

Strategic Sourcing: A Step-By-Step Practical Model

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Abstract. We hear and read a great deal of information in our Supply Chain profession about Strategic Sourcing. It is one of the most powerful tools that supply chain professionals and organizations have available to them to bring significant bottom line results to our company P&L statements. As our profession has evolved from the Purchasing Agent to Supply Chain mentality, strategic sourcing culminates the transformation as a collaborative process that is producing immediate and significant results required by the CEO. This workshop will be beneficial to both the seasoned supply chain professional as well as those who are new to our profession and will (1) define what is strategic sourcing, (2) provide a step by step review of a practical model, and (3) outline the benefits of successful sourcing initiatives.

What is Strategic Sourcing? By our definition, *Strategic Sourcing is an **organized** and **collaborative** approach to leveraging targeted spend across locations with select suppliers that are best suited to create knowledge and value in the customer-supplier interface.* We cannot overemphasize the importance of operating in a collaborative manner. Over the past several decades, most in our supply chain profession have transformed from the “purchasing agent” mentality where staying in silos was the norm to evolving into a “supply chain management” atmosphere where working with cross functional and cross locational teams is vital to success. Strategic sourcing is organized since some type of methodology or process is needed; it is collaborative since one essential requirement for any successful strategic sourcing effort is that of getting functional elements other than Procurement involved in the decision making and evaluation process.

A Review of Strategic Sourcing Model. The Strategic Sourcing process requires an **organized** approach or method that allows a supply chain function to systematically work on spend areas or processes that can result in cost saving benefits. There are 8 essential steps involved in the process beginning with identifying a spend area and culminating with selecting and managing a relationship with supplier(s).

All sourcing models, regardless of origin, contain the following eight essential elements:

- Identifying the targeted spend area
- Creating the sourcing team (Touch Point Required)
- Developing a team strategy and communication plan (Touch Point Required)
- Gathering Market Information
- Developing a supplier portfolio (Touch Point Required)
- Develop a Future State
- Negotiate, evaluate, commitment, and agree (Touch Point Required)
- Supplier Relationship Management

Worth mentioning is that during the process, Business Unit Manager ***Touch Points*** are vital and as we progress through the step by step methodology, we will interject when and why these ***Touch Points*** are crucial.

Business Unit Managers are defined as “any person in the organization who has an influence or is impacted by the spend area being reviewed.” Needless to say, you don’t necessarily have to possess a Managers title to qualify as a touch point; and certainly there are management levels that need more attention in the touch points process. We will now begin the journey of looking at each step of the process.

Step 1 involves the identification of ***Spend Areas*** that someone in the organization deems an opportunity for improvement. Usually, this is done at the CEO, CFO, or CPO level and involves selecting areas of spend that could produce cost reductions or process improvements. And one essential element needed at the outset is an Executive Sponsor to push the initiative along and keep it going.

Critical to this step is prioritizing the various spend areas so that the initial areas to evaluate match the goals and objectives of the company. And it does not necessarily have to be spend areas with large volume. One of our clients recognized that their internal policies and procedures required that any item over \$25 must have a requisition and purchase order. As you can imagine, their processes were extremely tactical and it was determined that a P-Card was the most important objective to reduce Procurement’s involvement in the day to day transactional business and to get their Procurement Professionals doing work on meaningful large spend areas.

Identifying those areas that are common across the business units is also extremely important. If one business unit or location has a significant part of the spend activity, then perhaps a local or regional sourcing effort is more appropriate. In any event, it is critical to identify where the spend is taking place and how much activity is being accomplished throughout the business units.

Step 2 entails ***Creating and Developing a Sourcing Team***. Most initiatives in strategic sourcing provide team members by seconding them on a part time basis. Rarely do sourcing initiatives have the luxury of having full time team members devoted to just the sourcing effort. Regardless of method, we emphasized in our definition of strategic sourcing that any sourcing effort is collaborative-which means getting departments and functions other than procurement involved.

Prior to selecting the team members, it is first important to obtain ***Executive Sponsorship*** of the sourcing initiative. Having the endorsement of the highest executive level possible will pave the way for eliminating or reducing resistance from operational levels. After Executive Sponsorship has been secured, it is vital to select team members from a cross functional viewpoint. Team member functional representations are composed of, but not limited to, finance, accounting, engineering, maintenance, operations, human resources, tax, research & development, information technology, health/environmental/safety, marketing, sales, and others. Also important are selecting cross-locational members to the extent that reasonableness will allow. Isn’t the majority of most high spend areas accomplished at the

“field” or location area and shouldn’t their input be highly regarded?? Of course, and one key to any successful sourcing event is getting their buy-in on the effort.

Touch Point #1 occurs during this step. Bosses and Managers of personnel who are to be team members want to know how this will impact them. For as far as they are concerned, their personnel have “day jobs” and someone is about to utilize their services on a part time basis to serve on a team. Successfully marketing the initiative and providing an effective touch point here will help with the organizational buy-in on the process.

Step 3 involves developing a **Strategy** on how the team will approach the identified spend area. Now that the team has been formed , the first order of business is to determine just how the team is going to accomplish the task. The team will normally develop a charter or mission statement with specific goals and objectives. Prior to finalizing the strategy in this step, the team must understand their current suppliers capabilities and the future requirements for the commodity or service from the business units.

They will identify and establish timelines and milestones as a road map to accomplish the team objectives. Finally and probably most important part of this step is for the team to develop a Communication Plan-a plan that outlines how they will convey team progress and updates. Some common means of communicating this are email, written correspondence, company newsletters, intranet, and face-to-face dialogue. Effective and constant communication will keep the company informed and provide a key element of credibility to the project.

Touch Point #2 occurs during this step and is used to convey to the Business Unit Managers the strategy of the team. This is a continuance of keeping all decision makers and others who have influence in the particular spend area involved in the direction of the initiative.

Step 4 calls for the team to gather **Market Information**. Now that the strategy and current capabilities were established in step 3, it is time to find out what are the supplier capabilities in the marketplace. Interviewing key suppliers and industry leaders will produce information necessary to determine who will receive the Request for Information (RFI). Once preliminary information about the market is determined, the team will decide who should receive the RFI and the extent of how broad a net will be cast to the marketplace of suppliers. Typically, RFI’s are designed to gather data on suppliers regarding quality programs, financial stability, service capabilities, plant locations, references from clients, organizational structure, and a mired of “other than price issues.” It is also a good time to send out your standard terms and conditions that will eventually be employed. This early review allows the firms to give cursory review to prepare themselves for further discussion if they qualify to the proposal stage.

Step 5 requires the team to begin reviewing the completed RFI’s and determining those suppliers that will be given future consideration. We call this Developing the Supplier Portfolio. The team begins to develop criteria for evaluation based on the information receive from the RFI’s. With this information, the team will begin to identify companies that have potential to be developed either on a company-wide or regional basis. During this step, the team will decide who will receive the Request for Proposal (RFP), a step whereby the team now solicits pricing and commercial proposals from the suppliers who appear to offer the greatest potential to the sourcing initiative.

Prior to sending the RFP's, the team will take the opportunity to perform Touch Point # 3. Thus far, key management and business unit managers have been informed of strategy, plans, and objectives. Now it becomes paramount to perform this touch point because "favorite" or "preferable vendors" may not be on the list of suppliers to receive the opportunity to submit a formalized commercial proposal. And rest assured, this will always generate interest and comments from many of the touch point recipients. Once approval / concurrence has been established, the RFP's are sent out.

Step 6 is one of the more important steps in the entire process, Developing the "**To Be State or Future State.**" Now that all of the RFP's are back in the hands of the team, the evaluation process entails developing a business case, performing GAP analysis, and establishing three very important and critical criteria for the team to consider when selecting the supplier(s); understanding **Total Cost of Ownership**, recognizing **Total System Cost**, and developing **Performance Metrics**.

(1.) Total Cost of Ownership mentality involves the team understanding that the true cost of any product or service consist of the Acquisition Cost + Operating Cost+Maintenance Cost+training cost+warehousing cost less any salvageable value. Price is important, but not as important to the understanding of Total Cost of Ownership. We live this practice constantly in the supply chain profession. Cheaper is not always better—and the team should make their ultimate decision based on what is the best value, not lowest unit price.

(2.) Total System Cost follows on the heels of Total Cost of Ownership but is differentiated by the fact that the team also recognizes that there is a cost of doing business with the supplier base. The Total System Cost involves not only the price we pay for the goods or services, but also includes the (a) interaction costs between our company and the suppliers and (b) "buyer" costs that we incur to conduct and maintain the relationship with our selected supply base. In summary, Total System Cost can be described as Supplier Costs + Supplier Profit + Interaction costs + buyer costs.

(3.) Establishing Performance Metrics with our suppliers is mandatory for developing an eventual successful relationship in the long term. During the era of Purchasing Agent mentality when the most important element was a "Three bids and a buy" process, there was not a need for performance measurement. Now that Supply Chain professionals are challenged with developing suppliers who can create value and benefit, we must also have a mechanism in place for measuring both their performance and ours. On time deliveries, warrantee issues, customer satisfaction, and quality issues are just a few of the multitude of performance metrics that need to be considered. Each commodity or service under review will have different metrics or criteria that is applicable to the commodity or service. The team must identify these and established the performance review methodology prior to beginning the final selection of supplier(s).

The final part of this step is for the team to understand and adopt the mindset that eventual award of contract(s) involves a **three-phase process**

Phase 1: Selection of vendor will be based on Best Value

Phase 2: Continuous Improvement Objectives must be established with the supplier(s)

Phase 3: Innovation from the selected supplier(s) will be the key to significant savings

Step 7 involves **Negotiating and Selecting Supplier(s)**. During this step, the team may elect to “short list” the suppliers to begin the negotiating process. Once this has been accomplished, the “short list” should be presented to the Business Unit Managers (touch point number 4) prior to notifying vendors of either their making the final stages or being eliminated from consideration. This touch point is critical in that if a favorite supplier of a influential Business Unit Manager is not selected, the team has the backup and compelling business reasons for explaining why the supplier in question was eliminated from consideration.

One word of caution and reality: Very seldom does this go without controversy or conversation from Business Unit Managers and you may be forced to proceed with including suppliers the team feels does not match the credentials and qualifications necessary for final consideration. But it is much better for the sourcing effort if this is discovered at this point versus having to add a supplier to the final list after you have notified them that they are not being considered as finalists.

Some points of interest that each sourcing team should adopt during the negotiating and selection stage:

- Think longer-term agreements than what has been considered in the past. It takes time to develop a trust and working relationship to fully realize savings whether they be in continuous improvement processes (phase 2) or innovation (phase 3). The likelihood of significant savings comes from supplier innovation!! Give it time to develop.
- Ensure higher levels of trust during the negotiations. Certainly, being firm but fair will yield more rewards in the long run. If the trust factor is not established during negotiations, you will probably never see innovation from the suppliers.
- Finalize your Performance Metrics during the negotiation stage. Doesn't make sense to do this after award of the contract.
- Develop a sense of commitment to succeed. Another words, display an attitude of “win-win” and really mean it.

Step 8 is **Supplier Relationship Management and Maintenance (SRM)**. Probably one of the most ignored portions of any strategic sourcing effort. Many times, the sourcing endeavor goes through a tremendously detailed and laborious process of vendor selection only to disband the team or not fully cultivate the relationship on both sides of the desk. Why is this step so important?? To gain the significant savings from Continuous Improvement (phase 2) and Innovation (phase 3) that was established earlier in the process.

Only by establishing an effective SRM program will you begin to realize the savings and improvements that were initially targeted early in the sourcing process. During this step, the team should be focused on contract execution, establishing field effectiveness teams to implement new ideas or processes, developing continuous improvement cost drivers with the selected supplier(s), and refining the score cards and metrics originally developed to measure performance.

SUMMARY: BENEFITS OF STRATEGIC SOURCING.

These include but are not limited to:

- Organizes our thinking about an approach to leveraging spend
- Forces us to operate collaboratively across business units
- Encourages us to think creatively about Supplier Relationships
- Provides a focus on opportunities to generate savings in targeted spend or process areas
- Requires us to develop new thinking about Performance Metrics
- Will lead to better quality improvement issues
- Improves internal teamwork and communications
- Will result in streamlined business processes
- Will produce Innovation from the supplier base

In closing, we offer the following vital statistics to consider:

- Depending on commodity or service, a typical sourcing effort from beginning to supplier(s) award will take from 4-6 months.
- Will require a team members time ranging from 5-20%
- As supply chain professionals, one of the questions asked most prior to any sourcing effort is “what are the savings that this sourcing effort will bring to the bottom line?” Good question and very valid. Based on commodity or service, this will obviously be hard to forecast or predict. But experience tells us that a typical sourcing project can yield a range of 5-15% in hard dollar savings.
- If your company has never participated in a sourcing effort, do not “Over launch” to many teams. Better to do one or two, get the quick wins, and establish the process for future teams.
- The teams (or at least a core part of the team) should stay in place after award to monitor performance and progress

REFERENCES

Book references:

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