

ACRES OF DIAMONDS

The Value of Effectively Managing Low-Dollar,
High Transactional Volume Spend

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The fact remains that the majority of procurement initiatives have traditionally focused on the big bang high-dollar, leveraged spend approach to procurement. While this approach is appropriate for certain commodities utilizing an event-centric tool, extensive research including a CAPS 2003 study indicates that it does not create a sustainable COGs savings model.

The examples provided by the Floor to Ceiling Analyses included with this report provides further confirmation of this assessment.

What is interesting to note is that low-dollar, high volume procurement is often overlooked by the majority of purchasing departments and software vendors, whose time and energy is usually focused on negotiating the big dollar contracts. This occurs despite the fact that statistical analyses of purchasing trends in both the public and private sectors consistently verify that approximately 90% of all transactional activity relates to purchases of \$25K or less. Ironically, low-dollar transactions also represent the greatest potential for sustainable savings. This trend is likely to increase in scope as discretionary spending caps are raised to accommodate front line efficiency requirements.

In one government agency analysis conducted by e-Procure, of the \$215 million in total annual expenditures \$37 million was related to purchases of \$25K or less. While this accounted for 17% of the total spend, it consumed an incredible 92% of all transactional activity. Referencing historical savings performance, a 10% reduction in COGs alone is well within the achievable range for these low-dollar purchases provided they are procured outside of a negotiated contract. Dependent on commodity types, this equates to a savings of up to \$3 million in the first year. The fact that both the cost and implementation requirements to achieve these savings are minimal in comparison to the return is the driving factor in the growing recognition of this important area of spend. What is also compelling is the substantial reduction in procurement cycle time, as well as quick and easy access to critical business intelligence. Although considered to be “soft” savings, this is where the most significant results will ultimately be achieved. (It is worth noting that with the majority of government agencies little if any business intelligence in terms of spend activity is readily available. For example, through our discussions with several major

suppliers to the Canadian Government, we discovered that this information was actually being sought directly from the vendors themselves.)

Since the majority of current applications are structured around a contract creation-compliance management process, a palpable vacuum has therefore been created relative to low-dollar acquisitions. Recognizing this void, and in an attempt to make the need fit the solution, software vendors are attempting an all encompassing “transactional pull” by way of creating master contracts for as many commodity groups as possible. Citing the purported merits of leveraging volume discounts through standing offers, coupled with the creation of “buyer-centric” tools promising easy access to electronic shopping malls, proponents of the catalog architecture are pledging big returns. In reality, the results are less than stellar. Agencies such as the Veterans Health Administration as well as other similar type organizations in both the public and private sector provide testimony to the fatal flaw of this approach.

The constant refrain from front line buyers that “they can usually obtain better pricing with one phone call” versus purchasing off of a negotiated big dollar contract is just one of many insurmountable hurdles. From both a buyer and supplier point of view, the myopic utilization of a catalog-based system for dynamic, low-dollar transactions quite simply does not work in the real world. Exacerbating the situation is also the belief that the propagation of big-dollar contracts will minimize the engagement of the SME business community. Recognition of this concern is reflected in the new statutes and legislation states such as North Carolina and Washington are creating to actually enhance SME participation.

The following Floor to Ceiling Analyses provide additional insight into the potential savings that exist with low-dollar, high transactional procurement outside of a centrally negotiated contract. Please note that all costs are in U.S. currency.

HP LaserJet 9050DN NETWORK-READY (Q3723A)



Current

Floor \$2,999 (w/estimated shipping \$3,399)

Institution (last buy) \$3,455

Ceiling \$4,428 (w/estimated shipping \$4,728)

HP Input Tray (C8531A)



Current

Floor \$588 (w/estimated shipping \$698)

Institution (last buy) \$805

Ceiling \$924 (w/estimated shipping \$1,034)

HP LaserJet 3550N Laser (Q5991A)



Current

Floor \$552 (w/estimated shipping \$652)

Institution (last buy) \$875

Ceiling \$1,215 (w/estimated shipping \$1,315)

NOTE: The posted Floor and Ceiling costs are the result of a market analysis for a single quantity, non-dynamic purchase. The numbers are derived through an amalgam of multiple sources as a means of establishing the chasm between the current Floor and Ceiling price range for the listed item. While the respective Floor and Ceiling costs will likely be lower as a result of a dynamic acquisition, the chasm or percentage difference will usually remain constant.

Historic “Flat Line” Results

When determining which commodities are likely to generate the greatest potential for Cost of Goods (COG) savings, it is important to establish historic trending relative to price fluctuations.

In those instances where there is an historic fluctuation in cost mirrored by a steady downward trend (such as in Example A), the likelihood for significant COG savings is substantial.

(Example A)

HP LaserJet 3550N Laser (Q5991A)



Current

Floor \$552 (w/estimated shipping \$652)

Institution (last buy) \$875

Ceiling \$1,215 (w/estimated shipping \$1,315)

Conversely, when there is minimal cost fluctuation resulting in a flat line trend (see Example B), the likelihood for savings is greatly reduced.

(Example B)

HP LaserJet 9050DN NETWORK-READY (Q3723A)



Current

Floor \$2,999 (w/estimated shipping \$3,399)

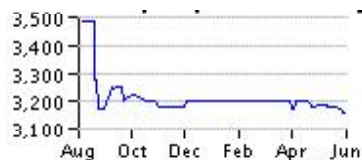
Institution (last buy) \$3,455

Ceiling \$4,428 (w/estimated shipping \$4,728)

This trend holds true even within the same commodity group, involving closely related items (see Examples C and D).

(Example C)

Enterasys Matrix C2 24PT



Current

Floor \$3,153 (w/estimated shipping \$3,303)

Institution (last buy) \$3,096

Ceiling \$3,699 (w/estimated shipping \$3,849)

(Example D)

Enterasys 1000BLX Mini GBIC



Current

Floor \$195 (w/estimated shipping \$295)

Institution (last buy) \$587

Ceiling \$803 (w/estimated shipping \$903)

Given the initial focus on COG savings, it is important to identify which commodity groups are likely to generate the greatest results. As time progresses, the savings associated with commodity cost reduction will be further and substantially augmented by the dramatic savings associated with a reduction in procurement cycle time.

Conclusions:

It is important to realize that true savings are inextricably linked to efficient, real world processes. With discretionary spend caps being raised on a consistent basis, the importance of deploying a solution that will meet with ready approval on the front lines is critical to achieving sustainable results.

It is our position that a true centralization of procurement objectives requires a decentralized architecture that is based on the real world operating attributes of all transactional stakeholders starting at the local or regional level. In other words, your organization gains control of its spend environment by relinquishing centralized functional control in favor of operational efficiencies originating on the front lines. This is the cornerstone of agent-based modeling.

By focusing on the areas of spend which provide a significant return in the shortest period of time, your organization establishes a solid foundation for continued initiative expansion and success across the broader enterprise. The key is to recognize the opportunities for savings that are not currently being cultivated within your company. This often means looking beyond the purported big bang savings associated with large-dollar purchases, and seeing the real opportunities for steady and sustainable savings.

About Acres of Diamonds

Russell H. Conwell was the founder of Temple University. During one of his earlier adventures in 1870, he was riding in a camel caravan along the valley between the Tigris and Euphrates Rivers in Mesopotamia when he heard a guide weave tales to entertain his American tourists.

Conwell, then only 27, was deeply impressed by a legend about a prosperous Persian farmer, Ali Hafed. Lured by the stories of a Buddhist priest, Ali deserted his fruitful lands to search for immense wealth in mythical diamond fields.

Far and wide Ali Hafed roamed, footsore and weary. Youth and wealth disappeared, and he died far from home, an old and disillusioned pauper. Not long afterward, the guide related, acres of fabulous diamonds were found on Ali Hafed's own land.

To the other tourists, this was just another alluring story, but in Conwell's mind a great truth had been sown. To him it said: "Your diamonds are not in far-away mountains or in distant seas; they are in your own back yard if you will but dig for them."

[About The Author](#)

Jon Hansen has been generating substantial savings for companies since he entered the high technology sector in 1983. Featured on CBC's Venture program for his innovative Procurement Programs Jon continued his innovation as President of Parts Logistics Management Corp. between 1997 and 2002. He has been honored as an Ottawa finalist for the Ernst & Young Entrepreneur of the Year Award in 2004 and 2005.

Recognized as a leading international authority on improving supply chain management Jon is often retained by organizations such as the Purchasing Management Association of Canada (PMAC), the National Institute of Governmental Purchasing (NIGP) and the National Association of Educational Procurement (NAEP) to provide either a 1-Day orientation seminar or 2-Day accredited course based on his award winning conferences and seminars.

Other Published Articles & White Papers

White papers, studies or articles authored by Jon Hansen include the following:

How to Eliminate Maverick Buying: Closing the Gap Between Sources of Supply and Demand Through Web-Based Procurement

Canadian e-Business Initiative (CeBI) Study and Analysis

Technologies Diminishing Role in an Emerging Process-Driven World

How Not to Abandon your e-Procurement Initiative

Dangerous Supply Chain Myths (7 Part Series)

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