



Brian Farrington Limited Procurement and Supply Chain Specialists

March 2006 Newsletter

MORE FROM LESS

The role of procurement in driving value for money initiatives has an ever increasing focus in both the private and public sectors although, paradoxically, recent research shows that in some organisations there is no professionally qualified procurement staff. In other organisations there is no procurement staff whatsoever. This phenomenon has to be accounted for. The simple explanation is that the procurement task is seen as mechanistic, capable of being executed by anyone who can issue tenders and place contracts. In recent times the public sector, in particular, has responded to this pressure by demonstrating that exemplar procurement strategies, policies and use of cutting edge techniques can drive out cost, whilst enhancing the supplier's contract performance. Service delivery inevitably will improve. Similar behaviour can also be found in the private sector, often following the appointment of an enlightened Chief Executive, Finance Officer or Head of Procurement.

LOOKING FOR IMPROVEMENT IN PROCUREMENT

A real issue is the benchmark against which current procurement performance will be evaluated. Whatever the benchmark the process must be robust and offer a genuine challenge to the existing order of things. A sample of contracts placed during the past year often provides a useful starting point. The contracts should be taken from a cross section of purchases.

It may include ICT where there are often large amounts of expenditure, significant service issues and where the contracts are placed by ICT staff.

Our experience and research clearly shows that many contracts do not effectively manage the risk that exists. The reason is simple. The contract has been provided by the supplier. Typically, the supplier wants 1 year's maintenance payment in advance. There is no provision of a bankers guarantee; hence the money is completely at risk. There is often no accountability for the supplier to meet performance criteria. There is no provision for liquidated damages or service credits.

Another area of attention should be the cost model for the proposed service to be provided. Our research shows that the 'buyer' compares prices by obtaining tenders from a selected list of suppliers. All things being equal, the lowest price will be awarded the contract. There is a great skill in evaluating price, through obtaining a cost model and clarifying obvious discrepancies.

There are professional reasons for doing so. An obvious one is when some suppliers make mistakes in their pricing calculations. They also include overhead recovery and profit margins that are not justified by the risk in a particular contract.

As we contemplate this area of knowledge it is worth reflecting on the extent of training that has been provided to senior "procurement" personnel in the areas of cost modelling and price clarification practices.

WHAT NEXT?

It is not a mammoth task to evaluate the quality of your procurement function. We have available a 20 point initial checklist that can be used to highlight possible areas for attention.

It is a very practical checklist, based on many years of experience in public and

private sector procurement, but using best practice wherever it is encountered. It will prove a stimulus for action and, if required we can support your organisation with interpretive comments when the findings are known.

If you would find the checklist helpful please contact Steve Ashcroft who will be happy to explain its use.

NEW PROCUREMENT DIRECTIVE 2004/18

Slipping into use, almost unnoticed, on 31st January 2006 was the "The Public Contracts Regulations 2006", for England Wales and Northern Ireland and "The Public Contracts (Scotland) Regulations 2006". These are the enactment of the latest Procurement Directive 2004/18 (Public Sector Directive) which seeks to update and make the rules more relevant to the Procurement climate of today, introducing the Electronic Auctions, Dynamic Purchasing Systems and a new procedure of Competitive Dialogue. However we would like to draw your attention to the "legitimation" of Framework Agreements. Until now, although in common use, they have not been recognised by previous legislation and the new rules will force behavioural changes to many in the Public Sector. We see many frameworks in practice that were loosely constructed and had many companies included. Whereas it may have been practice to select one company from a framework to undertake a project based upon experience or even select three to five companies for a mini tender, the new regulations will impact this way of working. In summary, all suppliers appointed to the Framework Agreement who are capable of performing the contract, must be invited to tender. In reality unless you ask the framework population you may not be able to determine a company's



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capability to undertake the contract. The effect could yet be an administrative nightmare. It might be time to look at the construction of your Frameworks.

We regularly contribute answers to the Q & A section of the Supply Management Magazine including the following item which generated an interesting debate with a number of correspondents. It is, therefore, re-published, in full for your information and interest. We would welcome your views on the subject, reflecting your experience and opinion on this habit of "Supplier hopping".

Q: The new MD of a medium sized manufacturing Business writes:

"I have noticed the very high turnover of suppliers to the business and am informed by my Purchasing and Logistics Director that this is because his policy is to discard any supplier who fails to perform. What is your view on this strategy?"

A: Ken Morris, Senior Consultant at Brian Farrington Ltd writes:

In principle, discarding a supplier that does not, and cannot, perform is not only acceptable, it is desirable and necessary. However, it is absolutely vital that this decision is made for the right reasons.

It may be very convenient to hold the supplier responsible, and awarding the business to an alternative source may seem like the easy option, but the cost and disruption of introducing a new supplier is very real and not without risk. For example, pre-qualification, due diligence, vendor evaluation, process approval, sampling and other verification activities require time and effort. The personnel in your company and the new source must become familiar

with the general and specific requirements of doing business together and it may take some time before communication is effective and efficient. For all these reasons, it is preferable to fix the problem "in situ" and make re-sourcing decisions for holistic and strategic reasons, in a controlled manner, rather than taking the reactive option.

Before condoning or condemning the strategy you have described, I would expect to see that certain processes were in place and objective decisions were being made, using hard data. The very fact that there has been a failure in the supply chain is, in itself, insufficient evidence that the supplier is at fault.

As a minimum, I would expect to see that there is formal agreement on the Service Levels that are required and will be achieved. These will vary from business to business and maybe from time to time. However they should include parameters that will define on-time delivery and quality standards. Other factors such as use of re-usable packaging, correct documentation and invoicing accuracy may also be considered appropriate. It is against these agreed parameters that the supplier should be measured and this data will form the basis for a rational and objective review with the supplier. Formally and systematically gathering this data is an integral part of many businesses and is used in a process called Vendor Rating. If not already in place, I would urge you to acquire or develop such a process. There must be no disagreement about the facts during performance reviews where the supplier is required to account for any non-conformance and propose a Plan that will address all necessary Corrective and Preventive actions. However, this is also the forum at which

any fundamental or contributory factors that are not within the supplier's control are addressed. These could include mishandling or storage of product, drawing or Bill of Material inaccuracy, different inspection standards, booking errors, late ordering, erratic scheduling, etc. It is the customer's responsibility to resolve these problems which can best be accomplished by an Action plan that also becomes part of the review process, along with the supplier's Action plan.

If the supplier is not the root cause of the problem, re-sourcing will not solve the problem it will simply relocate its source. Although the world is a big place and the supply market may be large, you will eventually run out of alternatives. The high turnover of suppliers in your business would suggest that you ought to be concerned, unless all the world is out of step except your Purchasing and Logistics Director.

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