

## Our thinking on...

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# THE PEOPLE CHALLENGE THE GROWING NEED FOR COMMERCIAL AWARENESS

**Fundamental changes over the last 20 years in the way organisations operate have resulted in a massive increase in the use of suppliers.**

Downsizing and outsourcing have both resulted in what we see as a shift in emphasis from contracts of service with employees, to contracts for goods and services with suppliers. In turn, this has brought about significant changes in the skills and knowledge required by employees in both customer and supplier facing roles.

Despite the increased role of suppliers in established companies, new-economy start-ups and not-for-profit organisations, this dramatic increase in exposure to suppliers has, surprisingly, not been matched by changes in customer and supplier management practices and processes. As a result, organisations may find that their employees are unwittingly exposing them to substantial commercial risk.

Ensuring that employees are commercially aware - that they clearly understand the nature of contracts and what drives costs in a business - is a necessary step in minimising an organisation's exposure to risk which may arise from employees interfacing with customers and suppliers.

With the best intention in the world to provide excellent customer service, employees need to understand their actions may have far reaching implications for the business and its internal operations, processes and costs as well as its contractual relationships with third parties.

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### The growth in vendorisation

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The increased use of suppliers is largely due to common acceptance since the late 80's of the creed of competitive advantage. This argues that a company should focus on what it does best or, where it is not best at anything, where it is least worst so that it can free up resources to focus on what it does best.

To management consultants and business managers the creed of competitive advantage has resulted in two parallel business strategies: outsourcing and downsizing.

Adopting these two strategies gives rise to a new style of organisation. Companies that have outsourced and downsized no longer hire armies of indirect staff. Managers whose task was previously to line-manage large teams of direct reports who carried out specific tasks, now find they have few, if any, direct reports. Instead, they are responsible for selecting, recruiting and managing suppliers to carry out the work previously done in-house.

Common examples of departments which are outsourced are IT, transport and logistics, facilities, customer handling via third party call centres and even sales and marketing department activities which are increasingly outsourced to agencies and syndicated sales teams.

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**A bank has a poor call centre handling its customer inquiries. The customer won't blame the call centre; it will move its account.**

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A significant side effect of all this outsourcing and downsizing has been the purchasing paradigm: while the process of purchasing goods and services has become simpler because companies are buying finished goods and services rather than components, the very products and services that are being bought are growing in complexity at a time when the product knowledge is increasingly residing in suppliers, not buyers.

Traditionally, corporate purchasing departments bought components, specified by technical experts within the business, which would then be assembled into finished goods. When buying components (commodities) in a competitive market, price is the only point of differentiation. Therefore, purchasing departments used market competition to obtain the lowest price for commodities they were buying. The purchasing department's role was to identify suppliers

of the required component and secure the best price for those goods to ensure that the company could obtain maximum gross margin on the finished product. It's not that simple anymore. The focus on core activities and outsourcing means that companies are now buying goods, rather than components, and then assembling these into finished products and complex services.

For example, car manufacturers who once bought steel, glass, upholstery, nuts and bolts for making panels, windows and seats now purchase ready made chassis, windscreens and seats. Hospitals, which once bought cabbages, onions and meat for its kitchens, now buy catering services, which provide meals to allow them to focus on patient care.

Many managers responsible for outsourced functions realise that successful outsourcing is difficult and is about more than simply farming work out to another company. They need to know enough about all the elements of the product or service being outsourced to be able to specify their requirements and they need to be able to manage their suppliers on a daily basis. Those that don't are probably oblivious to the damage they can do to their business. At the end of the day, the suppliers' brand is usually invisible. Yours isn't.

A bank has a poor call centre handling its customer inquiries. The customer won't blame the call centre; it will move its account. A retailer outsources deliveries to a logistics company and it fails to deliver a customer's computer on time. They lose the sale, not the delivery company.

Supplier managers, be they the budget holder, purchasers or contracts departments, are only one part of the equation. The sales and customer handlers are also crucial. They need to know how to evaluate the cost and implications of their decisions so they can assess the commercial implications for the business. They need to know at which point it is preferable to walk away than have an unprofitable sale.

Commercial activity is no longer the remit of just a contracts or commercial function or department. Rather it is a series of steps that combine to form the process by which an organisation operates to ensure it minimises its exposure to risk while achieving its corporate objective.

Those steps involve a far wider range of people and roles than previously. Unfortunately, many organisations, have not grasped the significance of their employees' roles in the process, let alone helped them develop the necessary skills to act effectively.

While the changes to the way businesses operate may have been the deliberate outcome of a strategic review to identify core activities and outsource non-core areas, the subsequent effect on corporate practices have, by and large, been accidental. They will continue to be accidental until employees are given the core competencies, skills and support they need to be able to think and act commercially.

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### **The commercial skills set**

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"We want our people to be more commercially aware" is a growing mantra in business. Equally as common is the chant "we want value for money". The two are linked, but many struggle to articulate what they mean by the two phrases and how they would recognise commercial awareness and value for money.

Commercial awareness is concerned with understanding commerce, the buying and selling of goods and services, and the key factors that influence success. It involves understanding the processes, relationships and costs involved in the transaction. Once a person understands the drivers of the transaction, he or she is better able to assess the value of the transaction and whether value for money or more value for money has been achieved.

Those involved in decision making which has implications for the health of the organisation

need to understand the implications of their actions. They should be able to determine if a particular activity or deal is delivering more for the same amount of money, more for less money or the same for less money - i.e. the value for money obtained.

There are four key and interdependent areas where knowledge and skills are required if individuals are to become commercially aware: the legal environment, the financial environment, risk, and persuasion and negotiation.

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### **The legal environment**

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Contracting is at the heart of commerce. It refers to the process of reaching agreement with another party for the purchase or sale of goods or service. Those involved with reaching agreement with third parties (suppliers and/or customers) need to understand that they are involved with contracting: and may be committing their organisation to obligations irrespective of whether their role authorises them to do so.

All too often individuals hide behind contracts, citing them as the reason for not doing things or for doing things in a certain way without understanding the actual contract itself or how contracts work. Do your employees realise:

- **They can enter a contract verbally?**
- **That it is enough for the other party to assume they were in a position to enter a contract to make the contract binding?**
- **That verbal instructions can be taken as contract variations with all the implications for costs and risk?**

Individuals need to understand how contracts are formed; the various elements of contracts, such as service level agreements and terms and conditions; how to establish and manage a contract; how to take account of intellectual property; and how to choose the right approach for your business.

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## The financial environment

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The financial health of an organisation is key to its continued existence. It is not the preserve of just the finance department, but is incumbent on all employees to ensure their actions do not jeopardise the health of the business. Therefore, individuals need to understand the drivers of financial health, particularly understanding the different types of costs and how they behave in different circumstances. Commercially aware individuals are able to identify cost drivers and take them into account when making proposals so that a true cost can be obtained.

Awareness of the importance of cash flow to organisations and an understanding of how cash flow is determined is crucial, as are budgeting skills. Add to this the ability to read and interpret annual reports and accounts and to use a range of financial techniques to identify and evaluate opportunities. This is not about making them accountants, but helping them speak the language of business.

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## Risk

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As with the financial issues, risk assessment and management cannot be conducted by a strategic risk group alone as it is the actions of those involved with the external interfaces that are most likely to expose the business to risk. At the very least, individuals need to understand the nature and possible sources of risk and some techniques for identifying, minimising and managing risk so that they can proactively evaluate and modify their own actions.

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## Persuasion and negotiation skills

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Reaching agreement with third parties to agree to a course of action and getting an agreement implemented requires the ability to get others to come around to our way of thinking. Without an understanding of what persuades people and the attributes of good negotiators, it is unlikely that individuals will be as successful as you or they might want. Good negotiators can be made.

An understanding of the dynamics of negotiation coupled with knowledge of and experience using tools and techniques for planning and holding a negotiation can improve performance markedly.

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## Conclusion

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The twin creeds of downsizing and outsourcing have fundamentally changed the way organisations operate. The traditional hierarchical pyramid structure has been replaced by a much leaner structure in which employees have a far greater interface with external parties, both customer and suppliers.

Consequently, many employees have assumed a much more commercial role given that their day to day dealings are with third parties for the purchase, sale and/or delivery of goods and services. While employees' roles have changed significantly over recent years, there has not been a corresponding change in the way organisations train and develop their employees.

Developing an understanding, and deployment, of commercial behaviours is paramount if organisations are to reduce their exposure to risk and ensure the longevity and financial well being of the organisation.

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## By Janet Izatt

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Tel +44 (0)1608 654 201

Email [intouch@maguireizatt.co.uk](mailto:intouch@maguireizatt.co.uk)

[www.maguireizatt.co.uk](http://www.maguireizatt.co.uk)

**MaguireIzatt LLP**  
Campion House  
High Street  
Moreton-in-Marsh  
Gloucestershire  
GL56 0LL