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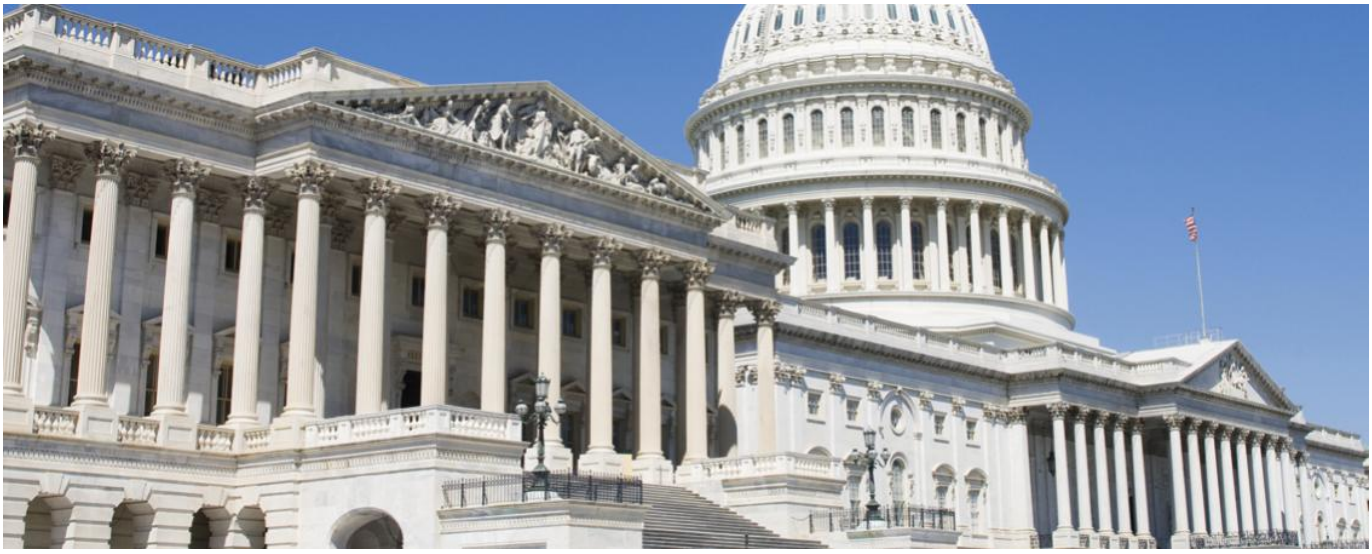

THE STATE OF COMPETITION

Enhancing Competition and Increasing Innovation Across the Federal Government Supply Chain

EXECUTIVE SUMMARY OF FAIR INSTITUTE'S REPORT ON COMPETITION

Full report available by request at contactus@thefairinstitute.org

October 2009

In partnership with:

censeo CONSULTING GROUP
Solving Complex Business Problems

About this Paper

This paper was prepared by the FAIR Institute, in partnership with Censeo Consulting Group. The issues highlighted in this paper are based on "on the ground" experience working across the federal government. Recommendations are based on commercial and federal best practices based on the collective expertise of the FAIR Board and Censeo Consulting Group.

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About FAIR Institute

The FAIR Institute is a nonpartisan, nonprofit* organization being led by several leaders in acquisition and supply management. The Board of Directors consists of the leaders in acquisition and supply management from private industry, government and academia including:

- **Raj Sharma**, President of FAIR and Co-Chair of the FAIR Board, President/CEO of Censeo Consulting Group
- **Dr. Allan V. Burman**, Co-Chair of the FAIR Board, former Administrator of the Office of Federal Procurement Policy and President of Jefferson Solutions
- **David Litman**, former Senior Procurement Executive for the U.S. Department of Transportation, and;
- **David Nelson**, former Senior Executive in Procurement with Honda of America and chair emeritus of the Institute of Supply Management
- **Paul Novak,** Chief Executive Officer, Institute of Supply Management (ISM)
- **Joseph Sandor**, Hoagland-Metzler Professor of Supply Chain Management at Michigan State University

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About Censeo Consulting Group

As experts in operations, supply chain management and acquisition, Censeo Consulting Group works with management teams to drive innovation and efficiencies by applying our unparalleled expertise, analytics, and a deep understanding of change.

Winner of ***Wall Street Journal's*** "Best Small Workplaces 2009"

Named by ***Consulting*** magazine as one of consulting industries "Seven Small Jewels" in 2008

THE STATE OF COMPETITION

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Competition is widely recognized as the cornerstone of any free market system, driving innovation, reducing costs, and limiting complacency. The Obama Administration and other stakeholders across the federal government, similarly agree on the importance of competition as a key element of a healthy acquisition system. Experts disagree, however, whether competition is increasing or decreasing.

But the extent of competition is not all that is unclear. There is also limited consensus in government or policy circles as to what competition in the government arena is supposed to achieve or how to measure it. Most often, we gauge competition by asking, *"How many contracts or how many dollars were competed?"*

The FAIR Institute believes that we should instead ask a more important question:

"Are we creating a competitive marketplace for federal contracts that

- *Is a source of innovation, one capable of attracting the most qualified, innovative, and ultimately best suppliers for any given need?*
- *Ensures lowest total lifecycle costs for purchased products and services, ensuring public dollars are spent effectively?"*

FAIR Institute believes that the current competitive environment does not allow the government to attract the most innovative and capable suppliers or manage total lifecycle costs in an effective manner.

We also believe there are many pockets of excellence across the government and the acquisition workforce continues to deliver value to taxpayers, to the extent possible. However, there are a number of issues that prevent progress in relation to competition:

- Limited knowledge of industry/supplier capabilities, economics, and cost structures
- Complex acquisition process and unique government requirements; and
- Acquisition strategies that inadvertently limit competition

Together, these issues create a competitive environment that could be compared to the current hiring process – complex, lengthy, and unattractive for the best candidates. The result is negative consequences for both government and industry:

- **"Barriers to Entry"** – The acquisition process and unique government requirements work to create significant barriers to entry, potentially inhibiting many suppliers from competing. Those suppliers that do choose to compete for federal business incur significant costs that ultimately get passed on to government.
- **Unattractive market characteristics that deter capable suppliers** – In many cases, suppliers either walk away or choose not to work with government. Like the best recruiting candidates, the best suppliers have many options and often choose not to work with government due to complex acquisition processes and requirements.
- **Unfocused cost management and negotiation strategies** – Instead of working on "win-win" scenarios, negotiations often get bogged down on a set of issues that neither reduce costs nor improve performance. Government often ends up in situations where it pays higher prices and also ends up with higher total costs. Suppliers end up frustrated and sometimes walk away from government work.

To address the highlighted issues, the FAIR Institute recommends that the federal acquisition system adopt a more proactive, systematic and holistic approach to fostering competition:

1. Develop a common set of definitions and metrics to measure levels of competition
    - Develop multiple quantitative measures that distinguish between competition types such as "full and open" versus competition within federal supply schedules
    - Develop qualitative measures that account for the "quality" of competition

2. Pursue strategies to attract new suppliers and reduce “barriers to entry” for the federal marketplace

    - Develop and conduct recruiting, education and outreach to attract new suppliers, especially in areas where significant gaps exist in terms of available suppliers versus those competing for government business

    - Assess “Barriers to Entry” and develop mitigation strategies to attract the best suppliers and enhance “quality” of competition

        - Identify and develop mitigation strategies for key structural, policy, and requirements barriers that limit competition across government

        - Assess any new policy and requirements in terms of impact on competition, ability to attract leading suppliers, and total costs

        - Conduct supplier surveys on a periodic basis to understand supplier perception and issues related to the federal marketplace

3. Strengthen capabilities in industry analysis and cost modeling

    - Develop organic capabilities for strategic industry analysis and detailed cost modeling

        - These capabilities are critical to developing more informed negotiation strategies and in structuring requirements and acquisition strategies

        - Given the technical nature of these skills, government should evaluate tradeoffs between building internal capabilities versus accessing external expertise

        - Sufficient internal capability, at least for interpretation of market provided analyses, is critical

    - Revise market analysis training and development courses to reflect broader economics and business principles

4. Modify acquisition strategies to enhance "quality" of competition and ensure adequate controls in sole source scenarios
    - Require programs to assess impact on competition, including analysis of tradeoffs, for any major acquisitions over a certain size
    - Require programs to conduct formal industry and cost modeling for procurements over a certain size with a requirement to understand industry cost structure, capabilities, and other key trends…especially critical in sole source scenarios*
    - Develop multiple award contracts over a certain size that have options for "opening" the market to new suppliers

FAIR's upcoming report on "Best Practices in Managing Sole Source Relationships" will further highlight the issues and strategies for managing sole source scenarios and creating "win-win" for both government and industry

Further information related to this report:

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Related Reports and Papers:

- Detailed Report: *The State of Competition*, October 2009
  By the FAIR Institute and Censeo Consulting Group
- FAIR Point of View Series: "*Win-Win Competition: A Perspective on Competition in the Supply Chain from the Private Sector*" – By Dave Nelson and Joe Sandor, October 2009

Federal Acquisition Innovation & Reform

The State of Competition

Enhancing Competition and Increasing Innovation Across the Federal Government Supply Chain

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Introduction

Issues in Achieving Competition Goals

Recommendations

Competition in Federal Procurement – A Key Government Priority

The Obama Administration has highlighted competition for government contracts as a key acquisition policy priority, one with potential for saving significant taxpayer dollars.

- **In a March 4, 2009 memo, the Obama Administration highlighted competition for government contracts, or the lack thereof, as an issue that results in a loss or waste of billions of taxpayer dollars**
  - **The memo directs the Office of Management and Budget (OMB) to issue policy guidance to:**
    - **"Govern the use and oversight of sole-source and other types of noncompetitive contracts"**
    - **"Maximize the use of full and open competition and other competitive procurement processes**

- **While they may hold differing views, other stakeholders and oversight groups such as the Government Accountability Office (GAO), Project on Government Oversight (POGO) and Professional Services Council have cited competition (or the lack thereof) as a critical issue**

Competition for Government Contracts – Increasing or Decreasing?

No real consensus exists on the definition of competition or measures used to assess level of competition for federal contracts

Is competition increasing or decreasing? Depends who you ask

- "The use of full and open competition in federal contracts dropped from 45% of contract dollars in FY 2000 to only 36% in FY 2008; meanwhile, the percentage of contracts not competed at all rose from 23% in FY 2000 to 27% in FY 2008." *Secrecy Report* Card 09, OpentheGovernment.org
- "The total amount of dollars awarded for no-competition actions has been relatively flat, and the average contract action size of no-competition contracts has fallen steadily, from $771,000 in 1995 to $153,000 in 2007". Center for Strategic and International Studies, February 2009
- "The biggest recipients so far of the federal contracts awarded with stimulus money are large companies that faced little competition for the funds. [Of] about 22,000 federal contracts with a total value of around $12 billion [signed to date], about a fifth of the dollars and almost all of the contracts agreed to so far have had four bidders or fewer." Big Firms, Little Competition Mark Federal Stimulus Deals, Wall Street Journal, Sept. 12, 2009

- **Regardless of the measure used, quantitative analyses generally do not address issues related to the "quality" of competition**
  - **Did the most qualified and capable suppliers compete for a given requirement?**
  - **Were the requirements written to align with commercial capabilities, in order to ensure lowest total costs and maximum competition?**
  - **Did we negotiate on the right terms through a deep understanding cost drivers?**

To have a holistic discussion about competition, we need consensus on a multi-level definition which addresses all aspects including set asides, multiple award contracts, etc.

FAIR Perspective – Significant Room For Improving the Competitive Environment Exists Within the Federal Government

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FAIR believes the current competitive environment neither leads to lowest total costs nor creates an environment to attract the most innovative and capable suppliers. We further contend that the primary issue related to competition is not <u>how many</u> contracts or dollars are being competed. Rather, it is whether we have created a competitive marketplace that allows us to partner with the most capable and innovative suppliers while managing total costs.

- **To improve competition, we must first reframe the issue of competition within the context of broader public policy challenges**
  - **At a time when government is taking on many complex policy challenges, from health care reform to clean energy to green buildings, we need an acquisition system that facilitates relationships with the most innovative, capable and ultimately, best suppliers for any given need**
  - **Given our budgetary pressures, we must also ensure that the competitive process leads to the lowest TOTAL LIFECYCLE COSTS, through an analysis of tradeoffs between capabilities and costs. Government must do its own "homework" to ensure transparent negotiations, holistic cost management strategies, and an environment that yields "win-win" scenarios for all involved.**

- **Going forward, the more relevant question is:**
  - **Are we creating a competitive marketplace for federal contracts that**
    - **Is a source of innovation, one capable of attracting the most qualified, innovative, and ultimately best suppliers for any given need?**
    - **Ensures lowest total lifecycle costs for purchased products and services, ensuring public dollars are spent effectively?**

Based on the above definition, FAIR believes there is significant room for improvement in how government contracts are competed and managed. The remainder of this paper cites issues and recommendations for improving the "State of Competition" for federal acquisition.

Introduction

Issues in Achieving Competition Goals

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Competition Issues Fall Into Three Categories

Competition issues can be grouped into three broad categories: Knowledge of Industry/Suppliers, Acquisition Process, Acquisition Strategy. Specific issues within each of these areas work together to create significant barriers to entry, a sometimes unattractive market for qualified suppliers, and unfocused cost management and negotiation strategies.

ISSUES IN COMPETITION		IMPACT
Knowledge of Industry/Suppliers	• Insufficient knowledge of industry and supplier capabilities, competition, supplier economics and cost structures • Information asymmetry – suppliers have more information about government than vice versa	**Unfocused cost management and negotiation strategies**
Acquisition Process	• Complex acquisition process • Unique government requirements	**"Barriers to Entry" that prevent capable suppliers from competing**
Acquisition Strategy	• Aggregation of "Unlike" Requirements • Long-Term Multiple Award Contracts • Transparency in Limited Competition Scenarios	**Unattractive market characteristics that deters capable suppliers**

Competition Issues Related To Knowledge of Industry/Suppliers

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KNOWLEDGE OF INDUSTRY/SUPPLIERS

Issue	Description	Impact
Insufficient Knowledge of Industry Structure, Competition, and Trends	• Not always but often, government lacks up-to-date knowledge of industry structure, value chain, competitive intensity, and trends shaping an industry	• **Requirements** that do not incorporate commercial standards (if possible), potentially inhibiting qualified suppliers from competing • **Evaluation criteria** not focused on key differentiators within supply base • **Cost management and negotiation strategies** not focused on key levers that drive costs –especially critical in sole source and non-competitive situations
Limited Understanding of Industry Economics and Cost Structure	• Often, government lacks detailed knowledge of the economics and cost structure of suppliers, a best practice in the world's leading corporations	

The world's leading companies and procurement programs understand that knowledge of their potential and existing suppliers' businesses, including capabilities, trends, and costs is critical to building and managing supplier relationships. In fact, companies such as Toyota and Honda not only understand their own suppliers but also their 2nd and 3rd tier suppliers (their suppliers' suppliers). This knowledge and the transparency that comes with it is a key factor that allows private sector to develop "win-win" relationships even in sole-source situations. *(See FAIR white paper "Win-Win Competition – A Perspective from the Private Sector").*

Within the federal government, knowledge of industry and suppliers is often shaped by experience and RFIs, as opposed to proactive due diligence. Insufficient knowledge of industry trends, structure and costs has an impact on every aspect of acquisitions, including competition. Requirements may be structured in a manner that does not align with commercial standards, leading to increased costs. Evaluation criteria may be too detailed and reflect the Government's risk averse approach as opposed to a focus on real differentiators of performance. Finally, cost management and negotiation strategies focus on levers that have limited relation to overall profitability or cost drivers, thereby limiting opportunities to reduce total costs. Altogether, the imbalance of knowledge and visibility into suppliers' businesses places government at a significant disadvantage relative to industry,.

Competition Issues Related to the Acquisition Process

ACQUISITION PROCESS

Issue	Description	Impact
Complexity of the Acquisition Process	• The federal government acquisition process, with the FAR and its many levels, is extremely complex and requires a significant learning curve	• **Increased Barriers to Entry –** the federal acquisition process and unique government requirements create significant barriers to entry, inhibiting many suppliers' ability to compete • **Unattractive Marketplace for Qualified, Leading Suppliers -** the acquisition process and requirements can also deter some of the most qualified and innovative suppliers from competing for government work, thereby limiting the capabilities available to government
Unique Government Requirements	• Unique government requirements, such as secure facilities and reporting requirements, can be costly to address • Other issues such an limited protection of intellectual property rights often act as a deterrent for new, qualified suppliers	

In many ways, the federal government hiring process serves as an analogy for the acquisition process. The acquisition process, much like the hiring process, is complex, difficult to understand for any newcomer and requires a significant learning curve. For example, the cost of responding to a government RFP, with its many evaluation criteria and other factors, often discourages firms from competing and can be a non-starter for small firms. In other cases, unique government requirements represent a substantial hurdle for many firms and can reduce the number of qualified firms drastically. Combined with onerous requirements unique to the government, such as secure facilities and cumbersome reporting requirements, the complexity of the process acts as a significant deterrent for qualified suppliers and represents substantial barriers to entry.

Just like the job market, the best suppliers have many options for their business and sometimes choose to not work with government. In other cases, those that want to work with government find it difficult to overcome the significant process and unique government requirements hurdles. The net result is reduced competition, but even more importantly, loss of critical expertise and innovative solutions readily available in the marketplace.

Competition Issues Related to Acquisition Strategy

ACQUISITION STRATEGY

Issue	Description	Impact
Aggregation of "Unlike" or Dissimilar Requirements	• Unlike or dissimilar requirements, often comprising multiple industries and areas of expertise , are aggregated into a single acquisition (Note – this is not the same as the intent of strategic sourcing which implies aggregation of "like" requirements)	• **Reduced Competition and Reduced Capabilities**– oftentimes when unlike requirements are aggregated, the competitive base is reduced to a few firms; in many cases, the most capable suppliers with niche expertise or capabilities forego such competitions in order to remain focused and avoid non-value adding partnerships • **Limits Access to New Capabilities/Innovation** – long-term multiple award contracts often limit options for bringing in new suppliers during the contract duration, potentially harming the government's ability to bring in new technologies/capabilities, especially in fast changing industries with short product lifecycles
Long-term Multiple Award Contracts with "Closed Markets"	• Many large contracts, in the tens of millions of dollars, result in a limited vendor base being selected for the contract duration • None or very limited mechanisms to bring in new suppliers in case one or more of the selected suppliers are underperforming	
Transparency in Limited Competition Scenarios	• In sole source or limited competition scenarios (such as small business set-asides), government may have limited means to evaluate costs and other key factors	• **Lack of Transparency and Controls**- Limits government's ability to establish controls and processes for managing costs, ensuring outcomes, and ultimately creating "win-win" scenarios

Due to many pressures such as an ever increasing workload and insufficient resources, acquisition strategies are often guided by the amount of time required to set up and manage contracts. This of course is a legitimate issue. However, other tradeoffs such as loss of expertise and impact on competition are not given as much consideration. "Unlike" or dissimilar requirements, such as a combination of very tactical and strategic requirements or ones requiring multiple disciplines (ex. training and strategy) are common in government procurement. Additionally, long-term multiple award contracts often limit a supply base for a number of years. While this may be an appropriate approach, it could be modified to "open" the market periodically to bring in new suppliers (especially important in fast changing industries).

Introduction

Issues in Achieving Competition Goals

Recommendations

Four Key Recommendations To Address Issues

Based on our federal and commercial expertise, and our assessment of issues related to competition, FAIR has developed five key recommendations to improve the competitive environment within the federal marketplace

ISSUES	IMPACT	RECOMMENDATIONS
Lack of Knowledge of Industry/Suppliers	Unfocused cost management and negotiation strategies	1. Develop a common set of definitions and metrics to measure level of competition
Complex Acquisition Process/Unique Requirements	"Barriers to Entry" that prevent capable suppliers from competing	2. Pursue strategies to attract new suppliers and reduce "barriers to entry" for the federal marketplace
Acquisition Strategies that Inadvertently Reduce Competition	Unattractive market that detracts capable suppliers	3. Strengthen capabilities in industry analysis and cost modeling 4. Modify acquisition strategies to enhance "quality" of competition and ensure adequate controls in sole source scenarios

Recommendation 1

1. **Develop a common set of definitions and metrics to measure levels of competition**
   - Develop multiple quantitative measures that distinguish between competition types such as "full and open" versus competition within federal supply schedules
     - Determine whether the aggregate measure of competition goes beyond full and open competition to include other scenarios (e.g. down selection through extensive market analysis prior to acquisition)
     - Determine whether follow on contracts to the same source, option exercises under previously competed contracts, and added scope under a previously awarded contract constitute competition
   - Develop qualitative measures that account for the "quality" of competition
     - Periodically assess, through a sampling approach, whether the best and most capable suppliers are competing for government business and whether some issues are inhibiting participation (see recommendation 2 related to reducing barriers to entry)

Recommendations 2 and 3

2. **Pursue strategies to attract new suppliers and reduce "barriers to entry" for the federal marketplace**
   - Develop and conduct recruiting, education and outreach to attract new suppliers, especially in areas where significant gaps exist in terms of available suppliers versus those competing for government business
   - Assess "Barriers to Entry" and develop mitigation strategies to attract the best suppliers and enhance "quality" of competition
     - Identify and develop mitigation strategies for key structural, policy, and requirements barriers that limit competition across government
     - Assess any new policy and requirements in terms of impact on competition, ability to attract leading suppliers, and total costs
     - Conduct supplier surveys on a periodic basis to understand supplier perception and issues related to the federal marketplace

3. **Strengthen capabilities in industry analysis and cost modeling**
   - Develop organic capabilities for strategic industry analysis and detailed cost modeling
     - These capabilities are critical to developing more informed negotiation strategies and in structuring requirements and acquisition strategies
     - Given the technical nature of these skills, government should evaluate tradeoffs between building internal capabilities versus accessing external expertise
     - Sufficient internal capability, at least for interpretation of market provided analyses, is critical
   - Revise market analysis training and development courses to reflect broader economics and business principles

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4. Modify acquisition strategies to enhance "quality" of competition and ensure adequate controls in sole source scenarios

- Require programs to assess impact on competition, including analysis of tradeoffs, for any major acquisitions over a certain size
  - Threshold for acquisition size should be large enough that it has an impact on the overall volume yet limits the amount of workload
- Require programs to conduct formal industry and cost modeling for procurements over a certain size with a requirement to understand industry cost structure, capabilities, and other key trends…especially critical in sole source scenarios*
  - Advanced cost analysis and modeling is especially critical in sole source situations and a key differentiator for world-class procurement organizations
  - Size threshold should be large enough that it does not unnecessarily increase workload but addresses a large percentage of spend
- Develop multiple award contracts over a certain size that have options for "opening" the market to new suppliers
  - For multiple award contracts over a certain size, government should explore option of allowing new suppliers to enter after the base and option periods. Top performing suppliers should not have to re-compete, while bottom tier suppliers may re-compete along with other suppliers
  - For multiple award contracts over a certain size, government should explore option of allowing new suppliers to enter after the base and option periods. Top performing suppliers should not have to re-compete, while bottom tier suppliers may re-compete along with other suppliers

FAIR's upcoming report on "Best Practices in Managing Sole Source Relationships" will further highlight the issues and strategies for managing sole source scenarios and creating "win-win" for both government and industry

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Win-Win Competition:
A Perspective on Competition in the Supply Chain from the Private Sector

By Dave Nelson and Joseph Sandor

FAIR Point of View Series

Opinions and Ideas from Government and Industry Thought Leaders

October 2009

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About the FAIR *Point of View Series*

The FAIR ***Point of View Series*** is a forum for thought leaders in government, industry and non-profit sector to present thought-provoking point of views in order to challenge conventional thinking and spur dialogue across all parts of the federal acquisition community. ***The ideas presented in this paper are the points of view of the author and do not represent the official views of FAIR.***

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About the Authors

Dave Nelson is a member of the Board of Directors at FAIR. He is also a former Senior Purchasing Executive at Honda of America, John Deere, and Delphi. Widely known as a sourcing and supply chain visionary, Mr. Nelson is also the author of The Incredible Payback: Sourcing Solutions that Deliver Extraordinary Results and The Purchasing Machine.

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- Joseph Sandor, Hoagland-Metzler Professor of Supply Chain Management at Michigan State University, one of the leading supply chain programs in the world.

*Non-profit status pending.

Win-Win Competition:
A Perspective on Competition in the Supply Chain from the Private Sector

By Dave Nelson and Joseph Sandor

In its paper on insourcing, the FAIR Institute made a case for deliberate, systematic and fact-based approaches to insourcing vital federal acquisition functions. Regardless of the scope and pace of insourcing, the amount of goods and services purchased by the federal government will remain enormous. To make the best use of billions of public dollars while achieving policy goals, the Obama Administration and Congress have emphasized the need for competition and transparency. It can justifiably be said that private sector firms, with a motivation to generate profits, have more incentives than government to receive the best value for procurement dollars. Acknowledging the myriad of policy, process, and other differences between commercial and federal procurement that may render some commercial practices impractical, it is still instructive to understanding commercial best practices related to competition can serve to inform future policy and process improvements in the government.

There is wide agreement across both public and commercial sectors on the benefits of competition. It drives innovation, limits complacency and also reduces costs and prices. It is the foundation of a free market system. However, as commercial practices demonstrate, a procurement strategy driven primarily by full and open competition is neither cost effective in itself nor does it support more strategic acquisition and supply management objectives such as continuous process improvement, value analysis and risk management. Rather competition strategy is guided by context of a specific need and the level of competition in a given market.

Collaboration is far less widely perceived as a good thing. When misinterpreted, the term connotes shady dealings and ethical challenges. Yet when suppliers and purchasers collaborate in a transparent win-win framework, innovation and savings result. Collaboration is almost necessary when organizations are left with sole source options.

Competitive bidding: not a panacea

Within the commercial sector, world class procurement organizations are relying more on cost modeling and cost understanding and less on competitive bidding and market tension. These firms are hosting competitive bidding on fewer goods and services, and hosting such bidding wars less often.

The decline in competitive bidding reflects two factors: the distinction between purchase price and total cost, and the benefits of strong purchaser/supplier relationships. While

price differences are immediately visible, it is harder to grasp total cost and value. For example, the purchase price of a Sikorsky Black Hawk helicopter is about $10 million. Every year of its 25-year life, it requires about $500,000 of repair and spare parts purchases. For item after item, the initial purchase price is not the largest component of total cost.

Robust cost modeling contributes to a more accurate picture of a purchaser's cost. Companies like Honda and Toyota understand the enormous sustainable advantages — competitive prices and superior total value — that come from collaborative cost modeling with their suppliers. Their cost based sourcing outperforms any competitive tension model yet devised because it is the foundation of a supply management strategy focused on reducing waste and optimizing total cost of ownership.

This approach clearly works for Honda and Toyota. But what does it mean for the federal government?

Healthy collaboration, not collusion

Commercial best practice supply management trends follow collaboration as the order of the day. Commercial firms want to become the customer of choice for their suppliers. As a result, supplier relation management is getting a lot of attention and best practice companies measure how their suppliers perceive them as a customer. Indeed, supplier perception is a key metric for many companies.

Of course a naïve buyer can be exploited through a non-competitive partnership. But if the goals of the collaboration are mutually developed, robustly pursued and accurately measured throughout the supply network, the payback is bound to be always better than from any combative strategy.

Superior supplier relationships are increasingly viewed as a key success factor in today's competitive marketplace. Such relationships have multiple components: collaboration with key stakeholders, open and trusting communications, mutual dependence, expanded opportunities for innovation, focus on cost prevention versus price savings, among others. A new mindset has emerged that embraces suppliers and customers in permanent, inclusive cross-functional activities. A recent Vantage Partners IT outsourcing study concluded that good supplier relations deliver at least 25% more value to purchasers.

Conclusion

Remember not too long ago, Big Blue was bleeding badly. The early nineties were bleak times for IBM - customers defected; the market seemed to evaporate overnight and new guerrilla offerings appeared seemingly out of nowhere. Profits and growth plummeted and the company looked like a goner. With $8.8B losses pundits predicted that Big Blue would be sliced up into dozens of little Baby Blues. Even faithful suppliers were jumping ship.

IBM's corporate DNA, however, would not be denied, and in less than 10 years, the stricken giant was back as blue chip stock again, with impressive prices and dividends.

What happened? New leadership? A leaned out organizational structure? Bigger than that - the company struck gold in its supply chain, and succeeded in tapping this rich vein to fuel new products and strategies. IBM corporate procurement was one of the keys to the turnaround.

From 1988 to 1999, IBM's spend with outside suppliers rose from 28 percent of annual revenue to over 60 percent, approximately $50 billion. Long-term relationships and high-level supplier performance therefore became critical to IBM's turnaround and financial health. Further, procurement had to reinvent how to buy materials and services, as well as how to prepare for strategic shifts.

IBM's turnaround was facilitated when procurement saved the corporation billions in procurement costs. In six years, then CPO Gene Richter's procurement team racked up an impressive list of accomplishments, including –

- Savings of $9+B, over 5 percent per year of the total spend
- Satisfaction ratings by internal clients rose from 43 to 89 percent
- Improved responsiveness to supplier expectations, and improved supplier relationships. In 1995 IBM placed number five or six out of seven or eight competitors; two years later IBM was in second place, and by 1999 Big Blue had captured first place in the hearts and minds of suppliers
- Audit readiness, a measure of business control, rose from 66 percent to 100 percent
- Purchases over the Internet rose from zero to $13 billion in two years
- Paperwork dropped; contracts were cut from 40+ pages to 6
- Won the Chairman's Award from Mr. Gerstner for e-procurement excellence
- Received *Purchasing Magazine's* Medal of Excellence in 1999.