Eggs, Lettuce, and Kilowatts

An Allegory for Energy Purchasing Managers

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The purchasing manager for Evergreen University has the job of buying food and beverage supplies for all cafeterias and snack bars located on the main university campus and its branch campuses. Her job also entails buying food and beverage supplies for all faculty lounges, fraternity houses, the university hospital, and for the concession stands for all athletic events of Evergreen University. Food and beverage purchases for these responsibility areas amount to about $20 million per year. She has a staff of five people.

She uses computer software for inventory maintenance, to flag economic order quantities, and to interface with accounts payable at the university. With this degree of sophistication it would appear the purchasing manager could institute some major economies in the way she buys food and beverage supplies for the university complex.

There is one problem. Evergreen University is a state university complex (the university, the branches, the hospital, etc.). By state law the purchasing manager is required to buy all food and beverage supplies through a wholesale food supplier based in the "State of Jefferson."

Many years earlier Bailey Wholesale Food and Beverage did a good job of lobbying in the Jefferson state legislature. The state legislature, wanting to promote home-grown businesses, passed a law that required all state agencies to do business with a state-based food and beverage wholesaler. Over time Bailey had purchased all of their meaningful competitors. A few very small ones remained. However, Bailey was the only one large enough to handle the business of the university and other sizable state facilities.

A VERY RELIABLE SUPPLIER

Bailey Wholesale is dependable. If the university purchasing department called for 400 dozen eggs, 150 cases of lettuce, or whatever, they were promptly delivered to the locations specified by the purchaser. There had been some times of crisis that Bailey had come through for the university. There was the unexpected visit by the Japanese ambassador's group last year when several of the faculty lounge/restaurants needed gourmet foods on a moment's notice. Bailey delivered on time. Bailey even hired a gourmet chef at their own expense and sent him along to help Evergreen's people through the crisis for the ambassador's group. Bailey's sales reps call on the purchaser and her staff on a regular basis. The purchaser and some of her staff often play golf with the Bailey reps.

The purchaser often brought up the issue of price on some of the products Bailey supplied. From time to time a small price break has been given to the university. Mainly though, Bailey's people told the university purchaser that since she was getting always getting prompt service, few (if any) billing errors and, their expertise during crises she should be satisfied with the excellent prices she was getting. So the purchaser, try as she might, couldn't get any significant price breaks from Bailey Wholesale, essentially the only supplier of food and beverage available to Evergreen University.

In a neighboring state (the "State of Madison") after last year's election, a new governor and a new state auditor came into office. It was found that purchasing for state-owned institutions in the State of Madison was in the dark ages. Various state agencies were tied to antiquated purchasing laws on everything from bulldozers, to writing pens—even food and beverage service. New laws were passed that began to phase in competitive purchasing. These happenings were not lost on the governor and legislature in the State of Jefferson where Evergreen University is located.

A NEW PERSPECTIVE ON PURCHASING

The major political happenings in the state next door weren't lost on Bailey Wholesale either. They knew that sooner or later that purchasing reforms would be brought up and likely passed in the State of Jefferson. Recently executives of Bailey paid a call on the purchasing manager at Evergreen University. They offered a discount of 5% (about $1 million per year) on all food and beverage purchases and a seven day a week delivery to Evergreen University if the purchaser would sign a new ten year purchasing agreement with them.

Bailey knew that in the neighboring state, even though the purchasing laws had changed drastically, the laws didn't void any existing contracts. The new laws on purchasing in the neighboring state went into effect as existing contracts expired.

Evergreen's food and beverage purchasing manager had been attending professional association meetings. She knew food and beverage costs in those states where open purchasing competition was permitted were running a great deal less than what Evergreen was paying Bailey. For example, she had priced soft drink syrup and found where she was paying Bailey about $3.25 per gallon, state universities in states with open purchasing competition were getting the same syrup for around $2.60 per gallon.

WHAT SHOULD SHE DO?

Should she sign the new ten year agreement? She knew the Bailey people really well. They had always come through when she was in a bind. (Remember the unexpected visit by the Japanese ambassador?) They had almost always delivered on time and had very few billing errors. They had lowered prices a few times on some items. Their prices had always *seemed* to be fair but now she was beginning to wonder. The university had a valid contract with Bailey. Its expiration date was about 14 months away. The purchaser didn't know when or if the legislature in the State of Jefferson would act on an open purchasing law. What *would* she do?

WHAT SHOULD ENERGY PURCHASING MANAGERS DO?

If all this sounds familiar, it should. Change the title of the food purchasing manager to plant manager or energy purchasing manager and you have a scenario that is similar to many situations today involving large electric power users and electric utilities.

Many traditional electric utilities are trying to marry their larger customers to them for an additional five to ten years with rate discounts, customized summary billing, and other incentives. The utilities feel that a new piece of paper will help secure their rights to continue electric service when retail competition is permitted in their state. It will only be a matter of time before your company is approached with some sort of a business proposal from your local electric utility in their effort to extend their contract with you.

If you operate several facilities, e.g., chain stores, you can likely expect to be contacted by electric utility company marketers from *outside* your immediate area. These non-local utilities usually will offer to audit your electric bills and offer to be your negotiator for utility purchases. All they want in exchange is to have the *right of first refusal* to serve electric power to all your facilities when the state law permits retail electric competition.

Too much is unsettled about the electric utility industry today to simply sign a long-term electric power contract for some immediate dollar savings. It may be very tempting to sign an agreement to have an electric utility company do your utility bill auditing and contract/rate negotiations. As the story about the university food and beverage purchaser goes—be careful.

HERE'S WHAT YOU SHOULD DO

Be attentive to what is going on in your state, in neighboring states, and at the national level with regard to retail electricity competition. Stay in communication with your trade association and participate in public input sessions regarding retail electricity competition. Read very carefully everything an electric utility submits to you, check with others in your industry (or trade association). Ask competent utility consultants and your legal staff to give you an opinion. Then be prepared to negotiate firmly and carefully with the utility. By following this approach you may be able to structure a win/win arrangement without compromising your choices for the future.

ABOUT THE AUTHOR

Robert W. Chatham is the principal at Precision Strategies, Inc., a management services consulting firm based in Long Beach, Mississippi. His firm provides consulting services to large industrial and large commercial users of electric power in all aspects of their business dealings with electric power suppliers.

Before accepting an early-out package in late 1994 from an electric utility organization, he had completed a long career in electric utility marketing. During his career he was involved in work with all classes of customers—particularly large industrial customers, federal accounts, and national commercial chain accounts. He has had experience with cogeneration projects and demand-side management projects. He also represented his former employer's interests with a state-level quasi-regulatory body.

His academic credentials include a bachelor's degree in electrical engineering and a master of business administration degree. He is a registered professional engineer.

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