

## Overview

The following paper has been prepared by the LBMX Group Consultancy Practice, a division of LBMX focused on helping Purchasing Co-operatives, Buying Groups and Independent SME's (small medium enterprises) become more effective through strategic process improvement. This paper is part of a series of papers describing key business process improvement strategies for these kinds of organizations.

One of the key ways organizations can become more profitable is to participate in aggregate purchasing activities with other organizations. By combining purchases with other similar minded organizations, Cooperatives and SME's can achieve significant financial advantage and compete more effectively with large corporate concerns. These organizations can achieve this leverage by coming together and forming buying groups, purchasing cooperatives or in the case of Coop's, Federated Cooperatives.

This paper will investigate the benefits of pursuing an aggregate purchasing strategy and discuss strategies on how these advantages can be achieved.

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## The Competitive Problem of Cooperatives and Independent SME's

The key issue in competing with large corporate concerns is cost. Large corporations have the purchasing power to buy products at a lower overall cost than Coops or SME's and can often sell products below the Coop's cost. They may also have new products months before Coops or SME's and are able to get stock, even when products are in short supply. The extra gross profit margins gained through the efficient use of the supply chain by large corporations has fuelled their rapid growth and enabled them to amass huge market-share power.

That being said, Coops and SME's can do the right things. They generally provide excellent customer service, have a strong niche marketing approach, are involved in community projects, and have excellent product knowledge. However they often accept a lower revenue growth and ROI because of the presence of these large corporate competitors. The reason is that large national and multi-national competitors have a much more efficient supply-chain.

In some sectors, the Coops and "Independents" are thriving because they have come together to create more efficient supply chains for themselves. They implemented aggregate purchasing strategies. These Coops or Independents have formed a Purchasing Co-op or Federated Coops (The Group) to help them compete.

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## The Solution is to Create Purchasing Cooperatives or Federated Cooperatives

A Purchasing Cooperative or Federated Coop (The Group) brings together similar independent Coops or independent SME's to create efficiencies in order to receive better net pricing and payment terms on the products they buy. The Group can perform activities more cost effectively than each individual Coop or SME. Successful Groups bring efficiencies to the supply chain that fit the requirements of the industry and then share those gains with member Coops or SME's.

These Groups leverage the purchasing power of independent Coops or independent SME's to extract rebates and other benefits from suppliers. They can also coordinate each Coop or SME to develop and present a group marketing strategy and presence.

There are many successful examples of this approach throughout the world. The next section will describe some examples to illustrate how successful this approach can be.

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## Examples of Purchasing Cooperatives or Federated Cooperatives

In almost all sectors of the economy Purchasing Co-ops or Federated Coops help their members become more competitive. Examples include the National Cooperative Grocers Association (Natural Food Cooperative) in America; Federated Cooperative (Agriculture, Grocery, Oil) in Canada; Capricorn Society (Automotive) in Australia and the National Merchant Building Society (Timber and Hardware) in the UK.

Whether these Groups are formed as a collection of Cooperatives or independent SME's, each Group's desire to coordinate aggregate purchasing policies is the central theme of each organization. In addition these Groups often focus on developing joint marketing strategies, scheduling meetings between supplies and members and facilitating the sharing of information between group members.

The size and scale of these Groups can vary, with both small and large Groups developing a strong and efficient supply chain centered around their members. For example Blue Hawk is an HVAC purchasing cooperative of 215 heating, ventilating & air conditioning distributor members with 939 locations throughout America. NCGA is a Federated Coop in America founded in 1999 and is made up of 119 member cooperatives with over 150 storefronts with combined annual sales over \$1.3 billion. IMARK is a purchasing cooperative of 1,100 independently owned electrical distributors throughout the United States with over 2,000 branch locations and \$11 billion in combined sales.

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## Concept of Aggregate Purchasing

The idea of aggregate purchasing is for members to “group” or “pool” their purchases to achieve cost advantage. This advantage can be in the form of lower prices but is ideally delivered as a rebate back to the Group which is then distributed to the members.

In most cases members continue to use the same method of purchasing products, whether by phone, by fax, directly with a sales person or via the Internet. The difference is that members will now direct their purchases to the one or two suppliers that the Group has arranged an aggregate purchasing agreement with.

Groups will organize purchasing programs in most, but not all product categories. Most of these programs will be rebate driven, whereby there is generally a standard rebate amount off of every purchase, often determined by product category. These rebates are generally paid after the fact and can be calculated and paid monthly, quarterly or annually. There can also be additional rebates for increased volumes over the previous year and additional rebates for purchases exceeding defined plateaus. In addition rebates can be targeted to grow specific product categories or geographic regions. The program can also include enhanced payment terms, and special advertising or promotional allowances.

It is important a collaborative approach be developed with suppliers as opposed to an adversarial price driven relationship. For example, rebates can be targeted to higher margin items that the supplier wants to grow. This means the more business the Group drives through a supplier, the larger the rebate payment – a win for all parties.

The process starts with the Group determining the collective volume in the targeted product categories (each member ultimately decides if they will support the Group on each category). The Group determines the rebate details and terms they wish to negotiate with each supplier. Key Group members often participate in committees at this stage, to determine the desired program and work with potential suppliers. Suppliers are asked to respond to the Group and a list of preferred suppliers is selected and members then direct their purchases to these suppliers. Finally, program benefits (rebates) are tracked and paid pro-rata based on participating member’s purchases.

This concept of aggregate purchasing can be extended to include event or pool buys. This is often a very good starting point for new groups. The nature of these event buys can be characterized as sale events, seasonal events, opportunity buy events, core product events and container events. The thread running through all of these events is that they are designed to provide pricing and rebate advantage to the membership.

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## Benefits

The benefits of an aggregate purchasing approach permeate throughout the entire supply chain. Members receive improved overall net pricing; lower invoice pricing (particularly for

pool or event buys); rebates (monthly, annual and performance) and improved / extended terms.

This process can also result in more efficient invoice and payment processing should the Group decide to participate in the billing process. In addition, members are able to leverage the expertise of all the members in choosing the best supply sources for all products. The Group also provides a forum of business peers to share ideas and discuss solutions to purchasing specific problems. Finally, the development of an aggregate purchasing program will require annual meetings with key strategic supplier executives further strengthening the supplier and customer relationship.

The suppliers also achieve a significant win from this kind of relationship. Suppliers are able to negotiate “the Group Deal” on behalf of all the members rather than individual deals with each Cooperative or SME. Should the Group wish to be involved in the billing process, centralized billing means lower administrative costs and greatly reduced credit risk for suppliers. A rebate strategy protects the “street” price of products while rewarding the Group members for support. This concept means that performance based rebates ensure that rebates are only paid if sales target is exceeded. The key benefit to suppliers is that those that win preferred status will have increased sales at the expense of other suppliers.

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## Operational Issues

There are important choices that need to be made when implementing an aggregate purchasing program. The details of this are outside the scope of this paper and are discussed in detail in the paper “Operational Issues in Group Management”.

The kind of choices the Group must make include the type of billing support they wish to provide the membership and the level of rebate management they will support. For example; it is important that the Group ensures rebates are calculated off real-time invoice data – not reports from suppliers. The Group must develop rebate programs at the supplier invoice total and category level and ensure the Group can track purchase volume plateau attainment in real time.

The Group must also ensure a focused buying strategy is used in most categories and that all entities participate in electronic invoicing.

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## Key to Success

A successful Purchasing or Federated Cooperative brings efficiencies to the business relationship between the supplier and the members and then shares the benefits generated with all parties. This truly creates a winning situation for both suppliers and the members of the Group.

This last section will describe the traits of successful Groups that are critical to the implementation of a successful aggregate purchasing program. Firstly Group members

must embrace a willingness to think and act collaboratively and accept pricing advantage by way of rebates. Key members need to participate in committees to determine preferred suppliers and all members need to direct their purchases to these suppliers as well as attend Group functions. The returns to members are dependent on participation in purchasing programs and not on how many shares are owned. It is important that members are financially secure.

The Group needs to ensure that suppliers are treated as partners rather than adversaries and work to develop professional relationships with the supplier community. Key members should be part of the advisory committee or board and it is important that the Group have strong professional management.

Finally the Group requires a strong technology strategy which includes electronic invoicing between the Group and all suppliers, electronic delivery of invoices and statements to all members, complete electronic rebate analysis, complete purchase analysis and full integration with the Group accounting system. Additional efficiencies can be created if the Group considers EFT (electronic funds transfer) payment transactions between the member and Group and between Group and supplier.

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### About LBMX Inc.

LBMX is a leading provider of technology solutions for buying groups, purchasing co-operatives, independent members and their suppliers. These solutions comprise rebate and purchase analysis software, member electronic document delivery and complete EDI services to assist members and groups to connect to suppliers.

LBMX's close association with this specific supply chain model has allowed LBMX to develop a unique understanding of groups, their members and suppliers. This has resulted in the implementation of LBMX technology solutions that are a fit with both the strategic direction and operational priorities of their customers.

Based on LBMX's "many-to-many" technology, LBMX solutions are helping to connect suppliers, groups and independent member owners resulting in over 250,000 trading relationships. This has resulted in significant operational efficiencies for all members of the supply chain as well as providing groups with access to line item member purchase detail upon which better buying and rebate decisions can be made. LBMX has customers in Canada, United States, Australia and New Zealand.

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