Using Sourcing/Bid Optimization in Supply Management

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Bid Optimization Outline

• Why use it?
• What is it?
• In what areas of spend is it applicable?
• Where does it fit in the strategic sourcing process?
• What are the advantages, challenges and results?
Why Bid Optimization

- The low hanging fruit has been picked
- It represents a step up the strategic sourcing value chain
- Supply situations are becoming more complex
- Reverse auctions losing steam
A Common Sourcing Situation

- Disjointed supply processes
- Multiple non-integrated systems
- Fragmented organizational responsibility
- Poor coordination of multiple business unit spends
- Changing issues on supplier relationships
- Lack of a positive benchmark
Buying Solutions

- Basic sourcing strategies provided cost savings
- Over time, basic sourcing strategies result in diminishing returns
- Continuing savings momentum requires new approaches
- Bid Optimization is a new approach
Bid Optimization

• Process to help companies buy better in complex situations
• Complexity - large number of:
  – potential suppliers
  – item/services to be purchased
  – specifications
  – constraints/business rules
  – geographic needs
A Real Example

• 2,200 shipping lanes
• 66 bidders
• Suppliers could bid on any combination of lanes
• Number of possible bids = \((2^{2200}-1) \times 66\)
• Actual number of bids = 28,000
Optimization Applications

- Transportation
- Ingredients
- Packaging Materials
- Natural Gas
- Hospital Supplies
- Janitorial Services
- Displays
- Chemical
Optimization Applications

- Armor Car Services
- Retail Store Inventory Services
- Trash
- Corrugated Packaging
- Office Supplies
- Landscaping
- Store Fixtures
- Legal Services
Business Rules
(scenarios/constraints)

• Limit the spend with any one supplier
• Require a minimum spend with MWOB
• Allocate all of the business for a lane/part/location to one supplier
• Allocate all of the business for a lane/part/location to a specific supplier
• No single sourcing
Strategic Sourcing Process

- Internal Assessment
- Market Assessment
- Supplier Information

Develop Sourcing Strategy → Solicit Bids → Evaluate Bids → Negotiate Implement
Sourcing Process with Bid Optimization

- Internal Assessment
- Market Assessment
- Supplier Information

Develop Sourcing Strategy
Sourcing Process with Bid Optimization

- Develop Sourcing Strategy
  - Reverse auctions
  - Negotiations
  - Size/scope of RFQ (regions, number of items, etc.)
  - Bid optimization

- Internal Assessment

- Market Assessment

- Supplier Information
Sourcing Process with Bid Optimization

- Develop Sourcing Strategy
  - Bid Optimization
    - Model the business problem
    - Define any number of multiple criteria
    - Allow for user preferences at various business units
    - No pre-lotting is necessary - suppliers are allowed to determine what they will bid

- Internal Assessment
- Market Assessment
- Supplier Information
Sourcing Process with Bid Optimization

- Internal Assessment
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Develop Sourcing Strategy
Solicit Bids
Sourcing Process with Bid Optimization

- **Internal Assessment**
- **Market Assessment**
- **Supplier Information**

**Develop Sourcing Strategy**

- Solicit Bids
  - Communication to suppliers
  - Template development
  - Bidding rules
    - Required bid on every item/service
    - No layered bids (e.g. volume discounts)
Sourcing Process with Bid Optimization

- Internal Assessment
- Market Assessment
- Supplier Information
  - Develop Sourcing Strategy
  - Solicit Bids
  - Evaluate Bids

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Sourcing Process with Bid Optimization

Evaluate Bids
1. Look at least cost (unconstrained) scenario
2. Add constraints (e.g. incumbents, MWBE, etc.)
3. Add scenarios contributed from executive level (e.g. distribution of business)
4. Include non-price factors
5. Decide to re-bid or negotiate
   • Uncovered items
   • Bids levels from incumbents
   • Eliminate some bidders
Sourcing Process with Bid Optimization

Internal Assessment

Market Assessment

Supplier Information

Develop Sourcing Strategy

Solicit Bids

Evaluate Bids

Negotiate Implement

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Time to Complete Process

• First time through
  – 6 months to one year

• Repeat buys
  – 3 months to 6 months
Advantages of Bid Optimization

• Find a low cost (near “optimal”) solution that covers all items to be purchased
• Test impact of business rules on costs
• Analyze all bids
• Reduce time to analyze bids
• Allows bidders to submit “expressive bids”®
• Allows for re-bids
• Verifiable process
• Transparent process to suppliers
• Replace reverse auctions
Challenges with Bid Optimization

- Change management
- Project based buying
  - Leader
  - Communications / buy-in
  - Volume aggregation
- Software, training, consulting cost
- Data requirements
  - Buyers
  - Suppliers
- Constructing templates for data collection
- Supplier training
  - 75 page training manual
  - Three Q&A call-in events
- Problem too large for software
- “Paralysis through analysis"
Example Bidding Rules

• Have to bid on every item/service
• No layered bids (e.g. volume discounts)
Example Feedback to Suppliers

• Their bid per item/service
• The lowest bid per item/service
• Their rank for the item/service
• For incumbents in danger of losing significant business
  – Do they want to change bids?
• For bidders who might gain significant business
  – Can you handle this new volume?
• How many more rounds of bidding
Reported Outcomes

• Fasteners
  – Suppliers projected price increase of 20%
  – Actual price increase of 11%

• Transportation 1
  – Suppliers projected rate increase of 10 to 15%
  – Actual rate increased was 1%

• Transportation 2
  – Rates up 2% from historical contracts
  – Rates down 5% from historical contacts plus spot buying
Providers of Bid Optimization Services

• Combinet
• Emportoris
• Procuri
• Iasta
• Ariba
• Other
Future of Bid Optimization
Thank You!

Questions and Discussion