

Getting Started – the basics of organizing a strategic sourcing program



UPS Supply Chain SolutionsSM

Imagine that the CEO just gave you the edict to “find internal sources of value that can translate into bottom line benefits over the next five years.” Because of the company’s growth, you know there are opportunities in procurement that just might deliver what the CEO wants.

...only in the last 15-20 years have companies embraced a more strategic role for procurement.

The fast pace of growth has kept the operations in tactical delivery mode, so much so that the number of transactions, suppliers, databases and staffing counts have ballooned. A quick look at operational data shows fragmented spend characteristics, diverse payment terms and SKU proliferation (see accompanying glossary in Exhibit 2). The organization charts show that procurement staff members are positioned to handle workloads, not manage commodities per se. You believe that a strategic sourcing program would save the company money, improve asset utilization and improve product quality.

So how do you get started? This paper will explore the opportunities and present a recommended approach for developing a strategic sourcing program.

The “fast growth” scenario mentioned above is not the only circumstance where companies find themselves in the tactical mode. Procurement has historically been perceived as non-strategic and a necessary means to ensure that the supply of goods or services is adequate for the demand. This mindset persisted for a long time, and only in the last 15-20 years have companies embraced a more strategic role for procurement. Some characteristics that often indicate sub-optimized procurement include:

- Paper and time-intensive transaction flows
- Large numbers of slightly differing product specifications, e.g., 300 different fasteners
- Significant off-contract spending
- Diverse commodity types supported by a generalist staffing model
- Large number of services and/or products sourced from a fragmented supplier base

Some firms have gained significant competitive advantage by strengthening their procurement practices and policies. The advent of the “Chief Procurement Officer” and “Procurement Centers of Excellence” in some organizations illustrates the strategic intent of those companies that view this area of the supply chain as a critical success factor. The best successes are those that take a long-term view of the initiative by building the proper foundation and executing aggressively over time.

Common Misstep

A very common misstep in organizing a strategic sourcing program relates to the supporting infrastructure – the strategy, process, organization and technology. Firms often get the short-term, quick hits right by consolidating suppliers, reducing SKU counts, and leveraging total spend by category. However, many of these gains erode over time due to the capacity constraints of the existing infrastructure. The technology infrastructure of the procurement operations is usually first on the list of limiting factors. Harnessing technology to automate transactions, organize and retrieve supply chain data and manage scale is critical to enabling the other components of the program.

The organizational infrastructure is also vital to success in the long-run. The organization must transform the staff members into strategic commodity managers, who are concerned about contracts, supplier management and other major issues. Getting out from under the weight of routine transaction processing can be difficult for some companies. This is why changing the business process becomes so important. Streamlining the order-to-pay procurement cycle is a way to free resources, reduce cycle time and improve inventory positions.

Governing the other elements of infrastructure is the procurement strategy. Establishing and linking the objectives to the overall corporate strategy can be a difficult task if the mission is unclear or is changing. Leadership and vision will be required to articulate a procurement strategy that serves the long-term operations.

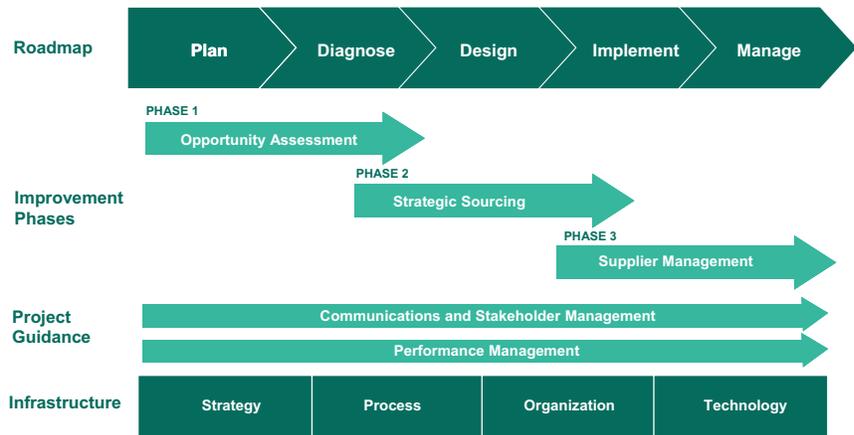
Streamlining the order-to-pay procurement cycle is a way to free resources...

Getting Started

To assist with the development, the strategic sourcing program should include a preceding opportunity assessment phase and be followed by a supplier management phase as depicted in Exhibit 1.

Some of the key tasks in Phase 2 include developing the sourcing strategy.

Exhibit 1: UPS Consulting Procurement Process Improvement Methodology



The reasons for the opportunity assessment are to:

- Charter the project objectives and scope
- Provide a business case for the change effort
- Determine categorization of spend activity
- Benchmark procurement practices against best-in-class practices
- Assess the procurement infrastructure (strategy, process, organization and technology)

The second phase of development (strategic sourcing) builds upon the intelligence gained and objectives set forth in the opportunity assessment. Some of the key tasks in Phase 2 include:

- Determining the business requirements for the overall program
- Designing the organization, including establishment of sourcing teams
- Developing the sourcing strategy
- Designing the processes
- Determining supplier qualifications
- Designing, communicating and analyzing RFPs and RFQs
- Leading supplier negotiations
- Selecting suppliers and confirmation
- Tracking benefits

Phase 3 of the “Procurement Process Improvement” involves refinement of policies, metrics and continuous improvement activities. It is very important to gain the input and agreement of suppliers throughout the engagement, but particularly so with regard to scorecards and metrics. First and foremost, metrics that grade supplier performance should be fact-based and data-driven. Second, the supplier must feel some ownership and control over the required performance and client relationship – an unattainable performance objective may have negative consequences for both the buyer and seller. Third, the scorecard must be discussed frequently enough to allow the supplier time to make adjustments.

Continuous improvement activities should be as much about internal improvements as external ones. For example, companies should re-examine the commodity teams to determine if they are functioning effectively both individually and as components of a broader portfolio. Spanning all phases of the strategic sourcing program is the need for project guidance - frequent and clear communications will be necessary throughout the duration, especially in Phase 2. Strategic sourcing benefits usually lag behind the major work efforts and communication is essential for keeping project momentum. Further, there is usually a diverse set of stakeholders who must be managed in addition to those in procurement, such as finance, operations and especially customers.

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In summary, we characterize strategic sourcing as a continuum where successive waves of activity result in future benefit streams. The ability to sustain these benefits is often determined by the strength or weakness of the infrastructure and the momentum of the overall program.

Exhibit 2: Strategic Sourcing Glossary Excerpts

Commodity Team - Typically a group or groups of people who focus on procurement and market conditions of a given category of goods or services, such as fuel or office equipment. They ensure that product and service requirements are met, negotiate contracts and ensure that the sourcing program is effective under changing market conditions.

Pareto Analysis - Often referred to as the “20/80 Rule,” where in many cases 20% of the items generate 80% of the activity. This analysis evaluates the relative contribution of each resource in a portfolio and isolates the majority contributors, i.e., ones that

contribute to the 80% threshold.

RFQ - Request for Quotation

RFP – Request for Proposal

SKU - “Stock Keeping Unit” often a term used for consumer products to describe the unique item number of a product used for inventory and sales tracking.

SKU Proliferation - A situation where a relatively small number of SKUs are generating most of the activity – sales, profit, inventory turns, etc. A Pareto Analysis is often used to determine the proper SKU lineup.

SKU Pruning - The effort to reduce SKU proliferation and result in a more effective portfolio of items. This is often performed after the Pareto Analysis has identified non-performing SKUs. Judgment must be applied to ensure that the resulting portfolio has a critical mass that is attractive to the marketplace or otherwise meets the needs of internal and external customers.

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