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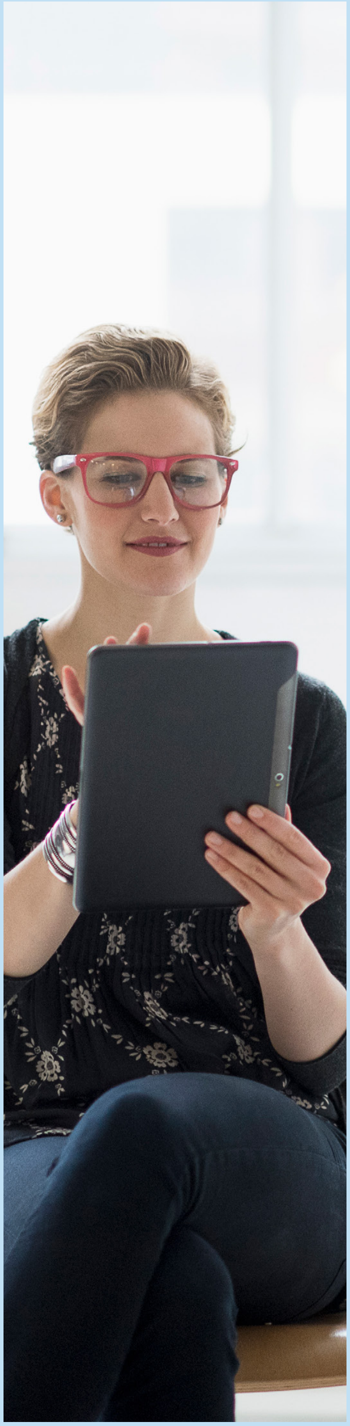

OPTIMIZING SPEND MANAGEMENT WITH 'CONSORTIUM BUYING'

Abstract

Consortium led buying models are the new disruptors in the procurement world. This collaborative buying augments the buyers' power and helps in leveraging economies of scale by sharing of purchase volumes, information, or resources. Read on to know more on what are the best practices and success factors needed for an effective consortium buying and how can buyers leverage the key benefits out of it.

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Buying in 'consortium' – a collaborative win-win

A consortium buying model is a collaborative arrangement among two or more independent organizations who join together to combine their individual requirements for goods and services. The idea is to leverage competitive prices, higher rebates, value-added services, supply availability, and assurance benefits from their external suppliers/vendors compared to individually procuring the same. A more complex arrangement could involve arrangements or partnership with a service provider for additional value-adds and skills sets, thereby creating a win-win for everyone.

Consortium buying can also be referred to as group buying, consortium purchasing, collaborative buying, cooperative purchasing, collective or joint purchasing, and bundled procurement.

Broadly, consortium buying can be distinguished based on the management responsibilities:

- **Member-owned consortiums:** When two or more organizations create a separate entity for providing services to the participating organizations. The board representatives are from the member organizations.
- **Third-party managed consortiums:** When a third-party collaborator facilitates the purchasing of services with the primary focus on aggregating volume, which individually purchasing organizations may not be able to obtain on their own.

Business operating models in consortium buying

A consortium buying model can be majorly formed using three different methods by targeting single/multiple industries and spend categories. These methods are:

Horizontal Buying Consortiums

- A consortium of companies from diverse industries with the focus on one broad spend category
- Example: A buying consortium for MRO supplies, and facilities management services
- Primarly used for indirect spend categories

Vertical Buying Consortiums

- A consortium of companies from the same industry with the focus on one specific industry/vertical
- Healthcare GPOs are well known vertical type in the industry
- Primarily adopted in the healthcare industry for the procurement of direct spend categories

Master Buyer

- One large buying organization with significant number of contracts, allowing additional companies to buy those off by extending its supply agreements with a percentage added on its base cost in order to act as a profit center.
- Low adoption due to the higher dependency on one large buyer

There is also a 'hybrid model' which can be formed by incorporating horizontal and vertical consortium buying groups where one spend category is targeted for the buyers from a similar industry. For example, a consortium buying group of MRO supplies for the automotive industry, chemicals and cyanide supplies for the mining industry, and facilities management services for retail chains.

Commercial pricing models in consortium buying

There are three key commercial models prevalent in the consortium buying arrangement:

- **Management Fee model:** A third-party charges a fixed annual fee for managing and running the consortium. The fee is determined by analyzing the spend value of the clients and scope of other category management support services offered
- **Commission (% of spend):** Based on the aggregate demand, a third-party charges a commission by acting as a facilitator for the buying organizations by negotiating prices and services with different vendors. There are two methods for this model:
  - Fixed flat rate for every transaction
  - Percentage of the total spend
- **Outcome-based (hybrid) model:** This model ensures savings through agreed-upon business outcomes for buyers in the consortium buying arrangement. This model can be of following types:
  - Incentive (% of savings)
  - Incentive (% of savings) + Commission (% of spend)
  - Incentive (% of savings) + Management fee

Consortium buying – benefits and advantages

The biggest advantage of consortium buying is – the capability to deliver relatively higher rebates. The consortium aggregates the spend from multiple buyers to leverage volume to negotiate the prices with suppliers. Along with increased bargaining power over suppliers, consortium also provides its members with certain benefits including increased spend visibility, effective supplier relationship management, and other value-added services such as tail-spend management and e-sourcing.

Below are the key benefits the buyers can leverage by joining consortium buying groups:

Cost reduction

5%-20% depending on the spend categories and current sourcing maturity level

- Access to competitive prices by the suppliers
- Reduced procurement process costs enabled by aggregrated buying and consolidated supply base
- Reduced costs associated with administrative (contract preparation and management) and logistical functions

Spend optimization

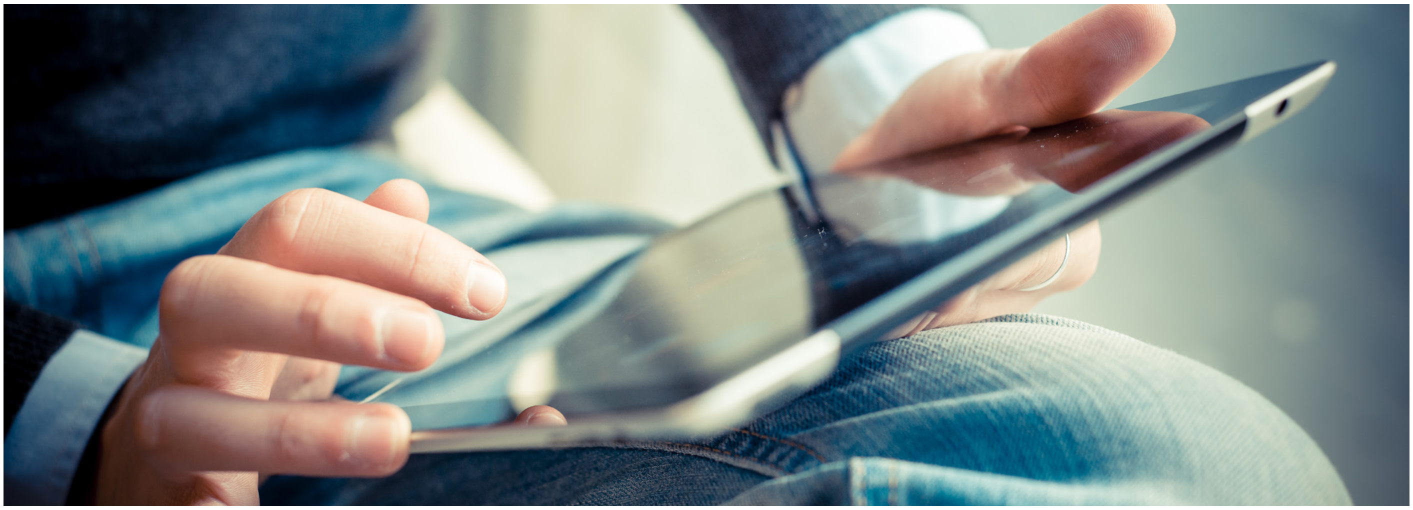
Reduction in number of SKUs

- Standardizes the purchasing processes by managing product and service contracts with different vendors, and fulfilling purchase requirements in a standardized way
- Undertakes additional activities (specification harmonization, visibility increase, spend categorization, clear reporting) to identify spend optimization opportunties

Improved supplier relationship

Single contract (or reduced number of contracts) and one contact point

- Reduced number of suppliers
- Increased involvement of suppliers through close collaboration and different contract models such as vendor managed inventory and consignment stocks



Value creation mechanisms

Higher rebates and spend optimization are the two key benefits of consortium buying which are delivered to the buyers. There are multiple mechanisms through which these are delivered, the following being the two key mechanisms:

i. Higher rebates based on tier-based volume

Most of the suppliers offer volume-based rebates to the buyers which increase with the increase in spend value/volume. The consortium enables the buyers to move-up on the rebate tiers.

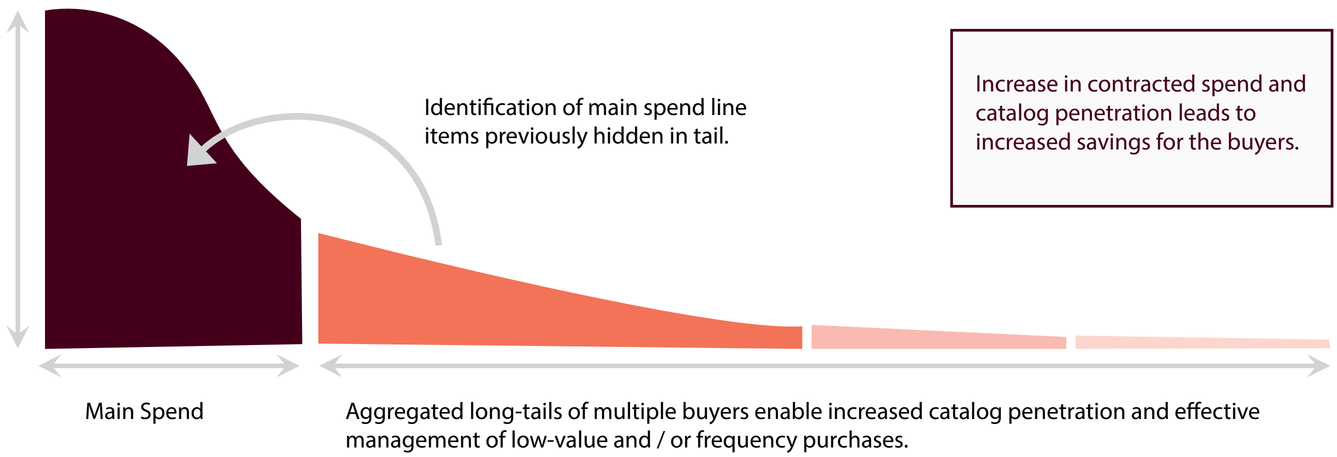
Below is an example (with dummy numbers) for tier-based volume rebates.

Volume rebates offered by suppliers to buyers **(Sample data)**	Annual Spend	Rebate offered by supplier for each volume-tier
	more than $40,000,000	5%
	$20,000,001 - $40,000,000	4%
	$10,000,001 - $20,000,000	3%
	$5,000,001 - $10,000,000	2%
	$1,000,000 - $5,000,000	1%

How the consortium enables the buyers to move up the rebate tiers (Sample data)	Client Name	Annual Spend	Original Rebate Tier	Rebate tier available through consortium
	Client A	$3,500,000	1%	4%
	Client B	$3,750,000	1%	4%
	Client C	$5,500,000	2%	4%
	Client D	$3,500,000	1%	4%
	Client E	$4,750,000	1%	4%
	Consortium	$21,000,000		

ii. Tail spend management

Some groups, particularly those with third-party service providers, can also bring in effective tail spend management policies and strategies by leveraging their domain and service line expertise to manage the tactical purchasing of consortium in an effective manner.



Best practices and key success factors

With a diverse set of business operating models and commercial models, third-party operated consortium buying groups seem to be the way to the future, as they effectively synchronize spend and service elements. Additionally, depending on the type of agreement, there are also various opportunities to shift/co-own the process responsibility of buying organization to the collaborative organization.

Some factors highlighted below could be key to delivering a difference and realizing the complete potential of these arrangements:

Targeting tail spend

- Typically it is seen that buying consortium is most suited for non-strategic purchases, particularly for tail spend items, where the buyers would not have confidentiality issues as the products and services would be non-customized and generic in nature. However, some organizations have been observed to collaborate to buy their direct/critical manufacturing materials as well.

Buying volume fragmented with multiple buyers

- Total spend of the consortium should ideally be fragmented among all the members, ensuring that no single member holds a higher portion of the spend value
- For the sustainable operation of a consortium, it must be assessed that there should not be any negative impact on the consortium's bargaining position in the event of a few members leaving the group

Minimum and maximum spend value to ensure equal distribution of benefits

- There should be pre-defined minimum and maximum spend value requirements for participating in the purchasing consortium, particularly in a model where similar rebates are provided to the buying organizations irrespective of their total spend

Incentivizing the buyers with a higher spend

- In case there are one or more larger buyers (compared to other members of the consortium) with higher spend, they should be provided with additional benefits.
- These benefits can be in form of higher rebates, developing strategic supplier relationships and additional services such as tail spend management

Minimum tenure of participation

- Consortium buying should have a minimum participation tenure or lock-in period to avoid disruption in its operations
- The consortium can include different provisions into the agreement to check early exits. For example, if a member wants to exit within six months of joining, any additional benefits / rebates incurred through the consortium should be paid back by the relieving member.

Consortium buying groups have been in the market for many years but have not been able to sustain its attractiveness with enough number of buyers. This could be mainly attributed to different maturity stages of the procurement organizations of the buying companies, which led to multiple operational challenges such as spend classifications, master data management, different taxonomies, and data security. With increasing inclination amongst many industries towards improving their procurement practices and new disruptions in technology making e-Marketplaces more effective, the stage now seems set to take this further.

Authors

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With over 9 years of experience in market intelligence, Gaurav has expertise in establishing MI frameworks and methodologies specific to the client's objectives with strong focus towards obtaining actionable insights. He has been responsible for developing sourcing strategies and operation models (supplier risk evaluation, sourcing model benchmarking, etc.) for fortune 500 companies from different sectors. He has assisted clients for complete supplier engagement lifecycle by providing market intelligence for supplier assessment, selection criteria, and performance evaluation. He also has hands-on experience in cost modelling, should-cost analysis, and cost reduction strategies.

Gaurav is a Bachelor in Commerce and an MBA in Finance and Marketing. He also has certification in supply chain management and equity research.

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Rohit has around 9 years of market intelligence experience for fortune 500 clients from energy, mining, and materials industries. Rohit conducts sourcing and procurement research across multitude of direct and indirect business categories, and has been responsible for delivering custom reports with insights on demand-supply dynamics, supply chain risk assessment, sourcing strategies and best practices, by conducting thorough primary and secondary research. He is skilled in performing supplier identification and benchmarking analysis with an aim of optimizing supplier shortlisting decisions and assisting category teams in developing strategies around supply base optimization, cost savings and negotiation opportunities.

Rohit holds an MBA degree from the University of Petroleum and Energy Studies.

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