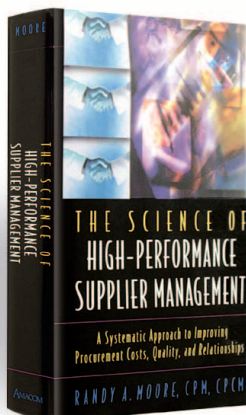


SOUNDVIEW Executive Book Summaries®



By Randy A. Moore,
CPM, CPCM

**A Systematic Approach to Improving
Procurement Costs, Quality and Relationships**

THE SCIENCE OF HIGH-PERFORMANCE SUPPLIER MANAGEMENT

THE SUMMARY IN BRIEF

Purchasing controls your company's future. Organizations that know how to harness the full power of the supply web are going to beat companies that view the procurement function traditionally. To be strategically competitive, relations with suppliers must be considered at the senior executive level and managed carefully. In this summary, you will learn to use a high-technology procurement discipline called the Systematic Technology for Procurement (STeP) process to improve the relationship. Using the disciplined techniques in this summary, you will be able to set up a business environment for proactive supplier performance management.

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What You'll Learn In This Summary

- ✓ **Form, train and charge a procurement team that will lead the procurement process.** You will see why having a team is superior to traditional deal-making at the highest executive levels.
- ✓ **Define your procurement strategy by identifying your objectives and inviting suppliers to be responsible for results rather than be mere suppliers of resources.** When suppliers are responsible for results they are more likely to be flexible and responsive to changing needs.
- ✓ **Prepare a Request for Proposal (RFP) that aligns your objectives, details your requirements, and outlines your contractual requirements.** A good RFP invites solutions and puts the focus on your objectives being met.
- ✓ **Evaluate, rate, negotiate, select and award a contract that meets your needs.** You will see exactly how to rate a proposal and how to keep suppliers focused on meeting your needs throughout the negotiation stage.
- ✓ **Manage the contract and reward superior results.** Once you decide that performance is what you want from a supplier, you must monitor the contract to be sure it is being delivered.

THE SCIENCE OF HIGH-PERFORMANCE SUPPLIER MANAGEMENT

by Randy A. Moore

— THE COMPLETE SUMMARY

Systematic Technology For Procurement

Unfortunately, the relationship between supplier and customer starts off dysfunctionally. This is because the supplier and the customer want two entirely different things. The supplier wants to give goods and services and take money. The customer wants to give money and take goods and services. For the supplier, money is the important ingredient in the relationship while the customer values the goods and services.

You must begin to understand who your good suppliers are and who to get rid of. You must learn to be the one who manages the relationship. Don't let your supplier's customer relationship management program (CRM) dictate the terms of the relationship. Instead, create your own Supplier Performance Management (SPM) program to manage your suppliers and their performance. To ensure you can manage supplier performance, you must pick manageable suppliers.

Supplier Performance Management

The objective of your supplier performance management program is simple: to improve the value of your suppliers' performance. Since roughly half of the average company's revenues goes to suppliers, then approximately half of its strategies for true gain to competitive position must be aimed at those programs and actions that make suppliers more efficient, effective and innovative. The buying organization must substantially increase the value derived from the purchasing transaction.

The value of goods and services has three dimensions: time, quality and price or money. Thus, there are three components to performance: *t* for time, *m* for money and *q* that relates to quality and quantity. When you change one of the three and hold one constant, the third must change. It works like this:

- If *q* is held constant and *t* must decrease, additional *m* will be needed;
- If *q* must increase, and *m* remains the same, additional *t* will be required; and
- If *t* can't be increased but *q* must be increased, then *m* must also be increased.

Four Basic Objectives of SPM

A good Supplier Performance Management (SPM) program requires your organization to achieve four objectives. These are:

- 1. Aligning procurement strategies with organizational objectives so that maximum value is derived out of each deal.**
- 2. Communicate requirements so clearly that there will be little need for changes later.** The supplier will know what you need and what must be delivered.
- 3. Manage the process so that the supplier meets expectations and understands the need for superior performance.**
- 4. Integrate company objectives into every contract.** The entire procurement department must buy into SPM or it won't work.

Toward a Systems Approach

To successfully manage supplier performance, you must apply a systems-engineering approach to procurement. This is what STeP is all about. A systems approach recognizes that there is a deal, and the deal is surrounded by a relationship, and the relationship is surrounded by a business environment that contains factors that impact both the buyer and the seller. Supplier management techniques that focus only on the deal fail to leverage the supplier base for true competitive advan-

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Systematic Technology for Procurement

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tage. Partnering and creating alliances or beating up on suppliers on price, quality and delivery aren't the answer.

What you really need to do is build a system that ensures fair value from your suppliers, and that system must build in a method for correcting performance deficiencies and motivation. In other words, you must create a system of remedies and rewards consistent with your business model. Don't rely on deals made on the fly. The worst deals are those made by executives on the run. Cutting a deal on a plane or the golf course and then telling the procurement team the deal is done except for the details is no way to manage suppliers.

The STeP System

This summary introduces the Systematic Technology for Procurement (STeP) process, which will allow you to take a systems approach to procurement.

There are four major components in the STeP process:

- **Alignment:** This entails ensuring that the procurement objectives are correctly synchronized with the overall strategy of the organization. Supplier performance management begins with management understanding what and how it expects the supplier to perform and what it plans to do if the supplier doesn't live up to expectations.

- **Preparation:** Once you know what and how you want the supplier to perform, you must find the appropriate supplier. This process typically involves creating detailed requests for proposals that meet all your needs.

- **Deal Transaction:** Once proposals are received, you must begin the negotiation stage. Push your own terms. Because you have gone through the alignment and preparation stages already, you know what you need and won't be persuaded to make the deal strictly on the supplier's terms.

- **Ongoing Interaction:** Once suppliers are on board, the planning that went on earlier will serve as a performance management tool. Managed properly, your suppliers will become a strategic weapon in the marketplace. ■

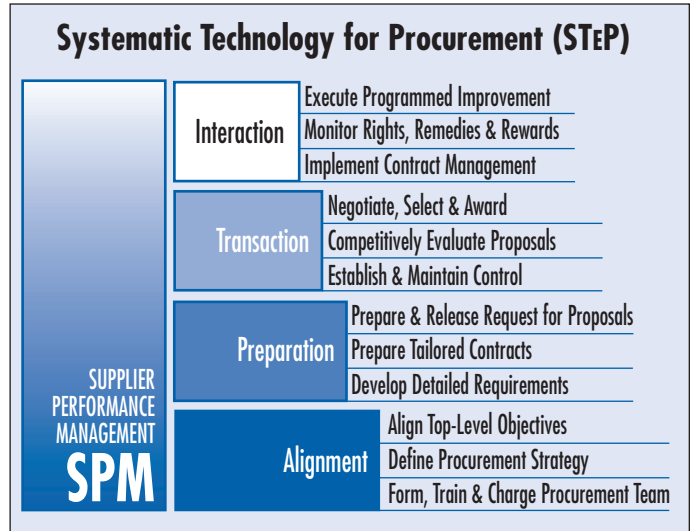
Alignment of the Procurement

The first of the four elements of the STeP system is to strategically *align* your procurement team.

Create Your Procurement Team

Your suppliers want to make as much profit from your company as possible. Your company's objective must be to ensure that it gets value for the money it spends.

To accomplish this, you first need to create a multidisciplinary team. This team will be high-performance, with



all members clear about purpose, roles, values, expectations, functions and goals. Members appreciate and use their differences in a nonjudgmental environment.

The team will do much more than create the procurement deal. It will ultimately be responsible for managing the supplier's performance for the duration of the contract. To create an effective team, you must be sure:

- **The team is composed of the right members.**
- **The team gets proper training.**
- **The team understands the company's objectives and how the procurement process fits in with those objectives.**

Building the right team takes time and money. Don't cut corners. You have two choices: implement a procurement process using a team approach or give the job to a procurement official and live with the outcome when you have to manage the deal.

The first choice might involve more time at the beginning as the team learns to work together and to integrate the organization's objectives into the procurement process. But in the end the result will be a procurement process that gives the company a competitive advantage. High performance demands teamwork from conception of the deal through to the completion of the work. Making the procurement team operate as a team is an essential part of making the supplier act like a team member.

Members of the Team

Everyone with a stake in the outcome should be represented on the team. At a minimum, the following disciplines must be represented either by full-time members or by advocates:

- **End User:** He or she must represent the needs of the user community. For example, if the team has been charged with procuring new storage methods for radio-

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Alignment of the Procurement

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logical images, the needs of general practitioners on location and radiologists who provide advice from a distance must be considered.

● **Legal:** A procurement agreement is a legally binding contract and must be prepared with the assistance of counsel. Having counsel as an actual and active participant makes more sense than waiting until the terms of the agreement have been reached only to have the lawyer object. Get a good deal-making attorney involved.

● **Procurement:** These members bring two important skills to the team. First, they are good deal makers. They also know how to administer a deal.

● **Finance:** The team needs financial expertise. It must know what the services or goods it is procuring should cost.

● **Technical:** Technical personnel can determine what service or product is required. Your team needs someone with enough technical expertise to understand your requirements and what is available.

● **Technical Writer:** This specialist can ensure that all communications between the team and vendors are clear, concise and consistent.

● **Senior Management:** On a critical deal, senior management participation is important. The role of a senior manager should be one of sponsor rather than participant. He or she should offer the team insight into the strategic importance of the procurement project.

Training the Team

Once staffed, the team must be appropriately trained. Jump-start the team with an experienced teamwork trainer or facilitator. The facilitator can show the team how to accomplish its goals without using a leader-follower model. The team will be less dependent on the leader's abilities. It will take longer to train the team, but the approach produces consistently superior results.

There are four areas team training must cover. They are:

1. Team Dynamics: Team members must understand something about team dynamics to understand what they are going through. A team facilitator can explain that they will go through the stages of forming, storming, norming and performing.

During forming, enthusiasm is high and the team is very productive. However, the next stage, storming, is characterized by defensiveness, argument and competition. If the team understands this is normal, it will pass and the team won't be torn apart. The next step, norming, is vital for high-performance teams. Members at this stage will focus less on the goal and more on harmony, team cohesion and trust-building. Members

Why Focus on the Procurement Process?

Why should you focus on the procurement process when you want to create greater profits? Because the alternative means of growing profitability have serious flaws. There are four accepted ways to increase profits. You can increase prices, increase sales volume, decrease operating costs or decrease procurement costs.

Increasing sales price is not an easy solution. Unless you can differentiate your product in the consumer's mind and add value, you won't be able to raise the price beyond what the market will tolerate. Increasing sales is not easy either. After all, if there was excess demand for your product or service, you would be able to increase the price and wouldn't have to consider increasing sales. Decreasing operational costs is also difficult. In many companies the focus is on the first three with no attention to the fourth, decreasing procurement costs. The missing ingredient in many organizations is a comprehensive and systematic initiative to leverage the supply web for competitive advantage.

accept the need to maintain team rules. They then easily move to the performing stage. Then, and only then, can the team's focus be concentrated on the objectives the team was formed to accomplish and the team charge be formulated. The team charge is simply a statement designed to make team members understand the organization's objectives and a mandate to structure the best deal the team can manage.

2. Roles and Goals: To be effective, team members must assume the roles of timekeeper, record keeper and gatekeeper. Training must cover this and the need for structured meetings, team schedules and agendas.

3. Tools and Techniques: The tools and techniques the team needs are embodied in the Total Quality Management process. These are process-driven methods designed to gather data, reduce the data to useful information sets and prioritize requirements.

4. Team Decision Making: When all the data has been gathered and the information has been prioritized, the team must make decisions. These decisions must be based on consensus and reflect the organization's strategic goals and objectives.

Defining Procurement Strategy

The primary objective of a strategic approach to procurement is to create competitive advantage from the relationship between customer and supplier. To accom-

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Alignment of the Procurement

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plish this objective, the team working on a complex deal must strive to sustain leverage and power over the supplier from the creation to the performance of the deal. You can buy either resources or results. Resource contracts are agreements to procure specific items, products or services that are generic. For the most part, in high-technology procurement you are seeking results rather than just resources. In these contracts, you are buying a solution or an outcome.

Contracting for results requires your team to focus on the scope of the solution. You must decide what system is acceptable, what performance and reliability requirements you have and what results will satisfy you. The results must have time, money and quality measures.

Aligning Top-Level Objectives

You must create a business plan for the procurement. The plan should be distilled into a deal summary sheet that can be used to secure upper management buy-in. To create the plan, you must know what the top-level objectives are. Get key decision-makers and stakeholders together. The plan must articulate the result you are seeking. This will be your mission statement.

Once the results desired are clear, you must determine what the top-level requirements will be for the deal. Brainstorming can yield three to 20 top ideas that go to the heart of the results you seek. Once clear objectives have been articulated, they must be aligned within the organization. Concise briefing packages will be helpful as you brief stakeholders and senior management. ■

For Additional Information on why traditional teams fail, go to:
<http://my.summary.com>

Preparation Within The Organization

Once your procurement team has aligned the procurement objectives with top-level requirements, you are now ready for the *preparation* element of the STeP process.

In the previous stage, you determined what results you need; the first step in the preparation stage is to detail those needs.

Develop Detailed Requirements

The next module in the STeP process can be accomplished by preparing a statement of work (SOW) that explains:

- **What** needs to be done.
- **Who** will be responsible for doing it.

- **Where** the work will be performed.
- **When** the work must be completed.

Your SOW will form the basis for monitoring the supplier's compliance. The SOW must be set up to allow you to easily measure supplier performance.

Be careful when designing the SOW. If you are contracting for results, you must avoid telling the supplier how to accomplish the job. Let the supplier worry about the "how" of performance.

Market Survey

Once you have gathered information from everyone in the company who will be affected by the contract, you can begin a market survey. The survey will gather external data on technologies that can be applied to your objectives and a list of possible suppliers. The idea is to identify as many technologies as possible that meet your requirements and as many suppliers as possible that can utilize those technologies to solve your problem.

Use a request for information (RFI) to find out what suppliers might meet your needs. The RFI should include:

- A statement of the procurement objective.
- A statement that this is only a request for information and not a solicitation for proposals.
- A statement that communication must be limited to a designated team member and that communicating with others is grounds for disqualification.
- A due date.

In addition, you will want information about the organization's structure and financial status, a description of its facilities and infrastructure that would be used to ful-

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Avoiding Additional Cost

One of the sneaky ways suppliers operate is to find ways to bill extra. They bid low on your project to get the contract and then hope you won't provide them with enough information to get the job done. For example, suppliers add extra money to the bill by claiming they have incurred additional costs due to delays and disruptions, or ask for an "equitable adjustment" when a new piece of data that was not available at the time the contract was negotiated led to additional work for the supplier.

You can guard against this by creating a procurement library. Have every department that will be touched by the contract contribute specific information about its needs. The library becomes the information repository for the team developing the contract requirements and a baseline of data for suppliers preparing their bids.

Preparation Within the Organization

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fill the contract, a list of key people and their qualifications, and information about technological capabilities now in place and being developed. References and contact person information should also be requested.

Tailor the Contract to the Deal

Writing the contract should not wait until the deal has been made. Instead, it should be part of the request for proposal (RFP). The contract will have four sections.

The first section contains the administrative elements of the contract, including party names, recitals, contact information, requirements for legal service, invoicing and payment instructions and shipping addresses. The second section contains the SOW, either as a referenced attachment or in its entirety within the body of the contract. The third section contains the standard contract language used by your company for most mainstream deals. Finally, the fourth section contains the specific terms tailored to the deal. These set the stage for performance management and future performance enhancements.

Prepare and Release the Request for Proposal

Your RFP should stand on its own. It has three functions:

1. To communicate the requirements
2. To solicit responsive proposals
3. To position the procurement team for evaluation and negotiation

The RFP should be divided into five sections. These, along with their minimum requirements, are:

The Executive Summary: Be sure it clearly and concisely communicates the basics of the proposed deal. Include the mission statement and the top-level requirements and a statement that indicated you expect performance promises to be an integral part of any response.

What Makes a Contract

“Contract” is a legal term. A contract is an agreement that includes:

- ✓ An offer and acceptance of that offer
- ✓ The passing of consideration between the parties — that is, evidence of an exchange of something of legal value, such as money for services or goods
- ✓ Parties that are competent (that is, they have the capacity to enter into an agreement)
- ✓ The purpose of the agreement is legal

In addition, the parties have to have genuinely consented to the deal — not tricked or induced by fraud, duress or deceit.

The Requirements Section: The SOW comes next. Be sure all requirements are listed as performance criteria. Avoid mandating methods and focus on requiring results.

The Terms and Conditions: These include the standard terms and conditions that your company uses in contracting as well as the specific terms and conditions unique to this deal, such as intellectual property ownership terms, rewards and remedies, specific warranties and an exit strategy.

The Proposal Instructions: This section lays out the technical requirements for responding, such as the due date, who to contact and how many copies to send.

The Evaluation Criteria: This section lays out what you expect from the vendor’s response. It lays out your top-level criteria. You may want to consider letting suppliers know they are welcome to come up with alternative proposals, so if you missed a possible solution to your problem, creative suppliers can provide you with a better idea. ■

The Deal Transaction

The third of the four major elements that make up the STeP process is the actual *transaction of the deal*.

Establish and Maintain Control

When the RFP is out, you must guard against letting control of the process pass to the supplier. Suppliers will do their best to derail your efforts at competition. Don’t allow it to happen. One approach is to schedule a presolicitation conference before you release the RFP. Those who attend will get a general idea of what you are looking for and may even begin sizing up some of the potential suppliers as teammates.

You also want to enforce communications discipline. Employees should be instructed that they are not to communicate with suppliers about the RFP unless they are designated as the team member who is to be the contact person. Vendors can and will try to get inside information about the RFP and will try to enhance their chances by soliciting support for their company. They must understand that doing so won’t be tolerated and will be grounds for disqualification. Questions that come in through the approved communications channels must be logged in a controlled manner. All questions and answers should be made available to all suppliers. There should also be a cut-off time for any questions.

Shortly before proposals are due is a good time for a bidder’s conference. Be sure that the team member who has been fielding inquiries leads the meeting. This reinforces that he or she is the person to turn to with questions. Use an agenda and don’t let the meeting degenerate into an open forum on the RFP.

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The Deal Transaction

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Evaluate the Proposals

You have two goals to remember when evaluating proposals. The first is to select the proposal that assures your company it is receiving the best overall value for the project. The second is to ensure that the selection process was fair.

A senior staff member should be responsible for selecting the winning supplier. He or she will receive recommendations from the procurement team. The team is responsible for sifting through the proposals and using predetermined selection criteria to winnow down the proposals to those that best solve the problem posed in the RFP. You may want to use sub-teams to evaluate individual parts of the responses. For example, a technical evaluation team can evaluate the soundness of a supplier's technical approach while a cost/price evaluation team looks at the cost estimated and proposed pricing.

When the proposals arrive, they must all be evaluated to see if they comply with the minimum stated requirements. Those that fulfill the minimum requirements are then evaluated by the appropriate sub-team. Next, using the evaluation criteria and the relative weight you assigned each in your proposal, you must tabulate the scores. The procurement team will by now have set a competitive zone (CZ). The CZ is the score cut-off for vendors. You should now only have two or three supplier proposals. Those who beat the CZ score are included in the procurement briefs sent to the ultimate decision-maker. Negotiation now starts.

Negotiate, Select and Award

Don't make the mistake of selecting the winner and then entering into negotiations. You should negotiate with all the suppliers in the CZ. The proper sequence is to negotiate, then select and then award the contract. Negotiations will consist of several rounds with each supplier. They should be told they are in the top group, but must understand that they have not been selected yet. Be sure that each supplier also understands that a deal may be made with any of the competition at any time during the negotiations phase. This puts pressure on the supplier's negotiations team to quickly commit to your performance and price requirements.

The team members who do the actual negotiations must be very well prepared. One of the best approaches to negotiations is to understand the principle known as BATNA. BATNA stands for best alternative to a negotiated agreement. Having a BATNA is very powerful and merely means that you know what your alternatives are if you cannot reach agreement. You may be able to do the work in-house or you may have another supplier avail-

able. You might be able to partner with another company. The important factor is that you know what your alternatives are. Because you do, you won't feel as if you must make a deal. It is better to walk away from a deal than to have to live with one that is worse than the alternatives identified in your BATNA. ■

Ongoing Interaction With Suppliers

The day the contract is signed is the day the customer must begin managing the contract or the supplier will start managing the customer. Implementing the contract management is the first module of the fourth and final element in the STeP process: *ongoing interaction*.

Implement Contract Management

If you have used the advanced procurement process outlined in this summary, you will be working with a performance-based contract that can yield significantly superior results. Such a contract requires ongoing attention.

You must manage contracts if you are to establish baselines for rewarding superior performance and punishing sub-standard performance. Contract management includes tracking documentation and making sure that milestones are reached. Contract managers make sure the supplier delivers and that there are no excuses for not delivering.

Rights, Remedies and Rewards

If superstar athletes have performance rewards built into their contracts, why shouldn't your suppliers have them, too? In the game of business, the players are your employees and suppliers. High-tech suppliers are your superstar athletes. Adequate isn't good enough for them. In order to win, you need to adopt a team approach, with suppliers and employees working toward common goals.

Just as your company probably prepares annual reviews for its employees, it should provide annual reviews for its suppliers. Such performance reviews require three things: goal setting before the performance period, performance assessment after the performance period, and feedback.

Goals and rewards must be built into the contract. Rewards can be more powerful than punishments. Consider this example. A contract has a built-in liquidated damages clause that is triggered if the supplier misses a critical date. As the supplier prepared the bid, it calculated the likelihood it would miss a deadline and built the penalty into the price. The supplier wins because its liquidated damages are covered in the price, but you lose because a critical deadline was missed. If instead you build in a reward for meeting or beating the

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Ongoing Interaction With Suppliers

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deadline, you won't find yourself paying for the supplier's missed deadline.

Rather than liquidated damages clauses, high-technology procurement contracts can benefit from clauses aimed at identifying important milestones and working together to correct deficiencies if they occur. Setting up a reward pool or rewarding outstanding suppliers can provide powerful incentives for superior performance.

Long-Term Programmed Improvement

Today, business changes at a rapid pace, and the contracts negotiated with suppliers months ago may hinder your ability to respond. Now try to imagine what it would be like if your key suppliers worked in concert with you. Together you formed a coalition with common goals and objectives. It takes more than imagination to make this vision a reality. It takes a plan — a programmed improvement plan.

Programmed improvement is about understanding the competitive direction of your industry and finding the pressure points in the value chain so that your suppliers realize that it is in their best interest to team with you. Teaming wisely creates competitive advantages for both of you. Suppliers who take notice of your objectives and consider them in conjunction with their own objectives can create valuable partnerships.

There are several programs you can consider to create

Why Manage Contracts?

The main reason to manage contracts is to avoid problems. You do this by:

✓ **Monitoring Your Responsibilities:** You must identify all contract requirements that drive the supplier's ability to perform. Failing to perform on your end may mean the supplier gets paid for its non-performance if your neglect meant the supplier couldn't fulfill its end of the bargain.

✓ **Monitoring the Supplier's Responsibilities:** Once your house is in order, turn to the supplier's performance. Make sure performance standards are met regarding the time, money and the quality and quantity required under the agreement.

✓ **Get Superior Short-Term Supplier Performance:** Use the positive incentives you built into the contract to motivate suppliers into higher performance levels.

✓ **Get Superior Long-Term Supplier Performance:** Long range, you want to encourage the supplier to make investments that will reduce its future costs and to bring you its best ideas first.

Creating Performance-Based Incentives

Consider creating a composite award pool. The award pool works like this:

- ✓ **Identify critical performance factors.** These must be critical to the success of your organization.
- ✓ **Create the pool.** Prior to finalizing negotiations, tell the supplier you want to set aside a portion of its profit as a performance incentive. Have it propose the number and tell it you will match the pool.
- ✓ **Negotiate performance milestones.** These are the goals that must be reached before money is paid out of the pool.
- ✓ **Hold periodic award fee events.** This keeps the supplier's eyes on the prize.

partnerships. These include:

- **Setting up supplier-tiers** is one approach. Suppliers who qualify for high tiers earn awards like preferential treatment in future contracts. Qualifying for a tier depends on meeting objectives that are of strategic value to your company.
- **Business Base Consolidation** of suppliers can work in organizations that are trying to reap the benefits of economies of scale.
- **Create a continuous improvement initiative program.** Encourage suppliers to continually improve through built-in incentives in contracts.
- **Create innovation initiatives.** Encourage your suppliers to share innovations that can benefit you both.

Managing the Unmanageable Supplier

What can you do when, despite your best efforts, you are faced with a supplier who isn't performing? The supplier may be behind schedule or may demand more money for work you assumed was part of the original contract. If you cannot persuade the supplier to perform as agreed, you must use what leverage you have.

Leverage can come from several places. You may find some in the contract itself. A good contract will provide remedies. If the supplier refuses to budge, you may have to sue or threaten termination. You may also find leverage in the market. Threatening to send out a new RFP could get the supplier's attention. Personal relationships can also provide leverage. Having the president of your company speak directly to the supplier's CEO can be effective. Finally, don't discount the leverage found in your checkbook. Performance can almost always be had for a price. ■

For Additional Information on how an office supplier could become a valuable partner, and for an example of using contract language as leverage in a dispute, go to: <http://my.summary.com>