

Strategies for Successful Procurement Partnerships
Part 4 of a 4-part series

Total Cost of Ownership

Determining True Product Cost

KEY TAKEAWAYS

Looking Beyond the Obvious for Hidden Costs

- Use the Request For Quotation (RFQ) to determine true product cost.
- Recognize that the bid price is just the tip of the iceberg – beneath the ice lies all the costs that provide the real cost of ownership.
- Look for hidden costs – such as costs of managing, logistics and distribution, reworking, training, cost of sourcing and more.
- Discover overall supplier strengths and weaknesses.

Good Communications Reduces Cost

- Share information – build trust.
- Share information – expect solutions.
- What matters – spirit and ability, not size.



By Joe Williamson
Senior Director of
Global Sales and
Customer Operations

This is the final part of a 4-part series of procurement best practices for securing a strong, strategic and valuable relationship with a great supplier. In these papers, I share some of the industry's best ideas and my own insights from the vantage point of a supplier, founded in 1960, with decades-long relationships to customers in medical, food and beverage, and other industries. In this time, we have maintained strong relationships by building, regardless of the product, true partnerships. We take nothing for granted, adapt to change, improve our processes and consider every customer's mission our mission, too.

Part I – *Trust and Character: The New Bottom Line in Procurement* – offers rationale and tactics to explore a relationship that goes deeper than just price. Part II – *Know Your Supplier: How to Experience Transparency and Accountability* – provides guidelines for evaluating, consolidating and building strong relationships with suppliers. Part III – *Total Cost of Ownership: Unite Cross-Functional Teams* – shares details on how to include key stakeholders within your own company in your forward-thinking procurement strategy.

This final part pivots to taking a Total Cost of Ownership (TCO) approach. This lets you determine true product cost only after understanding all of the hidden costs/risks you discover when you evaluate your outsourcing more closely.

Using the RFQ to Determine True Product Cost

Are you putting the best TCO ideas into managing the supplier bidding process?
Are you getting the most out of the pricing and services offered by the prospects?

A trained eye can instantly tell the difference between an RFQ based on TCO versus one that seeks out a simpler, price-only bottom line. The TCO-based RFQ includes a diversity of probing questions that represent the concerns of stakeholders across the company. For example:

- If a bid topic requests information from the supplier about ordering, receiving, inventorying, and purchasing, I know that procurement has consulted shipping and receiving.
- If an RFQ seeks information from the supplier about costs due to waste disposal, clean up, and pollution control, I know that procurement has consulted their fellow stakeholders responsible for environmental compliance.
- The bottom line cost of cheap labor from a low-cost country can be moot if you don't ask about and factor in waste and overhead costs in the RFQ.
- What sources of energy does your supplier use – natural gas? oil? – and how volatile or stable are these costs currently in the region or nation where this supplier operates?
- Do you know where your supplier sources materials? Does your supplier have multiple sources to avoid interruptions in sourcing? It is reassuring to know that your supplier has made contingency plans to maintain continuity of service.

Use the RFQ to Determine Supplier Strengths and Weaknesses

An RFQ that seeks a wide range of facts and explores many scenarios enables you to know your supplier and engage in valuable discussion. An RFQ that is narrow in scope – with limited opportunity to engage – prevents suppliers from showing you their wider range of capabilities. It also conceals their weaknesses. Add value to the bid process by taking a TCO approach to the RFQ. Make your line of questions, specs and requested details represent the priorities that are important to all the major stakeholders in your company.

Here are more best practices I have experienced:

Send the Same RFQ to All Prospects

This gives you a consistent, easy-to-compare assessment of all your prospective suppliers. This avoids confusion. Be clear on the deadlines. I find two to four weeks is fair – if it's always tighter than that, look into *why* it's a rush job. They happen – but a well-organized company makes them rare to avoid costly errors. This may be a great opportunity to enlist an innovative supplier to help make your fulfillment process more predictable – and less urgent.

If a Supplier Ignores Some of the RFQ – Beware

From the very start of the bidding process, you can determine the value of a prospective supplier by closely noting how close they pay attention to your RFQ instructions.

Request that nothing in the RFQ be left blank. Then, if a supplier's response is incomplete, you just received a *bigger-than-life* sign that this supplier doesn't manage details. Also, a supplier's unwillingness to share information is problematic. What's the risk? It's hard to say – and that's the point. Nevertheless, it's a huge risk, not knowing what's being ignored, overlooked or concealed.

Give Suppliers Time to Ask Questions

Allow time up front for initial feedback. Based on my own experience as a supplier, this is a great opportunity for OEM and supplier to engage on solutions and capabilities. The supplier may raise questions that are relevant, but were not included in the RFQ. The conversation helps clarify vital information to move in the right direction for the best solution.

Don Leeper, Senior Vice President of Finance and Administration at Kent Elastomer Products (KEP), recalls an example. "Our plant personnel met with a **potential new customer** who wanted an assembled latex tube to be used in an exercise application," he states. "Our team didn't wait for a solution. We brainstormed *with* the owners of this company to come up with designs that might fit for their application."

Research Your Suppliers

Knowing a supplier's capabilities empowers procurement with information. To further understand what suppliers have to offer, subscribe to their newsletters, read their blogs and ask for any other information that might help, including their internal documentation of process improvements. Fostering this conversation with a little extra research helps procurement understand how a supplier thinks and operates – before they even respond to the RFQ.

Bids – What to Accept – What to Learn from the Process

Embrace a good price, of course. But be the team that takes the time to look closely. If a supplier greatly underbids, the low offer might indicate they misunderstood the specs and requirements. In that case, the miscommunication (and troubles) have just begun.

Every fellow stakeholder in your company is part of the TCO process. Since you consulted with them before creating the RFQ, be sure to report back to them the results of the bid. Especially if the bid was not the lowest price.

Your final choice on a supplier is a great opportunity to continue educating all the stakeholders on your procurement rationale. Make a presentation that explains your decision to all the key stakeholders across your company, include c-suite executives, so that they will understand the depth and breadth of your procurement decision-making.

Without this explanation of your rationale, other stakeholders may focus on just going with the lowest bidder. It will be up to you to explain how this is an ineffective way to achieve real cost reduction – and can raise costs. How? The lowest bidder may not meet your criteria for lean production. The lowest bidder may not assure the quality you demand. The lowest bid might at first appeal to a financial statement – but end up with unresponsive service and erratic delivery that, in the end, raises costs.

On your part, beware of pressuring suppliers to drastically reduce costs. Cost savings – if any – will likely be fleeting. This old-school, hardball practice alienates good suppliers who are eager to make fair, mutually beneficial relationships that really help you meet and exceed goals.

Partnership + Good Communication = Reduces Costs

If your supplier hears from you only when you are placing an order, you are missing out on a great opportunity to build a strategic partnership that saves time and money.

Give your suppliers a heads up. Share your lead times with them. Let them know how long it takes for you to receive, inspect, assemble and process the products they send you.

As a supplier, we know how beneficial it is to understand leads times and forecasts, to anticipate ahead of the order placement. One supply chain manager for a major retailer told me that she gives her suppliers access to her company's portals so they can manage their inventory with accuracy. She includes the supplier in forecasting and monitoring sales so they can proactively process orders to replenish inventory. "A big part of our onboarding is getting our suppliers to monitor sales and sell-through on their own," she said.

In addition to manufacturing parts, Kent Elastomer Products (KEP) is a supplier that provides just-in-time systems for several customers, allowing them to ship product quickly. In one case, KEP managed the inventory of a medical diagnostic equipment manufacturer. "Previously, this customer faced 2-3 week lead times or longer depending on the volume of current business," says John Danes, Vice President of Operations. "Now, with shared information, we make automatic weekly shipments."

Look For What Really Matters

I began this series discussing trust and character – the new bottom line in procurement. It now comes full circle. How did we get here?

It's a combination of two main ongoing efforts: TCO that results in cohesive internal partnerships with key stakeholders in your own company. Supplier Relationship Management (SRM) that results in a strong external supplier partnership.

To achieve the latter, take the advice of longtime supply management expert Paul Ericksen. In his 2017 article for Industry Week, "How a Supplier Views a Customer," Ericksen writes, "I am a long-time fan of smaller, privately held suppliers." He lists many reasons, including their enthusiasm for satisfying customer needs, willingness to try new things, and an open-mindedness to collaborative relationships. "They tend to have the kind of drive and product expertise that lead to breakthroughs in either design or processing that corporate suppliers don't always exhibit."

Once your SRM seeks out true product cost that includes suppliers who meet Ericksen's definition, you'll receive more than a high-quality product. You'll enjoy a forward-thinking, win-win business relationship and the satisfaction of working with a genuine strategic partner.

Endnotes & Recommended References

"Managing Bids & Negotiating Prices." Woods Hole Oceanographic Institution.

Retrieved from whoi.edu/procurement/managing-bids-negotiating-prices.

Schmidt, Marty. "Total Cost of Ownership TCO Analysis: Definitions, Meaning Explained, Example Calculations." Business Encyclopedia of Solutions Matrix, LTD. Retrieved from business-case-analysis.com/total-cost-of-ownership.html

Marion, Gary. "Logistics and supply Chain Management." Updated March 11, 2018.

The Balance. Retrieved from thebalance.com/why-won-t-my-suppliers-do-what-i-want-3858742

Eriksen, Paul. "It Takes Two to Tango." December 4, 2015. *Industry Week*.

Retrieved from industryweek.com/supply-chain/it-takes-two-tango

Eriksen, Paul. "How a Supplier Views a Customer." June 23, 2011. *Industry Week*.

Retrieved from industryweek.com/procurement/how-supplier-views-customer

"5 Best Practices for Requisition and Purchase Order Management." July 22, 2014. News from Ariett. Retrieved from ariett.com/news/content/5-best-practices-requisition-purchase-order-management-0

Fritsch, Daniel. "Purchase Planning: Basics, Considerations and Best Practices." March 9, 2017.

EazyStock blog. Retrieved from eazystock.com/blog/2017/03/09/purchase-planning-basics-considerations-best-practices/

"Strategies for optimizing your accounts payable: Make your working capital work for you."

The Deloitte working capital series. Retrieved from deloitte.com/content/dam/Deloitte/ca/Documents/finance/ca-en-FA-strategies-for-optimizing-your-accounts-payable.pdf

"Receiving and Inspection." *WERC and Supply Chain Visions*. 2007. Retrieved from werc.org/assets/1/workflow_staging/publications/692.pdf

About Kent Elastomer Products

Kent Elastomer Products, Inc. (KEP), a subsidiary of Meridian Industries, Inc., was founded in 1960 and is a leading U.S. solutions provider for the global medical market, as well as dental, food and beverage, sports/recreation, laboratory, and industrial markets worldwide.

KEP is one of the world's largest manufacturers of precision-engineered, natural rubber latex and thermoplastic tubing. The company emphasizes continuous improvement, lean leadership training and communication. We stand alone as the only manufacturer of latex tubing in the United States.

Our headquarters, latex and custom-dip operations are located in Kent, Ohio. Extrusion operations are located in Mogadore, Ohio. Assembly, quality and shipping operation are located in Winesburg, Ohio.

Kent Elastomer Products publishes *Leader Views*, examining the best practices in global competition, lean manufacturing, sustainability and high quality values in production and services. It is available at KentElastomer.com.