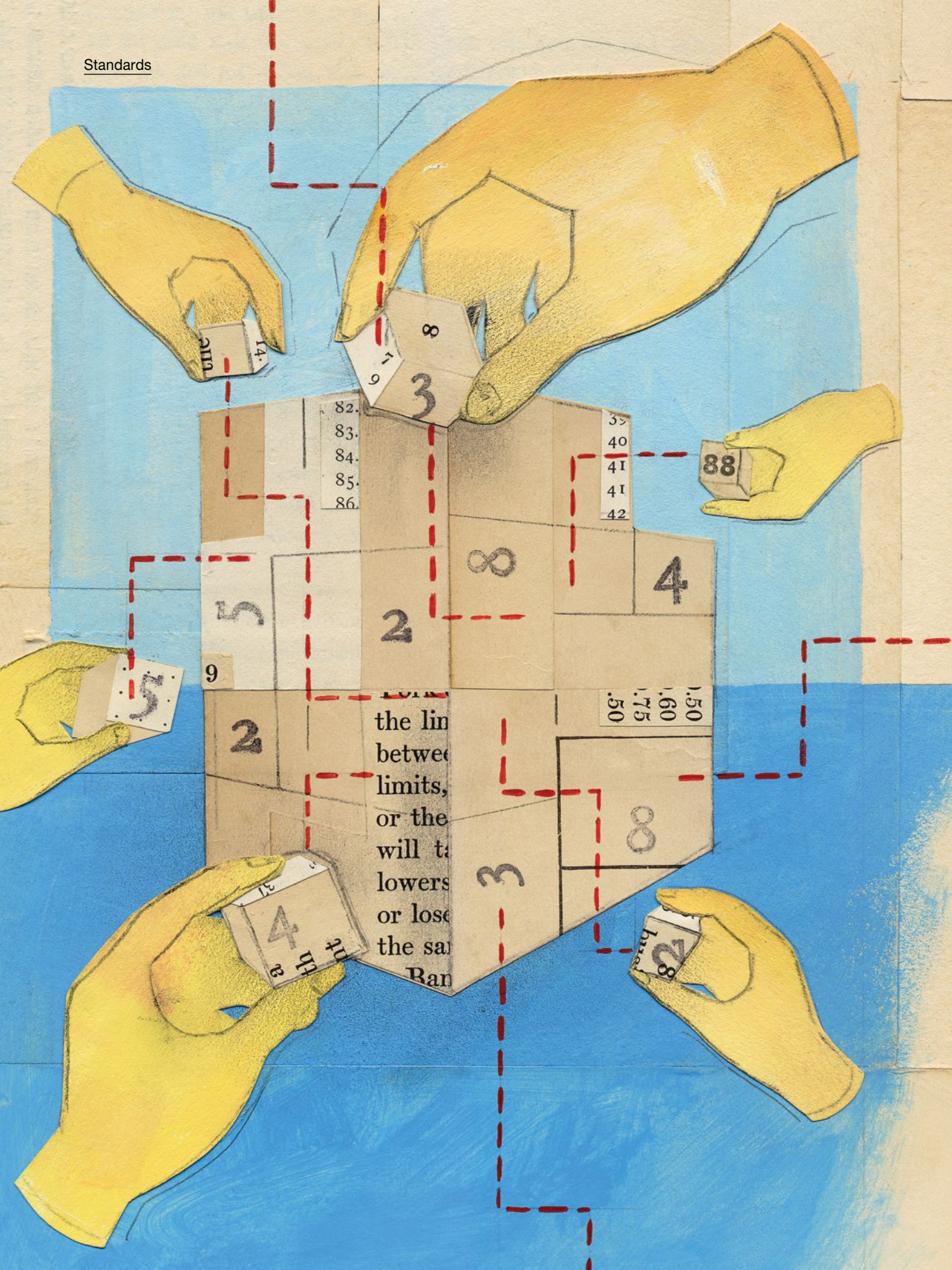
It is important to note that we do not believe that organizations pursue one activity to the exclusion of others. A caveat to keep in mind is that each of these activities can be pursued by any procurement organization in varying degrees depending on the "priority" that an organization assigns to these activities. We remind the readers that these are job advertisements, and NOT "real" activities. However, job requirements are often the contract for what an employee ends up doing when they step into the unit.

The choice

So, are procurement organizations walking the talk?

Our analysis points to the fact that while procurement requires more innovation, control and cost efficiency continue to be the bread and butter for mainstream organizations. Managers have a choice depending on their context. We believe that procurement professionals can be "planners, visionaries and forward thinkers" or they can be "controllers, gate keepers and firefighters." While one element requires creativity through managing change, pushing initiatives at the corporate level and taking a strategic view of the firm, the second requires them to focus on controlling their supply chain. Ideally, organization should balance the two approaches—our bias is not toward one or the other.

Finally, while we are all for creativity in procurement, control is a key dimension of the profession that is critical to have in place. These need to be carefully balanced. Large-scale creative change initiatives may well require significant corporate backing that many CPOs may not necessarily have. It is perhaps the reason that recruitment efforts are not likely to emphasize creativity and innovation. However, if firms expect innovation from their procurement function, they must take action to attract and retain innovation-oriented talent. •



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The right way to procure indirect materials

A new IP standard offers a framework to get the most from your indirect spend.

& services

Strategic sourcing can be a source of competitive advantage for those firms that do it right. Yet, the majority of articles on procurement best practices have centered on direct spend, or the raw materials and goods that go into manufacturing a product. Very little attention has been paid over the years to the indirect materials and services that are used internally by a firm, such as MRO, fleet management and utilities, even though a large firm may spend a billion dollars or more on this category (see sidebar for a definition of indirect spend).

In many respects, indirect spend is the neglected pet of a procurement organization, no one individual or entity is paying attention to the category. Or, as a commodity manager for a U.S.-based medical equipment manufacturer once summed it up in an industry magazine: “There was no focus on indirect spend. As a result, organizations learned to fend for themselves in the indirect spend categories, and everybody was doing their own idea of what they thought sourcing was.”

We found similar attitudes toward indirect procurement (what we’ll refer to as IP) during discussions with a number of IP executives through the course of our research into the state of indirect procurement (see sidebar: About our research). Their experiences can be summed up in three points:

1. IP is often performed by a variety of different departments within an organization;
2. there are few well-defined processes and fewer outcome-based metrics for IP; and
3. there are currently no guidelines or standards for indirect procurement (this is true despite the fact that the medium to large companies

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we surveyed were buying from hundreds to tens of thousands of indirect suppliers).

To address these points, and to isolate best practices for indirect procurement, a team of academics and industry executives from Microsoft, Magna International and Intuit paired up with COPC, a leading standards and procurement company, to systematically investigate the process of strategic sourcing of indirect materials and services. The objective was to develop a “generic” IP standard. We did this through several steps detailed below. (In addition to the insights gained across the four strategic areas of the IP standard, the study provided the opportunity to collect demographic data from the responding companies and analyze potential correlations; see Top-level correlations sidebar.)

As indirect procurement encompasses the purchase of a large variety of commodities, the initial standard was geared to be generic enough to apply to all procurement types. The scope of procurement for the IP standard we were tasked with developing was supposed to encompass all procurement related aspects from the viewpoints of the internal customer—the business unit using the product or service—and the suppliers, including source-to-pay (excluding ordering and receiving of

goods/services); and the termination of a relationship with a supplier (or a contract). By definition, some of these processes were the responsibility of groups outside of procurement.

In this article, we used analyses of field data on the procurement of indirect materials and services in large organizations to come up with a framework of best practices or standards. Specifically, we examined the drivers and challenges and an enabling framework to guide strategic efforts toward indirect procurement success. The enabling framework comprises five key stages that are interrelated. We conclude with a set of key lessons learned based on companies that have deployed this five-category framework. (Due to space limitations, additional related charts are available online at scmr.com.)

Step 1: Engaging experts

The first step was to engage a focus group of top industry experts. We wanted to understand the current state with respect to sourcing of indirect materials and services. Those engagements led to a number of high-level conclusions that informed the standard.

1. Neglect of indirect spend compared to direct materials spend. In comparison to the attention paid to

About our research

A leading standards setting and consulting company (COPC Inc.) and academics from leading universities were tasked with developing a systematic process for indirect materials and services procurement. Five key areas of interest were selected to investigate:

- reporting/analytics;
- supplier relationship management (SRM);
- change management;
- risk management; and
- customer relationship management (CRM).

A maturity scale was developed for four of the above elements (excluding reporting/analytics) to assess how each indirect procurement (IP) organization rated themselves on these elements. A survey questionnaire was developed and piloted with three IP organizations. The questionnaire was uploaded to SurveyGizmo, the online tool used by COPC Inc. Thirty-eight IP organizations from leading companies were invited to complete the survey online. Twenty-two completed responses were received and formed the basis of the analysis in this report.

Some of the 22 respondents spanned multiple industries. The total number of industries represented in the sample was 32. 56.25% (18 of 32) of the sample was predominantly from three industries: manufacturing (25%);

automotive equipment & parts (18.75%); and electronics & technology (12.5%). The sample consisted of low-, medium- and high-spending IP organizations. The two largest categories in the sample (64%) were: respondents with an IP spend of over \$10 billion (23%) and respondents with an IP spend of under \$500 million (41%).

Thirty two percent of the firms reported that their IP organizations were centralized; 27% of the firms had decentralized IP organizations and 41% of respondent firms reported hybrid IP organizational structures. All respondents indicated they were responsible for sourcing suppliers and terminating suppliers. The majority of firms (over 80%) were responsible for developing a sourcing strategy and onboarding suppliers. Less than half of the respondents were responsible for ordering/inventory and paying suppliers. About two-fifths of respondents were responsible for ordering and inventory. About one-quarter of respondents were responsible for paying suppliers. To a large extent, it appears that IP organizations were not responsible for ordering/inventory or for paying suppliers. Almost all respondents reported that they conducted some forms of data analysis such as commodity spend analysis. However, very few respondents reported having conducted demand analysis for key commodities.

direct materials, little to no attention was paid to indirect materials and services in the sample of firms that were examined.

2. A “pocket change” mentality. Too often, procurement managers thought of indirect materials as “pocket change.” Devoid of data, the managers were operating under the false premise that the sums involved were too small to warrant their time. This was reinforced in the next point.

3. Lack of systematic data collection, organization, display and analysis capabilities. In part, the neglect of indirect procurement can be traced to gaps in the data collection, summary and display capabilities of procurement and ERP systems. Without a formal data strategy and approach, most analysis tends to be rudimentary and conducted on an ad-hoc basis. This is hard to justify, given that some of the category spend in indirect procurement can be in the millions to billions of dollars range—anything but pocket change, even to a large organization.

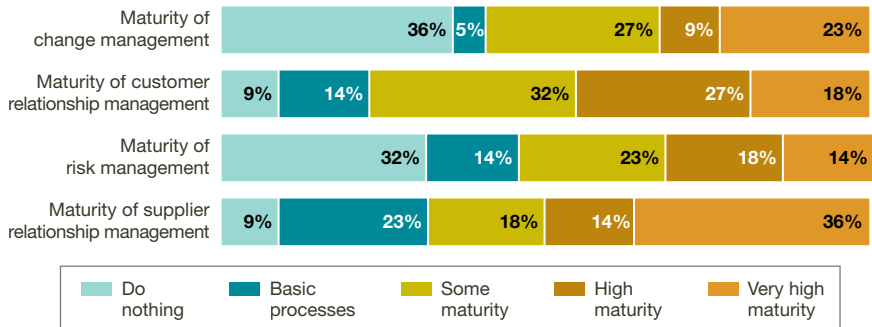
4. Not taking a process view. Most firms lack a systematic process for collating indirect spend because they feel no urgency to do so, especially when, in their view, there are bigger fires to fight.

5. Not involving people or the right people. Because many of the spend categories in indirect procurement transcend functional and departmental boundaries, the ideal setup would seem to be a cross-functional or dedicated-process team. While that approach is the rule for direct materials and capital expenditures, it is the exception for indirect materials and services.

6. Lack of metrics. Based on our focus group, there are no formal metrics for indirect spend. This is more involved than simply applying the metrics used in the direct spend category to IP. The real challenge is to develop a metric that is generic enough to cover the diversity within indirect procurement and yet be sensitive to a few localizing patterns that are peculiar to these category segments (especially, if they end up being a large proportion of overall spend of indirect materials and services).

FIGURE 2

Summary of benchmark study (high-level results)



Source: COPC Inc.

Step 2: Developing a standard framework

Using insights from the focus group, the second step was to develop a new industry standard for IP. A comprehensive standard framework would deliver benefits to the customers, or internal business units, as well as the suppliers of those goods and services.

Customers, for instance, should experience benefits such as clearly defined requirements that will effectively meet their needs; consistent, error-free and timely performance; well-designed processes followed by all well-trained

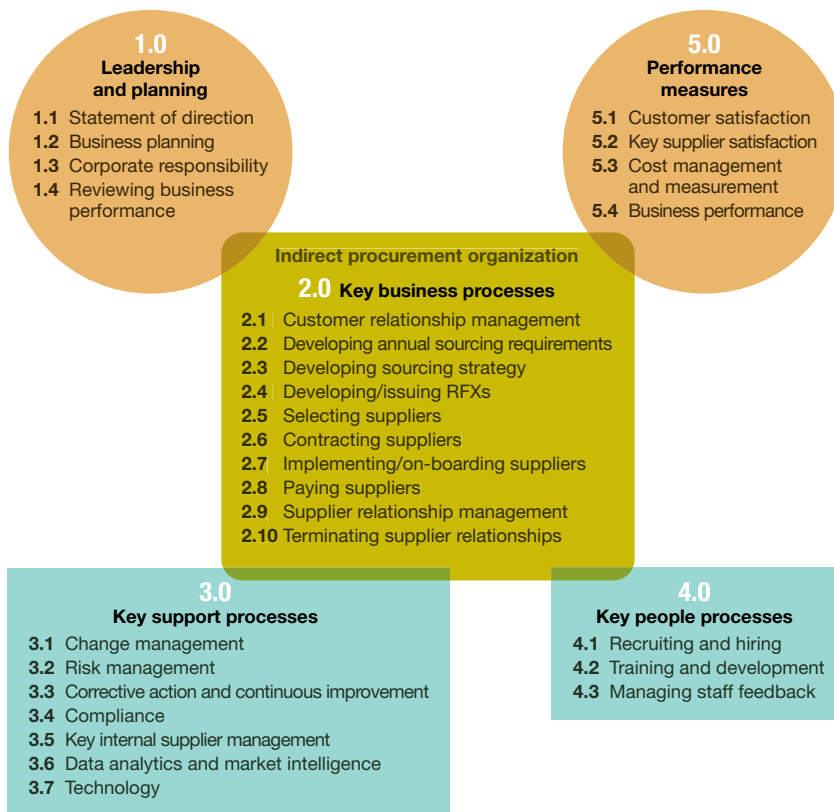
Defining indirect procurement

For this article, indirect procurement is defined as the sourcing of all goods and services for a business that enable various activities performed by the firm. In other words, goods and services classified under the umbrella of indirect procurement are commonly bought for consumption by internal stakeholders (business units or functions) rather than the external customers or clients. Indirect procurement categories include, but are not limited to:

- marketing related services (media buying, agencies);
- professional services (consultants, advisers);
- travel management;
- IT-related services (hardware, software);
- HR-related services (recruitment agencies, training);
- facilities management and office services (telecoms, furniture, cleaning, catering, printers);
- utilities (gas, electricity, water);
- consumable (grease, oil etc.);
- MRO (maintenance, repair, operations)
- capital goods (plant, machinery); and
- fleet management.

FIGURE 1

Indirect procurement standard framework



Source: COPC Inc.

is shown in Figure 1, and was met with approval from industry participants. For instance, Mike Simms, Microsoft's chief procurement officer, noted: "Sharing best practices while also establishing a framework to evaluate performance, measure improvement, and, ultimately increase business impact is a win-win for us and other companies who are participating in the development and governance of this new industry standard."

Chris Flum, director of North American purchasing for Magna International, added: "The standard was an essential step in ensuring companies can implement appropriate best practices and benefit from the latest knowledge in this evolving area."

The framework

As illustrated in Figure 1, five

category processes underlie the framework. They are:

Category 1: Leadership and planning. This is the starting point that comprises key activities such as: statement of direction; business planning; corporate responsibility and reviewing business performance. The purpose of this category is to give specificity to plans that pertain to the IP organization as closely as possible. To the extent this category can be considered a subset of an organization's overall strategic planning process, it shows accountability and responsibility for all activities in this and the other four categories.

Category 2: Key business processes. After considering leadership and planning activities, Category 2 assesses the key business processes affecting IP. With the intent of expanding a wider net that includes the extended supply chain, this stage encompasses supplier facing, customer facing and internal facing processes, including: 1) customer relationship management; 2) defining sourcing requirements; 3) developing sourcing strategy; 4) developing/issuing RFXs; 5) selecting and contracting suppliers; 6) Implementing/onboarding suppliers; 7) paying suppliers;

relevant staff for consistent execution and performance; and clear documented agreements (with performance requirements) with all internal suppliers to ensure that end-to-end processes perform at target levels. Suppliers, meanwhile, should benefit from clearly defined requirements and metrics; a clear understanding of procurement processes, timelines and expectations; appreciation they will be treated fairly; and a mutually beneficial relationship.

To do so, we created a governance structure comprised of two committees: The first was a steering committee comprised of executives from leading organizations who are responsible for all (or most) of their company's indirect spend. Initial participation in the steering committee was limited to North American individuals, with future plans to add global representation on the steering committee.

The second committee was a technical advisory council comprised of key individuals who manage or are subject matter experts for a significant portion of their company's indirect procurement operations.

The IP standard framework that came out of this process

8) supplier relationship management and 9) terminating supplier relationships.

The internal processes adopted for IP are consistent with strategic sourcing processes for direct materials. Similarly, supplier relationship management and customer relationship management were directly related and traced to IP.

Category 3: Key support processes. Category 3 considers the six key support processes for an IP strategy: 1) change management; 2) risk management; 3) corrective action and continuous improvement; 4) compliance 5) key support supplier management; and 6) data analytics and market intelligence.

These key support processes cover a firm's posture on risk assessment and mitigation and compliance processes that ensue from them. Business continuity planning completes the risk cycle. Overall change management that reflects a flexible culture was another key facet of support processes. Supporting internal supplier relationships with organizations within the company but outside the IP organization that support the IP organization is an important component of this category, as are data analytics and market intelligence to support all aspects of IP.

Category 4: Key people support processes. Category 4 focuses on the key people needed for an IP strategy, based on three activities: 1) recruiting and hiring; 2) training and development; and 3) managing staff feedback. Given the importance of human capital, this category involves hiring the right people and actively looking for new talent. Investing in training and developing employees is important after hiring. The last part is constant interaction with employees that includes actively seeking their feedback to promote a sense of belonging.

Category 5: Performance measures. The key performance measures considered in Category 5 are: 1) customer satisfaction; 2) supplier satisfaction; and 3) business

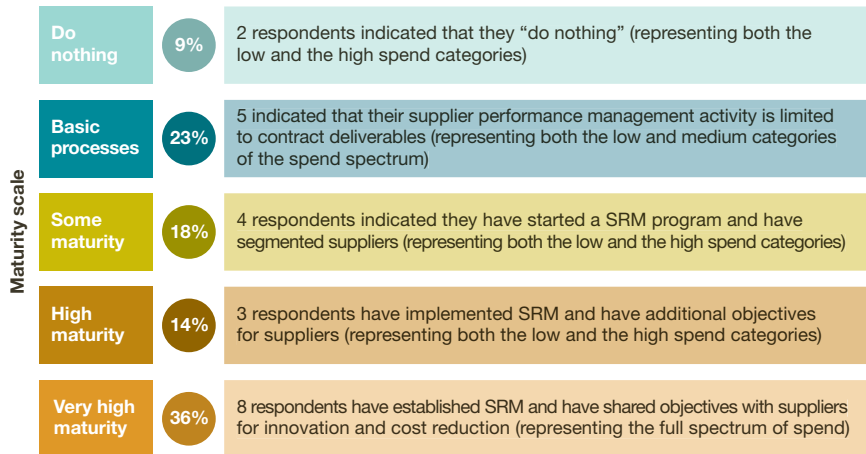
TABLE 1

Benchmarking analyses for SRM

GOAL: Determine how indirect procurement (IP) organizations handle SRM within their organizations

KEY LEARNING:

- Of the four areas benchmarked, SRM has the most maturity across respondents
- 68% of respondents have indicated some level of maturity in this area having started SRM
- 36% responded with the highest level of maturity



- 1 of 9 respondents (11%) with under \$500 million in spend was at the top box level for SRM
- All 6 of the respondents with over \$5B+ in spend were at the top box level of maturity for SRM

KEY LEARNING: Strong correlation between spend and maturity for SRM

Source: COPC Inc.

performance. The associated metrics track outcomes of customer facing and supplier facing processes, and internal bottom line outcomes.

How mature is your IP?

Following the development of the IP framework, we selected five key areas of interest for detailed investigation. They included:

- reporting/analytics;
- supplier relationship management (SRM);
- change management;
- risk management; and
- customer relationship management (CRM).

A maturity scale was developed for four of the above elements (excluding reporting/analytics) to assess how each IP organization rated themselves on these elements. The results for benchmarking the IP respondents are presented in the accompanying tables.

Rating of supplier relationship management (SRM)

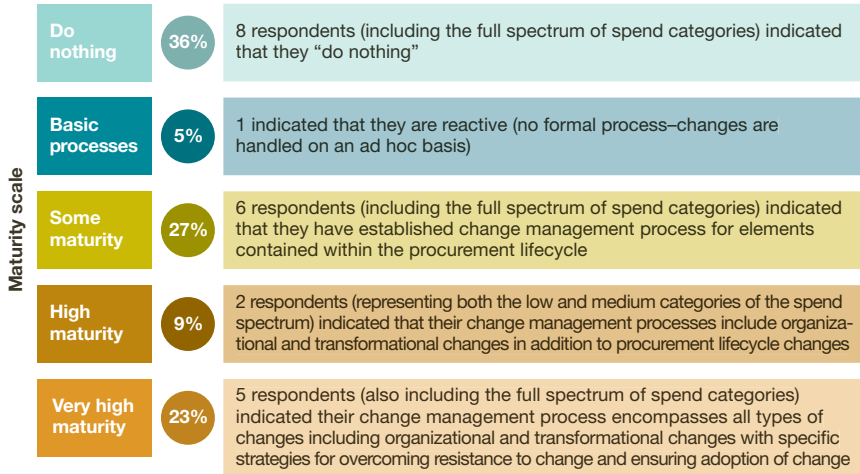
Of the four benchmarked areas, SRM (Table 1) had the most maturity across respondents. For example, 68% indicated

TABLE 2

Benchmarking analyses for change management

GOAL: Determine how indirect procurement (IP) organizations handle change management within their organizations

KEY LEARNING: No direct correlation between spend and maturity of change management process in IP



KEY LEARNING: Over half have some level of defined change management process, just under half of the respondents do not, and may benefit from reviewing best practices in this particular area, regardless of where they fall on the spectrum

Source: COPC Inc.

some level of maturity in this area by having started an SRM program, and 36% responded with the highest level of maturity. Only 9% of respondents said they were doing nothing in this area. More importantly, there was a strong correlation between spend and maturity for SRM. Only one of nine respondents with under \$500 million in spend was at the highest level of maturity, while all six of the respondents with over \$5 billion in spend were at the highest level of maturity for SRM.

The overall objective of the SRM program in leading IP organizations was to have a smaller but more strategic supply base to drive both price competitiveness and partnerships with vendors. To measure the impact of SRM, the following metrics were used: savings and implemented continuous improvement (CI) opportunities; business and supplier satisfaction; three to five innovative ideas annually; maintaining a healthy index of 95% compliance to contract; cost optimization and the number of innovation collaboration initiatives (ICIs).

The governance model for managing strategic suppliers included: establishing annual category plans with SRM targets; conducting monthly operations reviews to assess progress; ensuring representation across enterprises by meeting

quarterly to govern all different aspects of SRM performance; and looking for opportunities for centralization to drive strategy, technology and innovation. Centralization also helped detect market trends early, improved communication and ensured standardized disciplinary actions. Furthermore, these IP firms conducted annual executive business reviews and distributed supplier surveys to assess value, performance, innovation and customer service.

One key lesson from the SRM process was that the use of world class SRM processes, tools, templates and training—guided by technology—facilitates standardization, effectiveness and efficiency as well as collaboration.

Rating of change management

The key lesson from the change management module (Table 2) was that there was no direct correlation between spend and the maturity of the change management process. Over half of the surveyed respondents had some level of defined change management process in place. The other half, with no formal change management process in place, could benefit from reviewing best practices in this particular area, regardless of where they fell on the spend spectrum.

The best practices reported with respect to change management were: handling of changes via amendments to purchase orders (POs) or contracts; using system tools to log, track and manage change requests; having a series of reviews, approvals and signoffs that are managed by category managers; establishing standard procurement signing authorization levels, and in many cases, the IP organization conducting the negotiation. In terms of monitoring change, the best practices included: manual monitoring on an ad hoc basis; team-level self-monitoring; tracking variance to budget; establishing metrics prior to implementation, reporting results against metrics post-implementation via operational reviews; ensuring executive sponsorship; and ownership of results and leverage project management planning (PMP) structure for



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A large background image of a suspension bridge, likely the Brooklyn Bridge, with a worker in safety gear walking across it. The image is overlaid with a green tint. In the bottom left corner, there is a faint, light-colored line-art graphic of a mountain range.

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major projects.

Finally, the tactics used by leading IP organizations to handle resistance to change included: reacting to resistance on an ad hoc basis where necessary; establishing clear stakeholder/business owner alignment and sponsorship of change prior to implementation; using communication language choices to describe changes in an inspiring manner (i.e. cost savings vs. money left on table); providing transparency to decision-making rationale; conducting pre-analysis/assessment of resistance factors for executive management; engaging with customers prior to change to gain perspective and buy-in; and establishing training and education plans to ensure understanding of benefits of the change (i.e. readiness planning).

Rating of risk management

Risk management (Table 3) had the lowest maturity of the four elements (46% in the bottom two boxes). The data also suggest that while over two-thirds have some level of defined risk management process in place, just under a third of the respondents do not have a formal risk management process in place. These firms may benefit from reviewing best practices in this particular area. The level of maturity of risk management was higher in lower spend companies, based on self-assessment.

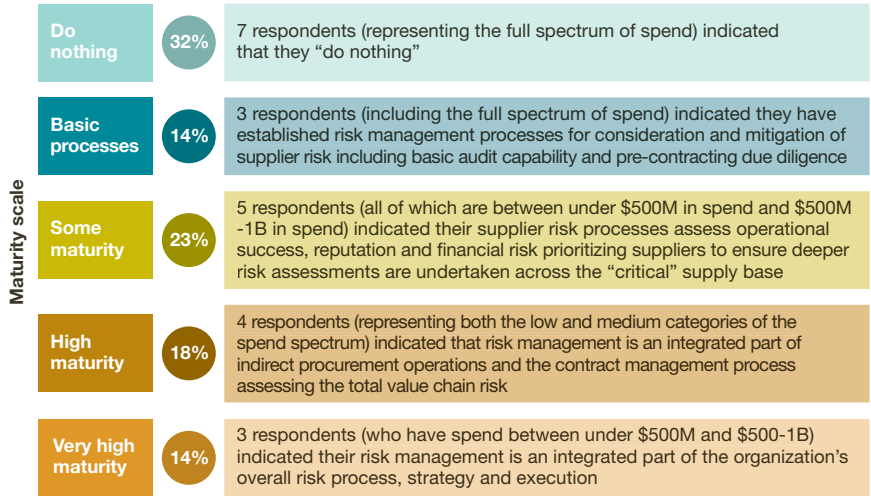
The key themes and best practices highlighted from the IP organizations on risk management were requiring business continuity plans (BCP) or disaster recovery plans (DRP) within their contracts. Another exemplar risk management practice was splitting contracts at the sacrifice of price to mitigate risk, and to engage with alternate suppliers. Cutting-edge firms created mitigation plans based on risk types such as: meeting regulatory/legal requirements; threats to market share or brand reputation; criticality based on potential impact on business; and events that could cause project or business delays. Also, leading firms

TABLE 3

Benchmarking analyses for risk management

GOAL: Determine how indirect procurement (IP) organizations handle risk management within their organizations

KEY LEARNING: The level of complexity/maturity of risk management structure was higher in lower spend companies, based on self-assessment, risk management had the lowest maturity of the four elements (40% in bottom 2 boxes)



KEY LEARNING: These statistics highlight that while over two-thirds have some level of defined risk management process, just under a third of the respondents do not, and may benefit from reviewing best practices in this particular area

Source: COPC Inc.

defined risk factors formally such as reputational/brand risks; labor law breaches; resource limitations; information security and privacy; fraud and data security; supplier capacity imbalances; cost pressures from business groups; geopolitical and market risks; financial and currency exchange rate risks, and physical safety risks.

For all of these factors, leading IP firms analyzed all high risks after categorizing all risks as low or high risk. These companies also evaluated critical suppliers for financial and physical disruptions and established standardized supplier risk ratings. Special priority was given to risks relating to fraud, cyber security and financial risks. Finally, many IP firms included supplier risk questionnaires as part of the RFP processes.

Rating of customer relationship management (CRM)

As seen in Table 4, a majority of respondents proactively engage with their customers through customer relationship management (CRM). It appears that IP Organizations that have over \$5 billion in spend are most likely to employ CRM. The data also suggests that IP organizations with

higher spend and more IP staff tend to more proactively engage with customers.

In terms of key takeaways and best practices, the data revealed that measuring customer satisfaction provided useful insights to the IP organization to assist in further engaging with customers. Respondents with higher levels of maturity were also surveying their customers. However, most IP organizations in our survey sample were not capitalizing on this source of information to drive actions that improve customer satisfaction.

Lessons learned

In this article, we have highlighted an industry-wide gap in a consistent way to approach indirect procurement. This, despite the growing evidence of the strategic importance of IP to overall spend and the “mistakes” made by organizations brushing off the importance of IP despite evidence pointing to the contrary. A new IP standard framework is a major step forward in closing this gap. And, based on the analysis of our research, there are a number of important lessons learned for each of the four stages covered by the standard.

Supplier relationship management (SRM). As noted earlier, SRM was reported to have the highest level of maturity among the respondent IP organizations. The most frequent segmentation criteria (or basis) for inclusion of suppliers was spend amounts and criticality of commodity being procured. In contrast to CRM, measuring supplier satisfaction as part of SRM was deemed to be important by only 32% of the respondent IP organizations. While, the theory on supplier development and supplier enrichment calls for a joint consideration of the focal firm’s objectives with the standard and the suppliers compliance to the standard, our data appears to support the idea that firms are a long way from this ideal. For the majority of IP organizations, the focal firm tended to dictate terms and policies when it came to SRM, and preferred the status quo.

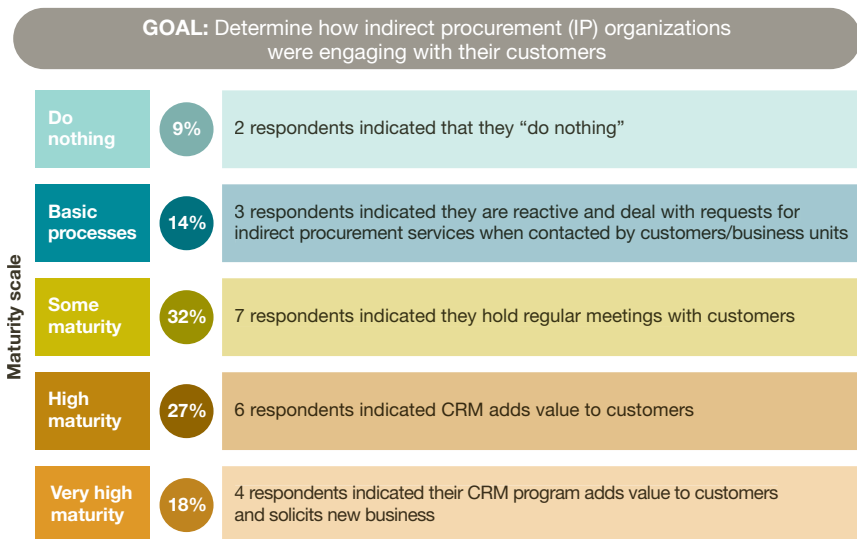
Change management (CM). In our sample, over half of the respondents had reported some level of defined change management process in place. At the same time, just under half of the reporting IP organizations did not have change management processes in place, regardless of where they were on the spend spectrum.

Risk management (RM).

In our sample, over two-thirds of the reporting IP organizations had some form of risk management process in place. Moreover, the level of complexity and maturity of risk management was higher in lower spend companies. This is somewhat perplexing as one would expect that maturity of risk management should have been higher in high spend companies due to higher exposure. It seems that high spend companies need to invest more in improving their risk management processes. It may also be noted that risk management was overall the lowest maturity area across organizations, with 55% of respondents indicating some level of maturity.

TABLE 4

Benchmarking analyses for CRM



- KEY LEARNING:**
- The majority of respondents proactively engage with their customers
 - The IP organizations that have over \$5 billion in spend are most likely to engage their customers
 - Data suggests that IP organizations with higher spend and more IP staff tend to more proactively engage with customers

Source: COPC Inc.

Customer relationship management (CRM).

Findings from our field research revealed that most respondents proactively engage with internal customers. This is natural as many functional entities via the request for quotes (RFQ)/request for proposals (RFP) processes would have to deal with the IP organization. However, our results also revealed that the objectives of IP were not aligned with the objectives of internal customers. This calls for more communication and real time monitoring to assess the extent of misalignment and then formulate strategies to fix the gaps. With respect to external customers, our research revealed that approximately 60% of the sample IP organizations stated that customer satisfaction was an important metric to gauge the effectiveness of the CRM process. However, only 40% of the sample IP organizations actually measured customer satisfaction. There appears to be a lag in maturity levels with respect to CRM among IP organizations.

With the development of the “Indirect Procurement Standard Framework,” and the lessons learned, we believe there is a tremendous opportunity to transform indirect procurement from the neglected pet of a sourcing organization into a vital component of strategic sourcing. Competitive advantage and savings are available to those organizations that employ the standard and do indirect procurement the right way. •

Acknowledgements

The following individuals were instrumental in the development of this article: Cliff Moore, Chairman, COPC Inc. cmoore@copc.com, Andre Frommer, Senior Director, COPC Inc. afrommer@copc.com, The Indirect Procurement Steering Committee and Technical Advisory Council, Mike Simms, CPO, Microsoft Corporation, and Chris Flum, Director of North American Purchasing, Magna International

Top-level correlations

In addition to the key insights gained across the four strategic areas of the IP standard, the study provided the opportunity to collect demographic data from the responding companies including: amount of IP spend, industry representation, size of IP organization, level of centralization of the procurement function, and whether or not a corporate mandate exists for the IP organization to be used for all procurement related activities. As a result, several potential correlations could be analyzed and assessed based on the responses provided. The questions addressed are listed below.

- Are some industries doing more in certain elements of procurement than others?
- Are more centralized organizations further up the maturity continuum?
- Is spend a predictor of maturity?
- Does the size of the organization relate to the level of maturity?
- Does having a corporate policy mandating usage of the IP organization for procurement relate to the operation being centralized?
- Does having a corporate policy mandating usage of the IP organization for procurement relate to the percentage of spend under management by the organization?

There were a number of key lessons from the questions referenced above. For example, respondents indicated a great deal of diversity in maturity among IP

organizations. Also, there was disconnect between the objectives of the IP organization and internal customer objectives. This disconnect can be alleviated with the inclusion of customer satisfaction as a specific metric in the IP framework.

We also found that most IP organizations are not responsible for ordering, inventory management or for paying their suppliers. This could lead to coordination problems as one part of the organization does not know what is happening in the other parts with respect to the same spend item or supplier. While paying suppliers could be viewed as a centralized function, not taking into account ordering levels, including reorder points for key commodities, can be highly risky. Similarly, not tracking the inventory of A and B items could be disastrous, especially if there is a significant spend across these categories.

Another key finding was that there is correlation between spend and maturity levels. In other words, IP organizations with high spend levels also have the highest levels of maturity (awareness and implementation) with respect to structured IP processes.

Finally, while almost all respondents reported having conducted some form of data analyses, very few analyzed the demand for specific products or services. Taken with a previous point about not tracking inventory levels, this implies a tendency to do maverick buying as opposed to reacting to true demand points and patterns.

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POWER to the buyer

Buyers may feel powerless facing a sole-source, but they have more power than they think because they overlook the pressures on the supplier.

BY FRANK MOBUS AND HOWARD LEVY

Today's supply chains increasingly rely on customized inputs rather than standardized commodities or services. Parts, software, machinery all the way up to totally outsourcing production to a contract manufacturer are often custom designed for the task at hand so that the supplier can effectively and efficiently drive the lowest total product cost. While that makes excellent business sense, it can create a major sourcing challenge because the supplier now becomes, in effect, a sole-source. As the sole-source, the power in the relationship may shift to the supplier.

Much the same happens when the input has to be certified by a third party, like a customer up the supply chain or a government agency, such as the FDA or the FAA. The government agency may have certified only a few suppliers and possibly just one. Similarly, design engineering groups

can provide the buyer with a specification conundrum where there is only one approved supplier at the raw material or finished product level.

The procurement problem is often compounded by the buyer's actions. The buyer may over-commit business before gauging the supplier's performance and end up being locked into working with an unsatisfactory firm. While it may be obvious to the buyer, a seller may not realize that they are in effect the sole-source. Instead they might find out how the buyer views things from "loose lips" in the buying firm, quite possibly side comments made by someone not involved in procurement, for instance, from engineering or quality.

Even where there are alternate suppliers, the buying organization may become so committed to one supplier that it, in effect, becomes a sole-source. Many companies are

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cutting back on the number of suppliers they use, which can result in one firm becoming a de facto sole-source for any given input. Inexpensive alternatives may be available from global best-cost countries such as China or Eastern Europe. Added resources may be needed in-country to ensure that quality, service and relationship management needs are met along with the added logistic costs, including capturing lead time impacts. Even alternatives to market-dominating Original Equipment Manufacturer parts may be available from the “gray market,” such as an off-brand that does not have the same warranty or service level guarantees. While these pathways offer alternatives, it means that one has to carefully gather information to make an apples-to-apples total cost evaluation of the gray market or best-cost country route.

In addition to these objective constraints, there is an even more difficult subjective problem that can exist in the minds of buyers, engineers, marketing and senior management. Frequently, the staff at a buying firm may become too familiar and comfortable with one supplier’s products that they rebel at any suggestion about exploring alternatives. They are so firmly convinced that only products from the usual supplier will meet their needs that they refuse to look objectively at alternatives. They may blame the procurement team for even raising the issue claiming that this could endanger relations with a supplier essential to the company. They may make dire forecasts of what would happen if the buyer did, in fact, switch suppliers. The natural inclination is to be wary about an unknown alternative.

As their bargaining power wanes, buyers may become even more gun-shy about negotiating. Rather than exploring cost-saving alternatives or confronting what has gone sideways in the relationship, they allow shortfalls to slide in the hope that they’ll be corrected later. In fact, the opposite happens: Left unchallenged, lower performance standards and higher prices quickly become the new normal.

The question for any procurement organization is this: Even if we’re dealing with a sole source, how do we return power to the buyer?

Buyers have more power than they realize

Even when buyers in an organization feel powerless facing a sole-source, they have more power than they think. Those on the buying side feel vulnerable because of the drastic consequences of losing their supplier. But they overlook an important question: What’s going on with the other

party—the account manager for the supplier? Specifically, how much of the account manager’s sales quota is dependent on this account? Is it half, three-quarters or perhaps even 100%? The point: The other side is also often under enormous pressure to maintain the business and develop approaches that will grow sales.

Following are some of the ways that a buyer can realize and build their leverage.

Adopt alternative technologies. In this age of rapidly changing technologies, it is always worth reviewing the state of play. Something new may have come along that completely replaces what the sole-source supplier has been providing. That is obviously often the case with regard to software and IT, but the new technologies can spill over into many areas. Even if the new technology is not really appropriate or is not yet ready for prime time, making clear that there are options coming on-stream can motivate a seller to make concessions. Maybe they won’t change their prices, but they could give a discount on upgrades or possibly provide them for free.

Break out part of the work to give to another vendor. There may only be one source for the basic equipment or software, but it may be possible to go with another firm for maintenance and training or even installation. The supplier may provide a variety of different components, some of which are indeed uniquely available from them but others of which can be found from other sources. It is important to review the contract from head to toe, to identify what really is sole-sourced and what could be sourced elsewhere. It is important to know the pluses and minuses of the alternatives. It can be counterproductive to threaten to go with another product when that product does not meet the buyer’s needs or when it has a poor reputation. The rule to follow: only threaten action when you’re ready to make good on the threat if need be. Just raising the possibility that the buyer’s firm may go elsewhere for business may lead the seller to improve terms. Particularly effective is to ask for a better deal on the items that could be sourced to another supplier. For instance, the buyer could ask for discounts on maintenance and training, such as extended warranties and free training on upgraded versions of the seller’s product. In the case of IT-related consulting, extensive support work is often done in best-cost countries (e.g., India), so ensuring your agreement reflects these lower costs could be a significant opportunity.

Perform part of the job in-house. In many ways this is a variant on the threat to give some of the work to

another vendor. But it has an added advantage. When the buyer talks about going to another vendor, the seller usually knows what the alternative vendors have to offer. By contrast, when the buyer warns that it may do part of the work in-house, the seller cannot necessarily be sure what capabilities the buyer has quietly been building up. However, an important similarity between the two threats is they work best when they are real: when the buyer actually does have the capability to do the work in-house and moreover is prepared to go that route if the seller refuses to budge. An empty threat undercuts the buyer's credibility in any future negotiation.

Lease rather than buy, or go to the used market.

This works most obviously for machinery. Often the larger and more expensive the machine, the more likely there is a used market or a leasing company. A leasing company is a firm that buys from the seller and then leases the machinery out. However, even with software, it may be the case that one can find the equivalent of a used market, namely, the buyer can announce it will not upgrade but instead stick with the older version.

Make the deal later rather than now. That could mean threatening to have additional meetings with the other vendors or even do a new quote to new potential sources. Just dragging out the procurement process can sometimes elicit concessions. For instance, if the seller is eager to make quarterly sales targets, whether to buffet the stock price or for the sales team to earn a higher bonus at the end of the quarter, they could be much more amenable to being flexible.

Jettison the whole project. The toughest competition today can be over who will get the limited budget resources to launch a new internal project, rather than which vendor gets the contract. Given these dynamics, it has become increasingly common for projects to be simply abandoned, for product lines to be shut down, for firms to exit what had been a major line of business. From the seller's perspective the very threat that this is being considered may be an effective way to show a sole-source supplier that nothing is guaranteed. If the supplier's terms are unreasonable, the buyer could simply abandon the whole game.

Create competition within the seller's own organization. The sales representative has to consider her reputation within her own firm. The buyer can ask for a different account manager for its territory, or go up the

organization to the regional manager, the national account manager, or the VP of sales. This approach is best used after research into what could happen has been done. Will the change be for the better? What are the chances the seller will refuse, and what are the buyer's options if they do? Indeed, the buyer should be prepared to make some concessions to a new account manager in order to demonstrate that the problem in the relationship was the old account manager, though of course at the same time, the buyer can ask for some specific things to which the previous account manager refused to agree.

Put the seller's short-term interest in competition with their long-term interest.

The buyer might tell the supplier that they will pay the price and continue to do business with the opportunistic sole-source, but that the situation is forcing them to work toward other options. Like designing out their part in future models or helping to establish a competing firm, for instance, a new start up that is not yet viable or a strategic partner that is willing to expand into a new product arena. Perhaps providing funding, engineering help or guaranteeing the new supplier business assuming their products obtains approval.

Buy the sole-source company. This may sound far-fetched and an individual buyer won't have the ability to do this. However, many large companies grow through acquisition and a small, sole-source provider that provides a competitive advantage given its unique product or technology could be a good target. Mergers and acquisitions continue to accelerate in many industries, so selectively you could broach this option with your senior management.

This is by no means a comprehensive list. Before entering into negotiations, buyers should carefully consider how things look to the other side. That starts with gathering as much information as possible about the challenges facing the seller. Did they just lose a major customer? Have they recently launched a new version of their product which they need to show is worth upgrading to? Have they opened a new facility that gives them more capacity, meaning they need more sales? Often the best sources of information are people in the buyer's organization who interact regularly with the selling firm, such as engineers. A worthwhile exercise is asking around within one's own company to see who knows something about the pressures on the other team.

Positive leverage

The approaches in the prior section are all about the consequences if the buyer does not cooperate. “Consequential leverage” is what usually comes to mind when we think of traditional business negotiations. But another way to influence the other side is through “positive leverage.” That means offering ways to make the deal sweeter if the other side cooperates, such as better long-term demand visibility enabling the supplier to produce in larger more efficient quantities or sharing cost savings from joint value analysis/value engineering sessions.

One of the most common forms of positive leverage is to offer more business in return for better terms such as a long-term contract. Or the buyer’s firm may have a number of business units that could purchase the seller’s output, which could include entry for the seller to high growth global markets. There could also be other products that the seller would like to sell to the buyer’s other divisions. The seller may also want to introduce new technologies to the buyer. These could make the seller more flexible on the current negotiation. In the case of a complete contract manufacturing outsourcing there is limited leverage on the current deal, but offering up larger potential opportunities down the road could make a difference.

Ordinarily, a buyer going down the positive leverage route is looking for something in return. The quid-pro-quo could be a lower price or a volume discount, but it could also come in other forms. For example, sellers will sometimes provide extra consulting, free upgrades, product samples or information about the latest marketplace trends. On the production side of the business it could be having the supplier jump through hoops to get to market quicker to generate revenue sooner on a high profit new product introduction or having “free” vendor managed inventory to reduce lead times and a reduction in the buyer’s inventory costs. Another creative approach is the buyer may help the seller market their product. Beyond serving as a reference, they might write a white paper, perform a case study or even serve as a demo site.

Turbocharge your internal teamwork

Whether you choose consequential and/or positive leverage, more and more sourcing professionals recognize the need to “sell” the proposed strategy to cross-functional team members, business units and senior management.

While negotiation courses emphasize the need for preparation prior to a supplier negotiation, a similar approach that requires extensive preparation, formal commodity strategy development, flexibility, creativity and positive professional persistence with your internal team members is becoming the norm. The more important the sole-source supplier, the more useful is having a cross-functional negotiation team. To be most effective, the team leader should assign roles, and hold pre-meetings complete with a written strategy. This should include “musts” vs. “likes”; a maximum supported solution; an agreed last acceptable solution; key approach factors your side will use; the BATNA (best alternative to a negotiated agreement); a list of your side’s leverage; target timing; and budgets. As the negotiation proceeds, the team should communicate updates with key leaders.

A cross-functional negotiating team can be an important vehicle for deciding your priorities. For example, actions to reduce supply chain risk has become a C-suite priority given the greater dependence on fewer suppliers, less inventory, the complexity of resourcing customized products and the potential dire revenue impact. Whether it is a hurricane, fire, bankruptcy or other supply chain disruption, procurement needs to proactively work internally with cross-functional team members and senior leadership to minimize risk through a prioritization and funding of selective strategic dual sourcing. Once an alternate source is approved, it is then best to leverage the percent of business among the dual sourced suppliers to maximize performance.

Another approach is to seek out allies in engineering, quality or other functions where the sole-source supplier is not meeting expectations. While some sole-sources are wise to have only a price issue, suppliers with monopoly positions may let their service or critical technical support slip. Reaching out to team members beyond procurement and realizing you are not alone with the current lower performing supplier may provide the needed traction to make dual sourcing a cross-functional priority.

Much can be gained from a deep-dive understanding of the supplier from key stakeholders in your firm. That includes a review of current agreements, including dates, price adjustments and payment terms. It also means reviewing the supplier’s historical performance, including quality, cost, delivery, innovation and relationship alignment. Often an on-site key stakeholder meeting

at the sole-source supplier can be enlightening, providing ideas on how to reduce costs, improve the relationship and better assess the supplier's capabilities. Such a cross-functional team fact-finding mission can help you better understand the supplier's situation: his objectives, his competitors, his industry position, news about the firm and so on.

Another option is engaging senior management at your company and at the supplier in on-site meetings to raise the profile and importance of the relationship and the need for change. As in any negotiation, pre-meeting preparation is critical to ensure the cross-functional team members (including senior management) know their roles.

A challenge that buyers often run into is the development of engineering resources primarily focused on new product introductions rather than current products, which may be the right overall business strategy. Quantifying significant potential savings with the alternative supplier through a quote or "should cost" analysis may provide the difference in justifying the needed engineering resources. A \$1 million savings will get much more attention than a lesser or unquantified savings. Another way to gain momentum is to introduce the dual source on a new product introduction that is not a high risk. This can help the team better assess the new supplier's capabilities while sending a message that the incumbent is no longer the only game in town.

Sometimes industry suppliers with potential to be an excellent dual source may be shut out due to factors such as a raw material specification that specifies the current supplier on the print or historical inaction on the part of the buyer's firm over the years. While it is tempting for the very busy buyer to ignore the next random e-mail or phone message from a new potential supplier, industry intelligence on leading or emerging suppliers could transform performance. Another creative process is a supplier cost reduction system, including savings ideas related to sole-sources. If engineering does not have resources, sourcing could consider funding additional or temporary engineers such as recent engineering retirees to support print revisions, testing, etc.

Another approach to achieving significantly better results with sole-source suppliers is adding the right "hired gun" to your team. Telecom optimization, IT, consulting, energy utilization and lease vehicles often benefit from outside experts that have core competencies in these areas.

Or if you have a very high profile or sensitive negotiation, bringing in an objective third party negotiation expert may be what is needed for the team to make progress. Another option is purchasing consortiums that could better your deal on rental cars, small parcel, laptops and maintenance, repair and operating items with a sole-source supplier.

And while loose lips can play against you, it could potentially play for you in the right circumstances. For example, just the act of testing out viable products from China may be enough for the engineer to let the current sole-source supplier know the procurement people are getting serious about global sourcing to get a more competitive price. Similarly, many companies have cross-functional commodity strategies to drive alignment across the internal organization. The opportunity to move from "no new business" to "preferred status" can be a strong motivator even to sole-source suppliers. Day-to-day actions most buyers would not even think about may also cause the sole-source supplier to be more flexible such as when they see their competitors' at your supplier conference or even their names on your lobby sign-in sheet.

Remain calm: Prepare, align and maximize supplier value

It is only natural for us to be acutely aware of our needs. It is harder to bear in mind that the other side also faces pressures. What appears to the buyer as a hopeless power imbalance may look quite different from the other side. The seller may be critically dependent on the buyer to meet their sales numbers. Along with the right extensive proactive preparation, internal team alignment, and procurement's professional persistence even the most difficult sole-source situation can be successfully negotiated.

Once the current negotiation is completed, remember it is not time to relax as you move through the next step in the strategic sourcing process. Active cross-functional performance management, including quarterly metrics reviews and innovation sessions should accelerate continuous improvement. The increase of customized products with sole-source suppliers has made procurement's job more challenging and interesting. For those who face the challenge head-on, the strategic management of these more complex supplier relationships can be rewarding and provide a great opportunity to maximize value and deliver a competitive advantage. •



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Foreign firms doing business in or with China are likely to sell products and services to Chinese state-owned enterprises. When a dispute requires the Chinese legal system for resolution, the SOE is likely to be favored. Self-enforcing contracts are a viable workaround to help level the playing field.

BY CHRIS CARR AND DAN HARRIS

Even after several decades of reform, state-owned enterprises (SOEs) in China continue to account for a significant portion of the Chinese economy. In fact, the central government, under President Xi Jinping, has made clear that the prominence and power of SOEs will grow.

Foreign firms doing business in or with China are likely to sell products and services to Chinese SOEs. However, doing deals with them presents very different challenges when there is a dispute—in sharp contrast to contracting with privately owned firms.

When a dispute with a Chinese SOE requires the Chinese legal system for resolution, the harsh reality is that Chinese courts typically do not view the parties as equals. This puts foreign firms at a significant disadvantage.

That inspires some to generalize that “contracts with Chinese companies are not worth the paper they’re printed on.” We have seen contracts that, in fact, were not enforceable in China. It is not uncommon. Unfortunately, these companies did not leverage the right tools and strategies to develop an enforceable contract. But it doesn’t have to be that way.

Self-enforcing contracts that bypass the United States and Chinese legal systems all together do work. We have found this to be a better, cheaper and more effective strategy. It structures the relationship so that court involvement is not necessary.

The article highlights the why and how to do just that and it provides recommendations and strategies for a winning, self-enforcing contract with a Chinese SOE.

Start by understanding the SOE landscape

In doing business with a Chinese SOE, there are some fundamentals that should be both understood and appreciated up front. They range from guiding

beliefs in the procurement process to the relative importance of SOEs to the Chinese economy.

To begin, the foreign business will most likely sell its products or services to the SOE, not the other way around. In doing these deals, it must be understood that the following five fundamental beliefs will drive the SOE’s behavior during the purchasing process:

- the price is too high;
- training is not necessary;
- proper equipment set-up is not necessary;
- after sale support and maintenance is not required; and
- attempts to protect intellectual property (IP) constitute foreign oppression.

When SOEs base their purchase negotiations on these five beliefs, some foreign suppliers may conclude that the Chinese are operating in bad faith. We disagree and take no position on that “clash of the civilizations” debate.

The key is to understand and accept that they believe their approach is fair. They see themselves as simply trying to level the playing field against a perceived unfair advantage held by the foreign seller. Later in this article, we detail how these five beliefs influence business relationships.

There is also the matter of the relative importance of SOEs to Chinese business, politics and the economy. Know that they are important, and that is not likely to change.

To begin, SOEs account for 30% to 40% of China’s total GDP and roughly 20% of China’s total employment. The state sector consists of three parts. First there are the enterprises the government fully owns through the State-owned Assets and Supervision and Administration Commission (SASAC) of the State Council and through provincial and local government SASACs.

Second, some SOEs are majority owners of enterprises that are not officially considered SOEs but are effectively controlled by these SOE majority owners. Finally, there is a group of entities, owned and controlled indirectly through SOE subsidiaries based inside and outside China.

Added up, this means China has approximately 150,000 SOEs, which are in most sectors of the economy. Roughly a third are owned by the central government and the remainder by local and provincial governments.

In addition to the size of the state sector, there are several initiatives underway that will strengthen the importance of SOEs.

To begin, the SASAC has articulated many industries important to China's economic and national security that will remain under govern-

ment control. Second, one of China's recent Five-Year Plans indicated it was pursuing a "national champion" strategy for certain industries the government deems important. Third, SOEs are viewed as a key driver of the government's plan to build China's indigenous innovation and to make China less reliant on foreign technologies. Finally, many Chinese SOEs are looking to go global and do business abroad. The recent "One Belt, One Road"

strategy—the core of President Xi's foreign policy—has made foreign expansion an explicit part of China's mandate. China's SOEs will help get it there.

How the courts view SOEs

It is important to acknowledge that China's court system needs more work regarding foreign businesses successfully obtaining meaningful remedies

against powerful SOEs that don't pay their bills.

Many of the disputes we handle are between wholly foreign-owned enterprises (WFOEs) as well as other types of foreign companies and privately owned Chinese companies. Surprisingly, we have found that in these sorts of cases the Chinese courts tend to treat the parties as equals, without bias towards either side. In our experience, many Chinese companies complain that the Chinese courts actually favor the foreign side over the Chinese entity when it comes to intellectual property (IP) infringement. That is, the Chinese courts just assume the Chinese company is an infringer and move on to determine what to do about the infringement.

However, when the Chinese party to the contract is an SOE, things change. Here, our experience is that Chinese courts treat the SOE better than they treat the foreign party. The likelihood of securing a favorable court decision in China against an SOE is low.

So, how can a foreign company level the playing field when dealing with SOEs? Some think the solution is litigation in California or arbitration in New York. But this is usually a mistake and won't work unless the SOE has assets in the United States. Even if that court or arbitration decision is in favor of the foreign party, China's courts are unlikely to enforce it. Those conditions bring the self-enforceable contract front and center.

Understanding the five core beliefs

It is best to go into negotiations with SOEs with both eyes open, acknowledging the five core beliefs mentioned earlier. It's worth mentioning that the five are common, but not universal. That said, it is best not to blindly bet your contract on finding that anomaly.

We mention this because foreign companies usually find all of this hard to believe. Even when they do believe it, foreign companies find it hard to truly internalize and to adjust their selling strategy accordingly.

Here are the five negotiation arguments likely to be encountered.

The price is too high. Expect the SOE to argue that the price is both too high and fundamentally unfair. It may view this as the legacy of foreign imperialism. Under this basic belief, trying to avoid paying full price for the equipment is morally justified.



The key is to understand and accept that they believe their approach is fair. They see themselves as simply trying to level the playing field against a perceived unfair advantage held by the foreign seller.

To avoid paying full price, the SOE may insist on:

- paying in installments, then not pay the last installment;
- a steep discount, effectively setting a new base price for the equipment; and/or
- an additional discount for future purchases after paying the discounted price for the first two units, for instance.

Training is not necessary. Requiring training in equipment use is just another way for the Western firm to unfairly extract more money and to keep the Chinese down. It is also a way of showing that the Chinese have something to learn from foreigners.

Proper equipment setup is not necessary. Requiring the SOE to retain the selling company for proper equipment set-up is a waste of time and designed to shift blame for operational failure to the Chinese. The SOE believes the equipment should “just work.”

After-sale support and maintenance is not necessary. After-sale support from the foreign equipment supplier is designed to unfairly extract more money from the SOE for fundamentally defective equipment or overcharge in the first place. It also is done to keep Chinese employees ignorant of the true nature of how the equipment operates.

Attempts to protect IP is foreign oppression. Intellectual property protection that prevents the SOE from copying the equipment is another form of foreign oppression. We have experienced seasoned business people in China flat out telling us this.

The SOE may not fully appreciate that equipment design is the result of years of hard work and R&D. And they clearly want to be able to copy it so that it can be manufactured in China at a “fair” price. The standard Chinese strategy will be to purchase as few units as possible, and then extract the “magic formula.”

Once these behaviors are understood and accepted, it will be substantially easier to effectively design a sales program and strategy that can succeed in the Chinese market. We now turn to the building and leveraging of self-enforcing contracts to achieve that.

The basics of self-enforcing contracts

Our own experience with SOE deals has mainly been in heavy equipment sales and intellectual property transfers.

There, it is rare for SOEs to sue their suppliers. On the other hand, it is common for these SOEs to not pay their bills.

We know of several companies bankrupted by non-payment for product delivered or services provided, from the imposition of charges for late delivery or trivial defect claims, or both. SOEs can be quite ruthless here. Some don't seem to care if they bankrupt their suppliers. They (correctly) assume there is a replacement seller ready to take over.

When doing a deal with a powerful Chinese state-owned company, your first step should be to enter a contract that follows some basic rules for developing a successful enforceable contract in China.

For example, China has great respect for the written word. Even in difficult situations, it is surprising how effective it can be to threaten a lawsuit in China based on an enforceable, Chinese-language contract. However, for the threat to be effective it must have at least some teeth and that requires a contract that works.

As a result, it is essential to plan carefully and develop a path that helps make your contract self-enforcing, with no court or legal system involvement. Here are several recommendations to make this possible.

Don't discount. An early mistake most Western companies make is to discount the price. The usual explanation is “we will discount the first equipment sale and then make up for that discount on future sales.” Bad move.

In fact, offering a discount simply confirms the other side's basic assumption that your price is too high. They will treat the discounted price as a new floor price for the product. That will be followed with a request for an additional discount



When doing a deal with a powerful Chinese state-owned company, your first step should be to enter a contract that follows some basic rules for developing a successful enforceable contract in China.

against the already discounted price.

Quite simply, never offer a major discount for the initial purchase other than for quantity or for customer loyalty. Hold the line and explain that the price is both fair and the same price around the world, on the same terms. What reason is there to change this policy for China?



Quite simply, never offer a major discount for the initial purchase other than for quantity or for customer loyalty. Hold the line and explain that the price is both fair and the same price around the world, on the same terms.

fully drafted letters of credit using truly neutral third parties. Chinese buyers, however, typically want to use only Chinese banks for their letters of credit. Unfortunately, those banks will nearly always favor their SOE buyer customers.

For SOEs planning to clone the equipment, installment payments fit perfectly into their plan. The equipment will be delivered and installed in stages, in accordance with the installment plan.

The SOE will delay payment from the very start and then use the payment delay (which it will usually blame on China's capital controls or some tax issue) to push the foreign side to deliver more than is required for each installment. The SOE will then reluctantly make a payment or two, all the while extracting equipment, training and know-how.

When the SOE believes it has gained "enough" from what you have already provided, the payments stop. The common standard is to make two of five payments in exchange for 50% of the

Get paid before delivery. This is the golden rule. If the deal involves delivering product to the SOE, write a contract that precludes shipment or delivery of a service until after payment. That might be in the form of a substantial deposit prior to delivery. SOEs will fight this, possibly killing the deal altogether. But so what? Going bankrupt due to non-payment is worse than no deal.

In many countries, issues related to payment can be resolved with care-

product and expertise. We constantly warn clients not to become complacent.

Other SOEs use installment payments to force discounts. They negotiate for a series of installment payments with a major final installment to be paid after installation and approval by their side.

This approach virtually never works well for the foreign seller as Chinese buyers are expert at finding problems with the equipment. The SOE will raise these problems as excuses for continual payment delays and then use their own delays to seek an after the fact discount in price, while holding the installment payments as hostage to achieve this goal.

If the SOE is unable to secure its desired discount during the basic installment period, it simply will not make the final payment, achieving a 10% to 15% discount by that single refusal to pay. If the foreign side threatens to sue for that final payment, the SOE will trot out a list of problems with the product and its installation—often problems the SOE itself caused.

Don't deliver equipment until installation conditions are met. Remember that the SOE may believe your rules for installation and usage specifications are just a subterfuge to "hide the magic" and charge more. So, the SOE will not do the proper set up and will ignore the specifications. But later, when the equipment does not work as expected, the SOE will most likely blame the seller for those failures.

Foreign equipment sellers cannot rely just on clear contractual specifications when there is a problem. The foreign seller should ensure the conditions are met before it delivers the equipment. And if the conditions are not met, the foreign seller should not deliver.

Our most experienced, sophisticated and successful clients usually charge a premium to SOE buyers simply to cover themselves in advance.

Design equipment to withhold critical components. Design the product so that a key component is unavailable to the SOE until it pays in full. For hardware, this might be a critical component for operation. For software, require the use of a password or software key that you can change each time a new payment is due.

Cover risk with standard risk management tools. There is inherent risk in any transaction so cover it with a letter of credit, a bank guarantee, escrow or insurance.

Be sure to use a truly neutral third-party professional not located in China. Any risk management product offered by a Chinese entity will likely be of little to no value in decreasing your risk.

Build training, maintenance and support into price. No matter how much the SOE tries to de-couple the pricing for maintenance and support, do not go along. The cost of training and support are best included in the full sales price, and not broken out.

Why do SOEs refuse to pay for maintenance and support? Again, trying to require an SOE to pay for these things is admittance that the product is defective. And why should they buy defective equipment? Furthermore, the equipment should work forever.

One exception here is training. If the SOE plans to clone the equipment, it may seek extensive training. The idea is to obtain the formula that will allow cloning. For this reason, training requires careful control.

Many foreign equipment suppliers offer whatever training proves “reasonably” necessary. This is nearly always a mistake. Neither Chinese companies nor Chinese courts truly understand or employ the western common law contracting concept of “reasonable.” Furthermore, SOEs typically ask for more information and training than necessary.

The contract should precisely set out the training to be provided. The same rules apply to provision for after sales support. Those obligations should also be spelled out clearly in your contracts for clarity and to control unexpected costs.

Protect your IP with a China-centric contract. Protecting intellectual property should be a core goal in all sales. But expect the SOE to contend that the product is too expensive to start, and IP protection just adds to that unfair price. The average SOE may purchase one or two items at a bargain price and then clone them in China at a “fair” price.

The obvious way to protect the intellectual property in your advanced equipment is to register your patents in China. But for various reasons, this often is not possible. Where there is no patent registration (and even when there is), incorporate IP protections into the sales agreement. The contract should preclude reverse engineering or manufacturing of a clone by the SOE or third party. A complex legal definition is not required. A blunt, simple

statement (in Chinese) should work.

In addition, the contract should define confidential information (including training and support information). Furthermore, such confidential information cannot be used by the SOE or third party. Specify monetary damages if these restrictions are violated. Injunctions rarely work in China, so contract damages are required.

Impose these restrictions with a written agreement enforceable by litigation in China. This is a key requirement. Your English language sales agreement enforceable outside China will not usually protect a foreign company’s IP in China. A separate IP protection agreement in Chinese, subject to Chinese law and enforceable by litigation in China.

The power of the self-enforcing contract

Most SOEs fully understand what is going on when we present them with a self-enforcing contract—and they often do not like it. Foreign business people are usually surprised that the Chinese SOE will willingly sign off on an onerous, 42-page, common-law focused contract. However, many will refuse to discuss a 10-page long, China-focused self-enforcing contract that is clearly written in Chinese.

The reason for this dichotomy is simple: Even powerful SOEs are hesitant to be pulled into the Chinese court system when the legal issue involves business rather than politics. They recognize that a self-enforcing contract takes away at least some of its power to be arbitrary and unfair.

Well-connected SOEs may simply refuse to execute a fairly written, self-executing contract. In that situation, the foreign party will need to weigh the risks and benefits of doing business with the SOE and consider whether it should just walk away from the deal. •



The obvious way to protect the intellectual property in your advanced equipment is to register your patents in China. But for various reasons, this often is not possible.

The New Language of Procurement

Forward-thinking players are setting their sights on advancing the future of procurement with active value management. But there's a long way to go to become an essential part of the enterprise performance conversation.

BY JOHN BLASCOVICH AND JOE RAUDABAUGH



The language of procurement speaks to an agenda driven by delivering value. Leading procurement organizations are well-versed in areas that resonate with financial officers and the performance narrative. They lead with hard value contributions of procurement,

can discuss their performance across an array of value drivers, and advance intangible value to their organizations as well. Knowledgeable about how their teams are performing, leading CPOs know what they need to do to improve their organization's performance and are laying out career paths to attract and retain the best talent.

Chief procurement officers who are literate in this new language are building the brand of procurement by making themselves valued partners to chief financial officers and the rest of the C-suite. In 2011, A.T. Kearney began homing in on benchmarking value delivery with Return on Supply Management Assets (ROSMASSM), a performance measurement framework built to help companies understand and measure how procurement contributes financially to the business.

In the inaugural ROSMA Performance Check report, we have gathered the feedback of hundreds of companies. The insights are powerful.

- Top-quartile performers are reporting hard financial results in excess of seven times their costs and investment base in procurement, providing a strong basis for reinvestment and recognition. These leaders generate about \$1.6 million in financial benefits per procurement employee each

year, with 35 percent of the financial benefits coming from using advanced methods that create hard value beyond unit cost reduction.

- Middle-tier performers are accretive. They typically generating four to five times the investment and costs of their supply management assets, including people and technology, but they have not improved their productivity since tracking began in 2011.

- Bottom-quartile teams are dilutive. The financial benefits they generate do not cover the cost of and investment in their organizations.

- Most organizations do not have the reporting and tracking capabilities to provide ongoing, accurate visibility into procurement's value-creating activities.

- Performance varies widely across all of procurement's key value drivers—spend coverage, sourcing program velocity, sourcing project yields and outcomes, compliance rates, and operating costs—regardless of company size, industry, or spend mix. Organizations with more mature/advanced practices have less variable performance across some of the drivers, but substantial productivity improvement opportunities are being missed.

The lack of tools for procurement-focused capability and resource management may explain the lagging adoption of value management practices in supply management.

The CFO community's sentiment toward supply management suggests that only 10 percent of procurement organizations have captured the respect, understanding, and mindset of their finance organizations regarding the value they contribute. Almost 15 percent are "out of mind" or "inconsequential players" to the CFO community and 75 percent have mixed and yet to be developed "brands."

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To view the full ROSMASM Performance Check Report referred to in this article, visit www.atkearney.com/rosma.

Because CFOs are the de facto scorekeepers, procurement's brand value must be addressed.

Setting the Stage

Over the past 30 years, performance dashboards and active process monitoring (visibility) have rolled across most enterprises: In the 1980s the focus was on manufacturing; in the 1990s it was on supply chain, research, and engineering; and in the 2000s it was on sales and marketing.

In the next wave of management practices, procurement will be enabled with new technologies. Since the 2008 global recession, there has been an uptick in CPO turnover. Now more than ever, the focus is on supply management. Forward-thinking players are measuring, communicating, and institutionalizing the value of supply management to secure recognition and support for the procurement brand and recognition of their supply management professionals.

Investment banking and private equity players have discovered that using procurement to create value is a powerful part of successful portfolio management. Procurement has also enabled success in mergers and acquisitions (think Anheuser-Busch and InBev, Procter & Gamble and Gillette, Walgreens and Boots).

Recognizing these trends, A.T. Kearney embarked on a journey with the Chartered Institute of Purchasing & Supply (CIPS) and the Institute for Supply Management (ISM) to bring common value management visibility and practices to procurement.

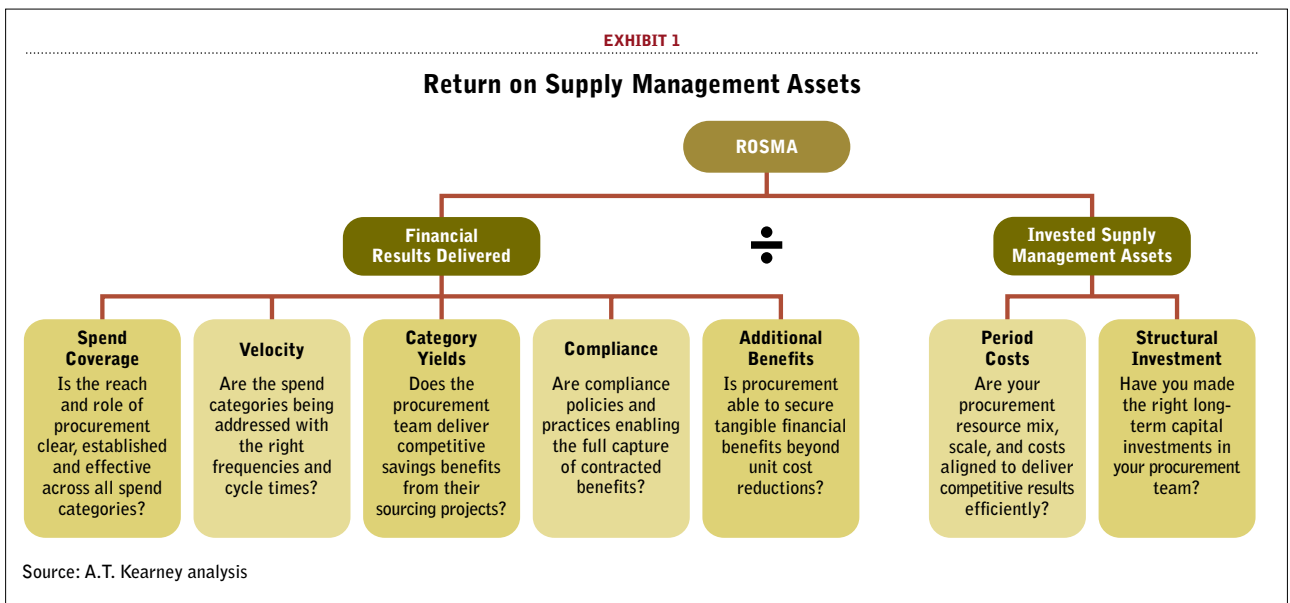
CIPS, ISM, and A.T. Kearney will continue to make the ROSMA Performance Check available for free to accelerate

adoption and harmonization of the framework so the profession and the finance community can align on a common standard. Procurement teams that use the framework can develop and pursue improvement pathways to nurture and sustain stronger driver performance levels and engage the support of their CFO communities. Each organization would be wise to craft its own assortment of KPIs to create its own unique scorecard. However, all organizations should adopt ROSMA value drivers or CFO-friendly derivatives as part of their financial KPIs.

Procurement has undergone a transformation over the past 25 years, evolving from an operation-focused support function to a more widely recognized profession that has seen waves of new technology, innovative methods and practices, and the elevation of some iconic professionals who have brought recognition to the value of procurement. The brand-building pathway ahead is just another step in the transformation—a step we can champion together. •

About the Study

This report is distilled from more than 400 completed, qualified, and accepted cumulative benchmarks along with more than 170 submissions focused on 2013 results (see figure). Contributors participated in the free benchmarking through ROSMA Performance Check gateways on the CIPS and ISM websites as well as via A.T. Kearney's 2014 Assessment of Excellence in Procurement (AEP) study, the longest-standing global study of supply management best practices. *To view the full ROSMA Performance Check Report referred to in this article, visit www.atkearney.com/rosma.*



NextGen: The Interview with Rob Handfield

Procurement analytics may be the next big thing, but we're still in early stages

BY GARY FORGER



This month we spoke with Rob Handfield about procurement analytics. Handfield is the Bank of America University Distinguished Professor of Supply Chain Management at North Carolina State University. He is also executive director of the Supply Chain Resource Cooperative. He serves as faculty lead for the manufacturing analytics group within the International Institute of Analytics, and is on the faculty for operations research curriculum at NC State. Handfield's latest book is *The Living Supply Chain: The Evolving Imperative of Operating in Real Time*.

NextGen Supply Chain: One of the hot topics in procurement these days is analytics. What's the state of analytics in procurement?

Handfield: Quite simply, procurement analytics is nascent. People get ahead of themselves very quickly here. It seems many go right to artificial intelligence. As if AI is already on the shelf and ready to go. It's not. We are much earlier in the development of procurement analytics.

That said, it's worth noting that AI will have a strong hand in the future. In fact, procurement analytics will rely on other nextgen supply chain technologies including the cloud, big data, cognitive analytics and mobile technology.

But today, we are at the stage of establishing the base for procurement analytics – data. And we're in the early stages of data organization and governance.

First, you have to be able to capture, store and use data to produce any analytics, whether they are KPIs or other decision-making measurements. We're still learning how to do that.

To that point, most data scientists today spend the majority of their time checking and cleansing data to ensure the database is clean in the first place. Little of their time is spent on identifying dots in the supply chain let alone connecting them to create new insights.

But it's not just about the data itself. The source matters too. Procurement analytics require not just internal data but external data. We have to consolidate and link these data sources. And all of the data needs to be in real time. Now it's easier to understand how nascent procurement analytics really are.

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NextGen Supply Chain: Internal data and external data? This must give some people qualms about data security.

Handfield: It sure does. We are moving to the idea of building trusted, protected databases. Think of them as cloud-based data lakes with rules. Not just anyone can contribute data. And there is governance as to who can pull data from the lake.

Data governance is the base of the procurement analytics pyramid. The next level up is business intelligence. This is a technology-driven process for analyzing and making decisions. This is where AI starts to enter the process. Without AI, it would be enormously difficult to analyze the streams of data coming into the data lake. And whenever we can automate procurement analytics, that's a good thing.

At the top of the three-level pyramid is business analytics. It needs the output from business intelligence to operate. Business analytics evaluates supply and demand trends to develop new insights into future sourcing obligations and supplier relationships, to name two. The ability to link supply and demand characteristics and anticipate how the supply chain will operate is the true nirvana of procurement analytics.

NextGen Supply Chain: What are some of the current areas of focus for procurement analytics?

Handfield: I would identify five at this point. And as you will see, they become incrementally more complex.

At the base is simple sourcing followed by spend analysis. Then there's the matter of con-

tract management, which, of course, includes risk exposure all the way down to raw materials by country.

Supplier risk is also part of the mix. For instance, how does a natural disaster affect the supply chain? And of course, there's corporate strategy. How do you build a supply chain to gain a corporate advantage?

NextGen Supply Chain: Why is all this important?

Handfield: We are moving into a new environment. Nextgen technologies from the cloud to AI are going to have a big impact on changing how companies manage procurement. Those who figure out first how to use these technologies will pre-empt others. Going forward, it's all about how to get information that can make predictions that will allow you to move before your competition.

NextGen Supply Chain: What kind of a trajectory do you see for procurement analytics in the next few years?

Handfield: Like I said, we are in the very early stages. That means leading companies will take the next five years to set up centers of excellence. These will pilot how to manage and use data to drive analytics. And young people will be a major part of making it possible.

In terms of what is accomplished early on, it's ok to go for easy wins. Once people start to get a sense of how much their supply chains can be helped with procurement analytics, they will demand more of it. Real-time data will be our new fingerprints in the supply chain. •