

For and against preferred supplier lists



Back in 2008, a Source survey suggested that 75% of large-scale clients already had preferred supplier lists (PSLs) in place and that almost everyone who didn't, expected to implement them in the next couple of years; figures for large organisations were even higher. All the evidence suggests that this is exactly what has happened, aided by a recession and falling demand for consulting services. But, although welcomed by consulting firms that have benefited from the change, PSLs are disliked by those which have found themselves excluded from what increasingly feels like a "magic circle" of first-tier firms. To discuss the pros and cons of PSLs, Source brought together:

- Cameron Smith, who trained as a solicitor and has spent the last ten years working in procurement, particularly around professional services. Having helped Barclays set up its preferred supplier list (PSL), he has set up his own procurement practice, LLPS Consulting, and is currently helping Lloyds Banking Group right-size its consulting spend.
- Charles Scott, who, as a partner at The Berkeley Partnership, wins most of his consulting work through relationships with senior clients who know the firm well. However, he is acutely aware that the increasing prevalence of PSLs, especially in large organisations, creates a barrier which may make it harder for many consulting firms to compete in the future.

The motivation behind PSLs is two-fold, argues Smith: "Reducing costs is the most obvious of these, but so too is the need to focus managers on using services which are adaptable across the organisation as a whole." In

a situation where you're using hundreds, perhaps even thousands, of suppliers, control is almost impossible, effort is duplicated and money is inevitably wasted. "PSLs are as much about stability and control, as they are about cutting costs," he says.

No one – client or consultant – could argue with these objectives: the criticisms of PSLs are instead mainly levelled at their implementation: that they are too rigid and restrictive; that they attempt to freeze a very fluid market; that firms are selected on the basis of generic criteria or, even worse, just price.

Smith agrees that PSLs can be implemented too rigidly and that this is rarely satisfactory in practice. An organisation that appears to have a very high level of compliance, so that the lion's share of its expenditure on consultants goes to its preferred suppliers, may have inadvertently encouraged frustrated end-users to reclassify consulting expenditure or find other ways to circumvent the process. "No one solution fits everyone," Smith counsels, "so you have to build into the structure some room for manoeuvre, the ability to add firms you think will do an excellent job, as well as to remove ones which are not being used." Competition between suppliers keeps down costs and increases quality and control: the company that has just two suppliers on their PSL loses that competitive tension. "I would prefer to have a larger number of firms instead of an arbitrarily low figure," he continues. "Ironically, you also run the risk of becoming too dependent on one or two key suppliers."

More of a problem in Scott's mind is the selection criteria typically used which mean that only certain types of

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consulting firms are considered. “The problem with a PSL is that you have to decide which firms are on it before you know what the work will be,” he argues. “What matters in consulting, is how a particular consulting firm responds to a specific problem, how they work out the best way to resolve it for the best value, and you can’t do this with a generic set of criteria. I understand the desire to make life easy for end-users and to get value for money, but this is the wrong way of going about it. The net result is that you will certainly favour larger firms and that you may get less than best quality.”

Is the solution better segmentation? At least recognising that the large, global firms should be judged against one set of criteria, and smaller, perhaps more specialised firms against another would ensure a diverse supplier base. However, even this simple categorisation will not capture the genuine differences between firms. “We provide old style management consulting, typically in the form of one or two people who work closely with the client team,” Scott points out, “and we’ve earned a lot of plaudits for the quality of what we do, but when we’re measured against generic criteria, we lose out to the large players because we’re not global, to the body-shops because we’re more expensive, and to the specialists because we’re generalists. We just don’t fit into a standard category.”

This comes down to ensuring that an organisation’s PSL (and selection criteria) takes into account, not just the different services a consulting firm delivers, but also its business model. “Looking at the best mix of resources is vital,” agrees Cameron. “Most projects don’t require armies of people where you, as the buyer, end up paying for ‘training and braining’, but a blend of experience and contractors. It makes sense to get 48 people from the contractor market and two people to oversee it. Going to just one firm won’t result in the best outcome.”

Another issue is the duration of many PSLs, with the gap between “refreshes” sometimes several years. “What’s the point of having a sophisticated approach to segmenting and selecting consulting firms if you’re going to set the result in stone for five years?” asks Scott. “The world moves on in terms of the demands of the business and consulting firms’ performance will vary.” Smith believes that two or three years is the optimum period, except perhaps where a specific deal is being agreed – a long-term outsourcing project, for instance. “Why would you lock yourself in for longer in more volatile markets?” he agrees. Instead, the key factor in determining the length of the contract should be the time it is expected to take to realise the benefits: if you’re expecting the bulk of expenditure to go on – say – a large-scale IT system, then limiting the life of the PSL to a year will be counterproductive and may well deter bigger suppliers bidding for it. But, whatever the longevity of the agreement, it should not encourage complacency on either side. “It’s crucial that the consulting firm develops a relationship with the end-users and continues to promote

its services internally, and for people on the buying side to carry out annual reviews of the market. The PSL should not be seen as anything other than a starting point,” says Smith.

But the biggest concern among consulting firms is that the process of setting up a PSL usually puts too much emphasis on the cost of the service, not the value it may deliver. Indeed, because the value that consultants can add will always be in relation to a specific project, it is hard to see how a PSL could ever take this into account. The solution, suggests Scott is to focus on the quality of a consulting firm’s past work.

“You could kill two birds with one stone,” says Scott. “If organisations gathered detailed data from end-users on how consulting firms have performed, they could use this data to select which firms should be on their PSL in the first place. You could then make the process dynamic, with firms’ performance being reviewed on an on-going basis. A firm that was rated poorly on a project might be put on notice; if the same negative feedback was received on the next project, they would be dropped from the PSL. Equally, new firms could be on probation, not formally on the PSL until the feedback from their initial work had been evaluated.” It could, he suggests, be the professional services equivalent of eBay: “As consumers, we now expect to read reviews before we buy something and to rate the people we buy from, from zero to five stars. It’s a well-understood concept.” Such an approach would not only keep consulting firms on their toes, but also ensure they focused their efforts on delivery, not on sales. “One of the main concerns I have with PSLs in their current form is that the best people in the consulting firm have to focus on selling, not consulting,” continues Scott.

Smith foresees four obstacles: “The first is how you measure value. A pound saved along with a pound earned is unquestionably better than just saving a pound, but how do you calculate that? What constitutes a measurable improvement? And consulting firms don’t help themselves: they need to be able to demonstrate the value of their services. We need to know what we’re getting from a £3,000 a day partner. The second issue is one of risk: we can’t just open the door to anyone in the hope they do a good job. Although in principle you want to ensure some flexibility, you also don’t want to be taking an unnecessary risk – which is what a selection process based on future performance would be.”

Thirdly, there is the issue of how you pull all of this information together. If a professional services firm performs badly on a project, they know because that client does not call them back. But, sitting at the centre of a large organisation, the procurement team may not know this and it may be possible for one business unit to carry on buying from a particular firm even after it has done a bad job elsewhere. “Centralisation is critical,” says Smith.

Finally there is the role of the procurement team itself. Where its priority – and performance targets – is on reducing prices and costs, then it is hard to believe that much effort will be spared to look at the value side of the equation. “The targets for the procurement department can be at odds with those of the rest of the business,” says Scott. “We’ve certainly seen occasions when the business wants to grow and needs access to specialists in order to do that, but where the procurement team are still concentrating on cutting costs.” In fact, this touches on a much more fundamental issue: “If you worked as a direct buyer, for example buying clothing for a company like Marks & Spencer, your performance measures and your choice of suppliers would naturally be completely aligned with the overall strategy of the business because they’re so important to it,” he continues. “Equally, you wouldn’t find an M&S buyer selecting a fixed set of suppliers for three years and refusing to consider new ones because the PSL wasn’t up for renewal for another three years. So why should buying consulting be different?”

But many procurement teams, particularly those buying consulting services, do not have that direct connection to the core of a business. “The role of procurement in an automotive company is completely different to that in a bank,” says Smith. “A car company depends on its suppliers to deliver reliable components while keeping prices low. A bank doesn’t depend on its consultants in the same way.” This means it can be difficult for a procurement team to widen its remit and to engage its internal customers in more sophisticated conversations about quality and value; price is more convenient and familiar.

The key, therefore, to the implementation of an effective consulting PSL lies, not only in ensuring that it comprises a diverse range of suppliers, evaluated by more discriminating criteria on a more frequent basis, but also in recognising that procurement people themselves can do more than cut costs.

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