

Procurement & Supply Chain
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Chapter 9

Category Sourcing: Developing
effective sourcing strategies

Learning objectives

- Understand why in most deals with suppliers there is room for cost savings.
- Understand what it takes to develop a sourcing strategy.
- Identify the different elements of a category sourcing plan.
- Know how to assemble a cross-functional sourcing team.
- Identify key success factors for successful implementation of sourcing strategies.
- Understand why real partnerships in b2b are scarce.

Reasons underlying cost-savings potential in purchasing

Suppliers slack in materials costs and prices may exist due to:

- **Traditional purchasing** – buyers involved later in process and fixed group of familiar suppliers used.
- Continuous and relentless **competitive bidding** among a fixed group of suppliers.
- **Overspecification** – can lead to monopolistic supply situations.
- Price increases passed on – ‘**French fries principle**’
- **Supplier cartels** in (international) supply markets
- **Suppliers’ customer relationship programmes**

HOW TO IDENTIFY COST-SAVINGS POTENTIAL

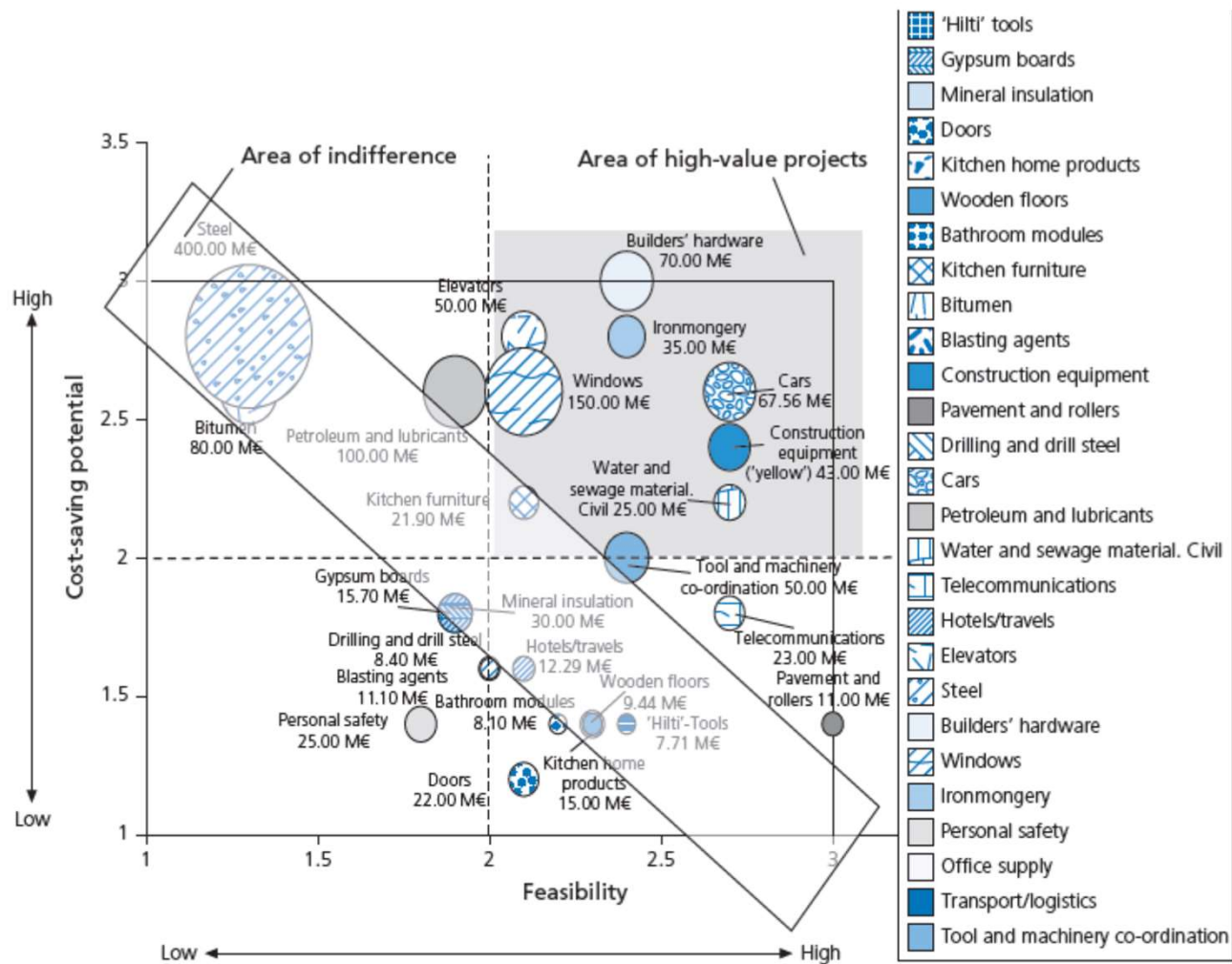
- Customized versus standard (off-the-shelf) specification.
- Modular versus component buying.
- Buyer–supplier dependence.
- Number of suppliers involved in last tender.
- Scope of last tender.
- Type and age of contract.
- Market price versus cost price differential.
- Level of purchasing involvement.

FIGURE 9.1 Category tree non-production related purchasing spend (example)

IT Infrastructure	Professional services	Office buildings	Office supplies
Mainframes Mid-range systems (W)Intel servers Other professional Hardware Database software Application software Middleware software Security software PCs Monitors Printers Other peripherals Outsourced computer services Telecom hardware (voice) Telecom utilization (voice) Telecom hardware (data) Telecom utilization (data) Mobile telecom services	Financial services Information services Legal services Management consulting services Other professional services	Security services Construction services Technical installations Interior construction Office furniture Catering equipment Household/office removals Parking services Rental/lease buildings Energy Interior decorating	Stationary White paper Copier services Other office equipment
	Marketing and communication	Facility services	HR
	Commercial printed matter Organization printed matter Media/communication Promotional items Sales/promotion events Photography services Translation services Market research Building displays Sponsorship	Waste disposal Food and beverage machines Catering Plant and flower services Cleaning services	Books and magazines Contributions Training and tuition Clothing Medical services Staff facilities Travel Hotels and conferences Representation costs Recruitment services Childcare Transport (staff) Car lease (private) Fuel (private) Temporary staff
IT Contracting	Industry related	Transport and logistics	Not relevant
Compliant suppliers Resellers Non-compliant suppliers	Raw materials Packaging	Courier services Storage services Archiving services Packaging Vehicles Fuel (business) Post-handling equipment Secured transport Postal services Safes	Internal invoices via A/P Unknown suppliers Non-procurement spend Vat Suppliers

Figure 9.2 Category prioritization matrix

Source: Skanska.



Used to classify category cost-savings projects on 2 criteria: cost savings potential and ease of implementation

Conducting a feasibility study

- Definition of category and sub-categories.
- Overview of current and future purchasing spend.
- Most important stakeholders and actors involved.
- Analysis of current supply base.
- Definition of future company requirements and needs.
- Functional and technical specification of purchased products and future needs.
- Important legislation that may affect requirements and buying process.
- Underlying cost structure and major cost drivers based on ownership cost.
- Assessment of initial savings that can be made.
- Assessment of ease of implementation.
- Overview of resources needed for category sourcing plan.

Developing a sourcing strategy

- Issues
 - Single vs. multiple sourcing.
 - Global vs. local sourcing.
 - Partnership or competitive relationship.
- Aspects
 - Buying on contract or buying on spot basis.
 - Price agreement vs. performance agreement.

Figure 9.3: Category sourcing plan (I)

- Business strategy and business issues:
 - Business goals and issues
 - Current and future business requirements
 - Business priorities
 - Important stakeholders
 - Infrastructure and other organizational conditions
- Analysis of historical data:
 - Historical usage & supplier performance reports
 - Functional, technical, quality, logistics and environmental specifications
 - Supply market analysis and supplier analysis
 - Current suppliers
 - Appraisal and ranking of suppliers
 - Price and cost analysis, important cost drivers
 - Legal and environmental conditions

Figure 9.3 (cont'd): Category sourcing plan (II)

- Customer requirements and purchasing process
- Objectives sourcing strategy: statement of measurable results:
 - Cost reduction
 - Quality improvement
 - Lead-time reduction
 - Inventory reduction
 - Reduction transaction cost
 - Reduction working capital
 - Innovation
- Commodity sourcing strategy:
 - Targeted number of suppliers
 - Supplier performance requirements
 - Location/geographic spread of suppliers
 - Type of preferred supplier relationship
 - Type of preferred contract
 - Supplier performance measures (KPIs)

Figure 9.3 (cont'd): Category sourcing plan (III)

- Planning of activities:
 - Briefing and team preparation
 - Spend and supply market analysis
 - Target setting and activity programming
 - Commodity strategy development
 - Sending out RFIs and RFPs
 - Sending out RFQs
 - Bid comparison and negotiations
 - Contract negotiations and contract signing
 - Communication and contract reviews
- Organization and team composition
- Summary of expected results and costs

Getting better results from suppliers

Driving down purchasing expenditure:

1. Check contracts already in place with suppliers and make sure these are updated.
2. Find the best possible supplier for the company's needs.
3. Develop the best possible solution for the company's needs with the supplier.

Myth of partnerships

- Logistics.
 - Giving the suppliers insight into the needs and materials schedules means they can anticipate future requirements.
- Quality.
 - Early agreement on quality requirements enables zero defects deliveries, which in turn result in a reduction of quality costs for the contractor.
- Product and supply chain cost.
 - Having understanding of the supplier's and the industry cost structure means targets are set to jointly reduce the supplier's underlying costs.
- Product development.
 - Introducing engineering knowledge and experience of the supplier early into the development process means time-to-market and start-up costs reduced.

Table 9.1 How buyer–supplier relationships may change over time

Aspects	Supplier	Preferred supplier	Supply partner	Design partner
Relationship characteristics	• Operational	• Operational	• Tactical	• Strategic
Time horizon	• From order to order	• 1 year	• 1–3 years	• 1–5 years
Quality	<ul style="list-style-type: none"> • As requested by producer • Quality control by producer 	<ul style="list-style-type: none"> • As requested by producer • Quality control by producer and supplier 	<ul style="list-style-type: none"> • ‘Sign-off’ by supplier • Quality assessment by supplier (process quality) 	<ul style="list-style-type: none"> • ‘Sign-off’ by supplier • Early supplier involvement in design • Quality assessment by supplier (design quality)
Logistics	• Orders	• Annual agreements + call-off orders	• Periodical scheduling of materials requirement by producer	• Electronic document interchange
Contract	• From order to order	• Annual agreement (1 year)	<ul style="list-style-type: none"> • Annual agreement (>1 year) • Quality agreement 	<ul style="list-style-type: none"> • Design contract • Life of type responsibility (product liability)
Price/cost	• Price	• Price + rebate	• Price + cost-reduction targets	<ul style="list-style-type: none"> • Price based on open calculation • Continuous improvement (design, quality, cycle time)

Summary

- Effective supplier management is a cornerstone for a successful business strategy.
- The international competitive arena forces manufacturers to look continuously for ways to improve their value propositions to customers.
- The foundation of any category sourcing plan is to make a sound spend analysis.
- Successful companies tie their purchasing and supplier strategies to their overall business strategies.
- The road to partnership is difficult.
 - Supplier strategies should be supported by senior management.
 - Activities are to take place in cross-functional teams from both sides.
- Buyer conflict is avoided by category sourcing programmes which focus on where to go for single sourcing, global sourcing or partnership.