

CIPS POSITIONS ON PRACTICE

PURCHASING & SUPPLY MANAGEMENT: STRATEGIC SOURCING

INTRODUCTION

The CIPS' practice documents are written as a statement in time. They are a collection of views on good practice within a particular subject area and are intended to provide direction on good practice with some guidance for context and interest. The reader is encouraged to use the CIPS practice documents for their own purposes, such as writing policy statements, guidance or procedures. This particular practice statement has been written primarily for the benefit of full-time purchasing and supply management professionals, but can be used by anyone associated with, or interested in, purchasing and supply management (P&SM).

This document is about strategic sourcing.

DEFINITION

Strategic sourcing is a core activity in purchasing and supply management. It can be defined as 'satisfying business needs from markets via the proactive and planned analysis of supply markets and the selection of suppliers with the objective of delivering solutions to meet pre-determined and agreed business needs'.

Strategic sourcing is a logical process involving the application of tools by skilled, competent and knowledgeable people; however - developing and implementing strategic sourcing is a functional process.

BACKGROUND

The need for strategic purchasing was explained by Peter Kraljic in his 1983 article 'Purchasing must become supply management' where he stated that "enhanced strategic awareness, greater flexibility, and stronger entrepreneurial thinking in the supply area can improve the supply security and lower the input costs of any industrial company"¹.

Historically, the two forms of sourcing commonly adopted had been reactive and tactical.

Reactive sourcing is described as being the procurement approach where no proactive sourcing strategies have been put in place and so the purchasing and supply management function has an entirely reactive role e.g. responding to requisitions or other unexpected requirements from the business.

¹ Kraljic, Peter: Purchasing must become supply management, Harvard Business Review, September 1983

Tactical sourcing is also to some extent reactive as it covers those business requirements that cannot be planned in advance, but are provided within a framework of strategic sourcing. It is however, proactively managed and so resources and processes are set aside to manage it within the purchasing and supply management strategy. An example of tactical sourcing is working with colleagues in Marketing and Sales, providing a bid support activity within fast-moving technology areas.

Strategic sourcing, in contrast to the reactive sourcing previously adopted, is entirely proactive. It is a complex commercial process requiring extensive knowledge and competence.

EXPLANATION

Developing the strategic sourcing strategy is a fundamental part of the purchasing and supply management process. Strategic sourcing is a logical process involving the application of tools by skilled, competent and knowledgeable people; however - developing and implementing strategic sourcing is a functional process.

Since it is such a broad area, it is advisable to sub-divide the subject into a number of sections as follows:

a) Positioning Purchasing and Supply Management for Strategic Sourcing

CIPS strongly recommends that every purchasing and supply management function develops a written, and regularly updated, overall strategy which states their objectives and activities over a given timeframe.

The strategic sourcing activity should form one part of the overall purchasing and supply management strategy. The first stage in implementing strategic sourcing is the positioning of the purchasing and supply management function within the organisation.

In order to undertake strategic sourcing, purchasing and supply management must be positioned at the appropriate level (senior) within an organisation and should report to the Board (or via an appropriate Board representative) and it must possess suitable human resources.

Strategic sourcing requires the application and interpretation of sophisticated strategic sourcing tools and techniques such as relationship management, by suitably authorised and competent professionals.

In order to sustain the high level position, resources and influence, CIPS recommends that purchasing and supply management professionals responsible for strategic sourcing create a suitable governance structure so as to:

- Illustrate where the purchasing and supply management functions sits within the organisation e.g. alongside Finance, Legal, Human Resources
- Illustrate the role of the function itself and those people that carry it out - the purchasing and supply management function's terms of reference, scope of responsibility and objectives.

CIPS also recommends that the purchasing and supply management function creates a Sourcing Board (sometimes referred to as a 'Procurement Board/Panel') comprising, for instance, decision makers, opinion leaders and influencers.

The Sourcing Board should be used to discuss strategies, policies, approaches, assist with decision making and to help influence others in the organisation on behalf of the purchasing and supply management professionals.

b) 'As is' Analysis

The second, and very resource-consuming stage in strategic sourcing is the 'As is' analysis stage. This includes:

Customer and business requirements:

- What do our customers need and what does the business need?

Spend analysis:

- Historical usage analysis of goods or services
- Supplier positioning
- Supplier historical analysis
- Transaction cost analysis
- Critical nature of products.

Future spend analysis:

- Forward/expected usage of goods and services
- Trends in the market.

Market analysis:

- Assessment of the market capability
- Analysis of power dependency in supply chains
- Analysis of individual marketplaces
- Supplier preferencing
- Relative positioning of your organisation
- Supply chain cost analysis
- The nature of the market - appropriate type of sourcing strategy - global, regional or local

- Potential size (and actual size) of the supply base.

Several analytical tools are appropriate for this stage including Porter's Five Forces, PEST (Political, Economic, Social, Technological) and SWOT (Strengths, Weaknesses, Opportunities and Threats).

c) Mapping Supply Chains

The process of mapping supply chains can be complex and the extent to which it is undertaken is dependent on the value and risk of the procurement in question and limited by the resources allocated to strategic sourcing by the organisation.

The 'As-is' analysis and 'Mapping' stages can take typically between three and six months. CIPS recognises this timeframe is too long for some organisations and moreover impracticable for some procurement situations. However, the longer term benefits of such proactive strategic sourcing are invaluable.

CIPS considers that good practice supply chain mapping includes many of the items detailed below:

- identifying profit and gross margins in supply chains
- Understanding interdependencies in supply chains e.g. power dependency
- Mapping the required products and services onto these supply chains
- Analysing spend by each supplier in respect of category and business unit
- Buying patterns by product, service, supplier, and business unit
- Sourcing patterns
- Pricing patterns - both past and forecasted, and also purchase price analysis
- Historical performance of suppliers
- Historical market trends and associated cost drivers (there are specialists in various fields)
- Value chain analysis
- Identifying and addressing dominant players in the supply chain
- Critical asset analysis (i.e. identify your critical assets which should be borne in mind when out sourcing)
- Technical analysis - alternative solutions to specification of requirement
- Risk assessment

- Cost modelling
- Portfolio analysis
- PEST analysis
- Complexity reduction i.e. standardisation
- Ascertaining the demand e.g. formulating the requirements
- Demand challenge - does the organisation need the 'requirement' (Defer, Diminish, Delete)
- Market potential/market modelling
- Determining the policy areas which need to be accounted for in sourcing -environmental and ethical policies for example
- Determining funding e.g. PPP/PFI.

CONSOLIDATE DATA AND GENERATE OPTIONS

Once the analysis has been undertaken and supply chains have been mapped, the next stage is to consolidate the data and to generate options. Although not ideal, where resources are tight, in terms of time and skills availability for instance, it is possible to omit some of the analysis stages and go direct to the brainstorming of options.

It is good practice to undertake all stages in strategic sourcing but where this is not possible, it is better to attempt some aspects of it than not undertake it at all.

Options should be perceived as 'baskets of opportunities'. In summary, this stage involves brainstorming options to fulfil the requirements, such as identifying the offering of suppliers and identifying whether there are other ways to fulfil the requirement e.g. instead of purchasing PCs i.e. goods, rather purchase a desktop service i.e. outsource the PC desktop provision.

Another example would be instead of buying meters, buy a billing service including meter reading and customer billing. A public sector example would be the PPP/PFI which is a sourcing option that can offer value for money in appropriate circumstances. The process of generating options is an iterative process in that colleagues examine, discuss and criticise options and their feedback stimulates the production of further options.

Having brainstormed a list of potential options the strategic sourcing team should subject each to a SWOT analysis and where appropriate, a detailed risk analysis. The options which seem to be the most favourable are then prioritised on the basis of the benefits and savings that they can deliver.

Clearly, any proposed strategic sourcing plan must fully support the organisation's objectives. Examples of options include make/buy options; dual/single source decisions; feasibility of starting up partnerships with suppliers; benefit sharing etc.

SELECTION OF OPTIONS

CIPS suggests that once a range of suitable strategic sourcing options has been identified, these should be presented by senior purchasing and supply management professional(s) to the organisation's directors or Sourcing Board to be considered in the light of where the business currently stands and what the customers require.

Occasionally, the strategic sourcing teams will be required to investigate further, or support their suggestions with business cases, ROI (return on investment models) and so on. Equally, the organisation may require further options, or clarification or changes to those options preferred.

If a purchasing and supply management function is insufficiently resourced, the presentation of such strategic sourcing options can be a means of securing more appropriate levels of resource from senior directors.

Equally, where the purchasing and supply management professional's impact on spend is limited, or where bought out expenditure is only 20% of turnover, the presentation of strategic sourcing options to senior directors, may be seen as a method of:

- Increasing the strategic sourcing remit
- Increasing other value-add of the purchasing and supply management function i.e. not simply price reduction
- Penetrating aspects of the business which can be transformed into bought out expenditure, via outsourcing for instance.

SOURCING PLANS

Once the preferred strategic sourcing options are agreed, these are developed into 'sourcing plans' which should be innovative and creative solutions to the organisation's requirements in support of the organisation's mission and objectives. Strategic sourcing plans should generate work-streams i.e. clear milestones to be achieved with resources e.g. project teams allocated appropriately.

This is where the process of acquisition begins involving design teams, outcome-based specifications, market development, advertisements, and policy compliance for instance.

Strategic sourcing plans include determining processes for tenderers' and supplier selection and performance criteria ensuring the supplier continues to meet customers' expectations. CIPS advocates the use of weighted evaluation criteria when determining the preferred options, as this is one method of persuading internal colleagues that purchasing and

supply management is not focused on price and cost alone, but considers issues such as speed to market and other appropriate and relevant criteria.

Therefore strategic sourcing plans include producing and managing the ITT process, conducting negotiations and everything up to the recommendation of contract award.

IDENTIFYING NEW SUPPLIERS

Traditionally, sourcing has been perceived as the identification of new or alternative suppliers e.g. sources of supply. Methods of identifying suppliers have included:

- Internet e.g. suppliers' own pages and B2B trade bulletin boards
- Trade associations and trade directories •business directories like Kelly's, Sell's etc.
- Supplier exhibitions
- Networking with other buyers
- Talking to specialist end users.

This process is now part of the strategic sourcing work streams i.e. only part of the sourcing process.

Following the development of strategic sourcing plans and the identification of work streams, the purchasing and supply management function should facilitate the implementation of the strategic sourcing strategy.

This may involve helping with, or leading, the contracting process, educating the internal customer or order placer; enabling the supplier e.g. getting the supplier ready to deliver by developing and managing them etc.

In many larger organisations, the strategic sourcing part of purchasing and supply management is what purchasing and supply management professionals are primarily involved with. They are rapidly becoming less involved with the other aspects of contracting; i.e. purchasing and supply management professionals have trained colleagues to manage the less strategic and more straight-forward aspects of purchasing and supply management.

MEASUREMENT

CIPS believes that all strategic procurement, including the design and implementation of sourcing plans, should be measured in terms of the benefits that they are delivered compared with what they were expected to deliver as set out in the original business case.

This might take the form of a post-contract audit perhaps one year after the contract had been let. The findings should be reported to and discussed by the purchasing and supply management professional(s) and their Sourcing Board in order to learn from experiences and build on current commercial arrangements.

CONCLUSION

CIPS holds that sound and effective sourcing expertise is a key element in the purchasing and supply management professional's tool kit. Increasingly, the term 'Sourcing' is incorrectly replacing the terms 'Procurement' or 'Purchasing' or 'Supply Chain Management'.

Strategic sourcing encompasses aspects of all of those activities and is not a replacement activity.

CIPS believes that strategic sourcing is a skill set which must be learned, developed and refreshed. Strategic sourcing, as described in this policy, is becoming a common skill set for purchasing and supply management professionals.

It requires great resource and excellent management information and so only some organisations are currently in a position to implement it. Further, strategic sourcing should only be carried out by competent and knowledgeable professionals.

This document encourages purchasing and supply management professionals to move away from reactive sourcing and to take a more proactive and strategic approach.

CIPS believes that strategic sourcing, and as appropriate tactical sourcing, have a vital role to play in the overall corporate plan with the potential to make a significant and positive contribution to the bottom line.