

success demands INNOVATION...

Accessing Innovation is the key to Cost Reduction in a Rising Market

As light bulb inventor Thomas Alva Edison once said
"Genius is 1% inspiration and 99% perspiration!"

It is this genius and innovation that we are all striving for in our businesses today. The ability to access innovation such as a new process, a design change or a product differentiation via the supply chain is the key topic for

discussion in our main article and in Professor Richard Lamming's comment.

Edison's percentages are also critical in the work of our sourcing teams. Only by approaching a high proportion of suppliers in a chosen supply market can we hope to identify the one or two optimum suppliers for our clients.

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Adopting a new strategic approach to purchasing.

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Transforming Cheshire: Transformation of Cheshire County Council's services and procurement.



Invitation

Purchasing Innovation:

How much innovation does your supply chain contribute to your products?

Please join us and Professor Richard Lamming to discuss this topic on:

Date: Thursday 3 May 2007

Time: 5.15 - 7.15pm followed by canapés and drinks

Venue: The Institute of Mechanical Engineers,
1 Bird Cage Walk, Westminster, London, SW1H 9JJ

Register: Visit www.vendigital.com/seminar
or RSVP via the attached letter

STRATEGIC purchasing

AL-KO, Europe's leading supplier of automotive technology, garden and hobby goods and ventilation systems, has adopted a new strategic approach to purchasing with the aid of Vendigital. AL-KO has consolidated its supply of standard fasteners and in the process it has reduced the number of suppliers to three and achieved 13% annual savings worth 136,790.

Due to its globally dispersed structure and wide product range, AL-KO rarely undertook bundled purchasing activities. This changed when Vendigital was invited to carry out a research study on all the standard fasteners used by AL-KO facilities.

After analysing the purchase history of over 400 line items purchased from sites in Germany, Italy and Austria, Vendigital structured a contract that would appeal to potential suppliers.

It soon became obvious that the suppliers were competitive for different parts. Therefore they were asked to quote on a line item basis – 65 suppliers registered their interest in the contract and 10 preliminary bids were received of which 6 were invited to participate in an online auction.

The online event was run on a line by line basis with 98 items negotiated, representing 80% of the total contract value. The auction ran for 25 hours with Vendigital providing round the clock support. It resulted in AL-KO managing to reduce its suppliers to just three whilst achieving a 13% annual savings worth 136,790.

AL-KO now plans to run the fasteners tender yearly to ensure a robust process of assessing the true market price. The next projects will be to identify new competitive suppliers of brake drums and flange nuts whilst gaining feedback on the market price. This will ensure a far more strategic approach to purchasing.



“We were surprised at the positive effect of combining systematic sourcing and supplier negotiation through online auctions. This has been a powerful way to reduce costs and identify supply options. We will certainly work with Vendigital again.”
Ulrich Pilhofer, Purchasing Director, AL-KO

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When a market is falling, it is relatively easy to obtain quotations from alternative sources of supply that can be used as leverage with incumbent suppliers. This tactic will ensure that prices fall in proportion to the market price.

Even in stable supply markets, by looking at lower cost regions or more efficient suppliers, lower prices can be found to exert pressure on the incumbent supplier. When the incumbent can offer no more in terms of reductions, these lower cost suppliers are often the beneficiaries of the business.

But how can leverage be maintained on any supplier when the market prices are rising? The answer is by accessing innovation.

In any liquid supply market there will be poor suppliers, exceptional suppliers and a much larger number of average suppliers. The cost effectiveness of poor suppliers is much worse than that of their counterpart at the other end of the spectrum, the exceptional supplier. In looking for lower costs in falling or static markets, typically a buyer will

switch from an average supplier to another average supplier in a lower cost economy. However, this shift in price is rarely as great as when one moves from an average supplier to an exceptional supplier even within the same economic region.

Shifting economic regions is typically a trade off between labour rates and logistics / supply management costs. Process innovation on the other hand can substantially diminish the labour content without increasing logistic costs at all. This process innovation may be a design change or an automation development. Alternatively it may be that the supplier can source the high labour elements of their own process in lower cost economies without exposing their customer to any increase in supply management burden or additional supply chain risk. Their innovation provides value for the buyer by reducing the cost of manufacture.

So how are these innovative suppliers identified and then engaged? Part of the answer is in statistics. We have frequently made the point in this publication that if a global supply



Market

market comprised a thousand suppliers and a buyer ran a tender that included only half a dozen of them, the likelihood that this sample would contain a supplier in the top five percentile of ideal suppliers for that contract would be very low. The probability that two or three of the top five percentile suppliers were within that small sample would be even more remote and this is critical. Without two or three of the exceptional suppliers competing for the business then the true market price will never be discovered. If we assume for a moment that a buyer takes on board this statistical point and conducts extensive market research that identifies the optimum suppliers, the question would remain why would these suppliers be interested in the contract?

Within rising markets the power balance swings from the buyer to the supplier, and the most innovative suppliers within this market will be aware of their own capability. Interesting them in new business requires much greater effort on the part of the buyer. Suppliers need to feel that they have a real opportunity to win business, particularly if the cost of bidding is high. In increasingly

capacity-constrained, rising markets, the supplier may need to be convinced to substitute business from current customers to a new customer with the risks that this presents.

Finding and attracting the most innovative suppliers takes considerable effort and requires the latest procurement systems and approaches, but is it worth it? We can only look at our own results to answer this question. Over the last four years, material and commodity prices in general have been rising. However, by identifying the most innovative suppliers within the global market and then tendering using appropriate market purchasing techniques, we have provided our customers with average savings that have exceeded 25% from their current costs in each of the last four years.

If you want to discuss the concept of cost reduction in a rising market then please call Vendigital: +44 (0) 1793 891777

Richard Lamming comment

In addition to the process innovation mentioned in the main article, approaching potential suppliers as a supply market can have a significant impact on product and technology innovation. This aspect of innovation can deliver competitive advantage for the customer by creating product differentiation, allowing margins to be augmented through product price increases. The ability to purchase this form of innovation is critical in the virtually integrated company of today.

Traditionally, companies added value to their own products themselves and innovation came from within the organisation. Now, with so much of a product being bought, much of the innovation needed to ensure a company continues to develop its products and market position has to come from suppliers.

While it is necessary to develop strategic relationships with suppliers specifically for this purpose, such long-term alliances can actually limit the discovery of truly discontinuous or disruptive innovation. Strategic suppliers are not always the leaders in innovation and their need for stability in the relationship may constrain them from thinking out of the box. It may be that other suppliers working without constraints have surpassed the existing supplier's innovation. Because they are deemed strategic, the incumbent's position may not be challenged or assessed in relation to other suppliers within the same supply market. In this situation innovation within the supply network is limited to that within the buying company and the strategic, but possibly too stable, suppliers on whom they rely.

In approaching a supply market there is a need to remain loyal to strategic partners but also search for fresh ideas: a dual thrust called 'strategic dalliance'. The capabilities of incumbent suppliers can be developed at the same time as other more innovative suppliers may be identified. With strategic dalliance, the procurement process itself can harness the innovative potential of many suppliers simultaneously. Use of functional requests for information or quotation to large numbers of hand picked potential suppliers, often outside the pool of suppliers normally approached, can effectively achieve supply market collaboration. Expertly done, such a tender can create a wealth of new ideas often leading to the application of technologies or approaches not previously considered. This can effectively step change a product's design or function – creating competitive advantage through discontinuous innovation.



Professor Richard Lamming is Director of the *School of Management* at the *University of Southampton*.

> Online OPTIMISER



Launch of the Online Savings Optimiser

We are pleased to announce that our Savings Optimiser is now available online. This will enable our customers to carry out spend analysis and opportunity identification on their own as well as via the more established route of Vendigital assisted Savings Optimiser workshops.

Over the past five years many companies have benefited from Vendigital's Savings Optimiser – a tool which analyses spend related data and identifies potential savings opportunities. As the Optimiser has developed it has become a far more accurate and comprehensive tool.

The new on-line Savings Optimiser retains all the functionality of the previous versions, including Propensity for Leveraged Tendering, Strategic Purchasing Framework, Relative Time & Return, category rankings and the purchasing project planning tool.

In addition, the on-line version uses a new technique called Market Calibrated Prediction Technology (MCPT) to calculate its output. Monthly feeds on material price trends as well as quarterly calibrations based on actual Vendigital purchasing project results are fed into the Optimiser.

By taking this market information and the spend data entered by our customers and applying a number of complex algorithms, the Optimiser predicts the likely range of savings which are potentially achievable. It also shows the more strategic attributes associated with each spend category.

Once the initial data is entered, it only needs to be updated after each major purchasing activity or when spend patterns change. A versatile range of editing and saving functions allows you to analyse spend at any time by site or by spend category on a regional or global scale. The live market feeds mean the output is always as up to date and accurate as possible.

Whether or not you are an existing user of the Savings Optimiser please contact us for more information on the benefits this powerful tool can bring to your company.

> Transforming CHESHIRE



Cheshire County Council is running a programme to 'Transform Cheshire'. This includes transformation of the Council's services and procurement.

As part of this exercise, the Council worked with Vendigital, in partnership with PricewaterhouseCoopers to run two online auctions for the categories of IT Consumables and Print.

The aim was to achieve cost reductions without compromising service, delivery or quality in any way. The ultimate objective was to create sustainable savings of valuable tax payers' money.

Alistair Jeffs, County Policy Development Officer at Cheshire County Council, explains: "The online auctions have been a huge success. We've also created a new framework to transform the way we procure our services and supplies so that all savings can be sustained in the longer term."

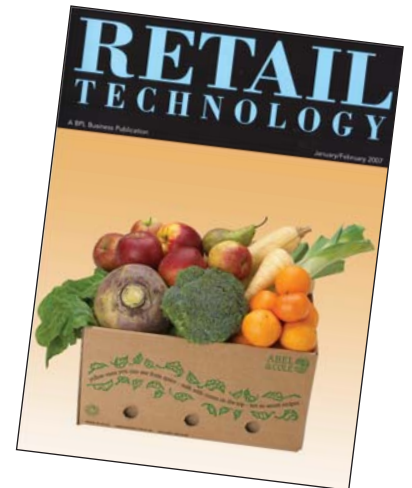
Vendigital worked closely with the Council to gather data on the goods purchased across the two categories. Comprehensive sourcing exercises were undertaken to find potential suppliers for each category. Both tenders were then run under the restricted Official Journal of the European Union (OJEU) process, using a prequalification stage to ensure that the potential suppliers met Cheshire's requirements.

Following the introduction of the new OJEU rules in early 2006, the auctions were run on a weighted combination of price and non-price criteria. The Council was adamant that quality, service, delivery and environmental considerations should not be compromised, so a 50% weighting was given to non-price criteria in each auction.

A saving of 50% on a million pounds worth of print spend was achieved in the print auction. The IT consumables saved over £220k on a total spend of £750k. This represents a 29% saving.

Alistair Jeffs concludes, "This has been a first for Cheshire – we have harnessed the scope of the internet to help us secure the best deals possible. We've worked extremely well with Vendigital and PricewaterhouseCoopers over a period of months to make these projects such a success."

> In the NEWS



Sustainable Sourcing

Vendigital's work with Abel & Cole, the organic food home delivery service, made headlines in Retail Technology magazine. The article reported on Abel & Cole's saving of 8% on its £1million annual spend on customer presentation boxes.

Stefanie Sahmel, Warehouse Manager at Abel & Cole was quoted, "We've utilised the latest technology offered by Vendigital to help us improve the way we purchase. We've found a great supplier who can provide a better product at a better price. The supplier also complements our position on business sustainability."

Back issues of Dynamic Procurement are available, please see our website
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