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A Creative Approach to Strategic Sourcing and Supplier Engagement

Purchasing managers and strategic sourcing professionals often follow a consistent methodology when planning and conducting a sourcing initiative. Having a process provides a framework that, when correctly applied, can produce sustainable savings in a consistent manner. Creativity in the application of the strategic sourcing process will have a dramatic effect on the results achieved, regardless of whether a seven step sourcing process or a customized internal sourcing process is used.

In order to best optimize the results of a strategic sourcing initiative, there are several questions that should be answered at the project's initiation:

- How can we improve our understanding of the sourcing process?
- What are the *X-factors* that arise when executing a sourcing project?
- What other considerations should the sourcing professional account for while administering the strategy?

Two frequently overlooked components of any strategic sourcing methodology involve the collection of innovative market information and the supplier approach strategy. Often during the course of a strategic sourcing initiative, new product developments, alternate technologies, and shifts in spend patterns present themselves. A Creative Sourcing™ process is dynamic, so the sourcing professional may need to implement a revised or new strategy to adapt to changing conditions and events.

The sourcing professional should consider how and when to approach both incumbent and alternate suppliers during the actual sourcing phase. Imaginative strategies and open communication will help motivate suppliers to present the best proposal and optimize the total project results.

Project Team and the Internal Benchmark

The benchmark will set the foundation upon which the sourcing initiative will be built and measured. Before the benchmark can be established, the project team must be assembled. The project executive or sponsor should identify the best resources both internally and externally to work on the initiative. The project sponsor must ask the following questions to begin to develop the team:

- Who within the core sourcing group is best equipped to work on this initiative?
- Who can be enlisted from other departments within the company to participate in the cross-functional team?
- Should additional resources be recruited from outside the company? (either consultants or business partners)

- What is the cost of applying these resources?

Determining the best, most cost effective resources will help to ensure that the ensuing process is a focused, collaborative effort that yields tangible results. Once the project team has been selected, the key decision makers must be identified and introduced to the project team. Establishing the roles and responsibilities for each team member at the start of the initiative creates a defined structure to help the process move quickly and effectively.

Filter out subjective thinking prior to beginning the initiative. The sourcing professional should recognize that internal biases may, and usually do, exist. These biases could include anything from previous negative experience with the process itself, former suppliers, or may simply be the opinions of individuals that are subjective and unrelated to the initiative at hand. In some cases, the sourcing professional themselves may hold the biases. In these situations, the professional must make other members of the team aware of their bias, so that other team members can help make the process objective rather than subjective.

Prior established relationships with incumbent suppliers should be approached in an objective manner. Revisit past decisions from previous sourcing initiatives and determine what new opportunities may exist this time around. If possible, approach the sourcing project as if it were for a new product in the developmental stage. Start the initiative with a clean, objective slate.

Lastly, the project team's motivation should be evaluated at this stage of the project.

- Are there incentives or bonuses available relative to the success of the initiative?
- Are high level executives and management supportive of the initiative?
- Does the team have the sponsorship and ability to drive change throughout the organization?

Positive reinforcement and the idea that the initiative is a highly visible, true team effort is an invaluable component of a successful outcome. Failure to have all of these components in place at the benchmark stage will ensure a mediocre result.

The internal benchmark for recurring purchases should objectively define what has been done in the past (qualitatively and quantitatively) and identify the implications to the spend category of future strategic plans. At a minimum the benchmark should identify what is being sourced, from whom, pricing structure, service level requirements and future considerations.

For new spends, the benchmark should identify the purpose of the expenditure and have some preliminary proposals or cost estimates as a basis for the spend category.

At the conclusion of each sourcing event, the recommended course of action should be compared to the benchmark and all of the quantitative, qualitative and cost avoidance results should be measured and reported.

Market Assessment

Traditionally, the next step in the strategic sourcing initiative is to conduct a Market Assessment. Here the sourcing team must look at a number of factors in determining the status of the marketplace.

First, ask the question “Is now the right time to source?” The team must look at market conditions to determine the feasibility of a sourcing initiative.

- Recent market events such as natural disasters that cause supply disruptions may hinder the efforts of both domestic and global sourcing. Commodity areas can be highly affected by these events. Suppliers may be implementing Force Majeure clauses contained in contracts.
- Currency fluctuations can effect whether offshore sourcing is an attractive option at this time.
- What are the competitors doing? Have competitors recently hit the market in search of price relief or to try to lock up supply?
- Have new technologies, regulations, policies recently changed the marketplace?

If now is not the optimum time to source, when will the initiative be more successful? When timing is poor, your best strategy may be to go for a contract extension at existing prices. A full sourcing event can be conducted at a later date when market forces are more favorable.

Review market price trending in the product area you are planning to source. Have prices increased or decreased over the past 12 months? Is supply tight or is product abundant? In many product areas, there are several moving parts that need to be tracked. Indexed-based commodities and products are moving targets that require ongoing attention to monitor market movements. Investigate not only the history of the market, but research what the experts of analysts of that market are predicting. A minimal financial investment in this data now can potentially reward the project with significantly higher savings in the future.

Assess any new developments in the market. Are there emergent technologies that will give your company a competitive advantage? Is the marketplace moving toward an innovative solution that may provide a cost advantage in the near future? Buying at the end of a product life cycle could cause the organization to overpay for outdated technology. Research and attention to these factors will help avoid a potentially costly mistake.

Collect Supplier Information

After the initial market assessment, look to qualify as many suppliers as possible. Limiting the potential supplier base can only limit the opportunity for a successful initiative. The larger the potential supplier base, the greater the chance to identify innovative opportunity and increased value.

Begin collecting information on the potential supplier base. The main focus should be to cast a wide net into the market. Identify the supplier base of competitors. Consider foreign suppliers even if there is no intent to import. Foreign suppliers may be willing to establish domestic importers or distributors if your volumes are high enough or they intend to establish themselves in the

marketplace. Their motivation will be to establish a foothold in a new market. This can potentially be used as an advantage in negotiations.

After developing the first pass supplier list, establish contact with each one to gauge their interest and viability in this initiative. Does this supplier have potential to become a part of my existing supply base? Are they able to provide the required service and volume commitments? If suppliers do not meet these qualifications, ask who they would recommend as a potential participant, or how they would suggest fulfilling the requirement. Be creative in finding alternate suppliers. Networking with fringe suppliers in this initiative can foster healthy relationships that may benefit a future project.

At this stage, most traditional sourcing processes utilize an RFI process to develop a short list of suppliers. However, it is too early in the sourcing cycle to disqualify suppliers that want to participate. Disqualifying suppliers at this time may cause you to miss a creative or innovative idea that may lead to the modification of the initial requirement or specification. Potential suppliers must be thought of as part of the sourcing team, and engaging as many as possible will help to develop the most innovative and cost effective strategy for the sourcing initiative.

Suppliers generally will not invest resources in competing for business that they have no chance of winning. If they seem to be an outlier, inquire about their interest and actively attempt to engage them in the process. Suppliers may hold some of the same biases that the internal team held at the initiation of the sourcing project. Attempt to identify and overcome the biases of the supplier. Any given supplier may hold the key to a creative solution that can help achieve superior results.

Develop Sourcing Strategy

The sourcing strategy should be developed and approached as a fluid, evolving process. Fine tuning of the sourcing strategy will be required as the team interacts with the potential supplier base through implementation and measuring results. Take note, however, that as market conditions fluctuate, or the goals of the organization change, the sourcing strategy may need to be revisited. A common mistake of strategic sourcing initiatives is to get stuck on the initial process and strategy regardless of a complex or moving market. Always be prepared to revisit the strategy and reincorporate ideas that may have been overlooked in a prior strategy.

One of the first goals of developing the sourcing strategy is to separate the requirements into minimum needs and maximum desires. Minimum needs are those aspects of a potential supplier agreement that must be met (i.e. expedited shipping, company logo branding, specific payment options). If a supplier is unable to meet these basic requirements but can provide some unique value, then consider partnering them with a supplier that can meet the minimum requirements. Maximum desires are bonus features of an agreement that will prove valuable to the company, but are not “deal breakers”. Establishing these criteria will and communicating them to the supplier will assist in the qualification process.

Listen to supplier concerns and input on the market. Communication with the potential supply base is a key element to any sourcing initiative. Strategic sourcing should be a process that is mutually

beneficial to both the customer and the supplier. Listening to and addressing supplier concerns will be motivating to both parties in the long run. Market information is invaluable to a sourcing endeavor. The wealth of knowledge that can be obtained from suppliers will have a positive impact on the project outcome and the cost-savings potential.

When sourcing a finished product, consider sourcing at the component level. In a case study, a large propane distributor was purchasing propane cylinders fitted with overfill prevention valves from one supplier. A sourcing strategy was developed to source the cylinder and valve as separate items with separate groups of suppliers. As a result of sourcing at the component level, the customer was able to realize significantly higher cost savings than if they sourced the finished product. This case study also shows an example of how creative solutions can increase bottom line savings.

Determine whether a single source or multiple sources is most practical for the product being sourced. While a single source may provide the best cost savings option due to economies of scale, it also limits the customer's ability to rely on other sources of supply as a contingency plan. Is it best for your company to have a sole, competitive source of product? Or would you be better served by forging agreements with multiple suppliers?

Be careful that internal biases do not arise again, such as fear of an internal team member that the new purchasing pattern may develop additional work load for them, or that the logistics and material handling may become too cumbersome. At this stage of the process, the critical objective of the sourcing strategy should be to consider all the opportunities and attempt to identify the value in each one, not to disqualify ideas and opportunities.

Solicit and Evaluate Bids

After identifying the sourcing strategy, it is time to conduct the RFX (RFI, RFP, RFQ, etc.) process. The RFX document should be supplier-friendly. One of the most common complaints of suppliers is that complex static Request for Proposals do not allow them to talk about the benefits, ideas, opportunities, and competitive advantage that they offer, and only allow them to submit a financial response. A straightforward and uncomplicated document will encourage suppliers to participate and allow them to present their most competitive offer. Keep the RFX open-ended. This gives suppliers the freedom to present more creative solutions and introduce more fresh ideas into the process.

Sell to the supplier. Educate the suppliers and market to them the reasons why this business is attractive and valuable. Provide the suppliers' salespeople with the business case that they can take to their management to drive steeper discounts and more value-added services. The more there is to offer, the more aggressive the suppliers will be in trying to win the business.

During the RFX process, open communication is once again a key element. Suppliers will often have questions about the RFX document and its content. These questions need to be addressed so that the suppliers can effectively respond to the RFX. Schedule individual time with each supplier to review the document and ensure that they completely understand the requirements and expectations.

Once the RFX responses are returned, each proposal must be evaluated. Creating a RFX rating matrix can be helpful in determining the value of a proposal. A rating system will allow the organization to objectively recognize both the quantitative and qualitative values of a proposal. The soft dollar value presented by a supplier can be just as important as bottom line cost reduction. The rating matrices will determine who meets the minimum requirements and will prioritize and weight the maximum desires outlined in the proposal.

Following the proposal evaluations and further qualification of suppliers, the core team can develop a negotiation strategy with the preferred participants.

Negotiate With and Select Suppliers

Negotiations with suppliers will begin following the initial bid process. Many sourcing professionals see the negotiation as an emotion filled battle with the supplier. In most negotiations, the best approach is to reduce or altogether remove emotion from the negotiation, and instead rely on a fact-based objective market picture for leverage with suppliers. With the proper market research, a solid business case can be made to the supplier and will drive them to a competitive offer. Look for creative ways to motivate the supplier by making them aware of some of the indirect financial aspects of winning the business, such as capturing a new market or taking business from a primary competitor.

Emotional tools are best used to create healing in a relationship as opposed to negativity. This is also the last opportunity to address any biases that may remain from the beginning of the sourcing process. Use emotional tools to create a need within the supplier to correct some past problems in the process or service. Provide the bidder the opportunity to repair the relationship by providing additional incentives in their offer.

Measure each supplier proposal against your internal benchmark from both qualitative and quantitative aspects. Are there one or more suppliers that stand out from your current relationships? Are the savings or process improvements dramatic enough to warrant a pilot with an alternate supplier? If not, consider using the market information collected to enter into a fact based negotiation with your incumbent suppliers.

Selecting a new supplier has three main considerations: monetary cost of change, political cost of change, and the time frame for change. What are the transitional costs associated with a new supplier? How will this affect established relationships between your organization and the incumbent supplier? How long will it take to implement new ordering processes and software programs? Are there regulatory or governmental issues that need to be addressed? And, most importantly, do we have the ability to drive the change throughout the organization?

Implement Recommendations

The final milestone of the sourcing initiative is to implement the recommended plan of action with the suppliers. The key to successfully rolling out the results of the initiative is to exercise change management control. Effective change management will ensure a smooth transition into the

recommended actions, eliminate encumbrances to new processes, and optimize the results of the project.

The strategic sourcing process should not end at implementation. Performance metrics should be put in place to ensure the positive results of the initiative. Suppliers as well as internal processes should be audited to ensure proper results well after the close of the implementation. Continue to keep suppliers (and even potential suppliers) engaged as the organization grows so that there is always interest from the suppliers in providing the best and most innovative solutions to the organization. Creative Sourcing™ begins and ends with knowledge of the marketplace.

About Source One Management Services, LLC

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