GPOs and Buying Consortiums Must Be on the Radar for 2011-2012

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Purchasing consortiums are rapidly establishing themselves as a vital link in today’s world-class supply chain strategies, used as a powerful tool to significantly drive down costs by supply chain managers in the most effectively run procurement organizations in corporate America. To find out why, Spend Matters, in conjunction with Allianza Partners, has researched the top 10 consortiums in the US. Though the common belief is that smaller businesses benefit most from consortiums, our research shows that very few people are aware of a powerful fact: 15-20% of the Fortune 1000 currently use buying consortiums! And 85% of the time, they’re seeing 10%+ of real savings! The space is rapidly expanding and evolving as even the most secure companies rethink their procurement strategies in the face of new economic realities and the impact of global finances. To meet this challenge and the needs of current and potential members consortiums are evolving and strengthening their own value propositions. The most common contracts we’ve seen are in office products, MRO, uniforms, relocation services, temp staffing, MFD’s, Rx benefits, teleconferencing, IT supplies.

Spend Matters wanted to take a closer look at the recent history of group purchasing models, teasing out the benefits and challenges to supply chain managers and their suppliers, providing a primer for companies seeking to learn more about this option. To be honest, we used to hold some skepticism regarding this model, but we’ve recently been won over by the overwhelming benefits. Now we firmly believe that consortiums are a reasonable option for procurement organizations.

In this paper, we will provide a description of the types of consortiums we’re seeing in the market today, discuss how organizations are utilizing them to their greatest benefit and end with a list of critical factors for success for any company looking forward in this direction. As you’ll see, the numbers don’t lie -- consortiums are a valuable tool that every mid to large-scale firm must put on their map for the last half of 2011 and heading into 2012.

What exactly is a consortium?

Call it a consortium, co-op, aggregation group, collective, purchasing alliance, GPO (group purchasing organization), buying group, Leveraged Buying Organization, Leveraged Procurement Group, Coalition or Cooperative Business Group, this model is actually far from new. Purchasing consortiums have been around for a hundred years. The first American healthcare GPO was established in 1910. Today, consortiums cross many industries, from food and industrial manufacturing to legal services and nonprofits, and the last few years especially have seen an explosion in this type of model.

Technically, a consortium can be defined as: “two or more independent organizations that join together, either formally or informally -- or through an independent third party -- for the purpose of combining their individual requirements for purchased materials, services, and capital goods.” Therefore, the main goal is to leverage this aggregated purchasing power to optimize cost reduction and value-added contractual terms and conditions from external supplier relationships. In other words, Company A and Company B as an entity have a lot more purchasing power than Company A or Company B alone.

Consortiums typically come in three types: vertical, where companies fall into the same industry (e.g. healthcare); horizontal, where companies fall into diverse industries; and master buyer, where a large multi-national company attempts to extend its own supply agreements to customers with a baseline percentage added in, thereby acting as a profit center.

It is somewhat ironic that our research reveals that larger companies actually make better use of consortiums than smaller companies, with “smaller” and “larger” defined not by revenue, but by employees. We consider a small company as having 1,000 or fewer employees; midsize as 1,000-5,000; and large as 5,000+.
Consortiums seem to be moving away from significant initial and annual membership fees to concentrate on administration fees (paid by the supplier) to fuel their revenue profile. As budgets tighten in this economy, membership fees are a relatively easy target for the financial cutting board.

So, if a small/mid-sized company (1,000 employees) spends $150,000 on Office Products and decides to join the consortium, the consortium might save them ~20%. That company will enjoy ~$35,000 saving per year. Yet, the consortium will bring in admin fees between ~$1,000 - $5,000 per year. A consortium, like every other business, has a cost to serve its clients/members. These fees are necessary to cover the costs of spend and savings analytics, creation and execution of requisite legal documents, pay the salaries of sourcing experts who serve as category managers, assign a consortium manager to the member, travel to the member, etc.

In the exact same scenario above, a mid sized client with 5,000 employees spends ~$1,000,000 and would save ~$170,000 per year and bring in ~$5,000 - $25,000 per year to the consortium organization. Clearly, this becomes a sustainable business model. The client thus enjoys very similar savings % on much larger volume and the consortium can accommodate the cost to serve this member.

So what are the benefits?

The number one benefit of consortium purchasing is one we’re all hungry for: significant cost savings. The chart below shows that organizations that go the group-buying route are realizing some high percentages of savings across a variety of industries. Back in 1997, Dr. Thomas Hendricks of CAPS did a study that concluded:

“[Organizations participating in purchasing consortiums] reported that purchasing through their consortiums saved them about 13.4 percent, which yielded an average annual savings of about $2.3 million for each member. Comparing this to the average annual cost of $300,000, and using a liberal interpretation, this results in an average return on “investment” of 767 percent!"

Things have changed since then regarding cost to join and thus, the ROI is even greater than his predictions 15 years ago. Today, ROI for members that participate in the top four categories is around 140 times, while what Hendricks talked about only yielded a 7.6 X return. Thus, we’re seeding value that is 20 times what Hendricks thought to be outstanding! Difficult to believe? It’s based in fact...and that’s why we believe every firm of decent size should be scoping out consortiums as an option.

Another (often overlooked) benefit is working with other leading procurement organizations to benchmark best practices and glean market expertise. Consortiums have a way of providing the potential to create a new dimension of strategic alliances at a level that far surpasses individual buyers working solely with individual suppliers. Consortium members also typically enjoy increased product availability and improved supply efficiency versus working with individual suppliers on a one-to-one basis.

The consortium is a form of quasi-outsourcing, insofar as sourcing, contract management, and supplier management are handled by a third party. The benefit of this is that the managers are working within their core competencies within each category, giving a deep knowledge and understanding and providing a management level most companies likely cannot achieve internally. Savvy consortium members contact their consortium’s subject matter experts with questions and in the process find out just how competent they are.
But there must be a catch.

Consortium buying doesn’t come without its own set of challenges. Some companies worry about trust within the group or a limited supply base. Larger members of the group may think they are more entitled to better pricing and terms -- a detriment to these alliances. “Strong suppliers may insist on keeping individual consortium members as separate customers to continue to extract higher margins,” said one paper we read on the topic. Larger members simply need to run a cost benefit analysis on specific categories where they may be able to do better on their own, exempt that category and fully participate on the many other categories where significant savings await.

While these risks may exist, horizontal purchasing consortiums, mediated by a third party, are eliminating many previous drawbacks and quickly bringing advantages to the forefront. The largest challenge by far for these groups is intelligently leveraging the collective buying power of the group while tailoring contracts to fit individual members' needs. And ultimately, suppliers must benefit as well. The goal is to reduce the winning supplier's margin percentage while increasing their total margin dollars, using the consolidated volume of the group. Suppliers fear a loss of margin percentage, and then a loss of business.

Yet a good consortium model will provide suppliers with committed volumes and reasonable term contracts -- reducing selling costs and allowing those reductions to offset the margin percentage losses. This greatly reduces supplier risk in industries notorious for frequent supplier changeover and it greatly reduces the need to waste resources on defending existing business. It’s already a done deal for the contract period.

Critical Factors for Success

Top performing organizations ask and answer a lot of questions before diving in. Here are some critical success factors for companies looking to explore the consortium option:

- Thoroughly evaluate the track record of the consortium/coalition/cooperative
- Focus on the categories where you are most interested in participating
- Review their process of sourcing/awarding/managing the supplier contract for the categories of interest
- Get references from present members and contact them
- Pay special attention to the Subject Matter Experts (may be called category managers) for your categories of interest -- they must be very competent as they may have to help you sell the concept within your organization
- Review the dispute elevation/resolution model between the client/supplier/leveraged contract provider
- Most leveraged contract providers have very low (if not zero) costs to enter, make sure your choice is near the low cost entry point
- Contact outside experts for advice if/when you need further perspective on these groups
- Consider multiple consortiums based on the core competencies within the categories you are interested

Conclusion

The numbers have spoken: purchasing consortiums can be an extremely valuable strategic initiative that should definitely be considered by supply managers. With today’s “doing more with less” way of thinking, Spend Matters and Allianza have found much data to support the fact that these alliances can help supply managers not only leverage a group’s spend for more competitive pricing, but also have a variety resources to fall back on if the organization is understaffed, etc. There is undeniable evidence that consortiums are bringing significant and immediate value to their members.