INTRODUCTION

Long gone are the days when companies can afford to have excess staff and cover all eventualities and requirements, in fact the majority of organisations operate extremely leanly even when times are good. During the process of conducting our assignments we have noticed that this important factor is a key contributor in companies losing focus on overhead expenditure. This together with a number of other key points has lead to our clients receiving uncompetitive pricing for some of the commodities they need in their business.

While there are too many factors to mention here we have identified six main points that you can use in your business and help you to R.E.S.C.U.E. your overhead expenditure.

Resource

As we have already explained most companies operate with minimal staff resource, often resulting in procurement becoming "managed" by personnel that already have a major role within the business. We have seen purchasing being undertaken by Finance Directors, Production Managers, Secretaries, Operations Managers and other personnel with many different primary roles. Our involvement with different organisations has allowed us to witness many different personnel being involved in procurement within the same company.

Example - One organisation was split in to six business units, each one with an individual manager. The primary role of each business unit manager was to plan and then achieve an ambitious production plan. They had neither the time or the skills to have responsibility for procurement They were all purchasing on an individual basis and while there were some bespoke requirements they all required some general products and services. There was no co-ordination, no co-operation and no monitoring of their and the suppliers performance. In many instances they were just obtaining one quotation at the time the product or services was needed leaving no time for negotiation. In addition, they also had a member of the office staff covering the same role for their own requirements and repeating the same mistakes.

Salesmen adore situations such as this. They take advantage of the lack of co-ordination and quote higher prices than they normally would to an organisation with a developed procurement function. They know that on the majority of cases their quote will not be challenged and they will develop a very familiar relationship that will ensure repeat orders come their way without any requests for new quotations.

Not surprisingly we managed to identify significant savings in virtually every category we were asked to review. However, while we were helping the client to implement the savings we also developed a series of recommendations to ensure that they did not continue with their previous bad practice and erode the savings we had generated for them. During our investigation we noticed that the member of the office staff had more time resource than the business unit managers. We recommended that some of their current duties be transferred to other personnel so that they could then manage all the procurement activity on a full time basis. We helped them develop a procurement strategy, an approved supplier list and on-going supplier performance monitoring. Lastly, we introduced regular internal meetings to allow the business unit managers to raise supplier issues and identify future critical production requirements. This allowed the buyer to receive enough notice to ensure materials and services were purchased on time and competitively. In addition, the meetings give the buyer the opportunity to give notice on any suppliers changes and issues within the supply chain.

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Expertise

Many companies do not possess a dedicated purchasing function and while there are many valid reasons for this it can result in the personnel designated as being responsible for purchasing not possessing enough or the right purchasing experience to be able to manage every product & service their organisation requires.

Example – A client in the financial services sector had a significant requirement for temporary labour but because the company did not employ dedicated procurement personnel they did not possess the experience on purchasing such a commodity. This resulted in five suppliers being used on an ad-hoc basis across a relevantly modest annual expenditure of £58,000. This not only reduced the companies leverage but they were also unaware of what they were going to charged each time there was a new requirement and they did not know what the agencies were charging in terms of margin.

We initially determined the range of personnel that the company required and confirmed the specification for each role. In parallel we discussed the capabilities and past performance of each supplier our client had used to determine if they should be included in the tender process. It is important to note that a minimum of three suppliers should be approached in any tender process but to ensure we had a selection of suppliers that covered all the roles and disciplines our client required it was decided that six suppliers would be included in the process.

Before reviewing any new quotations it is important to understand the current cost structure of any commodity that is being reviewed. We analysed the previous twelve months requirements, detailing the role, the hours worked, the rate per hour charged to the client and how this was constructed in terms of holiday pay, national insurance and suppliers margin.

Any supplier that is not prepared to divulge their margins in relation to this commodity should be discarded, as this is standard practice.

The result of the review after providing feedback, short listing the relevant suppliers and further negotiation was to select just one supplier. They were one of the original suppliers but because we had been able to discuss all of our client's requirements we had been able to negotiate a significant improvement on their margin. A new procedure was agreed to manage any new requirements and regular meetings planned to discuss performance and specific KPI's. Based on incurring the same demand the review had reduced the costs to £30,000, which was a reduction of more than 48%.

Status Quo

If a particular supplier or range of suppliers and products perform at a reasonable standard there are tendencies for them to be left to their own devices year after year. This is a trap that many companies fall in to especially on products and services that are not deemed to be highly important. It is our philosophy that if a product or service has to have money spent to obtain it then it is important. Obviously no organisation should spend scare resources reviewing minor areas of expenditure but they should at least focus on the items that represent 80% of the commodity expenditure. By continuing to purchase the same product for a number of years companies are not exploring new technologies, process, products and suitable alternatives.

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Example – One of our client's was in the publishing industry with a vast range of products being sold on a global scale. Not surprisingly they had a significant requirement for packaging products, which they then used to ship their products to their customers. A few of their products were unusually shaped and therefore difficult to pack and as a result the client, together with part of their current supply base had developed some bespoke cartons to package the items in question. This had been implemented a number of years ago with specially manufactured tooling being purchased by our client. While the volumes were still similar to when they were first introduced the bespoke cartons had become expensive, as the supplier could not sell them to anyone else and the cost of changing the tooling had to be included in the cost to our client. In addition, our client also incurred regular tooling maintenance costs, as they were responsible for any costs the supplier incurred in ensuring the tooling was fit for manufacture.

Our review initially focused on benchmarking our client's costs on a like for like basis. As the products were specialised and high profile in terms of cost we selected a total of six companies to take part in the tender with one of these being part of the current supply chain. The process included quantifying the volumes of each carton, the delivery requirements, the maximum production runs our client would commit to and providing both a sample of each product and it's corresponding carton. We did this to ensure that all suppliers had the same information and that nothing was left to interpretation, as they had the actual samples to review.

While we did identify an improvement of approximately 17% it was not sufficient to provide an acceptable payback period against the costs of the new tooling that was required. None of the suppliers we approached were prepared to absorb the new tooling costs and it was not possible to transfer the current tooling. In addition, our client would still have financial responsibility for maintaining the tooling even though the anticipated costs that we had managed to negotiate were less than they had incurred historically.

We presented our findings to our client and recommend that they allow us to explore alternative products on the understanding that they would be proved to be fully fit for purpose should any be identified. Our client agreed. From our experience we knew that standard cartons are made to a specific style, which in turn has an industry wide FEFCO number. We approached the suppliers from the initial tender again but on the basis that their offer must be based on a standard carton. The results of analysing the proposals and the further negotiations was to select a supplier that had shown some initiative by including in their proposal some simple modifications to some of the standard cartons that they had proposed. These modifications were easy and simple to provide and did not involve any tooling. Their prices were not the most competitive but they still provided a significant improvement to the client and their modifications meant that their cartons were more robust than the competition and provided better protection for the product they carried. We felt that this was the most commercially attractive solution for our client, as any products damaged in transit can quickly erode any additional savings they might have obtained by using a cheaper option.

This assignment shows the importance of keeping an open mind and for continuing to challenge and review the products and processes that are being purchased. While the bespoke cartons were very good we demonstrated that they were over engineered, that the client had become comfortable with them and had fallen in to the trap and not considered there were any alternatives.

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Control

When companies do not possess a dedicated purchasing presence there is a natural tendency to have numerous personnel purchasing the same commodity and these are usually within different departments within each specific organisation. This leads to no direction or strategy, maverick purchases, numerous suppliers, ineffective negotiations and lost leverage.

Example – Many of the assignments that we have undertaken has included the commodity of office stationery with annual values ranging from a few thousand pounds to in excess of £250,000. With only a few exceptions the purchasing of this commodity was spread across many different personnel and departments. This would not be so bad if they had implemented a proper pricing structure and had developed much more control on the products personnel were allowed to purchase.

Each assignment involved the same process in initially obtaining the details of the purchases each client had made over the last twelve months. The data was then sorted in descending order in terms of annual value of each product. We identified the items that represented 80% of the total expenditure and if required selected a few of the lower value items if their volumes warranted it. Once this process was completed the resulting list was what is termed the core list and where the main negotiations would focus. The core list should represent the items that a company purchases on a regular basis. All stationery suppliers understand that stationery will be supplied on a core and non-core basis and that they will provide a much higher discount against core items.

It is very important to ensure that the units of measure of products are taken in to account during the process of analysing quotations. For example some suppliers will supply tape in packs of 6 rolls and some will be include 8, 10 or 12. Any analysis must ensure that the quoted price is based on the same unit is measure as the original data. A simple calculation of dividing the quoted price by the new unit of measure and then multiplying the resulting figure by the current unit of measure will ensure the analysis is correct. It is our standard procedure to make sure no mistakes have been made by the suppliers and so we calculate the percentage variance. If some items are showing a very high variance, i.e. more than 80% we will ask the supplier to check them.

Each supplier should also be asked to confirm that prices are fixed for 12 months. They might complain about this especially on printer cartridges and paper but they should be able to provide it. In addition, the suppliers should also confirm the discount structure that they will provide on any new non-core items that are purchased from their catalogues. These should be in the region of 40 to 50%, as catalogue prices are grossly inflated.

All the stationery reviews we have undertaken have generated significant improvements ranging from 21% to 37%. In addition, we have introduced on-line ordering, monthly consolidated invoicing and developed procedures that reduced maverick spending by introducing a central administrator and where required, installing an authorisation procedure on non-core and high value purchases. This ensures that the company channels the majority of their requirements through the core list and maximises savings.

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Unknown

Salesmen use various tactics to persuade companies in to deciding to select them and award their companies with attractive business. Some of these tactics are quite benign such as developing a familiar relationship and providing free samples or attractive initial offers but others are a little more suspect and can lead to companies being enticed in to selecting a product or service on the back of what seems a very attractive benefit but are actually paying higher than the market rate.

Example – A client requested us to look at their landline telephone costs, as they had a significant requirement with a number of sites across the UK and a high volume of calls to few European destinations.

We initially looked to understand the current agreement with their supplier and to obtain the necessary data. Any review of telecoms will involve a significant amount of data, as it is imperative that an itemised call report is obtained detailing each and every call. The data needs to cover a minimum of 3 months and include the destination, when the call was made, i.e. peak, off-peak or weekend, the duration, a description of the call, i.e. mobile, local, national, geographic etc and the cost. All calls to mobiles phones should show each individual provider and all international calls should show the name of the country. By having all of this data it is then possible to calculate the cost per minute for each different type of call and its destination. It will also be possible to see if the supplier is charging to the nearest second or a minimum call charge.

In addition to the call data the supplier must also confirm the details of any line rental they are providing. They need to confirm the type of line, i.e. analogue, ISDN30 etc, the number of lines / channels and the costs involved.

From the discussions we had with our client we could see that they had a very good relationship with their supplier. They were very happy with the service they received, the fact that they occasionally carried out some requests without invoicing and that they received free inter company calls. They made it clear to us that any new supplier would have to provide the same benefit.

When we analysed the data in more detail we quickly identified that the inter company calls represented a small fraction of their total activity and if they had been charged the current market rate it would have accounted for less than 2% of the total costs. This was a classic example of the company focusing on what seemed a very attractive offer from the salesmen, i.e. to provide free inter company calls and not checking the rates they would be charged for the other calls.

Our review showed that they were paying 26% higher rates on their remaining call traffic. We managed to renegotiate a new agreement with the current supplier to bring the call rates in line with the market and retain the free inter company calls in return for a new 3 year agreement.

If we had only been able to obtain an improvement with a new supplier we would have had to understand how the company would manage the transfer of the line rental and calls without our client losing any service. It is always useful to obtain references from some of the suppliers current clients to see how they performed on an actual transfer.

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Examine

Companies are constantly changing, moving in to new fields or markets, opening new offices or sites and increasing their business levels. Even if a company does not alter significantly in size or turnover there still can be dramatic changes in nature of their business. Any of these situations can have a significant effect on the supply of overhead products and services and yet it is surprising the number of times we see that they have not had to foresight to see the need to review their costs to make sure they correspond to their current business levels or mix.

Example – A client in the retail sector had requested us to look at a number of overhead areas with the main cost area being distribution, which involved both parcel and pallet shipments mainly in the UK. The company had been able to obtain attractive rates a few years ago but they then just kept renewing the agreements on an annual basis with the focus on minimising any increases the suppliers might request.

Our client was using five suppliers, two for parcel deliveries and three for pallet deliveries. We initially looked to understand the nature of each agreement, the destinations they delivered to and if there were any special requirements or restrictions. We quickly identified that one of the suppliers was providing a specialised service, i.e. delivering palletised product to high profile customers within specific time slots. It was decided that this area of the business should be excluded from the assignment, as the value was relatively low in comparison and the risk in potentially changing suppliers was too great against any potential benefit we might identify.

From the remaining suppliers we obtained the details of all the shipments they had made during a recent twelve month period together with their current pricing structure. In addition, we obtained the details of the packaging our client used to ship their goods, which included the dimensions of the smallest and largest boxes they used, the average weight of each parcel, the dimensions of the pallets they used and the height they stack products to. We also had to determine of the pallets were stackable during transit.

When we compared the data from the suppliers against the current agreements we noticed that our client's profile had significantly altered. They had introduced some larger boxes, the average weight had increased and they were sending more multi parcel shipments to the same address.

The larger and heavier items meant that our client was incurring volumetric and out of gauge charges and they were missing out on not having a multi parcel rate.

The result of our review and subsequent negotiations was to replace the remaining four suppliers with a new one that would manage all the remaining traffic. We negotiated new rates based on the current profile, which included a multi parcel rate, a reduced single parcel rate, a more competitive pallet rate structure and the removal of volumetric charges. All of these were introduced on the basis of being fixed for 12 months and with agreed set of KPI''s, monthly reporting and quarterly face to face reviews. The financial improvements were in excess of 20%.

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FINAL COMMENTS

We hope that you find this information useful and that it can help you to improve and control the cost of the overhead products and services you require.

As you can imagine there were many other examples that we could have used for each R.E.S.C.U.E point but we felt that the ones we have used were the most appropriate.

Please remember that if you do not have the resource to use this information and review your overheads in an effective and timely manner we would be very interested in talking to you, even if it is regarding just one particular commodity.

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