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STRATEGIC SOURCING

STRATEGIC SOURCING

Strategic Sourcing
- A way Forward

- ***What is STRATEGIC SOURCING ?***

It is a methodology used by Institutions

in a systematic and continuous manner,

Re-evaluating and Improving the

Purchasing Activity.

Strategic Sourcing
- A way Forward

Features of Strategic Sourcing :

Strategic Sourcing is an important link in Supply chain management

Strategic sourcing intelligently brings the Small & Medium Enterprise Suppliers into the pool of supply Base and effectively Extracts better Quality and Service.

Strategic Sourcing encompasses the overall requirement of Cost , Quality , Delivery thro' disciplined approach.

Strategic Sourcing
- A way Forward

Features of Strategic Sourcing : (contd ..)

- It has a Long Term Perspective
- Sourcing is from Identified Suppliers
- It involves Development of Suppliers and make them dedicated
- It Improves Buyer / Seller Relationship
- Minimizes the Risk of non-performance
- Important in a Make or Buy Decision

Strategic Sourcing

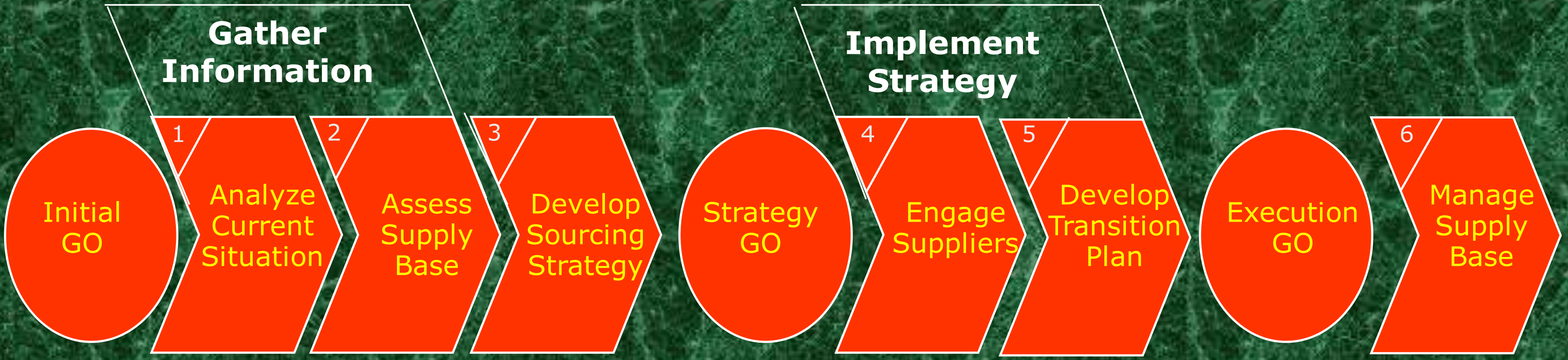
- ✓ STRATEGIC SOURCING is a methodology to maximize the value of an organization's spending power for goods and services, relying on information about previous spending, the suppliers you are doing business with, and the number and types of procurement transactions you have.
- ✓ STRATEGIC SOURCING drives down costs on goods and services, ensures that the taxpayer gets true "market-based" prices, and empowers procurement professionals in the with enhanced capabilities in dealing with suppliers, ensuring that savings continue into the future.
- X STRATEGIC SOURCING IS NOT outsourcing, is not moving contracts from in-state suppliers to large national chains, is not replacing state employees and is not putting the public at any financial risk.

Sourcing

Strategic

Tactical

Strategic Sourcing



Procurement

STRATEGIC SOURCING PROCESS

- Conduct an internal assessment
  - Spend categories: each has common characteristics such as raw materials, customized items, standardized items, and services
  - Important to understand the spend category, to identify the users, stakeholders, or consumers of the category
- Assess the market
  - Porter's five competitive forces model is a good starting point to understand the current market situation

Strategic Sourcing
- A way Forward

Strategic Sourcing
- A way Forward

Basic steps involved in Strategic Sourcing are:

1

- ***Assess the current spend*** **What is bought where ?**

Create an extensive profile of the current buying practices .

Each business group should be mapped , the product & services it buys , the vendors being used , the logistics arrangements etc should be studied in detail.

Use methods of Internal meetings, interviews , accounting Information , supplier visits and set the priorities.

Bench mark the information on cost , quality , delivery and product parameters.

Analyze Spend

Analyze Spend

<u>Buyer's View</u>

- What are we buying across divisions?
- How many suppliers do we use?
- How does pricing compare across divisions?
- Can we consolidate our spend by reducing suppliers and obtain better pricing?

<u>Tools</u>
Spend Analysis

<u>Opportunity</u>

➔ Even though companies are looking to consolidate suppliers, many are also looking to increase diversity spending

Strategic Sourcing
- A way Forward

Basic steps involved in Strategic Sourcing are:

2
- ***Assess the Supply Market*** **Who Offers what ?**

Survey the market to understand who offers what ?

Each business group need to have different set of Supply Group .

External surveys, Market meetings, Professional Associations are the best methods to collect data on Market Conditions.

Analyze Market

Analyze Market

Buyer's View

- What are the conditions of the specific market?
  - Rising input costs, capacity constraints, barriers to entry, etc.
- Who makes up the supply base?
  - Many players, dominant players?
- Are there new products, services or suppliers entering the market?
- Are there diverse suppliers?

Tools

Internet research
Supplier Diversity team
Benchmarking (Collecting Data)

Opportunity

→ It is often difficult for corporations to determine whether there are diverse suppliers available

- Register your certification and participate in match-making events
- Some categories have fewer diverse suppliers – which creates more opportunities

→ Don't compete on price alone. Bring new products, services and solutions that other suppliers don't offer

Strategic Sourcing
- A way Forward

Basic steps involved in Strategic Sourcing are:

3 • ***Create the Product group*** — **What is Required & what is the Specification ?**

The most important task in Strategic sourcing is to identify
What is required and what is the specification of product?

In most of the companies the product would be over specified and
Will be paying for excess spec.

Identify each product group and decide on the specification
requirement:

Ask the following questions:

Are specifications for this product too high or low?
Are we buying features we don't use?
What do users value?
What are the costs and benefits associated with features/services?
What would happen if a service/feature was removed?

Identify Internal Requirements

Identify Requirements

<u>Buyer's View</u>

- What are the product and service requirements of the users?
  - Quality requirements
  - Product specifications
  - Service performance expectations
- Are requirements different across divisions?
  - Look for harmonization opportunities

<u>Tools</u>

Specifications
Surveys
Interviews

<u>Opportunity</u>

➔ Fully understand the client requirements fully so you can assess your capability to deliver them

- Incumbents have a better opportunity to understand client requirements

➔ Develop creative solutions for client requirements

- There is more to the sourcing process than just selecting the lowest price

➔ Influence how customers define their requirements

Strategic Sourcing
- A way Forward

Basic steps involved in Strategic Sourcing are:

4

- ***Identify Suppliers and Create Sourcing Strategy*** — **Who is suitable ? What are the different strategies to use ?**

Identify the supplier group from the Market information and the Suitability .

Each Product Group is to be separately handled as the supplier Group and behavior differs .

Each Supply group has its own strength and weaknesses.

Different Strategies are used for different Supply Group.

Develop Strategy

Develop Strategy

Buyer's View

- Based on the internal requirements and the dynamics of the industry, determine negotiating strategy
  - Negotiate with current supplier(s)
  - Bring in new suppliers
  - Go out to bid through:
    - Reverse Auction
    - Traditional RFI, RFP, RFQ

Tools

eSourcing tools
Cross-functional teams
Project Management

Opportunity

→ Companies are more likely to open up bids if they know there are multiple capable suppliers
  - Make your presence and your abilities known

→ If you are the incumbent, maintain contact throughout the strategy development

→ Develop capability to be successful regardless of strategy

→ Maintain contact with Supplier Diversity

Strategic Sourcing
- A way Forward

Basic steps involved in Strategic Sourcing are:

5 • ***Negotiate & Finalise***

What are the Supply conditions ?
What are deliverables ?

Once Supply group is identified , Efforts to be put to understand their capabilities and negotiations on Commercial starts

Finalise the terms of contract without any ambiguity and design the method of follow up.

Manage Negotiations

Manage Negotiation

Buyer's View

- Develop key criteria for evaluating proposals based on internal requirements
- Initiate negotiations under chosen strategy
- Compare and rank results based on key criteria

Tools

Online RFX
Weights/scoring
Standard templates
Reverse Auction

Opportunity

→ Provide value beyond traditional unit price reductions:
  - Creating unique solutions
  - Innovation - new products and services that provide better quality and lower costs
  - Standardization
  - Usage/Inventory Reduction
  - Cycle Time Reduction

→ Embrace eSourcing through online RFP and auction participation

→ Provide options like partnering with another supplier to increase capabilities and capacity

Award & Contract

Award & Contract

Buyer's View

- Based on results, determine who the best overall supplier(s)
  - Often a cross-functional team decision
- Finalize specific contract terms and conditions with suppliers
  - Involve buyer, finance and legal

Opportunity

→ Appeal to all stakeholders

- Client category teams will be weighing price reductions with quality of product/ service and supplier diversity goals

→ READ and UNDERSTAND the terms and conditions

→ Ensure you are not signing "bad" business

Tools

Automated weights/scoring
Online contract management
Cross-functional teams

Strategic Sourcing
- A way Forward

Basic steps involved in Strategic Sourcing are:

6

- ***Implementation and Assessment***

What is the command struture ?
What are the assessment points and frequency ?

A well developed command structure is to be put in place to measure the efficiency of the system.

Frequency of assessment is decided between both parties and deviations recorded.

A feedback mechanism is developed to meet the requirement In all parameters.

Implement Strategy

Implement Strategy

Buyer's View

- Determine how contract will be rolled out
  - Change management strategy
- Identify and track performance metrics
- Communicate value to stakeholders

Tools

Supplier Performance
Supplier Portals
Spend/Diversity Reporting

Opportunity

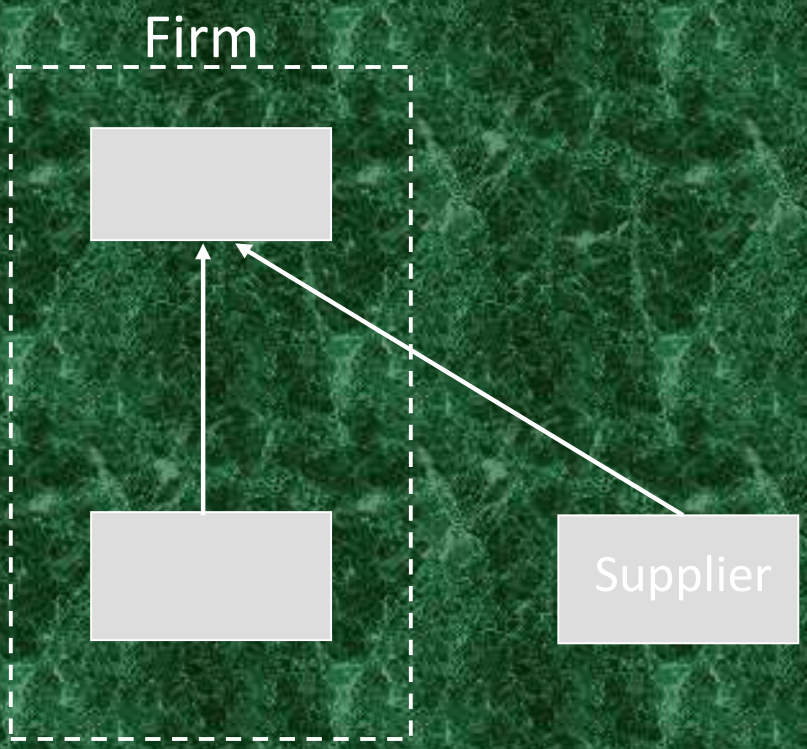
- ➔ Help companies to track their diversity spending by:
  - Providing proof of certification and recertifying each year
  - Confirming sales amounts with each division
- ➔ Ensure quality and price performance measures are met on a continuous basis
- ➔ Meet technology requirements
- ➔ Provide recommendations for process improvements or cost reductions

Outsourcing

- Sourcing
  - selection of suppliers
- Outsourcing
  - purchase of goods and services from an outside supplier
- Core competencies
  - what a company does best
- Single sourcing
  - a company purchases goods and services from only a few (or one) suppliers

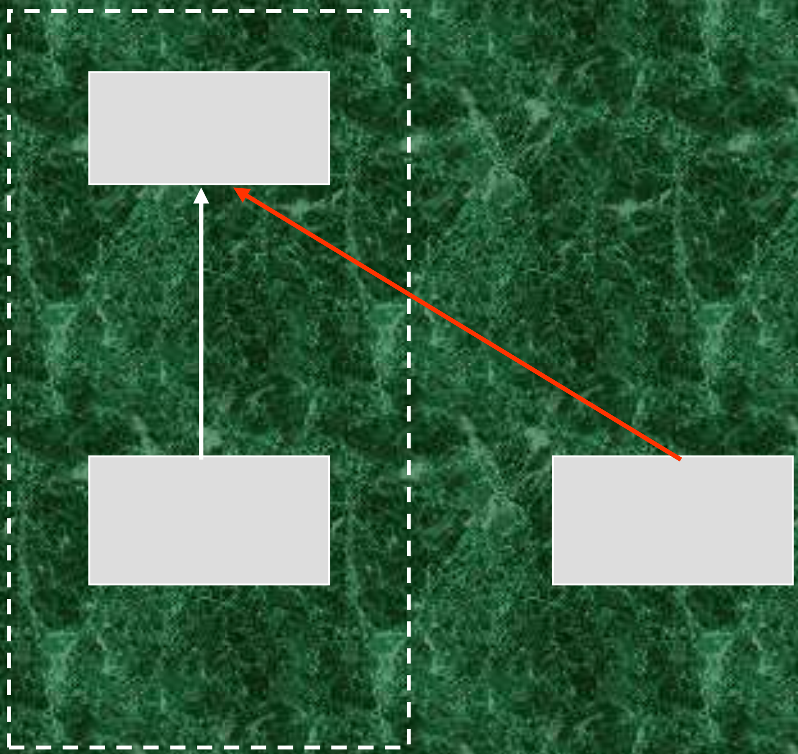
Outsourcing

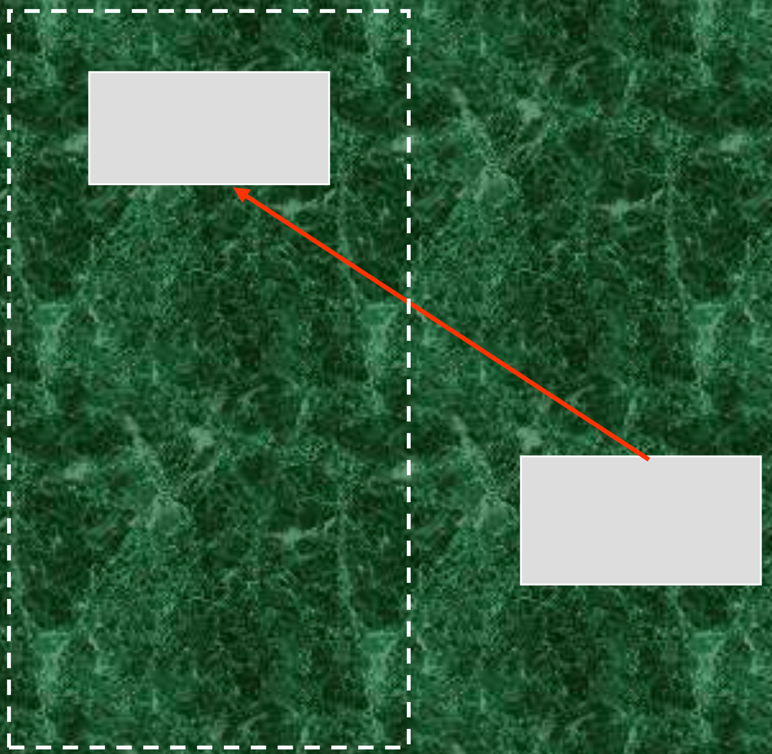
Outsourcing: moving some of the firms internal activities and decisions to outside providers



Question: When should the firm outsource activities?

Outsourcing

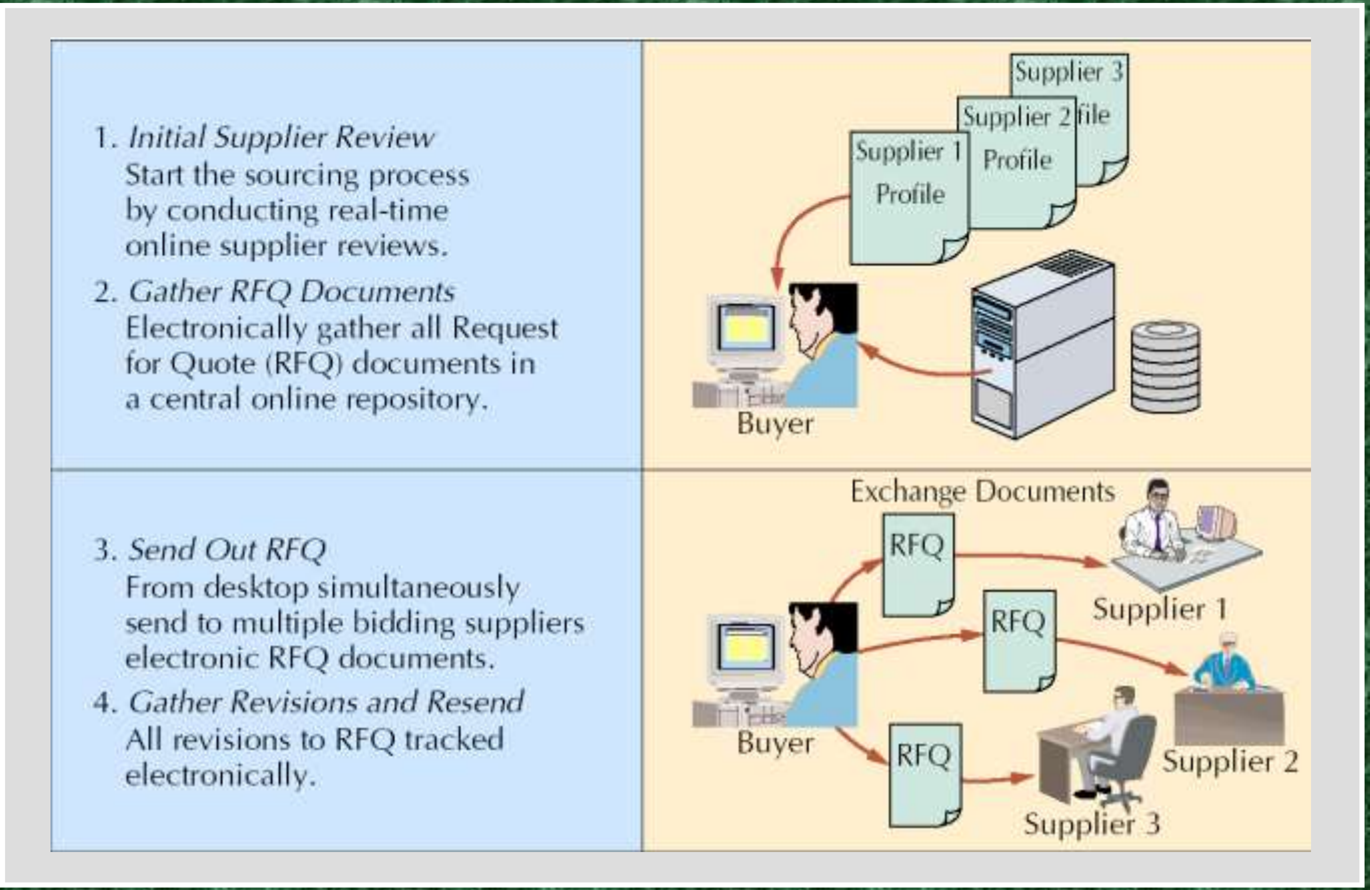




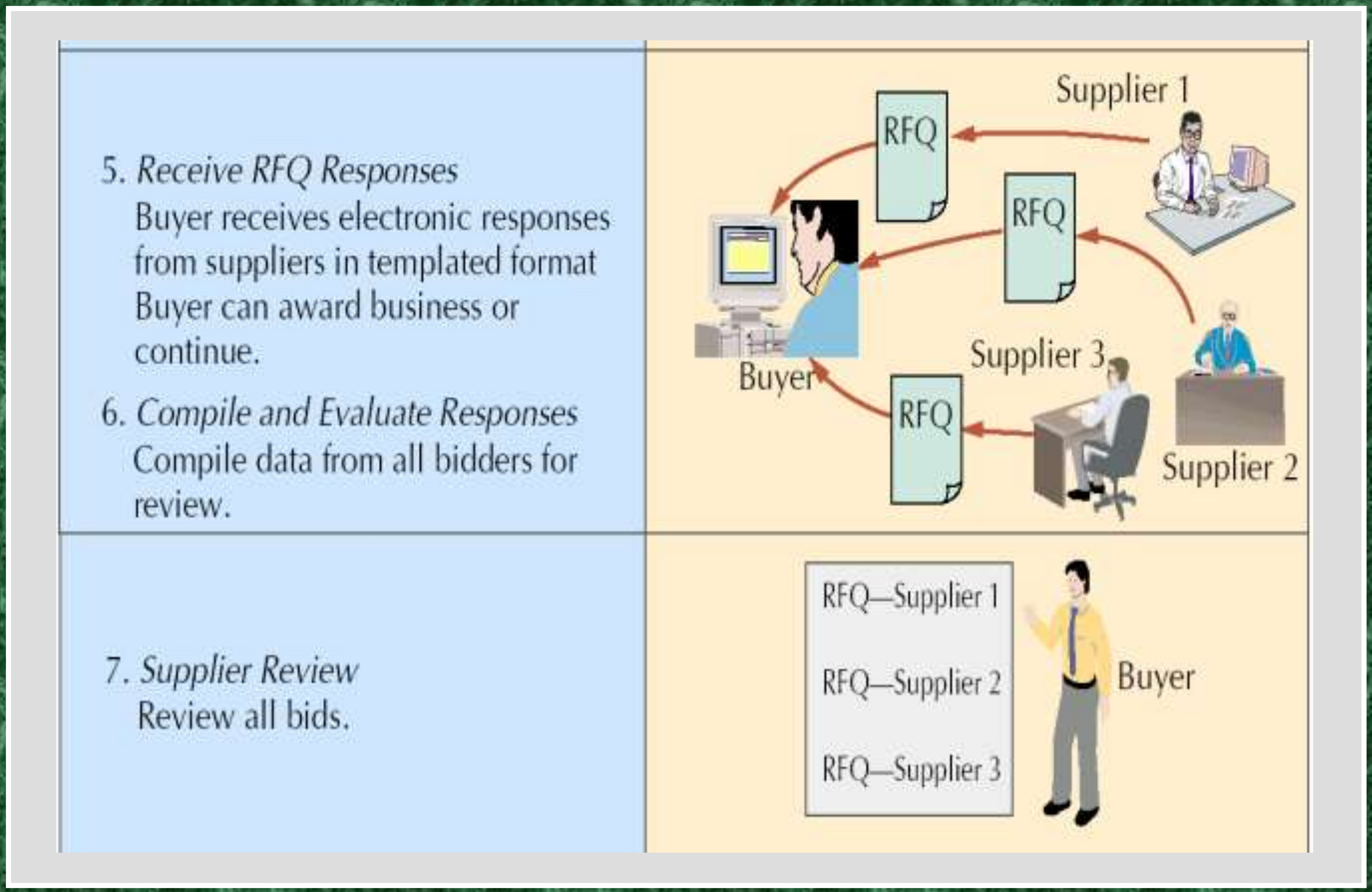
A firm may outsource some of its activities…

… or the whole of it!

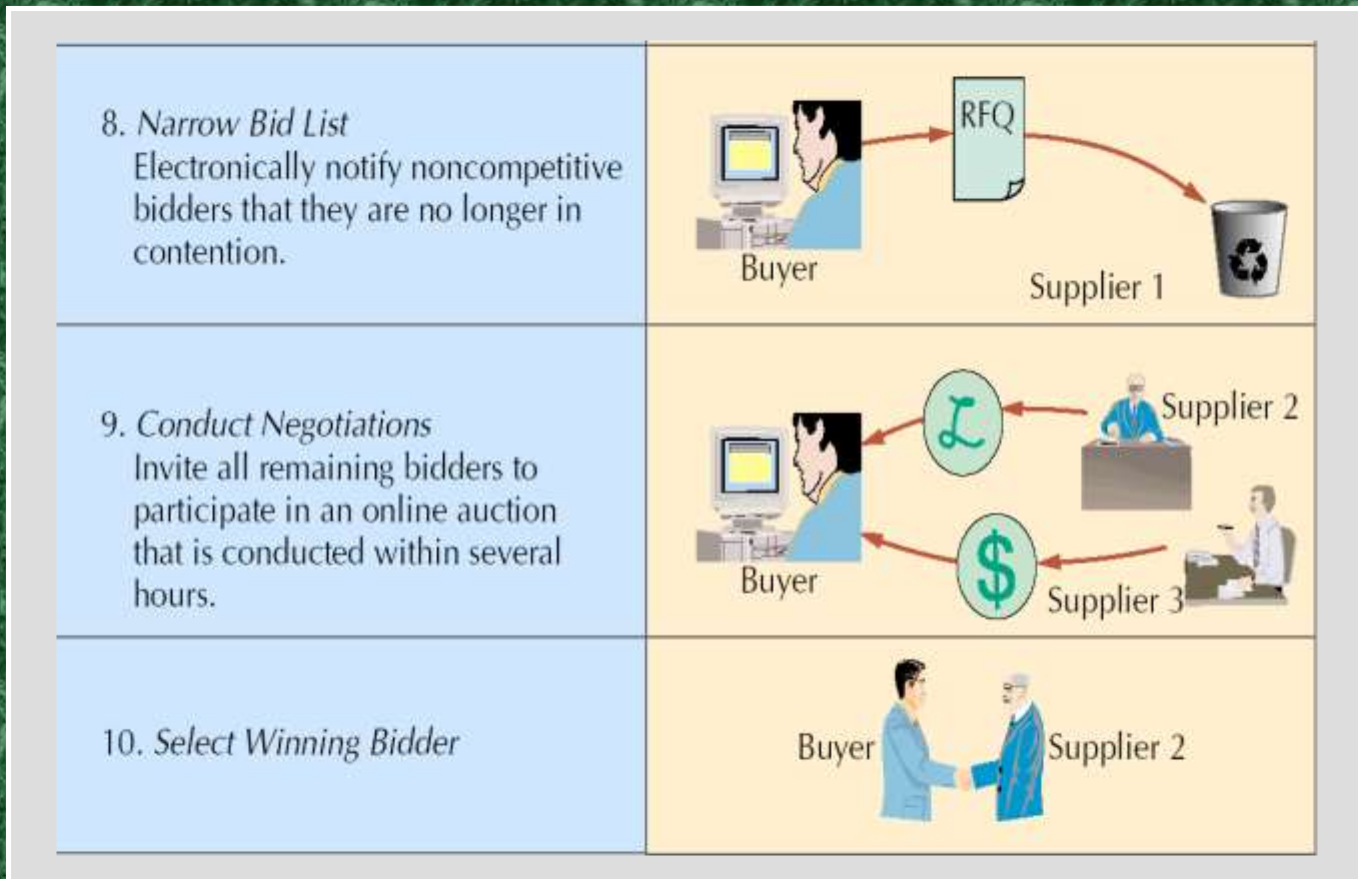
Online Sourcing/ Procurement Process



Online Sourcing/ Procurement Process (cont.)



Online Sourcing/ Procurement Process (cont.)



Examples of outsourcing

- Toshiba has outsourced manufacturing to Solectron
- GM has outsourced its interior design to Delphi
- Many firms outsource problem solving to McKinsey & Co.
- Advertising is often outsourced completely.
- Many companies outsource logistics and transportation.

Why do firms outsource?

- Organizational reasons
  - Focus on service
  - Focus on core capabilities
  - Transform the organization
  - Increase flexibility

- Operational reasons
  - Improve performance (quality, productivity, etc.)
  - Obtain expertise, skill, and technology
  - Risk management

Why do firms outsource?

- Financial reasons

  - Transfer assets to the outsourcing partner.

  - Free up resources for investment in other purposes.

- Cost driven reasons

  - Transform fixed costs into variable costs.

  - Reduce costs through outsourcing partner efficiencies.

- Revenue driven reasons

  - Expand and grow with the help of another organization.

  - Obtain access to outsourcing partner’s network.

Two Main Reasons for Outsourcing

- **Dependency on capacity**
  - Firm has the knowledge and the skills required to produce the component
  - For various reasons decides to outsource
- **Dependency on knowledge**
  - Firm does not have the people, skills, and knowledge required to produce the component
  - Outsources in order to have access to these capabilities.

Reasons to Outsource

- Improve the business focus
- Improve service level
- Access to larger capabilities
- Share risks
- Accelerate benefits of re-engineering
- Replace outdated systems
- Reduce or control costs
  - Provide a cash infusion
  - Make capital funds available
  - Free non capital resources

WHAT IS OUTSOURCED?

- Advertising
- Architecture/Engineering
- Audio Visual
- Asset Repair
- Communications
- Computer systems support
- Construction
- Customs Brokerage
- Environmental
- Facilities Management
- Fleet Management
- Food Service
- Fork Truck Repair
- Graphic Arts
- Hearing Testing
- Human Resources Internal Audit
- Inventory Management
- Investment Recovery
- Janitorial/Custodial
- Laboratory Services
- Legal
- Logistics
- Mailroom
- Management Information Systems
- Manufacturing Engineering
- Manufacturing -- Subassembly
- Marketing
- Medical Order Entry
- Payroll
- Printing
- Purchasing
- Quality Assurance and Control
- Research and Development
- Real Estate
- Records Managment
- Recruiting
- Relocation
- Risk Assessment and Management
- Safety
- Security
- Security Alarm Systems Telecommunications
- Telemarketing Temporary Labor
- Training
- Translation Services
- Travel
- Vehicle Maintenance
- Vending Management
- Vibration Analysis
- Warehousing
- Waste Hauling
- Wellness Programs

Outsourcing Decisions at Toyota

- About 30% of components in-sourced
- Engines:
  - Company has knowledge and capacity
  - 100% of engines are produced internally
- Transmissions
  - Company has the knowledge
  - Designs all the components
  - Depends on its suppliers' capacities
  - 70 % of the components outsourced
- Vehicle electronic systems
  - Designed and produced by Toyota's suppliers.
  - Company has dependency on both capacity and knowledge

Outsourcing Decisions at Toyota

- Toyota seems to vary its outsourcing practice depending on the strategic role of the components and subsystems
  - The more strategically important the component, the smaller the dependency on knowledge or capacity.

Examples of Outsourcing Problems IBM

- PC market entry in 1981
- Outsourced many components to get to market quickly
- 40% market share by 1985 beating Apple as the top PC manufacturer
- Other competitors like Compaq used the same suppliers
  - Suppliers and competitors did not follow
  - IBM market share shrunk to 8% in 1995
    - Behind Compaq's 10% leading share
    - Led to eventual sale of PC business to Lenovo

Growth in Outsourcing

1960	1970	1980	1990	2000
				Maintenance
			Order Entry	Legal
		Mfg.	Payroll	Recruiting
A-E	Janitorial	Logistics	Integrated Supply	Internal Audit
Waste Disposal	Catering	IT	R&D	HR
Security	Medical	Fleet	Temp Labor	Vending Management
	Travel	Relocation		

STRATEGIC SOURCING PROCESS

- Kraljik's portfolio matrix: Kraljik introduced first comprehensive portfolio approach for purchasing and supply management
- Includes the construction of a portfolio matrix that classifies products on the basis of two dimensions: profit impact and supply risk (low and high)
- The result is a 2x2 matrix and a classification in four categories:

- Non-critical items : Require efficient processing, product standardization, order volume and inventory optimalization.
- Leveraged items: Allow the buying company to exploit its full purchasing power, for instance through tendering, target pricing and product substitution
- Bottleneck items: cause significant problems and risks which should be handled by volume insurance, vendor control, security of inventories and backup plans.
- Strategic items: strategic to production or service delivery because of their unique characteristics.

Kraljic's supply matrix

Supply risk	Low profit impact	High profit impact
High	**Bottleneck items** *Supplier's technology critical *Difficult to substitute *Unique requirements	**Strategic items** *Unique specifications *Supplier's technology critical *Difficult to substitute
Low	**Non-critical items** *Many suppliers available *Easy-to-find substitute products	**Leverage items** *Large volume purchases *can find substitutes *many suppliers available

Low — Profit impact — High

STRTEGIC SOURCING PROCESS

- Assess the market (cont.)
  - Original equipment manufacturers (OEMs): an OEM is a company that supplied equipment to other companies to resell or incorporate into another product using the reseller's brand name.
- Collect supplier information : Purchasing and supply must make an assessment of current and potential suppliers.
  - Information sources :
  - On-file records of suppliers used in the past
  - Commodity and supplier directories
  - Online and printed catalogs
  - Purchasing and supply management colleagues
  - Trade magazines
  - Suppliers websites
  - Trade shows and conventions
  - Sales presentations

STRATEGIC SOURCING PROCESS

- Develop the sourcing strategy: a long-range plan for managing the supply of purchased items. Linked to their analysis and goals, and tied to the corporate and supply chain strategies.
  - Supplier certification program : buying firm will make a visit to the supplier's facilities, observing the suppliers' equipment, personnel, facilities, and systems that monitor quality in order to ensure they meet buying firm's specifications and quality standards.
  - Important to have a good understanding of internal dynamics

STRATEGIC SOURCING PROCESS

- Solicit and evaluate bids
  - Verbal quotes: verbal agreement is requested for lower cost, non-critical purchases
  - Request for information (RFI): to informally collect general information on price, design, timing, and/or other terms the firm is interested in obtaining.
  - Request for quote (RFQ): used when purchasing requirements are clear and used in practice for non-critical or leverage buys
  - Request for proposal (RFP): formal, binding request or pricing and is used for the more complex critical and bottleneck purchases.
  - Invitation for bid (IFB): used for more costly purchases. The number of suppliers will be asked to bid (Reverse auction)

FACTORS IN SUPPLIER SELECTION

- Use of evaluation forms
  - Factors to be included:
  - All aspects of quality
  - Supplier certification
  - Capability of supplier’s facilities
  - Physical distribution capabilities
  - Supply chain relationship capabilities
  - Purchasing should make an assessment of each supplier

FACTOR IN SUPPLIER SELECTION

- General performance criteria: whether a supplier's product or service design will meet specific performance criteria
- Quality criteria: purchasing may asses supplier’s quality plan and activities to continually improve its products, services, processes, employees, suppliers
- Delivery criteria : purchasing will asses the ability of supplier’s of getting the product or service to the customer
- Relationship criteria : supply chain relationship quality

NEGOTIATING THE CONTRACT

- Expensive; time-consuming
- Purchasing may use negotiations when ;
- changes need to be made to the initial specifications or drawings, after the original purchase order is issued
- changes occur in the marketplace that affect the quantities needed or prices agreed upon
- no acceptable bids are received
- other problems have arisen during the contracted period
- Importance of cost information
  - Large firms employ cost analysts to analyze the supplier's cost elements and profit margin
  - For specialized items companies may hire a third party with specific knowledge
  - Activity-based cost accounting : tracks both direct and indirect costs to each specific product sold

Supplier Management

Relationship Management	Metrics	Structured Process Improvement

• Define Appropriate Management Structure
• Contract Management
• Issue Resolution
• Market Dynamics - suppliers position relative to market
    • New Products,services & technology
    • New suppliers
    • Competitor evolution
    • Pricing relative to market
• Communication Plan
	• Confirm goals
	• Understand issues & current metrics
	• Create metrics
	• Confirm collection methods
	• Set up review procedure
	• Take action based on metrics
	• Communicate results
		• Set Goals
		• Review progress
		• Communicate results

Dependent on the category and the supplier

Quarterly Business R...

MANAGING THE SUPPLIER RELATIONSHIP

- Importance of managing supplier relationships due to outsourcing
- Arm's length relationship: buying and supplying firms bargain from certain strengths for control of the resources
- Ongoing relationship: buying from a desired supplier on a regular but informal basis
- Partnership/strategic alliance: when the relationship has been more than satisfactory and the two parties see a reason to work together more often and share more information
- A means to build stronger, extensive ties between customers and suppliers to lower costs and improve quality and customer service

MANAGING THE SUPPLIER RELATIONSHIP (CONTD..)

- Partnership/strategic alliance (cont.)
  - Two examples of partnerships
    - Vendor-managed inventory (VMI): A means of optimizing Supply Chain performance in which the manufacturer is responsible for maintaining the distributors inventory levels. The manufacturer has access to the distributors inventory data and is responsible for generating purchase orders.
    - Just-in-time II (JIT II)

MONITORING SUPPLIER PERFORMANACE

- Supplier performance surveys: internal survey may be used to evaluate supplier's performance
  - Supplier scorecard
- Annual supplier meetings: purchasing and supplier representatives may meet annually
- Supplier recognition and awards: the buying organization may give awards to suppliers with a demonstrated high level of performance

SUPPLY MANAGEMENT CHALLENGES

- Difficult to align purchasing objectives with organizational objectives
- The flow of supplies and services may be delayed or interrupted because of weather, strikes, supplier bankruptcy
- Risk of price increases
  - Forward purchase contract: contract to purchase goods at some future date, priced in today's currency value
  - Hedging strategies
  - Ways to reduce risk:
  - Careful supplier selection
  - Use of long-term contracts
  - Developing strategic alliances
  - Use of ongoing supplier performance assessment

Thank you