Abstract. Sourcing strategies must become resilient to swings in commodity markets, currency markets, and supply and demand shifts. In just the past year, we have significant peaks and valleys in each of these economic indicators, and any one of them could have easily caused a past sourcing strategy to become obsolete, and the combination have stressed all but the most comprehensive strategies and supplier relationships.

Many of the traditional strategic sourcing process steps did not prepare us for these risks, and as commodity prices escalated, many sourcing managers were reacting to these changes. Indeed, even companies business models have been challenged as they became the “shock absorber” between their suppliers and customers trying to, but unable to pass through the increases. As a result, businesses went bankrupt, companies declared “force majeure” due to the lack of availability of key raw materials, new entrants were sought in a reactive manner, and supplier and customer relationships have been damaged.

This presentation will explore some tools and techniques, data sources and provide direction to aid in improving sourcing strategies from reactive to proactive and better serving the business and supplier relationships.

Background. When we look at commodity price trend charts over the past several years, we can see periods of relative stability shown in the following chart between January 2002 and January 2005, followed by periods on severe up-and-down price swings in 2006, 2007, and 2008. Sourcing strategies created in the stable periods often did not include risk analysis of significant upward or downward price movement. Some strategies created at a price peak or trough as in July 2006 or in the 1st quarter of 2007 may have been overly conservative or pessimistic based on the forecast outlook for the following period. The real question is whether the strategy was developed to the swings, whether up or down and what the triggering events were within the strategy to adjust the tactics.
As prices for commodities started to move rapidly upward, many companies were faced with supplier price increase requests and were pulling out their price increase mitigation strategies, looking for improved forecasting tools and data sources to help predict the inflationary pressure moving through the supply chains. Shortages developed in some industries and talks of allocation were becoming more commonplace. Just when it seemed there was no end in sight to this upward spiral, the housing and credit crisis struck, eroding consumer confidence, and their ability to continue to purchase goods and services. The commodity prices seemed to go into freefall and supply managers sought to unwind, allowed price increases and seek reductions from the suppliers, who weeks before were demanding the increases.

During these periods, there also has been intense pressure on improving the management of working capital, with laser focus on payables terms days and inventory levels. These pressures moved down the supply chain putting increasing levels of strain on balance sheets, and setting businesses up for potential failure as the credit crisis impaired business from accessing the credit markets to fund inventory to support new orders, or to finance the payables associated with longer terms and expanding new business.

**A Plan of Action.** Following a traditional strategic sourcing process, here are some practical suggestions for improving sourcing strategies that can allow for incremental improvement to be made through each step in the sourcing process. These strategy and tactic ideas need to consider when preemptive or preventative measures are recommended and when reactive or corrective measures are most appropriate. The key point is to consider these questions during each step of the strategic sourcing process, and make decisions based on data and impact to the business model.
Strategic Sourcing Process

**Step One – Business Plan.** When you are chartering your strategic sourcing team, make sure to include finance and treasury resources, at least as contingent members, of your team. Make sure the scope of the team includes examination of price and currency trends and potential for hedging. Include working capital elements as key deliverable items for the team. Depending on the cost structure for your category, consider adding other resources for major elements of cost such as transportation and logistics cost, taxes and duties, labor as well as the key commodity or raw material cost drivers.

**Step Two – Process Plan.** Add work steps and time in your plan to evaluate commodity market price swings, labor rates and productivity, transportation and logistics costs, taxes, duties, currency fluctuation, and working capital improvements. Including data and forecasting tool acquisition, and industry benchmarking for best in class terms, and inventory levels.

**Step Three – Data Acquisition.** Add sources of forecast data to your plan – for all the elements identified in the process plan step by examining the total cost breakdown for your category and ensure that you have sufficient data to cover 80 to 90 percent of the total cost.

**Step Four – Evaluation.** Add risk scenarios to your evaluation process for increases and decreases in all major cost areas. Work with business unit management to understand the business model risk of these scenarios. Consider risk mitigation strategies for each scenario and key triggering points for each scenario.
**Step Five – Selection.** Prepare your contract clauses for escalation and de-escalation and include in your negotiations. Ensure that the “shock absorber” risk is fully understood on both the supplier and customer end of the business model. Consider the contingency plans for shortages and supply disruptions, particularly when determining the inventory and payables strategy.

**Step Six – Implementation.** Assemble and monitor your Key Performance Indicators and trends with the triggering points for contingency plans.

**Step Seven – Performance Measurement.** Monitor supplier health and industry structure for changes, use internal data, as well as external sources such as news alerts, economic forecasts, and broker studies.

**Conclusion.** Sourcing managers can improve strategies and supplier relationships with these evolutionary changes to their strategic sourcing processes. This will require some new data, new team members and some serious discussion on risks, sensitivity analysis, mitigation strategies, but these improvements will produce a vastly-improved strategy that will have the built-in, proactive approach.

**REFERENCES**

**Web site reference:**

Commodity graph, [http://www.propurchaser.com](http://www.propurchaser.com), used with permission.