Understand The 5 Secrets of a Chief Procurement Officer

Recognizing the importance of suppliers to both cost containment and competitive advantage, many CEOs and CFOs have looked to upgrade their procurement capabilities and practices in recent years. Yet, few people involved in selling in business-to-business recognize this change occurring in procurement. In this article, the author provides the five secrets for CPOs to help their sales teams be better prepared in dealing with procurement organizations in their markets. This information is incredibly useful to pricers as a reminder of how our customers are thinking and reacting. Author Chris Provines, newest member of the PPS Board of Advisors, is Vice President, Global Pricing, Reimbursement & Government Affairs at Siemens Healthcare and Distinguished Adjunct Professor at Graduate School of Business at Rutgers University. He can be reached at cprovines@mac.com.

In the recent economic downturn, companies turned over every stone in search of costs to take out of their business. One of the first places companies usually look for cost savings is in supplier related costs. It is not surprising. In many industries, supplier related costs usually account for the single largest expense of a company or, in service related businesses, a close second behind people related costs.

Recognizing the importance of suppliers to both cost containment and competitive advantage, many CEOs and CFOs have looked to upgrade their procurement capabilities and practices in recent years. Yet, I’ve often been surprised at how few people involved in selling in business-to-business recognize the change occurring in procurement, or let alone, are prepared to deal with the change. This article will explore five secrets of a Chief Procurement Officer and how to use these insights to your advantage.

**Secret #5 Supplier Segmentation**

Just as good marketers segment customers, good procurement organizations segment suppliers and supplies into categories. This is part of the category management and supplier segmentation approaches that many procurement groups use.

Procurement typically segments its suppliers and supplies into categories or segments based on:

1. **Supplier characteristics**: unique capabilities, technical excellence, position in industry, geographic presence, and financial stability
2. **Buyer characteristics**: percentage of supplier’s business, supplier switching costs, business risk due to supplier unavailability
3. **Product/part characteristics**: performance characteristics, technical complexity, costs, volume, and lead time characteristics
4. **Relationship characteristics**: relationship quality, congruence of goals, supplier willingness to invest resources, supplier willingness to do risk sharing

A supplier segmentation model and procurement tactics for dealing with suppliers in each segment might look like figure 1 below.

Suppliers in the strategic segment in figure 1 are typically suppliers that account for a large portion of the customer’s spend and...
also supply goods and services that are critical to the customer’s business. If your customer has put you in this segment, then procurement and your customer will have high expectations of you as a supplier. They’ll be looking for ways that you can bring value beyond simply taking costs out of their business. As a selling organization, it is important that you are prepared and can clearly articulate the ways that you can create value for your customers.

Creating value for your customer could include things like innovating together, providing customers with access to unique products and providing access to your firm’s capabilities. For example, one of Porsche’s suppliers worked closely with Porsche on the development of carbon-ceramic brake technology. As a result, Porsche was able to use this technology in its cars four years earlier than other luxury-car makers.6

On the other hand, if customers believe that the products or services you provide fall into the commodity segment in figure 1, they will be looking to drive costs out through negotiating lower prices, reducing the number of suppliers, and making suppliers hold and manage inventory. In this segment, there are very different procurement objectives and a different balance of power between buyer and sellers.

One of the exercises you should go through as a business is to try to map where you think your customers would place your key offerings in figure 1. It could be that different segments of customers would view your products or services differently.

For instance, there may be segments where your product or service accounts for a relatively larger percentage of the customer’s overall supplier spend. This means you may feel more intense pricing pressure in that segment. So, be sure to conduct the exercise at a segment level. After that, spend some time making sure that your selling and pricing tactics are aligned with the tactics that procurement will likely use against you.

Secret #4 Negotiation Games

Procurement professionals are under increasing pressure to deliver greater savings. In a recent survey, 66% of CPOs indicated that they have seen their savings targets increased and 81% have asked suppliers for price cuts.6 The negotiation process is one of the areas where procurement often looks to drive a quick hit and capture some savings. Obviously, as procurement negotiates harder, it could impact your pricing if you are not prepared.

One of the areas of personal pride for many procurement professionals is the ability to negotiate. While it depends on the business model, in many buyer-supplier markets, the average procurement professional has many more suppliers to deal with than the average sales representative has customers to deal. Therefore, procurement has a chance to practice negotiations many more times than the average sales professional. Moreover, it is not unusual for well run procurement organization to invest heavily in training their organizations in negotiations. One of the outcomes is that your sales teams may be out matched in both negotiation skills as well as negotiation experience.

There are many potential negotiating tactics that procurement

### Figure 1: Supplier Segmentation and Procurement Tactics

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<th>Customer Characteristics</th>
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<td>Standard</td>
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<tr>
<td>• Consolidate spend</td>
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<td>• Reduce number of suppliers</td>
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<tr>
<td>• Leverage competition</td>
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<td>• Minimize transaction costs</td>
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<td>Key</td>
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<td>• Long-term agreements</td>
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<td>• Improve specs</td>
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<td>• Optimize supply chain costs</td>
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<th>Supply Characteristics</th>
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Switching costs | Sources of supply | Lead times | Complexity | High | Low |

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could use and we’ll touch on a few here. One tactic is to find out when your fiscal year ends. I can remember watching negotiations with a vendor. It was clear that the closer the timeline got to the end of the supplier’s fiscal year end, the more anxious the selling team became. Successive visits by increasingly higher ranks of management from the vendor would come in to help “close the deal.” Since the vendor in this example was a public company, the procurement group could easily track how the vendor was doing from a sales perspective. Procurement knew that the vendor was behind in sales and hence procurement was in no rush to speed up negotiations. The closer the time got to the end of the vendor’s fiscal year, the more desperate the vendor became.

“Down selecting” is another negotiation tactic that procurement will use. Usually this occurs during a bid process – a request for proposal. Procurement starts with a number of potential suppliers. They then decide to “down-select” and eliminate a number of vendors out of the race. Companies that are still in the race feel as though they have a real chance at winning the business, which may or may not be true. Down-selecting is often used as a tactic to have the suppliers “sharpen their pencils” and sweeten their bid pricing and terms.

Manipulating perception of competition is another tactic that procurement will use in negotiations. This involves creating the appearance of a strong competitor or multiple highly qualified and interested competitors. The obvious reasoning behind this from a procurement perspective is to gain more leverage in the negotiation process. It often works because sales teams are unprepared or do not fully understand the differentiated value that their firm brings.

In business-to-business markets, it is important for sales teams to be prepared to effectively deal with procurement negotiation tactics. The obvious basics need to be in place – things like negotiation training, competitive intelligence and account level segmentation. Given that customers have different needs, motivators and behaviors, the sales team should also be given tools to effectively trade-off or trade-up during negotiations. Figure 2 provides a simple framework that segments accounts by behavior and offers some items to trade-off or trade-up during negotiations.1

For instance, a price-driven customer may be pushing hard for further price reductions during negotiations. The sales team should be given guidance on what services or changes in customer behaviors, such as ordering frequency, could be “traded-off” for a better price.

Likewise, a customer that is technology-driven may be interested in priority access to new innovations or technical-expertise. Clear rules and guidance should be given to the sales team.

Without a disciplined way to trade-off or trade-up, you could find yourself in a situation where you are lowering price, giving away many services for free and still losing business or having dissatisfied customers.

Secret #3 Counting Savings

Driving savings is seen as one of the core responsibilities of procurement professionals. Yet, counting savings and getting its own organization to recognize the procurement savings contribution is often a big challenge for many procurement organizations. Many procurement organizations struggle with the process of accurately evaluating and counting savings, which sometimes results in wrong supply decisions as well as skepticism within their own organization about their real contributions. This is usually due to unclear savings definitions, pressure to hit short-term savings targets, a focus on price as opposed to total cost of ownership, and a failure to accurately count the risks and costs associated with vendor changes.

As a selling organization, it’s important that you understand these issues and be prepared to help procurement accurately count your savings or value contribution. Many procurement organizations look at savings in at least two dimensions. The first are “hard” savings or cost reductions. These are true reduction in costs that occur as a result of procurement activities. The second area is cost avoidance. This is usually avoiding an expense or a productivity improvement of some kind.

There are a few proactive steps you can take to ensure that your differentiated value is fully understood and aligned with the way procurement thinks:

1 Take a total cost of ownership view of your value and educate procurement on this perspective
2 For credibility, when using value calculators or selling tools, breakup your savings or value analysis into two categories: cost savings and cost avoidance
3 To the extent there are sizable switching costs or risks of switching that work in your favor, be sure to value those and include this in your value analysis
Secret #2 Integrating Value into Supplier Selection

Many procurement professionals will claim the use of sophisticated supplier selection models. However, the reality is that many use simple, subjective and incomplete models for supplier selection. Indeed, in one study, only one third of world-class procurement organizations used total cost of ownership models for the majority of their spend. The simplistic models used sometimes include ranking methods or weighted points across a number of decision criteria. The decision criteria are usually items like net price, quality, delivery, performance history, service, and technical capabilities.

In pricing, Nagle and Smith showed how bias and misleading insights can result when companies use weighted or attribute models for determining the value of their products or services. They proposed economic value analysis, an approach to quantifying the value of the differences, as the most appropriate foundation for understanding value and setting price. This same logic applies in procurement. While the use of attribute rankings or weighting factors for supplier selection is much easier, it can often lead to misleading or wrong supplier decisions.

For B-to-B sellers and pricers, there are a couple of insights here. First, as part of the selling process, you should try to understand the decision rules or “methodology” the customer’s procurement group will use for supplier selection. Do they look at total cost of ownership? Or do they use simple ranking or weighting methods? Second, if they use a simple weighting or ranking methodology and you believe this will work against you, you need to take proactive steps to educate the customers on a more holistic total cost of ownership view. This, of course, assumes that you have differentiated value, have quantified the value and have evidence to support the value.

Secret #1 What will get the CPO Fired or Promoted?

While in the midst of negotiations or during the RFP process, it may feel like all procurement cares about is your price or costs. The reality is that while saving money is one of the key goals of procurement, particularly in tough economic times, most CPOs are also very concerned about supply continuity, quality or a supplier causing damage to the company’s brand or image. A recent survey of top performing CPOs revealed that reducing supply risk scored almost as high as reducing costs even in the midst of the worst recession in decades.

Supply risk can be caused by natural disasters, labor disputes, supplier financial problems or other causes. There are countless stories of problems at a key supplier causing significant business disruptions to companies. This is often caused by businesses choosing a single-sourcing strategy. Consider when lightning struck a power line near a major microchip manufacturer. The resulting power surge disrupted production and destroyed inventory. One of the customers of the microchip manufacturer, a mobile-phone manufacturer, chose a single-source strategy and did not have alternative sources of supply. This ultimately cost the mobile-phone manufacturer $400 million in sales.

Additionally, many CPOs and their organizations aspire to be much more than a group that is known for taking costs out. Procurement wants to be seen as a group that is more critical to the business. Innovation is one of the basic ways in which a business builds value and suppliers are often seen as an excellent potential source of innovation. Yet, many procurement groups haven’t even begun to fully focus on supplier-sourced innovation, or worse yet, have win-lose tactics that force their suppliers into a transactional relationship.

A major supply disruption caused by a supplier could be one of the things that places a lot of pressure on a CPO and even might get him or her fired. Alternatively, bringing in important innovation from the supplier network that helps the CPO’s company capture more share, enter new markets or compete differently will be viewed as a major win. So, it’s up to the supplier to understand these dynamics and find ways to position its offerings and capabilities in ways that take advantage of these dynamics.

Conclusion

While an increase in procurement’s influence and more sophisticated procurement practices may be intimidating, sales teams and their organizations shouldn’t be afraid. Suppliers with real advantages and differentiated capabilities should be well positioned. This assumes, of course, that these suppliers are prepared to explain and demonstrate their value. It also requires a selling sophistication, which includes understanding needs and behaviors of accounts, segmenting accounts and being prepared to customize approaches in a thoughtful way. Hopefully, using the five secrets of CPOs discussed here will help your sales teams be better prepared in dealing with procurement organizations in your markets.

Endnotes

b The CFO’s View of Procurement: Same Page, Different Language; report by Aberdeen Group, Aberdeen.com

f Ibid


j This was adapted from: Zoltners, A., Sinha, P., and Zoltners, G., The Complete Guide to Accelerating Sales Force Performance. AMAcon p. 383-5


o Ibid
