

An Introduction to Strategic Sourcing

MANY AUTHORS HAVE ALREADY WRITTEN on Strategic Sourcing and Supply Chain Management. In general, each describes a sourcing process that includes somewhere between five and seven steps. The primary differences among their books are in the ways those steps are defined and segmented. The process described in this book should look familiar in that it includes six steps, starting with the inception of the initiative (Project Kickoff) and concluding with final monitoring of the implemented program (Continuous Improvement). This book's process, however, specifically applies Strategic Sourcing techniques to indirect spend categories and offers insights and strategies that have been applied successfully for decades. Our process is not based on theory; the techniques described have been refined through years of experience alongside many types of organizations to reduce their costs for indirect goods and services. As you will discover, the process itself serves primarily as a project management tool. Creative strategies and adaptability in the face of uncertainty are the key elements that make your sourcing initiative truly strategic.

In the first edition of this book, published back in 2010, we noted that many organizations still neglected to apply Strategic Sourcing techniques to their indirect spend categories. Instead, indirect spend was treated as a series of one-off purchases or was sourced with a simple three-bid strategy with little effort beyond reviewing the supplier price responses. Typically, with indirect spend, per-item prices are relatively low, the product or service is not crucial to the business, and the overall costs are rarely examined because of the difficulty entailed in gathering meaningful spend and market data.

Things have changed in the years since our first edition, but not as much as we might have hoped. Most organizations are now familiar with a Strategic Sourcing process. True best practices for sourcing indirect spend, however, are still rare. Sourcing managers are still accustomed to the old way of running bids and still continue to engage suppliers at arm's-length, which does not engage the supplier community in a way that maximizes competition. Concepts like category management have become even more important, yet even organizations with dedicated category managers suffer from diminishing returns and increased costs as they attempt to hire in-house specialists for virtually every category of spend.

In the current world of procurement, leaders and managers shouldn't focus on effective sourcing processes alone, but they should also turn their attention toward ensuring a high return on investment for the function, creating efficiency and effectiveness metrics that drive results faster, increasing visibility, and engaging their stakeholders and suppliers effectively. Strategic Sourcing, combined with proper category management techniques, continues to allow organizations to shift away from thinking about indirect spend in an ad hoc manner and provides spend visibility, objective decision-making, and a project management tool to ensure efficient use of the sourcing team's time and efforts.

VISIBILITY

Strategic Sourcing provides a new level of visibility into business processes, operational concerns, and spend details that may not have been available to management and stakeholders in the past. The process provides a road map for collecting and analyzing this information and determining how particular products or services truly fit into the overall business operations of an organization, from the identification of a need to the use of the product or service, and (if necessary) its disposal. This includes identifying the following:

- Who buys the product?
- How is it ordered?
- How is it received?
- How it is paid for?
- Where is the payment information stored in your systems?
- What are the payment reconciliation processes?
- Where is the product stored?
- When is it used?
- Why is it needed?
- Who are the suppliers?
- What value-adds or services are provided?
- What happens to the product after its useful life is over?

As we discuss throughout the book, all of this information is necessary to properly perform Strategic Sourcing, to ensure the most efficient processes and tools are utilized, and ultimately to implement and maintain the final program developed through the process.

OBJECTIVITY

Strategic Sourcing allows organizations to change the way they manage indirect spend, shifting it from a series of one-off purchases to a more coordinated effort with checks, balances, and objectivity to justify costs and requirements. Historically, indirect purchases and spend for most organizations were managed by one or many individuals, with little oversight from management and no requirement to justify their selection of suppliers. Strategic Sourcing provides a

process to identify the true requirements of the organization (rather than those of the individual(s) managing the spend) and to identify suppliers and price points that appropriately meet those requirements. The process is performed in such a way that requirements are identified well ahead of supplier identification, and stakeholders agree to those requirements before exploring alternatives to the existing arrangement.

PROJECT MANAGEMENT TOOL

Finally, a well-designed Strategic Sourcing process becomes a project management tool that can ensure engagements will not end in failure due to scope creep or lack of clear paths forward and that those working on the project will make the most efficient possible use of their time and resources. Attempting to reduce costs without a formalized Strategic Sourcing process can easily end in frustration, as roles are not clearly laid out between team members, steps are not identified, and timelines are not set.

As discussed throughout this book, even organizations that employ a strong Strategic Sourcing process will face many challenges, and teams can easily get bogged down in noncritical details or fail to reach consensus at critical points. The process in itself includes steps that can be integrated into a comprehensive project plan to avoid convoluted outcomes.

The Strategic Sourcing process has six basic steps:

1. Data Collection and Spend Analysis
2. Research
3. The RFx Process (requesting information, quotes, and proposals from suppliers)
4. Negotiations
5. Contracting
6. Implementation and Continuous Improvement

Our goal is to help you navigate through specific activities that most sourcing books fail to cover—dealing with and effectively utilizing internal constituents, motivating the supplier marketplace, and gathering the information required to make informed decisions during each step of the process.

Data Collection and Spend Analysis

Once you identify the need for Strategic Sourcing, the next step is collecting and analyzing spend data. The purpose is twofold. First, you need this data to determine where you should focus your efforts. Your resources are more than likely limited, and it will not be possible to immediately reduce costs across all of your organization's spend areas. You need to identify areas of opportunity and develop a project road map to provide context and timelines for your efforts.

Second, you need these data to determine both the quantitative and qualitative requirements associated with a particular spend category. When we discuss the quantitative aspects, we are referring to current price points, discounts, payment and freight terms, and other costs associated with a particular area of spend or specific suppliers. Qualitative requirements refer to the quality

and services tied to these costs. The current suppliers were more than likely chosen based not just on price, but other value-added considerations as well, and these factors need to be understood and considered. The quantitative baseline and qualitative requirements become the launching pad for the rest of the engagement, which makes it critical not just to identify them, but also to make sure they are agreed on by other interested parties within your organization before moving to the next step.

Research

The research phase provides context for the categories you are sourcing. The purpose of research is to develop or refine your sourcing strategy by determining what competition exists in the marketplace. This entails identifying any available alternative products, services, or processes and whether or not current market conditions make it a good or bad time to go to market.

The RFX Process (Requesting Information, Quotes, and Proposals from Suppliers)

During the RFX phase, you will execute the sourcing strategy that you developed during the Data Collection and Research phases. In all likelihood, this will include requesting proposals or quotes from alternate suppliers or performing a reverse auction. Depending on market conditions, the competitive landscape, and how the product or service fits into your overall business strategy, however, it could also mean focusing on other cost reduction strategies that do not involve bidding out the business. During the RFX stage of Strategic Sourcing, you will also evaluate the proposals and other information submitted by suppliers to determine both their quantitative (cost savings) and the qualitative (service/value-add) benefits. This culminates in an objective grading or scorecarding process.

Negotiations

Once you've received, refined, and analyzed the initial proposals, you will move into the Negotiation phase of Strategic Sourcing. At this stage, you will develop target price points for the products or services you buy, identify preferred suppliers (incumbents or alternates), and request that suppliers meet the established targets in order to win your business. Chapter 6 provides strategies for identifying price targets and leveraging multiple bidders against one another.

As discussed in Chapter 6, organizations should not view Negotiations as separate from the rest of the Strategic Sourcing process. Even thinking of it as a distinct "phase" can be misleading. Some form of negotiations should be taking place with the supplier community throughout the Strategic Sourcing process.

Contracting

Once you've selected the final supplier (or suppliers), your next step is to award the business. The Contracting phase converts the business terms you agreed to during the sourcing phase into a legally binding document that details the rules of engagement between the customer (you) and the supplier. The Contracting phase does not necessarily end with a signed contract. It could result in a pricing agreement with agreed-to terms or a simple purchase order.

Implementation and Continuous Improvement

Often overlooked, Implementation and Continuous Improvement ensure that the work performed throughout the Strategic Sourcing process pays off for years to come. Simply entering into an agreement with a preferred supplier does not result in cost savings. You need to ensure end users and stakeholders adhere to agreed-upon terms and crack down on maverick purchasing. You need to track savings to ensure the supplier is holding up its end of the bargain (price) and your organization is holding up its own end (volume). This means rolling the agreement out internally, reviewing invoiced pricing as well as other internal documentation to ensure internal customers are not buying off-contract, and requesting credits for improper billings—and that's just the start.

IN SUMMARY

Part One of this book covers each of the steps in the Strategic Sourcing process in great detail. While some of the challenges discussed may not apply to your organization, we have taken care to use examples we find in many of the organizations we work with, regardless of size, industry, or type of project.

While the Strategic Sourcing process on its own can produce cost savings, working to optimize your results requires reflecting on the steps in the process and determining the best way to customize those steps for your organization. Developing cost-savings strategies, delving into market research, and negotiating with both internal stakeholders and external suppliers requires a highly creative approach—it is not all analytics. Applying Strategic Sourcing techniques to indirect spend categories can be a challenging endeavor; however, for organizations looking to cut costs or enhance profitability, these spend areas can provide a wealth of untapped savings opportunities.

