

A FRAMEWORK FOR MANAGING THE STRATEGIC SOURCING PROCESS

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ABSTRACT

This study presents a methodology for capitalizing on the advantages of centralized purchasing in a multiple facility firm and aligning it with the company's strategic plan. We review the primary strengths and weaknesses of a centralized versus decentralized purchasing paradigm and present reasoning as to why the terminology change to Strategic Sourcing is more descriptive of the process. We then offer an approach to overcome some of the weaknesses of centralized purchasing and transform the process to that of Strategic Sourcing.

BODY

As companies have adopted supply chain initiatives, internal and formally functional departments have been tasked with realignments or restructuring. This requirement is especially apparent in the purchasing effort. Annual expenditures by purchasing departments are estimated in excess of \$2 trillion and are the largest single cost of doing business for a company [12]. The image and status of the purchasing function has been based upon its perceived contribution to corporate performance and to the performance of other departments [4]. Through the 1970's [1] this has often been a second class roll in strategic decision positions [2] even though the purchasing function is responsible for committing 50 to 80 percent of corporate revenues for goods and services [7], [2]. Through their research [4] conclude that purchasing issues and strategies are on par in importance as those traditionally accorded to marketing, finance, or operations. It is recognized that purchasing decisions do impact firm performance and that the acquisition and management of resources impact corporate performance. Recent research is establishing that world-class purchasing practices boost long-term competitiveness and short-term profits [2], [7]. It is the level of capabilities and strategies that determine whether a function is tactical or strategic [4]. Historically, nonpurchasing personnel have viewed the purchasing function as simplistic in roll (support) and not important in corporate performance although recent studies note a shift in corporate practices around the early 1980's [7]. This shift in perception of purchasing from a tactical to one of strategic importance has been documented [20], [12], [1].

At one time, purchasing was viewed as a tactical function within the firm, wherein purchasing managers' chief function was to act as negotiators and trackers of requisitioned items. There are many firms today who still hold that view. Over the past two decades, however, supply management organizations have taken a more prominent role within corporations as the benefits of their efforts have been recognized as driving significant bottom line impact. As has been noted by numerous executives worldwide, the savings dollars generated by driving costs down for materials and services provide a bottom line impact that an increased top line cannot match. This means that for every thousand dollars saved on materials and services, organizations would be required to generate an additional ten thousand dollars of sales, based on a ten percent contribution margin.

As the role of purchasing changed, so did the title used to describe the changing job requirements. The use of purchasing changed to procurement to more fully include a responsibility greater than that of just placing orders. The term “purchasing” fails to describe the activities associated with current materials management requirements [9]. Later the term strategic was added to the title to reflect both the impact on a company’s financial health as well as an alignment of that effort with the company’s competitive priorities. A further evolution of that function has been to the term “Sourcing” and most recently Strategic Sourcing.

Strategic sourcing has been defined as “the process of designing and managing supply networks in line with operational and organizational performance objectives” [14]. A listing of strategic sourcing definitions used in prior research has been compiled by [14], [10]. As past research has focused on different dimensions of strategic sourcing, [10] present a listing of strategic sourcing dimensions identified in prior research. An evolutionary development hierarchy of five stages that a purchasing function might transition through in reaching an integrated and seamless supply chain status was presented by [18].

Strategic sourcing enhances an organization’s performance by “(1) improved ability to achieve strategic goals due to alignment of purchasing strategies with business strategies and (2) improved contribution from purchasing outcomes resulting from increased support that purchasing process receive from being aligned with business strategies” [9]. As companies realign to implement supply chain management practices, strategic sourcing is considered a requirement for the future [3].

Procurement Models

There are two basic models for procurement; centralized and de-centralized. In a de-centralized model, each plant’s or operating entity of the larger company strives to maximize locally its own performance measurement without concern for the larger organization. Decentralized organizations tend to fail to develop higher level skill sets, lack coordination across business units and often cannot challenge purchasing decisions mandated by more powerful functional units like marketing or engineering [2]. In the classic example, each operating entity buys the same item from the same supplier individually, thus incurring repeating acquisition cost and forfeiting any quantity discounts or inventory management schemes.

In a centralized environment, a single element of the organization has control over the purchasing function. Centralized purchasing organizations tend to grow into large bureaucracies [2] with the image of little concern for functional requirements. Benefits of centralization include cost reductions, improvements in the quality and timeliness of services, creation of a high level of buying expertise, streamlining and standardizing the purchasing process, and the benefit from economies of scale. In addition, common items may be warehoused to meet the larger quantity specifications at lower per piece quantity prices in order to have supplies readily available when needed. In an unanticipated result, [4] concluded that as purchasing decisions become more decentralized, the business units performance declines

The major complaint against a centralized system is that it is often perceived as slow when reacting to problems within a particular facility or division. Proponents of decentralization believe that moving responsibility of decisions closer to the source will result in quicker reactions and speedy solutions. A centralized purchasing system also requires one experienced purchasing department, and therefore when initially beginning a centralized system, many purchasing jobs must be cut.

A third type of organization that is gaining acceptance is that of a center-led organization [16]. This organization structure uses a small but high-powered purchasing group as a nucleus and lower level purchasing activities placed within the operating units.

As the number of outsourced items grows, corporate attention focuses on cost and this focus reinforces the idea of centralized sourcing. The use of outsourcing as a strategic issue and risk companies are exposed to should they outsource a core competency was investigated by [15]. They found that few companies out-sourced their procurement function and that most respondents were satisfied with their company's procurement efforts.

Strategic Sourcing Objectives

1. Provide Business Collaboration

When large corporations work to aggregate spend to increase their leverage or buying power, this is generally accomplished by pooling buying from multiple locations and sometimes multiple divisions within a corporation. This is no easy task since most divisions generally like to work independently of one another. With this factor, these divisional entities behave differently and have different needs. If there is an opportunity to aggregate spend and create a solution that fits all areas of the business, one must be able to have all parties agree to the strategy. This process is not simple and requires supply management professionals that are adept at creating a collaborative approach among the parties. The process simply includes bringing influential people within the business groups together to define sourcing strategies. This can be a daunting task if the locations are not geographically near each other or the people have significantly different needs. By using some techniques discussed later, a sourcing person will have more success in this process.

2. Create a disciplined and consistent approach to strategic sourcing.

This is especially important in large organizations or those companies that are involved with governmental procurement contracts which require those contracted with it to follow strict procurement guidelines. The consistency of approach benefits large corporations in many ways. One benefit is to ensure its sourcing agents do not commit the company dollars to suppliers that are not a good fit for the business. This means that suppliers must have a cultural, technological, structural fit that meets the overall objectives of the buying organization. If the supplier does not provide products and services that match the needs of the buying organization, then committing to a long term contract to this supplier will waste important time and financial resources on an ineffective supplier.

The supplying organization must be a cultural fit to the buying organization if the contract is substantial and requires significant resource sharing between companies. Many companies try to do business together only to be bogged down by clashing personalities from all levels of the organizations. An example of this would be if a supply management professional negotiated a two million dollar annual savings to buy office supplies with a supplier but the buying locations would not buy from this new supplier due to service issues or personality clashes between sales and the user communities. While the potential savings are staggering, if the buying organization does not buy from this new source, the savings will not be realized. Finally, if the supplier is not structured to manage the needs of a buying organization, then the buying organization may not be able to meet its basic needs and will not continue to do business.

3. Create Additional Competitive Tension in the Marketplace

A key measure of a sourcing organization's ability to perform well is how they create competitive tension in the marketplace. In other words, does the buying organization have the ability to make those suppliers in the market feel as if the products or services they wish to buy have substantial value to those able to offer them a solution and that there are many willing to participate to "win" the business? When a sourcing organization can effectively drive a feeling among the available suppliers that the business is valuable and needed, then the suppliers will work hard to win the business. Many times this means they will offer improved terms, reduced lead times, additional technical support, and of course lower pricing. Overall, this creates additional value to the buying organization and reduces the overall cost of the products and/or services. Again, this cost savings goes to the bottom line of the buying organization. An example of a creative sourcing organization might be to create a competitive reverse auction when there are only two suppliers bidding for the business. This is difficult given most suppliers are knowledgeable of their competition and should understand there is only one competitor working against them.

4. Increase Overall Savings Contribution to the Organization

The bottom line is that strategic sourcing groups are chartered to drive savings to the corporation by driving down product and services costs. This is a simple concept although the group must be sound with their approach if they will be successful in maximizing the benefits of the actions. Any sourcing person can save money, but only the best can create a buyer supplier relationship that provides the minimum cost for a product or service and derives the greatest value out of the relationship. Sound sourcing processes help facilitate this.

The Transformation Process

An extensive overview of tactical and strategic sourcing has been presented by [13]. They also note that there are distinct differences between tactical and strategic purchasing and that for best results, each has to be managed differently. The importance of strategic fit between supply chain strategies and competitive strategies was presented by [5]. A method for segmentation the supplier base to assist in the identification of tactical and strategic suppliers is presented by [6]. Strategic fit has been discussed strategic management of products or suppliers but not towards the function as a whole [22].

From their research [9] describe a thirteen step process for transitioning from a traditional procurement function to a corporate strategic sourcing perspective. Slaight [19] describes a seven step sourcing process consisting of; Internal assessment, Market assessment, Supplier information, Develop a sourcing strategy, Solicit/evaluate bids, Negotiate/select suppliers and Implement recommendations. Using these steps, the sourcing manager or team, measures and reports results, captures learning from the project and assures compliance. This work addresses itself essentially to a single facility with multiple operating departments. Both perspectives require that the firm first recognize that sourcing/procurement can be a critical business success factor. Virolainen [22] presents a framework for developing an integrated procurement strategy that involves five phases that attempts to integrate corporate strategy with the functional activities.

A survey methodology was used by [17] to assess the impact of Interorganizational Systems (IOS) on sourcing leverage and process efficiency. They found that IOS Breadth significantly impacted Sourcing Leverage. IOS Breadth was measured by the number of suppliers the firm had electronic linkages with and/or the number of suppliers with whom the firm routinely interacted. They further reported that an integrated IOS improves process efficiency. One of the factors useful in measuring the degree of integration of an IOS is Internal Integration. The major thrust

of our paper is to present a methodology for improving both the interaction with suppliers and the degree of information sharing within a multiple facility firm.

Ghodsypour and O'Brien [8] present a model combining linear programming with an analytical hierarchy process for selecting suppliers and determining purchase quantities. We note that it should be relatively easy to incorporate an analytical hierarchy process within the process described in our work. Prior research has cited the potential advantages of a closely linked supply chain process built upon well structured and tiered supplier relationships similar to that of the Japanese Keiretsu relationships. Although this works well for Japanese companies, it is illegal in the United States due to antitrust laws. The question then becomes, "How do we erect an efficient procurement function that supports the company's competitive strategy that also gains competitive advantage through supplier relationships?"

What is missing from the literature is a method, model, or framework that companies can follow and customize to their environment that will help to ensure that tactical needs of decentralized operating units will be provided as purchasing moves to a strategic sourcing perspective to contribute to a corporate competitive strategy. A method to move procurement in this direction is presented in our gateway model.

The Strategic Sourcing Process

The proposed Strategic Sourcing process is a 5-step process that ensures business objectives and targeted benefits are met. Since communication is a key success element, we propose a series of "Gateways" to ensure that all stakeholders are in agreement at certain key times. A second, often overlooked but necessary function of the process, is to ensure that the results of each of the sourcing projects are distributed to the buying locations the corporation.

Step 1. Analyze

The Analyze phase of our sourcing process includes gaining external market knowledge, establishing an internal sourcing team, deep data analysis of past supplier performance, extensive discussions with business people to understand current needs, and segmentation of the supply base. This process may take a significant period of time for a sourcing agent to complete, however, the benefits of understanding the marketplace and competitive forces is tremendous. Because this process may take a significant period of time, sourcing agents may begin this process as early as 6 months prior to creating a formal strategy. We strongly recommend that the organization appoint a Sourcing professional to spearhead this and other steps in the process. The Sourcing professional will begin the process by doing a thorough analysis of external market conditions, supplier performance, and business need, guided by a Market Research checklist. As the process develops, an understanding of opportunity is developed and the need for a collaborative sourcing team is recognized.

Led by the Sourcing professional, the sourcing team is comprised of representatives from across the business organization. Supply Management works with the heads of the business units to nominate the people they want to participate on the sourcing team. Expanding the information previously developed by the Sourcing Professional, the team develops a recommendation on how to proceed with the sourcing process, including the negotiation strategy and expected deliverables from the negotiation. Input by the cross-functional team is one of the most important elements of the sourcing process as having the stakeholder buy-in to strategies help facilitate common goals and increased compliance. Overall, strategies are more likely to be successful if they are created by key stakeholders within the organization.

The Sourcing Professional will review the information and recommendation developed by the Sourcing team with his/her manager and gain agreement on strategy, timing, and expected benefits. This is considered the first Gateway in the process. A Gateway is a scheduled stopping point in the process to ensure that all parties are in agreement with strategies before the project moves forward.

Utilizing a strategic plan template, which is a template that is a synthesis of answers to questions a sourcing team must answer to ensure a thorough investigation of the spend category, the Sourcing professional will document the information and recommendation learned in the Analyze step and will request a Gateway review. To ensure all of the steps have been adequately covered in advance of the Gateway review, the Sourcing professional will utilize an “Analyze Phase Completion Checklist” and will meet with the Sourcing Process Improvement Leader.

Step 2. Recommend

The intent of the Recommend step is approval of the sourcing strategy developed during the Analyze step and a commitment of resources by the right business leaders. The Gateway review should include the vice-president, Corporate Supply Management, and his staff. Normally, it also includes the leaders of the larger business units affected by the specific sourcing initiative.

During the Gateway review the Sourcing team will present market information, supplier segmentation information, and recommendation on negotiation strategy, along with expected deliverables from the effort, using a Strategic Plan template. The Gateway Steering team (comprised of the management team mentioned previously) will ask questions to assess comprehensiveness of the recommendation and will eventually agree to the recommendation. Ensuring the business leaders are at this Gateway meeting increases their understanding of the supplier strategies, and includes a commitment to provide resources to make the process happen.

GATEWAY 1: Flow chart 1 here

Step 3. Select

The intent of the Select step is effective negotiations and selection of the right supplier to fulfill business needs. In this step the sourcing team communicates the sourcing strategy more broadly throughout the business, and stresses the need for the business to speak with one voice. Special effort is taken to reduce the opportunities for a supplier to use contacts within the firm to gain inside information and reduce market competition. Instead, the team identifies disciplined communication strategies for suppliers to ensure they are aware of the need to ‘give their best offer’ or potentially lose the business. This supports the increased competitive tension aspect of the sourcing process. In some cases, the business has a valued partner which they are working closely with. In this case, the buying organization must instill a desire to provide the lowest cost option otherwise a potential for loss of business could result. This is a complicated process.

At the appropriate time, supplier negotiations occur, either using the appropriate negotiation process, including face to face negotiations or reverse auctions. The Sourcing team negotiates with the supplier to fulfill the deliverable requirement agreed to with the Gateway Steering Team.

After the negotiations are concluded, the Sourcing professional requests another Gateway review with the steering team, where the results of the negotiation are compared with the expected deliverables from the Recommendation step. If the Steering Team is satisfied that the appropriate

negotiations have been completed, the Sourcing team is given approval to agree to the negotiations and select the supplier.

GATEWAY 2: Flow chart 2 here

Step 4. Implement

The intent of the Implement step is to award business to the selected supplier, develop a contract (using a uniform standard contract template) and begin the implementation plan. Detailed communications about the completion of the sourcing Select step are delivered across the organization. Suppliers assist in the development of the implementation plan. The team identifies barriers to any implementation and develops plans to overcome the barriers.

Compliance to the new agreement is developed and sustained by use of specialized reporting done out of the data warehouse. Savings arising from the sourcing project are reviewed, validated and reported by Finance.

Step 5. Manage

GATEWAY 3: Flow chart 3 here

The intent of the Manage step is to ensure continued supplier performance. The sourcing professional will monitor supplier performance, ensure all contract deliverables are met, host a regular business review with supplier management, be aware of the financial stability of the supplier, and will explore any new appropriate offerings in the marketplace. Output from the Manage step is input for the Analyze step as the process is re-created near contract completion.

CONCLUSIONS

The strategic sourcing process is managed uniquely within each company although many include some of the basic elements included in this study. Through a review of the purchasing and supply chain literature, we have attempted to present a method or framework that allows for companies to gain the benefits of a centralized procurement model, supplier reduction, volume reduction, spend aggregation, and yet avoid the perceived disadvantages of a centralized procurement model, slow response to functional units. Some of the key elements of this process are process discipline, stakeholder participation and support, and a project manager capable of creating a collaborative environment. With these key elements, an organization can drive considerable cost savings initiatives throughout the organization.

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Appendix A

Gateway Model;





