

RADHIKA DHAWAN PURI

Radhika Dhawan Puri has over a decade's experience in Business Journalism. As a journalist, she has specialized in corporate reporting, management concepts, economic and public policy, and investigations. She has freelanced for international organizations and government departments including the World Bank in Jakarta, Indonesia. She is currently taking a sabbatical and is based in Singapore. Radhika started her career in 1992 with Business Today as a Bureau Assistant. Her contribution to Journalism won her the World Press Institute Media Scholarship (instituted by the World Press Institute) in 1999. She then moved to Businessworld where she drove conceptualization and ideation for the magazine.

Radhika won The PoleStar Award titled, 'Best Feature in IT Journalism', for 2002 for her article, 'E-Sourcing', that appeared in Businessworld.

e-SOURCING

Buying magnesium, a metal used in the making of aluminium, is a fresh challenge each year for Hindalco's purchasing team. Nearly 1,200 tonnes of metal have to be imported and purchasing managers have to scout for agents, across Australia, the US and Hong Kong. Last year, e-sourcing specialist Commerce One stepped in and offered to help Hindalco source the metal from a wider pool of global suppliers, especially from China. It said that through rapid-fire reverse auctions Hindalco's sourcing costs could be reduced.

The procurement function is all set for a big shake-up as India Inc. takes to e-sourcing

But Hindalco's purchasing team was uneasy. Says K.K. Patodia, Vice-President, Hindalco: "We were quite skeptical as to whether the projects savings would actually accrue or not." That's when A.K. Agarwala, a director at the company, stepped in. He urged the team to try out the new way of sourcing.

Eventually they organized an auction to buy six months' worth of metal. The result: a 4% or Rs.10 lakh saving. Excited, the team held another auction for out-bound logistics and managed to shave off 10% of the costs.

Hindalco now hopes to widen the ambit of its e-sourcing initiatives. Says Patodia: "Our procurement team is now developing suppliers for more strategic items like a special form of coke which is difficult to get in India.

"The team is also developing a software which will allow the company to hold its own auctions and automate the buying of various materials. Impressed, Group Chairman Kumaramangalam Birla has declared e-sourcing a group initiative.

A similar movement is taking place in other companies in corporate India. That very unsexy back room function called purchasing is undergoing a paradigm shift. Suddenly, the skill sets required, the vocabulary used, even the job profile itself, is changing. No one is quite sure yet what the new role for the purchasing man is going to be, but one thing is clear – the relationship between the purchase manager and the supplier stands changed today. Says VS Krishnan, President of the RPG group: "Kingdoms will be challenged".

The driver of this change is technology. Organisations like the RPG group and power and fertilizer maker DCM Shriram Consolidated (DSCL) emerged from process improvements a few years ago. E-sourcing – the act of buying and ordering materials through the Web - offered a new opportunity to drive inefficiencies out of the system. The size of the online sourcing pie in India has expanded to Rs.5,000 crore, from a zero base last year. Even six months ago, most e-sourcing specialists in India - India-Markets, Commerce One, Free Markets and 01 Markets - had a hard time selling the concept to Indian corporations. However, now, there is a clear buy-in. Says Rohan Ajila, Managing Director, India Markets. "We hit the inflection point about four months ago." Says Vivek Agarwal, COO, Commerce One: "The pull factor for corporate India has kicked in."

Consider the evidence

- Tata Engineering (Telco) has signed a Rs.1,500 crore e-sourcing deal with Free Markets, the largest sourcing deal in India. Telco's Rs.362-crore pilot project generated savings of Rs.22 crore last year
- Seven firms that are a part of the Pune-based Kirloskar group have set up India's first private sourcing network. The reverse auctions worth Rs.50 crore have resulted in savings of Rs.7 crore
- Manufacturers like Birla Tyres, ITW Signcode, Hindustan Motors, Goodlass Nerolac, Ballarpur Industries. Indo Rama Synthetics and Heinz India have started reverse auctions. Says O.P. Lohia Chairman, Indo Rama Synthetics: "We are trying to see what else we can do with this process in the company?"

Of course, firms like Telco have long understood how smart sourcing helps prune costs. Through the 1990s they rationalized their vendor base so that they could work closely with fewer suppliers and reduce transaction costs.

Then the Internet became a reality. Online connectivity with suppliers became feasible and cheap. As James Abraham, Director of the Boston Consulting Group (BCG), puts it: "The tools that technology offered were simple."

After finishing its ERP implementation in 1999, Telco connected online with 700 suppliers. Orders were placed, purchase orders generated and delivery tracked – all on the Web. That slashed 35% of transaction costs. Last year, it piloted reverse auctions of Rs.450 crore through Free Markets and is now extending that to cover Rs.1,500 crore of its annual purchases of Rs.4,000 crore. That makes Telco the only India firm with both the segments of e-

Achievements

Telco has gained Rs.22 crore of savings by putting Rs.362 crore of transactions through the reverse auction process. Online procurement with 700 suppliers has been on since 1999

Challenges

- Getting employees to internalize the e-sourcing process by promoting widespread use of the auction tool
- Reorganising the purchase functions – like managing aggregated buying across business units or plants
- Taking the e-sourcing process wider and deeper into the organization by extending it to a larger portion of procurement

sourcing up and running. Not only has it addressed online sourcing (what to buy, from whom and at what price), but has also tied up online procurement (the ordering and buying) for many materials. But Telco is still an exception. For most of corporate India, the buzz is only just beginning.

The compelling objective is to cut costs in a recessionary market. Direct materials, the ingredients that go into making everything from trucks to soaps, account for about 60% of the costs of a finished product. Companies have slashed anywhere between 5% and 25% of these costs by using tools like reverse auctions. Last year, Heinz held six auctions for commodities like outbound freight and laminated packaging and saved 10% off its costs. Says Pradeep Poddar, Managing Director, Heinz India: "E-sourcing is, perhaps, this decades way of managing costs better".

Most corporations are currently experimenting with pilot auctions so that they get a feel of what the process entails. However, early adopters are gradually moving a step forward. Says Mythily Ramesh, Head, Wipro's

MOVING UP: Hindalco, Heinz, DSCL

Achievements

- Have piloted reverse auctions worth hundreds of crores. Comfortable with the tool.

Challenges

- Putting together a comprehensive online sourcing and procurement strategy
- Planning the automation of the procurement process, e.g., which materials and suppliers should go online
- Deciding the tools for the kind of procurement required

marketplace, 01markets. "Some firms are trying to move from the proof of concept stage in internalizing e-procurement."

That is exactly where a frontrunner like Telco is poised today. Now that it has understood the auction process. It has begun trying out on its own Free Markets has sold Telco a software solutions called Quick Source. This is an auction engine that allows the company to conduct its own auctions for simpler items like hotel and taxi bookings – items where Telco knows the market and vendors are largely based in Pune. Managers can organize the auctions themselves and train the suppliers.

On the other hand, Telco gets Free Markets to pitch in for items that require specialized vendor knowledge or global access. For its new car, Magna, Telco partnered Free Markets because it needed to access a vendor base from all over the world. But hiring e-sourcing consultants like Free Markets can cost a lot. (Free Markets is far more expensive than the others since it runs its auctions out of Pittsburgh.) That's why Telco has chosen to bring in

consultants only for mission-critical items. Says Amit Kalyani group: "If companies start controlling the process, then a part of the savings that is transferred to us can entirely be retained by them."

Most e-sourcing solutions are headed this way. Recently, India engineering set up a common online sourcing hub for the Kirloskar group. Typically, none of the Kirloskar firms (average turnover Rs.100-crore) could have borne the cost of an e-sourcing hub. But, as a group initiative, it was affordable. Says Vilas Panse, Associate Vice-President, materials, Bharat Forge: "I get 100% of the benefit at a fraction of the cost. I'm a purchasing guy, that deal appeals to me."

Seven of the group's largest companies have put 7,000 vendors on this network. Non-strategic items like cutting tools and electrodes, used group-wide, were chosen. Companies could contact the suppliers and conduct their own auctions. Already, Rs.50 crore of transactions have resulted in savings worth Rs.7 crore. This hub also helps in sharing supplier knowledge. If one company has sourced from a particular vendor, then the others don't have to spend time validating the supplier again.

Often this kind of aggregated buying helps weed out gross inefficiencies in the procurement process. Consider the example of DSCL Fresh from its ERP implementation, DSCL ran a check on the purchasing pattern of 35 categories of indirect materials like conveyor belt components and earth-moving parts, typically the cogs that kept their 12 plants humming smoothly. To their shock, 13,000 purchase orders (pas) were raised in one year for these items. That meant a purchase man had made the effort of finding a supplier, running a quality check, negotiating a price, confirming with his superiors and ensuring delivery of a part, 13,000 times in one year. All this for items worth Rs.20 crore, a fragment of DSCL's annual purchase value.

Last April, 21 suppliers for 17 categories were chosen, typically those who had adhered to deadlines and quality, and invited to join a private sourcing hub created by DSCL. The purchase department decided annual pricing and standards upfront and put up the product catalogues on the Web. Each supplier and 60 people at DSCL were given rights to access the system. Each time an item was needed, a person logged into the system, hunted up a supplier and sent the request online. Since the prices and standards were pre-approved, the orders needed no authorisation by the purchase department. Says Prem Das, DSCL's additional General Manager: "The time from deciding to buy an item and buying it is now down to zero." DSCL now plans to move strategic items like naphtha to the system.

The hub also allowed DSCL to significantly reorganise its purchase function. The company had four strategic business units: sugar, chemicals, power and fertiliser, each handling its own sourcing. But certain items like lubrication oils were common. Therefore, the items were divided into five categories and one man was made responsible for negotiating long-term price. Says K.K. Kaul, Vice-President, DSCL: "Purchasing managers can now concentrate on managing relationships with suppliers."

Yet, DSCL is ensuring that it does not end up biting off more than it can chew. Its efforts to redefine the procurement function is so far still limited to its indirect materials and a select group of suppliers. But others like Hindustan Motors and Hindalco are trying to implement full-scale e-procurement. Both of them have worked with a variety of B2B sites last year to get comfortable with reverse auctions. Now both Hindustan Motors (with Commerce One) and the Kumaramangalam Birla group are developing the software solutions internally so that it can be shared across the entire group.

Once the system is up and running, it will greatly speed up the procurement process. Every time a purchase man needs a part, he can hunt up suppliers online and email them the request for quotations (RFQs). Once the bids are returned, the company can invite the suppliers to a reverse auction. Or, if the part is specific to the company's requirements and cannot be bought through an auction, an offline negotiation will be done. Once the vendor is finalised, a PO will be raised, the vendor will signal that he has received it. He will also be able to signal when the delivery is made. Thus, the entire paperwork is eliminated. Says K.Chandran, General Manager (Corporate Planning), Hindustan Motors: "The whole feeling of purchase is different. All the manual intervention is gone." The auto company saves Rs.3,000 per transaction with each supplier since it automated the procurement process.

All of this is easier said than done. It all depends on how far the e-sourcing initiative is entrenched in the company. For instance, Telco has set a benchmark that three months is the maximum length of time it will take for each auction - in deciding on a category, finalising the suppliers, holding the event and awarding the contract. Also, where new suppliers are identified, the evaluation process would be quick and thorough. For example, for a toolings auction for Magna, the Chinese suppliers were the lowest bidders. However a visit to China revealed that aesthetically the Chinese designs were not up to the mark.

For companies like Hindustan Motors and Hindalco, training and convincing hundreds of suppliers to actually start using the network will be a tough task. DSCL had quite a job getting 21 suppliers online. Each time the supplier transacted on the DSCL system, he had to pay a fee of Rs 50 to Commerce One. Most suppliers were reluctant to pay.

It isn't just suppliers who have to be convinced by the e-sourcing logic. Quelling the internal resistance from the procurement department is no less crucial. Most e-sourcing initiatives bring in a measure of transparency and are, therefore, seen as a threat by purchasing managers. It is important to anticipate these organisational blocks.

The RPG group offers an important lesson on how this can be done. Two years ago, President V.S. Krishnan called the purchasing heads of six companies and tried to aggregate buying across the group for some items. As a result of the reorganisation, one person became the purchase manager for plastics for the group and another one for synthetic rubber, and so on. Krishnan himself headed the panel in which there was a knowledge management person to facilitate the sharing of information. The structure worked, says Krishnan, because it was simple, without any of the bosses overseeing the process. "We did not alienate the purchase manager by taking away his authority. We've just changed his job," he says. His advice to his chief executives is they should ensure that the purchase manager gets his due place.

But that may not always be possible. So far, the purchase manager's main role has been to negotiate with suppliers and track delivery deadlines. Now all that has changed. Hindalco's Patodia says: "There is all this psychological warfare, gestures, body language and suddenly you have to get used to working without that."

The elimination of jobs is inevitable.

Take DSCL which had to redeploy two people from its purchase unit who became redundant when the hub went online. Says Panse of Bharat Forge: "We hope that the savings created by this process will generate the funds for redeploying of people."

Yet much of the notional savings are often generated by raising a new set of questions. Explains Darryl Rolley, Managing Director (Asia-Pacific), FreeMarkets: "What we find in many companies here is that they will set up a contract only for three months and will do it for four times a year. That's four times as much work."

Instead, he says, the questions to ask is: What is the company's spend on this item? How many times should we source it in the year? Will a prenegotiated annual contract work?

As soon as these questions are asked, Rolley says two things will happen: less resources will be applied in redoing the same contract. And more savings will accrue by locking in a supplier or even entering into a long-term contract.

For RPG's reorganisation to work, an annual purchase plan had to be made and then shared with the group purchase panel at the beginning of the year. This inevitably forced the individual purchase departments to think in terms of long-term contracts. The Purchasing Head of Telco's Pune plant Y.N. Bedekar, finds himself putting in longer hours at work and his job profile has changed significantly.

He now has to aggregate purchases from not just the Pune plant, but the Jamshedpur plant as well, so that the firm can derive maximum benefit from the reverse auctions. FreeMarkets' Rolley says: "It raises the sourcing function to another level and brings the purchase man upfront."

But is the Indian purchase manager ready to step into the limelight?

We are in the business of creating competition

In 1994, Glen Meakem presented an idea to his bosses at General Electric. Why not create an Internet-based platform, where sellers could openly bid for buyer contracts and put an end to the traditional way of haggling over contracts? GE rejected it. That was a big mistake. Meakem left and eventually set up the online auction firm, FreeMarkets. Today, it is quite easily one of the biggest and the only profit-making B2B company in the world. It auctions any and every sort of industrial component or material. Excerpts from an exclusive interview with Businessworld.

Your view seems to counter the belief that true value can be generated via partnerships with suppliers. In the last few decades, the success of the Japanese model has been linked to this.

You don't have to let long-term supplier relationships go. If I have a long-term partner, that's great if they are providing world class pricing and quality. So they shouldn't mind being put into a competitive environment. Corporations in a long-term relationship have no idea what the global market costs are. You can't be transactional in these relationships.

You need to go out and benchmark at a minimum whether you are at global market cost, not a build up cost and a supply-based approach. There is a lot of evidence that Japan has over-partnered. The time is right for Japan to adopt a whole new market-based approach to supply.

But there is the issue of retained knowledge with suppliers. How do organisations balance these goals with that of short-term gains?

Make no mistake. There are some categories of spend that you can't put

through this process. For example, if you are Dell Computer and you need an operating system, there is only one source. You can't put Microsoft through this sourcing process.

How many of your buyers actually switch? Suppliers complain that buyers use this as a tool to beat down prices and go back to the original supplier in any case...

We do have some data, mostly from North America. These companies go to a new supplier 40% to 50% of the time. More importantly, they are switching to a low cost bidder a third of the time.

Is the value derived from reverse auctions sustainable and repetitive?

This has been proven by us and by strategic sourcing initiatives that happened prior to e-sourcing in the early 90's. Price increases creep back in. You tend to lose the gains. This has been proven time and time again globally. The reason why corporations have buyers is because they are always negotiating.

How does this work in industries where cartels function? Have you seen industry structures that don't lend themselves to this sort of sourcing?

Yes, all the time. We had plastic injection moulders back in 1996-97 who swore they would never bid. Jack Welch in his book said that GE would never participate. Let me tell you that GE participates all the time. Why? They have no choice. If I need to buy a lot of cement and I say that this is where I'm going to buy, everybody has to compete. Buyers have a lot more power than they know and we let them use that power. We are in the business of creating competition.

The purchase manager's guide to e-sourcing

Internet-based sourcing is about what to buy, from whom, at what price. Online procurement is the act of buying. A comprehensive e-sourcing strategy must have both elements. What does it entail?

- Start the process with a few pilot exercises to let the purchasing function get comfortable with it before extending it to the entire purchase function
- Pick high-value commodities so that you can derive maximum benefit when using reverse auctions
- The more fragmented industry (e.g. packaging and freight), the greater the price drop. In a reverse auction, the competition will be greater
- Take time to educate and train suppliers. E-sourcing puts the buyer in the power seat and leads to some supplier discomfort that the company must deal with
- Be ethical about reverse auctions and do not use it just as a price-cutting tool with incumbent suppliers
- Fine tune requests for quotations (RFQs) constantly so that suppliers have a clear idea about buyer needs

Indian suppliers gear up for change

In 1999, when the Pune-based diesel engine maker, Kirloskar Oil Engines Ltd (KOEL), decided to do its procurement online, it asked all its suppliers to adopt the same e-commerce platform it had invested in. Much to its surprise, the suppliers adopted it faster than Kirloskar had anticipated.

Take the Pune-based UGC Logistics, which manages Kirloskar's logistics and also supplies its engine components. It invested in an Oracle-based ERP package and adopted Kirloskar's e-commerce platform. "This way I was able to reduce my costs by 5-6% and reduce inventories by 75%," avers S.A. Dhole, CEO, UGC.

Even two years ago, progressive suppliers like UGC were a rarity in India's procurement map. In 2000, the Automotive Components Manufacturers Association requested Sona Koyo Steering CEO Surinder Kapur to head an initiative to educate Indian suppliers on e-procurement. Most suppliers were still in denial, says Kapur, quibbling about which ERP package they would use. "But now, the stage of disbelief is over. It's very real today. Everyone is preparing to be an active player," says Satish Sekhri, CEO, Kalyani Brakes, which has conducted three auctions and participated in a global auction conducted by Delphi in 1999 for a brake assembly part.

As Indian corporations take to e-sourcing, suppliers, too, are gearing up for change. "I don't think suppliers have a choice. The ones who adopt will survive," says Vijay Verma, Kirloskar's Vice-President (Business Development). Kapur reckons that 30-35% of the component suppliers are ready to bid on the Net. As a first step, suppliers are e-enabling their organisations and putting in place ERP systems that enable a better understanding of their costs. The next step is to connect their suppliers. But costs could be a big issue: a full-fledged ERP system had cost Sona Rs 2 crore. Sona is trying to rope in its vendors with an ASP model. "We are talking to Oracle to see if the suppliers can pay on a usage basis rather than put in a large amount upfront," adds Kapur.

In the rapid-fire auction environment, the ability to take quick decisions is now crucial. "With e-procurement, you have to give the best price without knowing the competitor's price. It means you've to be globally

competitive," says Neeraj Mathur, Vice-President (Purchasing and Supplier Development-India), Delphi.

Will e-procurement hasten the exit of weaker players?

"Yes, suppliers whose costs are high will be priced out of the market. E-commerce will hasten their exit," says Sekhri. In a bid to survive, smaller suppliers have already begun gearing up. "There's a huge focus on quality, the Six Sigma process, 100 PPM programme, inventory controls, and absolute transparency," adds Atul Lall, CEO, Dixon Utilities, which supplies printed circuit boards and colour TVs to LG.

Indian suppliers have clearly seen the writing on the wall: either they shape up, or run the risk of being shipped out. ■■■■