

So what's it to be?

Lowest price – or best value?

Remember John Glenn's famous quote when he was asked what it felt like sitting atop the rocket, ready to launch? "I felt about as good as anybody would, sitting in a capsule on top of a rocket that were both built by the lowest bidder."

It's a sad fact that procurement is still seen as a reactive function whose only goal is to get the lowest price from suppliers. How often do you hear the line: "The folks in the buying department will beat them down on price?" Laudable as this first appears, when you look a little closer it becomes clear that the most important element – value for money – is often overlooked entirely by this rather combative approach.

The truth is that a poorly-spent pound usually works out far more expensive than a well-spent pound. In many cases the cheapest bid does not necessarily imply the best value, or even good value. Indeed, on large contracts suppliers are adept at offering lower initial prices, safe in the knowledge that they will make up the profit later on in the contract with unspecified extras. It is all too familiar a situation, the short-term view taken at the cost of good longer-term economy.

Perhaps the most obvious example here is that of IT procurement, which can fail to produce long-term and genuine cost savings in a number of ways. First of all there is the issue of ongoing support. The immediate benefits of buying the cheapest PCs appear obvious, particularly for larger organisations that are replacing hundreds if not thousands of machines. But the extra cost of more regular servicing can soon wipe out those short-term advantages, not to mention the loss of productivity in staff who spend far too much time on the phone to the helpdesk, trying to sort out the latest glitch.

Secondly, there is the testing and deployment process. Most of us know of companies that have ordered complete IT systems from the lowest price vendor, only to be tied up in endless delays during installation. Procuring IT that has been tested off-site and has a high level of QA would have been a better long-term investment, even if the up front costs were higher.

Finally, there is the issue of being fit for purpose. The lowest-cost option is not necessarily the future-proof option. Organisations can find themselves hindered by systems that are not capable of supporting their longer-term ambitions. In extreme cases the system has become obsolete by the time its installation has been completed.

The procurement of IT has become a matter of public debate as a seemingly endless stream of stories about public sector projects going off the rails hit the headlines. But it is important to remember that procurement problems are not confined to the public sphere – nor to the purchasing of technology. A multi-million pound industry has grown up the around the recovery of overcharged services from badly managed procurement projects, most notably in energy and telecoms where companies have allowed existing contracts to run out of control.

Procurement as a function has suffered from becoming very process orientated, rather than output orientated. Partly, this is a consequence of the high degree of automation involved. The advent of ever-more sophisticated technology has also led to a degree of under-resourcing, and staff find themselves tied up with the procurement procedure, rather than the business reality.

It's worth considering what a well-run proactive procurement function can really provide. Success starts with asking the right questions. "Are we getting best price?" is more often asked than "Are we buying the right goods or services for our company?" Moreover, the bigger question should be "are we looking at how we can get best possible value while reducing the costs of doing business with our key suppliers?"

A procurement function worth its salt will not simply be seeking the cheapest deal but will also be focussing on how to add best value across the whole purchase-to-pay cycle. From the initial selection of goods, tendering, supplier selection and contracts, right through to safe delivery and correct payment, the procurement function should ensure that each stage is carried out with maximum efficiency and minimum cost.

In many cases the art of negotiation is a dying one. Yet the process of adding best value frequently starts with face-to-face dialogue at the beginning of a relationship with potential suppliers. Is the 24-hour delivery service really necessary for small IT peripherals? Can a twice-weekly delivery schedule save money for both parties? Equally, are there costs to be shaved in return for shorter invoice payment terms?

Procurement also has responsibility for ensuring that best value is retained over the lifetime of the contract. Many procurement projects fail completely or go over-budget because of open-ended contracts, ill-defined user requirements, or poorly executed contracts for sale. Ten-year contracts for complex projects that are written on two sides of paper are not unknown, yet they cannot adequately describe the scope, costs and terms involved.

If negotiation is a dying art, then supplier management is an under-appreciated one. Most organisations can name their top ten strategic customers. However, they cannot name their most strategic suppliers. In long-term relationships it is not uncommon for service levels to slip, only to pick up again just before the renewal date.

Complacency on both sides damages the relationship. But, more importantly, it ensures that real efficiencies and cost benefits remain elusive. In well-managed, measured and audited relationships each party knows from where value is derived. Moreover, well-managed suppliers will pull out the stops when necessary – and save significant amounts of money over the lifetime of the contract.

In many companies there is still too much waste, and potential cost reductions that remain unrealised. With supplier margins continuing to be squeezed through competition – although valuable cost reductions can still be had through good negotiations – there are bigger prizes to be won by ensuring procurement is undertaken professionally and with proper management control and visibility.

With the ever-increasing complexity of IT, and the supplies and service necessary to do business, it seems extremely likely that good procurement practice will be a key differentiator in those businesses that will flourish and those that will flounder. The importance of getting good value and not just cheapest price can no longer be ignored. This holds true for large corporations as well as small businesses who want to grow. The better value you get from the spend on running your business, the greater profits you can make.