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The Power of Effective Procurement and Strategic Suppliers

WHAT CFOs NEED TO KNOW

BY JAY BAITLER

Senior financial officers are paying more attention to procurement costs—and with good reason. Because of challenging economic times, the intense focus on fiscal responsibility, and supplier contracts averaging \$2 million and higher for a large portion of *Fortune* 500 companies, more and more companies are putting their procurement process under the microscope. While the purchasing function was once considered a back-office operation, it has steadily become as important as generating revenue.

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Smart procurement practices pay off. Saving \$1 in procurement equals \$15 to \$20 in revenue, according to our experience in the Staples Contract Division, which provides office supply solutions to medium-sized and large organizations. In fact, a West Coast customer is saving more than the \$250,000 it spends on office supplies each year through accounts payable transaction expense savings alone. The road to savings like these is through working with a strategic supplier—not just a vendor.

Our evolution from vendor to strategic supplier was driven by the changing requirements of some of the world's largest and most respected organizations. To become a strategic supplier, we elevated performance levels related to three initiatives: the ordering process, ease of doing business, and customer intimacy. Let's look at the key components of a procurement program and then examine the three initiatives.

LOWEST TOTAL DELIVERED COST

Office supplies are a common proving-ground category for what eventually becomes a wide-ranging initiative to change the way companies buy products and services. To be most effective, financial and procurement managers should internally sponsor a sustainable "frictionless" procurement program—one established to drive out costs present in the purchasing process. Combining the efforts of both financial and procurement managers leads to long-standing operational excellence and soft cost control in corporate purchasing.

Key components of a frictionless procurement program are consultative planning based on metrics-driven objectives and migrating to an e-procurement system. Only a strategic supplier can deliver on such advanced business processes as order behavior management to help achieve cost reduction goals and seamless end-to-end electronic processing. As a strategic supplier, we're staffed with business process experts—people who have the knowledge and tools to help companies realize immediate savings and put them on the path to long-lasting improvements across the purchasing function.

We educate customers that product pricing represents the shortest-lived advantage and that the real savings comes from focusing on the lowest total delivered cost of goods or services measured over time. The lowest total delivered cost represents the soft-dollar or back-end savings generated by process improvements (such as reducing small-order activity), as well as the hard-dollar or product savings.

As a CFO, lowest total delivered cost can become your

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mantra for refining procurement. From start to finish, you can continuously measure all processes associated with buying products or services and take the following steps to achieve lowest total delivered cost:

- ◆ Thoroughly analyze your supply chain;
- ◆ Improve warehouse management;
- ◆ Add more distribution channels, such as retail stores and the Internet;
- ◆ Stimulate order consolidation; and
- ◆ Streamline processes such as order entry.

A strategic supplier must add value in all of these areas to sustain a win-win relationship that delivers shared savings. But adding value has become more challenging for suppliers as financial executives have raised the bar on savings and performance measures because of advancements in e-procurement technology and an economic downturn. In response, we now promise to reduce a customer's total cost of procurement by 10% to 15% and cut traditional implementation time with any e-procurement system by 30%.

Here's how we streamlined operations to deliver office supplies with the lowest total delivered cost to the customer.

REALIZING THE PERFECT ORDER

Refining procurement can begin with focusing on each step within the order process. Strategic suppliers approach the life of an order holistically, realizing that the customer's total experience starts at the time the order is placed, continues through the time it's delivered to the final destination, addresses the need for easy returns, and ends with payment of the invoice. Suppliers should present an all-encompassing view of how they perform at each stage.

When we conducted an internal inventory of every function associated with the customer's buying experience, we realized that each department—from sales to fulfillment—was striving to meet unique objectives. If all individual departments reached 99% of their goal, the overall performance levels in customer satisfaction for Staples would only be 90%. Finding a unified objective to

drive further improvements in customer satisfaction yielded a new and exciting goal: the “perfect order” as defined by the customer. Today, the perfect order is the overriding, daily business mission of all Staples employees worldwide. A set of metrics defines the perfect order from a business perspective, allowing Staples and its customers to better control quality of performance and measure order success more accurately. Here are some of the key metrics we use:

- ◆ Order entry accuracy,
- ◆ Order fill rate vs. unit fill rate,
- ◆ Percent of items miss-picked,
- ◆ Percent of orders delivered next day,
- ◆ Products delivered undamaged.

MAKING IT EASIER TO DO BUSINESS

A customer may want to walk in, call in, or log on to place an order. It’s important that a strategic supplier

Sorting Strategic Suppliers from Vendors

Here are some questions CFOs should ask potential suppliers so they can sort the vendors from the strategic suppliers who can ultimately cut costs tremendously.

- ◆ Can you develop a plan to achieve a frictionless procurement program that delivers the lowest total delivered cost through both hard-dollar and soft-dollar savings?
- ◆ How do you monitor the life of an order?
- ◆ Are you flexible, willing, and able to conduct business via our preferred method?
- ◆ Can you support e-procurement integration on my existing or future systems?
- ◆ Can you serve as a strategic consultant to help us achieve annual savings goals and make recommendations for refining our purchasing processes over time?

does business in the manner the customer prefers and supports all ordering processes equally. Offering Internet-based transactions is now critical.

We realized the power of the online channel after the launch of StaplesLink.com—the e-procurement site for Contract Division customers—in 1999. Embracing e-procurement has greatly enhanced our ability to easily connect with customers and conduct business more efficiently.

Today we approach e-procurement as “electronic intimacy” with our customers. In this context, intimacy means giving purchasing managers maximum flexibility to manage procurement exactly as they want while enabling cost control. It means providing company-specific contract pricing, real-time inventory availability, and real-time status of thousands of orders in one central location—no matter how the order is placed (fax, phone, or Internet)—so the purchasing manager can save time. It means defining, accessing, and easily ordering a group of “favorite” products from a universe of 80,000 online items. It’s definitely popular. Customers have told us that the sum of all the features makes their lives easier, and the numbers speak for themselves: E-procurement sales through StaplesLink.com currently account for more than 70% of the Contract Division’s orders and revenue.

To make doing business even easier, Staples Contract also works with Staples retail stores. We’ve networked our computers with the stores, providing customers convenient access to last-minute purchases or on-the-road product and copy center needs. Purchases are billed to the customers’ Contract account at the lower of the contract or store price.

LIVING IN THE CUSTOMER’S WORLD

The strategic supplier must bring strong knowledge of the customer’s business and be ready, willing, and able to live in their world. This calls for talking regularly and openly with customers to address their specific issues, but, unfortunately, this business fundamental isn’t top priority with every supplier. We realized we certainly weren’t getting enough input from customers on a regular basis, nor were we using it to our optimal advantage. That all changed. Driven by shifting customer needs, our sales representatives evolved into consultants, we expanded the reach of customer advisory boards, and we now take periodic “inventories” of customer touch points.

As more and more customers began to transact through StaplesLink.com and other e-procurement systems, we realized that our sales associates were perform-

ing a consultative role that added new value. Because office supplies are usually the first commodity integrated into an e-procurement system, Staples Contract representatives work through integration issues with new and existing systems, taking responsibility to connect our customers with large e-procurement investments (such as Ariba, Commerce One, SAP, PeopleSoft).

But technology is just one piece. Our consultants also help customers draft and deploy a plan with the objective of significant return on investment. Organizations that are 100% compliant with an ROI-based purchasing plan (like our West Coast customer who saved \$250,000) will achieve the greatest savings. To pull off significant ROI, customers work collaboratively with us to implement each strategy and formally review progress on a quarterly basis. The near-term benefit of the review is to modify processes key to meeting the program's measurable goals. The legacy benefit is to drive any inefficient purchasing behavior out of the organization.

To better understand the customer's internal processes and workflows, we conduct an audit. We then work with the customer to establish new processes that move their organization to the optimal methods of operation.

Functioning as a strategic supplier is an iterative process based on working seamlessly with financial and procurement executives and instituting new business processes supported by the latest technology. Cooperative initiatives help buyers and sellers zero in on the true costs of transactions, and, by working to each other's mutual advantage, such initiatives drive down costs faster than any other approach.

For example, stimulating order consolidation and increasing average order sizes yield substantial cost savings for both customer and supplier. In the last 18 months, Staples Contract helped reduce the number of customers' small orders by 45% and helped increase average order size by 15%. Such changes result in lower operating costs (such as invoice processing) that we ultimately pass on to the customer. And through the use of StaplesLink.com, product returns decreased by 35% over the same period, which provided additional savings.

But even after attaining dramatic results for customers, it's critical for suppliers to seek and employ input from them that enhances the partnership and shapes future initiatives. To learn more from our customers, we increased the frequency of our customer advisory board meetings, which bring together 15 to 20 executives to help Staples better understand their business issues and challenges. This open forum for direct feedback and sug-

gestions allows us to continuously improve programs in the ways our customers desire. In addition, we all can share best practices at these meetings.

Beyond sales representatives serving as consultants and work with our customer advisory board, we also seek to better understand customer behavior by taking an inventory of customer touch points—an activity that's key to staying in touch with the customer experience. Here are a few questions we ask:

- ◆ Is the customer able to easily locate the product online?
- ◆ Is the website easy to navigate?
- ◆ Is the call center performing effectively in peak periods?
- ◆ Are products delivered on time?
- ◆ Is the invoice accurate and easy to understand?
- ◆ Can returns be completed with minimal hassle?

From the customer's perspective, the completeness and quality of the answers may rest with the procurement function.

WELCOMING FINANCIAL EXECUTIVES TO THE PROCUREMENT TABLE

Since we embarked on our own evolution, we've witnessed an increased interest among CFOs to play a more active role in refining procurement. It's important that financial executives support working with a strategic supplier that delivers lowest total delivered cost and shows an active interest in how their organizations do business. At the end of the day, financial executives need to understand the relationship between what suppliers are doing for their organizations and the resulting financial benefit.

THE GREAT PAYOFF

Becoming a strategic supplier has paid off for Staples Contract and its customers. The number of ongoing customer engagements has grown dramatically; e-procurement activity has increased revenue-per-employee ratios by a factor of three; and 95% of Staples Contract's new customers are conducting some of their procurement activities online. As for our customers, they are achieving lowest total delivered cost programs with immediate savings of 10% to 15% and continuous improvements through win-win relationships that deliver shared savings over time. ■

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