Cost Reduction In Purchasing & Procurement

Strategies, Examples & Techniques That Show How To Achieve Cost Reduction in Purchasing
I. Procurement Consultancy Services

Setting Up New Procurement Department
- Results Expected: A world class Procurement Department with comprehensive processes, policies and procurement systems.

Procurement & Purchasing Cost Reduction
- Results Expected: Typical results you can expect are anywhere from 5% to 20% savings.

Procurement Gap Analysis & Best Practices Implementation
- Results Expected: At the end of the project your team will have a plan that outlines the actions to take to close the gap.

Customized Consultation Based on Special Requirements
- Results Expected: In-depth implementation of your organization procurement plans.

Supplier Development & Relationship Management.
- Results Expected: Proper processes to select and qualify suppliers, plus strategies to manage supplier relations and development.

II. Procurement Software

E-Purchasing
- PPC E-Purchasing handles both direct and indirect goods and services purchase and automates and streamlines the purchasing process. PPC E-Purchasing includes: RFQ, Quotation, Purchase Order, Delivery Order, Invoice, Reporting, Catalogue etc.

E-Bidding (Reverse Auctions)
- E-Bidding is a sophisticated eBidding Solution designed to deliver significant purchasing savings. PPC E-Bidding is a web-based solution and is accessible on the web.

E-Tenders
- E-Tender is a sophisticated web-based solution designed to cover the entire tendering process from tender specifications right up to tender approval and award.

III. Procurement Trainings Outsourcing

You can outsource training your procurement staff, by sending them to attend our public courses or running a course only for your team. Below is a list of some of the course that we do.

Best Procurement Practices
Cost Reduction in Purchasing
Purchasing Performance Measurement
Purchasing Negotiations
Capital Equipment Purchasing
Leading & Managing For Procurement
Category Management in Procurement
Preventing & Managing Backdoor Selling
Purchasing for Non-Purchasing Professional
Excellence in the Procurement of Services
MRO Purchasing
Commercial Contracts
Contract Management & Administration
Contract Development
Contract Negotiations
Contract Terms
IT Contracts
Oil & Gas Contracts
Construction Contracts
Tender Management
Contract Specification Writing
Strategic Sourcing
Seven Step Strategic Sourcing
Implementing Global Sourcing
Strategic Sourcing for Best Supplier Selection
Materials & Inventory
Materials & Demand Planning
Inventory Management
Warehouse Management
Supplier/Vendor Managed Inventories
Supplier Management & Development
Improving Supplier Performance Thru Audits & Surveys, Supplier Relationship Management & Development, Supplier Selection & Qualification & Certification, Supplier Risk Management
Supplier Rating & Collaboration

1. How Much Can You Really Save in Procurement?

The flat out answer is a lot. How much is a lot? In an organization, even 1% savings of total spend (most of this spend comes under purchasing & procurement), means millions of dollars in savings. But, the great news is that by implementing the right cost reduction strategies, 70% companies can achieve anywhere from 5% to 20% in cost savings.

The chart on the right shows exactly the savings that can be achieved. You'll notice that 40% of organizations can actually achieve 5 to 10% savings. This is a huge amount of money since these savings go directly to the bottom line i.e. profit.

Imagine telling the CEO or CFO that $1 saved on procurement spend, can equal 6 or more sales dollars. Let’s repeat this again:

To equal the savings of $1 in procurement, any organization needs to increase sales by at least 6 times. Let’s illustrate this again with another chart.

The table on the right what was presented to an Executive Committee showing them that if they were to reduce costs just by 5% it would equal a sales increase of 6.75 times just to match this 5% savings. This organization achieved saving of $8 Million, which would equal 54 Million in Sales Revenue Increase.

Which is Easier:

Save $8 Million or Increase Sales by $54 Million?

The executive Committee in this case unanimously answered that it was easier to save $8 Million.

Now that we know the great impact procurement savings make on the bottom line, let’s focus on few strategies to actually achieve these savings.
On a side but important note – if you want to convince your CEO or CFO to spend some money and hire 1 or 2 extra people to help with cost reduction, both charts above will help tremendously. After all, when the CEO of the company was shown that $1 saved equals $6.75 in sales, he immediately instructed the HR Director to hire 2 new people to help the Procurement Director to achieve the 5% savings = $8 Million. This was done amid a hiring freeze!?

2. How to Ask Suppliers for a Reduction in Their Price!

Below is an email we received from one of our clients that attended the “Cost Reduction in Purchasing Training Course”.

This is an excellent example that with little work (but knowing what he is talking about) a Professional can get the supplier to offer good reductions.

“For a long time, I have a supplier who is ripping me off in term of service and maintenance of my heavy vehicle. When I asked for a price revision, they gave me a lot of mickey mouse stories that their price cannot move. I told them, (as in what I learned from [the training]), to show me a documented breakdown of the cost. If they can justify the cost, I will not touch the price. 10 minutes later, their big boss called me up saying that they will give me 20% discount! It is not as much as I hope, but for the cost of a phone call, why not?”

Very simple – ask suppliers for a documented breakdown of their cost. If they don’t give it, then they should give you a discount.

If they give it, then you have a very powerful tool to start your negotiations and get your price reductions. What tool? This is what follows next.
3. A Powerful Tool To Use in Determining Whether You've Been Over-Charged?

The tool we’re talking here is the PPI (Producer Price Index). In US and many other countries, the government will have the data for price of goods being sold directly from producer – hence the Producer Price Index.

However being an Index, this tool does not show the actual price of the goods/services in question, but shows the movement of the price as a percentage compared to the previous period. Normally this price movement will be shown on a month to month basis.

So with the detailed breakdown you would have got for the cost of any goods, determine what’s the current price movement – if the supplier quoted you a 2% increase in the price of that good/service from the previous period, but the PPI only increase 0.5% - then you’ve been overcharged! Not so however, when you go back to the supplier and state your case with full facts. Here’s another statement from our client (again attending the “Cost Reduction in Purchasing Training Course”)

“Just started working today and this afternoon I applied what I learned about PPI and applied it just now to negotiate price for diesel. Usually I know that diesel price has gone down, but I do not know by how much. Therefore, suppliers will normally lower down the price automatically. But like what you have said, perhaps it is not enough. I checked with the price movement of diesel, and studied the percentage change and requested for discount based on the percentage movement. The supplier at first lamented the price I offered is too low. I said it is a reasonable demand, and should they not agree to it, I would bring it elsewhere. 5 minutes later, they call me up and said “Your will shall be done

[In this case] supplier offered me a discount which is equivalent to 0.8%. … the PPI … is in the region of 2%. Therefore, I asked them for a 2% reduction, to which they agreed.”
4. Resisting Any Price Increase from Suppliers.

Before actually finding out how to resist price increases, it will help tremendously to understand why suppliers ask for price increases. Sometimes there are valid reasons, most of the time there are not. Here are 3 reasons why suppliers ask for price increases:

- Those who sell are trained to always be “testing the water” for price increases.
- Increasing margin is a universal objective.
- There may be legitimate reasons for the increase.

Let’s say you just received a letter from the supplier announcing a price increase:

“Due to recent price increases in the Oil, our price will increase by 11% effective immediately”

What do you do?

First of all JUST SAY NO. And you can up that by saying the following:

“Not only can we not give you a price increase, we were just coming for a price decrease.”

This should do it for some cases. However, you may not know when there’s a genuine reason for the increase. So if the supplier comes back and insists on the price increase, then ask from the supplier his justification for the price increase. You can say something like:

“If you are increasing my price, I would have to pass this cost to my customer. So tell me, what should I tell them when announcing my price increase?”

Then ask for full documentation from the supplier. Here’s some of the things you can ask them to provide:

- Demand from the supplier detailed and documented support to confirm their reasons for requesting a price increase.
- Analyze and verify increased cost with other sources. (Is this a legitimate reason?)
- Counter with demands for supplier to initiate cost reduction program. Show them how!
If it is reasonable to go to other sources, suggest that the price increase will force the investigation of other suppliers in the market or substitutions. If you must accept an increase, document what you did to resist it and your justification for acceptance.

By following the above steps, you will ensure that in most cases there will be no price increases. Of course if there are legitimate reasons for the price increase you would have to live with it, but again, after following the process outlined here you will still get a lower price increase than the one announced at the beginning.

5. Implementing ABC Classification of Your Suppliers/Items

What’s important here is that doing ABC analysis is one thing. Following up on that analysis however, is another.

Based on our experience many organizations have some kind of classifying of suppliers/items based on spending. What’s most important is the focus on A & C’s. But before going into that, let’s quickly explain ABC or Spend Analysis.

5.1. What is ABC Analysis?

ABC Analysis is a method of tiered supplier valuation that divides suppliers into categories based on cost per unit and quantity held in stock or turned over a period of time.

ABC Analysis allows purchasing managers to segregate and manage the overall suppliers into three major groups. This allows different supplier management techniques to be applied to different segments of the inventory/suppliers in order to increase revenue and decrease costs.

"A" Category items/suppliers generally represent approximately 10% of an overall inventory by item/supplier, but represent 80% of value of an inventory.

"B" Category items represent about 15% of inventory items/suppliers and about 15% of the value.

"C" Category items represent 50% of actual items but only 5% of the inventory value. Most organizations can afford a relatively relaxed inventory process surrounding these items. All of this can be summarized in the chart below.
5.2. **How does ABC analysis help in Cost Savings?**

Looking at the chart above, the opportunities for savings are on the A category, since that's where most of the spending is. Further, the following 3 points will help anyone involved in purchasing to have the right focus before embarking on a cost reduction initiative.

a. Those people who focus most of their time on C items, are “Getters”, Not Buyers. By “Getters” we mean that these people are activity focused rather than result focused. You will achieve most results/savings by focusing on A suppliers/items, not C. Getters are very tactical, and just focus on doing things, but not doing “the right things”.

b. Real Buyers focus most of their time (80%) on dealing with their top suppliers/items (10%), since that’s where you will achieve the most savings. A 1% savings on 80% of your total spending (A suppliers/items) will be higher than even a 10% savings on your C suppliers (only 5% of your spending)

c. Real Buyers “Get Rid of the C’s”, by improving the process of dealing with them.

Again just having the classification is not going to help much, unless the workload from C items are dealt with. For any procurement professional doing ABC/spend analysis, the following 2 actions are recommended:

First, focus on streamlining the C suppliers/items. When you have reduced the time you have to deal with them, then you will have enough time for A suppliers/items. You can pass these purchases directly to end users, or create an approved catalog from which end users can buy, or provides end users with corporate credit cards for purchases under C category.

Second then, look at all contracts with A suppliers/items, meet with them and find out how both of you can come up with cost reduction initiatives.
6. Strategies to Reduce Indirect Spending/MRO

While Indirect Spending/MRO (Maintenance Repair Operating) savings go directly to the bottom line, they are often overlooked because of the following reasons:

- If purchasing savings programs exist they usually focus on high dollar value items used in the products being manufactured.
- Indirect expenses items are frequently not handled by the purchasing department or those trained in purchasing.
- Indirect is viewed as 100’s or even 1000’s of monthly purchases with values too small to justify careful scrutiny.
- Little or no top management attention is given to this area.

However, opportunities in indirect cost reductions are endless: from light bulbs to janitorial services, from copy paper to travel expenses, from rent to spare parts, from telephone to courier services.

If these expenditures have not been looked at carefully, our experience shows that 10% to 25% savings are usually available. Below are 5 ways to reduce indirect spend.

6.1. **Buy from Authorized Distributors**

Many of these savings are easy to grasp like low hanging fruit. For one recent client, we simply changed the supplier of a packing material to an authorized distributor instead of the past supplier for a savings of 30%.

The client was not aware that he had been purchasing from an unauthorized distributor, who in fact was buying from the authorized distributor and then adding his markup to the final price.

6.2. **Watch Those Staff Tickets**

Other opportunities may be a little higher in the tree. For example one client was extremely surprised to discover they paid almost 40% higher ticket fares on 133 airline tickets because employees were selecting carrier’s based on employee’s preference rather than lowest fare.
This same analysis also showed that 32% in lower fares could have been obtained on 127 trips by using 7 & 14 day advance ticketing. These plus numerous other travel related savings resulted in a total of 12% savings in travel expenses alone.

6.3. **Get Suppliers to Pay you 52% Return Per Year**

Another twist for a company in a good cash flow position was to save $132,000 annually by simply training employees who purchased MRO items to insist on a minimum 2% discount for payment of invoices within 10 working days.

Two of our clients who are very large Multinational companies with worldwide presence implement this policy – How do we know that?

Because their invoices to us clearly state that – If you want to get paid in 10 days we need to give 2% off the invoice amount. If not they will pay within their normal terms – anywhere from 45 to 90 days.

Where does the 52% return per year come from?

10 working days = 2 weeks
1 Year = 52 weeks

So all in all we have 26 periods (52/2) where we can get a 2% return on our money saved.

2% Discount X 26 periods = 52%

This number is the minimum without taking into account compounding interest. A very, very useful number to bring along when you ask your CEO or CFO to implement this policy!

6.4. **Reduce Suppliers**

Savings are also found in areas like advertising, which is usually off limits to even very aggressive cost reductions programs. One study of a multi-product line manufacturer showed 57 different brochure printers were being used.

Reducing this number to 10 saved 16% of a $1.4 million expenditure and also provided savings in administrative costs since fewer invoices had to be paid and fewer supplier records maintained.
6.5. **Reduce Admin Costs**

Even mundane areas such as courier services can generate profits when users are educated in "best practices". One company discovered 23% could be saved by using "Overnight by 3:00 P.M." instead of "Priority Overnight by 10:30 A.M." Many users admitted that, in most cases, the 4-1/2 hours would not matter. This same company expects to save another $11,000 per year by using faxes vs. courier service.

6.6. **So how does your organization realize these indirect savings?**

To begin, it’s important to view indirect spending not as fragmented, insignificant purchases charged to various department budgets, but strategically as annual expenditures by the entire company, grouped into specific categories of goods and services.

In this way, $100 per month in office supplies purchased by the accounting department, to which little attention will be given, becomes $60,000 per year in office supplies for the entire company. This amount of annual volume will be of significant interest to office products suppliers who will be more than willing to give substantial discounts for an annual contract of this or even smaller amounts.

You may also want to review the reasons given above for overlooking indirect spending as a profit generating area and see how they relate to your operation. It can also be of great benefit to conduct a training program for non-purchasing personnel involved in indirect spending. Usually employees involved in considerable purchases are not even aware that it is important to ask for and expect discounts.

It is also important to give your indirect savings program an on-going emphasis, not a one-shot or program-of-the-month effort. There are so many ways to save money in this area, that year after year motivated and creative people will keep developing new opportunities.

The first savings may come from answering the question:
"Are we buying things right?"
but subsequent and significant savings are also available in determining:
"Are we buying the right things?".
The above examples are just a few of many ways to reduce cost through application of good procurement and organizational practices. By viewing your expense spending as a revenue generating opportunity, today’s enlightened management has another tool to increase profits.

7. Follow Up & Follow Through

Many of the strategies covered here, are not difficult to implement. However these and all other strategies require diligent and disciplined follow up and implementation.

Here’s some simple methods to keep the ‘fire burning’ and continually realized cost savings:

- Implement an E-Procurement System. This will streamline the procurement processes, not to mention that when you catalogue the items your organization buys in the e-procurement system, the end user will not be able to buy from any unauthorized suppliers.

- Implement an E-Bidding System. This is more like a reverse auction where, suppliers bid down on the price of the item you want to buy. Careful however – e-bidding should be used normally with commodity items where the specifications are very clear cut.

- Have continuous training (our favourite subject) of yourself, all other procurement staff and end users as well. You’ll realize (if you have not already) that more often than not, procurement will not be able to achieve substantial savings if end users have already agreed with the suppliers on what to buy. Sometime, these same end users will also have disclosed the budget that is allocated for such purchases. (Maybe now you’re thinking that for some purchases the supplier’s price just came right at the budget you had allocated for it 😊)

Finally, be there all the time. Whenever something does not go according to what you planned, make sure that everyone notices that you are there and you know about it.

There’s nothing worse than implementing sound procurement policies that will enable to achieve substantial savings, only to have much less savings due to poor execution and follow up.
8. Important Note

The information in this report is provided with the help of Robi Bendorf, Lifetime CPM, CPSM, and MCIPS.

This information is only a miniscule of what Robi Bendorf provides in his training program on “Cost Reduction in Purchasing”, where you will discover 20 ways to reduce costs in purchasing and reporting samples to submit to your higher management. Further, when attending you will also discover:

- ✓ Checklist of Cost Reduction Initiatives in Purchasing (Resulting from Experience)
- ✓ Learn proper Cost Reduction Reporting Procedures
- ✓ How to Sell Cost Avoidance to the CFO?
- ✓ Master data mining and learn the art of strategic plans
- ✓ Accurately monitor your cost improvements
- ✓ Learn how to get control of your time
- ✓ Develop your skill in handling Purchase Price Indexes

This training program which is usually fully sold out (it has been sold out for the past 5 years that we’ve been running it), is limited to 25 participants only.

To get full information about this training program and register go to:


Or send an email to:

seminar@purchasing-procurement-center.com