# Ten Missing Links in Strategic Sourcing

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The last seven (7) years have been exciting ones for the supply management professional. Organizations around the globe have implemented strategic sourcing processes and results have been spectacular. The potential of Supply Management value-added has reached the Executive Offices of organizations, with many CEOs announcing to shareholders and to Wall Street the impact of their Strategic Sourcing efforts. These efforts have now been organized in a wide swath of industries, including financial services, software and even the Federal Government.

Strategic sourcing continues to contribute results to the bottom line. Yet, strategic sourcing efforts are still sub-optimized in a number of areas. The purpose of this article is to provide advice to organizations wanting to improve the impact of their strategic sourcing efforts.

Areas needing further development, in order of importance:

1. Training and Development
2. Fully Deployed Category Strategies
3. Fully Developed and Employed e-Procurement
4. Management of Indirect Spend Decision Making
5. Contract Compliance for Indirect Purchases
6. Properly Developed Market Analysis
7. Fully Integrated Cross-Functional Involvement
8. Total Cost Implementation
9. Market-Rationalized Pricing
10. Supply Chain Integration

Each of these areas will be covered in turn.



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## 1. Training and Development

Few comprehensive training and development plans have been implemented by major corporations. Most training programs are focused on less experienced staff and even these programs aren't typically tied to key performance dimensions. The primary philosophy is that organizations are hiring "experienced" staff; therefore, no training is required. Development generally is ignored by most organizations, except for high potential staff.

As a result, staff use current organization practices and supplement them with knowledge / technologies provided by process jobs / organizations. Thus, a patchwork of inconsistent practices is applied. These inconsistencies are somewhat tempered by standardized strategic sourcing processes but still exist in many of the "steps" during the implementation of sourcing projects. Inconsistencies in areas such as lotting strategies, team formation, sourcing strategy, e-auction use, RFI / RFP development, negotiations, and incorporation of appropriate terms and conditions are found in most organizations.

These inconsistencies, and the accompanying reduced quality, can be addressed by the creation of an effective cross-organization training and development program tied to the most important decisions of supply management. Effective negotiation training programs have shown that an additional 2 – 3% cost savings is possible with better techniques.

## 2. Fully Deployed Category Strategies

This refers to the deployment of a category management plan that incorporates sourcing projects addressing the entirety of the category spend. A reasonably developed plan may exist after a full strategic sourcing project has been initiated by the organization, with support by outside consultants. These plans do not tend to exist 1-2 years after the initial sourcing study or spend analysis.

The goal of category strategies it to fully address all of the spend in the category, even though some of the spend may be already under contract. Oftentimes, organizations have addressed only 20-25% of the spend as they approach a new fiscal year. As a result, they are not able to book the total cost savings and supply chain enhancements that are available.

What is needed is a comprehensive plan, supported by all corporate decisions and business units that address 100% of the sourcable spend by the end of the present fiscal year.



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This requires that plans follow the existing budget planning cycle of a typical organization. Once all the sourcing projects have been identified, the task of the supply management team is early implementation during the next fiscal year. In this way, negotiations can both ensure themselves of the best savings opportunities, and the resources required for implementation. For an average organization, at least 25% of potential savings are foregone due to late or inadequate planning.

### 3. Fully Developed and Deployed e-Procurement

All large organizations have ventured into e-procurement at some level. These solutions range the full spectrum of possibilities, from desktop purchasing to e-auctioning to data warehouses. Yet, only 17% of organizations plan to increase their investments this year. Feedback includes:

a) E-auctions are inappropriately conducted.
b) Desktop systems and middleware aren't capturing the level of data needed.
c) Costs are prohibitive and the payback is unclear.
d) E-procurement implementations are not tied to Supply Management or business strategy.

All of these comments are troubling. As an example, e-auctioning has been in place since 1997-1998, yet there is a perceived misuse of the tool. Another example is the return-on-investment. How is it measured and what are the decision criteria?

Organizations should ensure that e-procurement plans are tied to strategy. E-auctions should be viewed as a tool, and not be forced on organizations as sourcing mandates. As is true for all enterprise-wide information systems, the goal is to provide useful and meaningful information to organizations. In keeping with generally acceptable accounting practices, push for at least a 2:1 payback in not more than two (2) years.



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## 4. Management of Indirect Spend Decision Making

Too often, supply management does not effectively impact all of the indirect categories. Sourcing decisions are consistently being made outside the function under the guise of superior knowledge and procedure. Department managers continue to drive decisions with wide-ranging levels of supply management support. Oftentimes, these decisions are based on personal preferences, poor evaluation criteria, and without the requisite amount of supply-side input on terms and conditions.

Organizations have responded to this issue by establishing high level corporate champions of the category. At best, however, results have been subjugated by the sheer will of users that only want to give the appearance of supply management involvement. The quality of corporate contracts does vary; in general, however, the pricing agreed to typically is not benchmarked or tested beyond the experience of the departmental user.

What is needed is a structured, collegial, equal partnership of the supply management staff with user departments. Every team member should have an equal voice, and all corporate indirect expenditures should be subject to a team-based sourcing process. For every category not handled in this fashion, assume a potential cost savings loss of 5-8%.

## 5. Contract Compliance for Indirect Purchases

The rules of the road for compliance are to achieve at least an average of 85%. This compliance level should be much higher, say 99% for direct purchases and perhaps 75-80% for indirect purchases. Stories abound with 25-30% compliance for indirect. Sourcing staff are very well intentioned, but can't get the local support for corporate contracts. The low percentage is due to poor team negotiation, inadequate lotting, and lack of understanding of sourcing benefits.

Contract compliance has been a perennial problem for indirect purchases. Users fail to see the benefits for the corporate buy and they can find lower prices, typically from a local supplier. This is where effective lotting strategy and contract negotiations can improve performance.

Some corporate arrangements will never get 100% compliance, but a high percentage is possible if one question can be answered: "What is in it for the local user to employ the new



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contracted source of supply?" An edict from the Chief Financial Officer or President to use the agreement is not a sustainable long-term solution because, ultimately, the local user has to see the benefits before they have confidence that the solution best suits their needs. More effective use of end-user customer surveys could provide succinct data that can be used for sourcing planning and lotting. One strategy is to focus on the 80% of spend categories, and let the local user decide the source for the remainder.

Improving compliance by 1% increases savings by a factor of 4 to 5 if the items / services are in the 80% spend of the category.

## 6. Properly Developed Market Analysis

Every organization has a definition of what a market analysis is and when it should be done. Market Analyses are typically done 1-2 times a year by commodity managers (more frequently for volatile commodities), and are subsumed into the scoping stage of strategic sourcing. Some organizations use Michael Porter's Five Forces framework: this provides excellent data about the supplier's power in the market. Others develop cost curves that show manufacturing / service costs and selling prices. Still others say the e-auction show the market price. In truth, all of these approaches are useful, but they lack an overall assessment of the market. As a result, the sourcing team does not have a comprehensive view of the state of the market.

Market analysis should show the following:

a) Overall market spend / revenue by segment
b) Top suppliers
c) Competitive factors
d) Buyer or seller market
e) Future trends in pricing, delivery, quality, features, and substitutes
f) Market prices
g) Changes in technology
h) Market versus organizational need
i) Profitability and survival
j) Cost drivers



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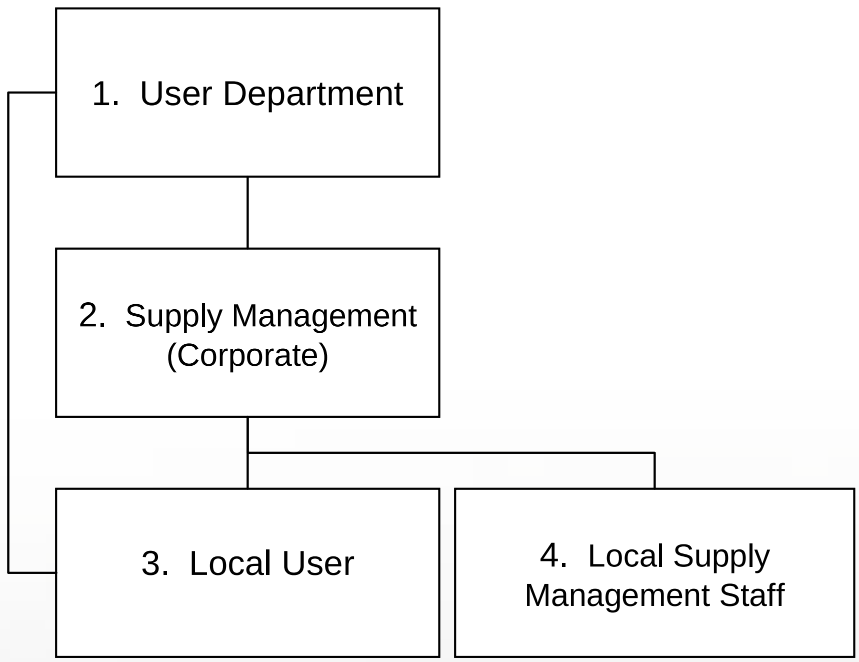
A cross-functional team must be developed to collect this information and to develop a full market study. Without an adequate market study, lotting strategies cannot be accurate and this may result in an opportunity cost of 6-7%

## 7. Fully Integrated Cross-Functional Involvement

This issue tends to be present for indirect purchases. The lack of effective involvement could be present on four levels:




Inappropriate participation by staff at any of these levels will result in less than expected improvement and poor implementation. Sourcing projects should not be started until and unless the right level of participation can be garnered; even promises of support is better than nothing.

Some organizations take a view that if cross-functional staff are invited to meetings and/or offered an opportunity to review the products, then they are assumed to agree with the team's work if choose not to attend. This might sound perfectly acceptable and logical, but it is, in fact, the cause of poor alignment around goals, misuse or lack of use of selected suppliers, questionable usefulness of contracts, and suboptimal results.



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In my dissertation (completed in 2003), there was an industrial relationship between high levels of cross-functional involvement and integration with supply management results.

## 8. Total Cost Implementation

Few Fortune 500 organizations, despite touting the use of total cost, have actually implemented it in the string of total cost activity, starting at the sourcing decision through implementation. Total cost evaluation is relevant in all of the following steps of sourcing:

Market Assessment → Sourcing Strategy → RFI → RFP → Sourcing Decision & Negotiation → Implementation And Measurements

Few companies achieve a complete implementation of total cost because implementation is difficult and requires considerable investment in software, training, and process improvement.

First, organizations should develop a total cost model that is tailored to the category being purchased. This “formula” should be used to evaluate the market, identify potential sources, make decisions, and monitor supplier performance. Software should be developed and supported by effective tools such as Microsoft Access or Excel. Sourcing teams should use the formula in source selection and in setting up costs of performance metrics keyed to service level agreements (SLAs) or overall performance. Total cost results should be viewed as “hard” savings, thus require sign-off by financial management staff.

Taking a total cost perspective can identify and manage 20-30% of purchase prices.

## 9. Market-integrated Pricing

As was mentioned, supply management staff use e-auction tools as a way to achieve market pricing. Staff may also use past purchases, benchmarks from other companies (commodity pricing only) and past experience to establish market pricing. But what is “market price” anyway? It depends on a number of factors:

a) Buyer volume
b) Supplier capacity



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c) Buyer specifications
d) Changes in raw materials and direct labor
e) Local, regional, and international conditions
f) Currency rates
g) Supplier efficiency
h) Supply chain costs (i.e. transportation, financing)
i) Market timing
j) Actions taken by other buyers and sellers
k) Length of contract

E-Auctions can definitely lower prices by 5% than those received through face-to-face (F2F) negotiations. End prices are not market prices, because prices obtained from e-auctions only partially address the above factors. Sourcing team should demonstrate market-based pricing when securing approval for corporate deals. An algorithm can be developed to calculate a market price. By insisting on this type of analysis, organizations can better understand whether their contracts include true market pricing.

## 10. Supply Chain Integration

Infrequently, the strategic sourcing decision is one that integrates the costs of and impacts the full supply chain. Normally, purchase prices are negotiated only with consideration for transportation and possibly inventory management. The complete set of supply chain interests may not be reflected. Logistics, distribution, finance, service, and account management factors are often not included in the sourcing decision, unless the sourcing project involves outsourcing of an entire operation. Indeed, representatives of the functions managing these costs / issues oftentimes do not participate in the sourcing team.

Organizations should ensure consideration of the supply chain in direct and indirect strategic sourcing, to include:

- Forecasting
- Order Processing
- Lean Management
- Order Administration



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- Scheduling
- Account Management / Inside Sales
- Storage
- Inventory
- Transportation
- Customs
- Currency
- Special Financing Costs
- Raw Material Hedging

Supply chain considerations will provide an enterprise-wide sourcing solution that will be more sustainable in the long term. Supply chain costs (including inventory) could support as much as 40% of the purchase price.

## In Conclusion

The supply management profession has made significant strides over the last ten (10) years. Organizations have experienced improved results using processes such as strategic sourcing. Many of these organizations have mature processes, benchmarked across the globe. It is time to assess where improvements can be made, and hopefully, the ten (10) areas described in this article can be considered by supply management staff and targeted improvements can be made where needed. A more comprehensive strategic sourcing process can thus be created and then pass into another phase of process improvement.



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