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Sourcing Strategies & Procurement Processes

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Abstract
Not long ago, purchase function was seen to be a desk job, monotonous paper work, dull and passive and more of an administrative function. The purchase managements were the fall guys whose only aim was to keep feeding shop floor and avoiding stock out situation. Today the situation has changed totally. Procurement function is considered to be a strategic initiative and seen to be adding value to entire business process. Profile of the procurement managers has changed and expectations from these managers are different. Modern day procurement managers manage procurement and sourcing function both at strategic and operational levels. They are proactively engaged in building supplier networks, estimating, controlling and reducing costs besides performing other functions and ensuring service levels. Their job functions are increasing becoming cross functional together with supply chain and manufacturing functions. Procurement process and paper work is today managed by the ERP systems which drive the procurement business process. A sourcing or tender process is used to select the best product or service for a certain category of expenditure. Unfortunately, lots of these processes are not run well, resulting in loss of large saving opportunities, delivery of poor quality products, or less favorable terms. When selecting suppliers through a tender or sourcing process, the buyer works in collaboration with internal customers or budget holders. Internal customers are buyer's colleagues working in other departments, such as finance or manufacturing. They are the ones who originally raised the need for the purchase and who will be actually transacting with the selected supplier. Internal customer involvement is usually highest (around 70%) at the specification stage and then drops to around 30% in subsequent stages.

Keywords: *Sourcing Strategies, Procurement Processes*

1.0 INTRODUCTION

Strategic sourcing is an institutional procurement process that continuously improves and re-evaluates the purchasing activities of a company. In the services industry, strategic sourcing refers to a service solution, sometimes called a strategic partnership, which is specifically customized to meet the client's individual needs. In a production environment, it is often considered one component of supply chain management. Modern supply chain management professionals have placed emphasis on defining the distinct differences between strategic sourcing and procurement. Procurement operations support tactical day-to-day transactions such as issuing Purchase Orders to suppliers, whereas strategic sourcing represents to strategic planning, supplier development, contract negotiation, supply chain infrastructure, and outsourcing models.

The term "strategic sourcing" was popularized through work with a variety of blue chip companies by a number of consulting firms in the late 1980s and early to mid1990s. This methodology has become the norm for procurement departments in large, sophisticated companies such as fortune 500 companies. Strategic Sourcing is the process of developing channels of supply at the lowest total cost, not just the lowest purchase price. It expands upon traditional purchasing activities to embrace all activities within the procurement cycle, from specification to receipt and payment of goods and services. The steps in a strategic sourcing process were defined, in 1994, as: Assessment of a company's current spending (what is bought, where, at what prices?). Assessment of the supply market (who offers what?). Total cost analyses (how much does it cost to provide those goods or services?). Identification of suitable suppliers. Development of a sourcing strategy (where to purchase, considering demand and supply situations, while minimizing risk and costs). Negotiation with suppliers (products, service levels, prices, geographical coverage, Payment Terms, etc.). Implementation of new supply structure. Track results and restart assessment (Continuous cycle). A slimmed down strategic sourcing process was defined, in 2012, as: Data collection and spend analysis, Market Research, the RFx process (also known as go-to-market), Negotiations, Contracting, Implementation and continuous improvement.

Note that while the modernized process combines the market assessment and cost analyses steps of the older model into a single "market research" step, and the supplier identification and sourcing strategy development steps into a single "go-to-market" step, negotiation has split into "negotiation" and "contracting." This change is due to the heightened importance of market intelligence in modern strategic sourcing plans, and its ability to deliver value by improving both pricing and contract terms when leveraged against the identified suppliers. Note also that, while both descriptions of the sourcing process are accurate to some extent, there is no standard set of steps and procedures. As strategic sourcing is put in place and practiced over time, many large, sophisticated organizations will modify the process to better meet their individual corporate needs.

2.0 LITERATURE REVIEW

2.1 Procurement Function

Procurement function as explained above is one part of the sourcing function. In an ERP enabled environment, procurement function consists of detailed indenting process, procurement budget management, purchase order release, shipment schedule planning with seller coupled with ensuring compliance with documentation and system updating processes. All these processes are driven by ERP. Procurement function deals not only with procurement of raw materials and components, but also with capital equipments, project procurement, spare parts procurement for aftermarket, managing rejections, defective returns, warranty replacement process with suppliers too. Vendor development is a key function in procurement. Sourcing and vendor development are some of the skill sets required to be developed by Procurement team. Procurement function works closely with procurement logistics or inbound supply chain. A procurement professional needs to have operational knowledge of logistical activities in supply chain network, the various agencies, knowledge of policies, customs rules, Taxation, commercial, logistical and customs documentation besides knowledge of commercial trade rules and terms.

2.2 Procurement Process and Sourcing Strategy

Though interlinked closely, both procurement process and sourcing strategy are not one and same.
Sourcing strategy deals with planning, designing and building a reliable and competitive supplier base, determining the strategy for procurement, defining pricing strategies and supply chain requirements. The strategy involves integration of its objectives in line with or confirming to the objectives of stake holders in operations, finance. Marketing and distribution. Lastly sourcing strategy involves planning to competitive buying sources for its raw materials, components and services along with alternative variables. Procurement Process as described above, deals with operational zing business process of procurement function and ensuring performance.

2.3 Shift in Sourcing Strategic Approach

Having realized that suppliers play a key important role in the supply chain network of the business, there has been a change in the way organizations perceive and approach supplier relationships. Several factors have contributed to the shifting of the perceive value of supplier partnerships. Complex business models at global scales coupled with market demands have necessitated companies to set up manufacturing or assembly facilities closer to markets as well as in locations where conversion costs are relatively cheaper. This necessitates that the business be supported by a solid vendor base which is able to ensure supplies at all locations. Advancement in technology and R & D capability enhancement is leading to shorter product life cycles. New versions and product innovation means products become obsolete faster. Besides new introductions of products depend upon speedy development of new design supplier parts and the suppliers having to keep pace with changing designs and requirements. Lean Manufacturing and cost per unit concept is demanding that the managers keep looking to reduce the procurement cost as well as procurement logistics cost.

By developing a relationship with suppliers in a collaborative mode, buyers are able to get supplier companies to hold inventories for them at buyer location and postpone taking inventory ownership up to the point of consumption. Today preferred suppliers follow the buyer into countries where buyer is setting up facilities and take on value added services including managing warehousing in the spirit of customer relationship management. Therefore, managements have realized the fact that to be able to develop global business model, they have to develop supplier partnerships and work with collaboration spirit and invest in developing the supplier capabilities as well as invest into building the relationship. Supplier management is no longer transactional.

Outsourcing a business practice to another company may also be incorporated into a sourcing strategy for services. This strategy may involve the transfer of staff and assets to the outsource company. Due to the strategic and complex nature of outsourcing, many organizations such as Procter & Gamble, Microsoft and McDonald's have created what is referred to as Vested Outsourcing agreements to help build highly collaborative win-win business relationships.[5] Researchers at the University of Tennessee provide guidance on how to create Vested Outsourcing agreements in their book Vested Outsourcing: Five Rules that will Transform Outsourcing.[6]

2.4 Sourcing plan

The sourcing plan is the result of all planning efforts on strategic sourcing. Into this planning, all sourcing events are organized and detailed with tactical and operational information such as the sourcing team responsible for each event, when the sourcing event is supposed to begin and end based on each RFX step (RFI, RFP, RFQ), the requirements, specifications of all services or materials, and negotiations/cost goals. The objective of the sourcing plan is to manage the timing and quality of all sourcing events in the strategic sourcing program. Many procurement professionals continue to conduct sourcing and RFX activities manually using spreadsheets; however, this creates risk for error and gaps in the sourcing process.

2.5 Sourcing optimization

Operations research is a discipline of applying advanced techniques to help make better decisions. Optimization, in turn, utilizes mathematical algorithms to rapidly solve a business problem by evaluating all possible outcomes (or many outcomes) and selecting those ones that yield the best solution. When applied to sourcing and supply chain operations, optimization helps the sourcing professional simultaneously evaluate thousands of different procurement inputs. This evaluation can take into consideration the global market, specific current supply chain conditions, and individual supplier conditions, and offers alternatives to address the buyer's sourcing goals. Furthermore, it allows internal stakeholders in the buying organization to impose constraints on the award or specify preferences to favor certain non-cost objectives such as limited switching, reduced supplier numbers or higher quality outcomes.

2.6 Cooperative Sourcing

Cooperative sourcing is a collaboration or negotiation of different companies, which have similar business processes. To save costs, the competitor with the best production function can insource the business process of the other competitors. This is especially common in IT-oriented industries due to low to no variable costs, e.g. banking. Since all of the negotiating parties can be outsourcers or insourcers the main challenge in this collaboration is to find a stable coalition and the company with the best production function. This is difficult since the real production costs are hard to estimate and negotiators might be tempted to portray their real cost much higher than they actually are in order to demand higher fees for insourcing. High switching costs, costs for searching potential cooperative sourcers, and negotiating often result in inefficient solutions.

2.7 Sourcing Business Models

Sourcing Business Models are a systems-based approach to structuring supplier relationships. A sourcing business model is a type of business model that is applied to business relationships where more than one party needs to work with another party to be successful. There are seven sourcing business models that range from the transactional to investment-based. The seven models are: Basic Provider, Approved Provider, Preferred Provider, Performance-Based/Managed Services Model, Vested outsourcing Business Model, Shared Services Model, and Equity Partnership Model. Sourcing business models are targeted for procurement professionals who seek a modern approach to achieve the best fit between buyers and suppliers.

2.8 In Popular Culture

Strategic sourcing from a professional standpoint is lampooned in the American syndicated comic strip *Sally Forth*, in which the titular character's husband Ted Forth is employed within this field for the duration of the series's run. *Sally Forth* is currently written by the writer-illustrator team of Craig MacIntosh and Francesco Marciulianoand frequently lampoons many aspects of business and procurement culture and new trends in purchasing innovation.

3.0 SOURCING PROCESS

A sourcing or tender process is used to select the best product or service for a certain category of expenditure. Unfortunately, lots of these processes are not run well, resulting in loss of large saving opportunities, delivery of poor quality products, or less favorable terms. When selecting suppliers through a tender or sourcing process, the buyer works in collaboration with internal customers or budget holders. Internal customers are buyer's colleagues working in other departments, such as finance or manufacturing. They are the ones who originally raised the need for the purchase and who will be actually transacting with the selected supplier. Internal customer involvement is usually highest (around 70%) at the specification stage and then drops to around 30% in subsequent stages.

3.1 Specification Development

What are the needs of your internal customer i.e. the person who requires the product or service to be purchased? As a buyer, you challenge and "translate" these needs in specifications that suppliers can understand.

The objective of buyers at the specification stage is twofold:

- Reduce total costs

- Safeguard a competitive market at the upcoming negotiation stage

Developing specifications in its turn is a 4 step process:

- Assess Customer needs
- Assess what the market has to offer
- Develop specifications
- Define winning criteria

3.2. Market Assessment

Once you have a clear picture of the business requirements, your next step is to formally invite suppliers to quote for your business. You formally approach the market via:

Request for Information

- This is used to pre-qualify suppliers to whom you would send the RFQ.
- An RFI is usually a simple and short questionnaire for the supplier, which enables the buyer to judge if the supplier is promising and has a good chance to win the business.
- An RFI is optional. If you know the market relatively well, there is no need for an RFI.

A Request for Quotation

- This is a formal request to the supply market to quote for your business.
- The RFQ is a more complex document with a company presentation, bidding instructions for suppliers and detailed information about the project and requirements.

3.3. Negotiation

At the negotiation stage, you analyze the offers and select the most promising suppliers to negotiate with. Only then you prepare for negotiation. During the meeting, your goal is to clarify the terms of the offer and get additional value beyond what has been offered, this might range from a lower price, a better quality product, improved payment terms etc. At the end of this process, you conclude the deal with the best supplier.

Most suppliers build in a price concession in their first offer. In order to obtain this concession, you must:

- Build competition – To get the best results at the negotiation stage, you should have two or more credible alternatives.
- Carefully analyze all quotations to get a feel for a stretching but credible target.

4. Contract Discussion

You prepare a formal contract with the supplier and you limit your companies' exposure.

4.0 STRATEGIC PROCUREMENT PROCESS

The procurement process can be complicated one. Strategic procurement is an organization-wide process. It requires input from all departments and functional areas for an organization. Organizations should set up a strategic procurement team. This team sets the overall direction for procurement, aligned with the business strategy. The team will then use the data from the strategic procurement process to develop and implement a strategic procurement plan.

Step 1: Conduct an internal needs analysis: To begin, you'll need to benchmark current performance and then identify needs and targets before developing a procurement strategy. This involves the collection of several different types of data. The purpose for collecting initial data is to benchmark current performance, resources used, costs for all the departments/functions in the organization, and current growth projections.

Step 2: Conduct an assessment of the supplier's market: In this step, the strategic procurement team identifies potential countries that are feasible sources of the required raw materials, components, finished goods or services. If there are specific requirements, it may limit the number of countries that are suitable. For instance, if one of the raw materials used by the organization can only be found in one country, then options are much narrower. For manufactured products, there will be a much wider range of potential countries from which to select. Services may be limited by the technological requirements of the organization.

Step 3: Collect supplier information: It is important for a company to select suppliers carefully. A supplier's inability to meet selection criteria can result in significant losses for the organization. The business reputation and performance of the supplier must be evaluated, and financial statements, credit reports, and references must be checked carefully. If possible, the organization should arrange to inspect the supplier's site and talk to other customers about their experiences with the supplier. The use of agents, who are familiar with the markets and stakeholders, can also be beneficial to this process. Organizations may select more than one supplier to avoid potential supply disruptions as well as create a competitive environment. This strategy is also effective for large multinational organizations and allows for centralized control, but more regional delivery.

Step 4: Develop a sourcing/outsourcing strategy: Based on the information gathered in the first three steps, an organization can develop a sourcing/outsourcing strategy. The following are examples of sourcing strategies: Direct purchase: Sending a Request for Proposal (RFP) or a Request for Quote (RFQ) to select suppliers. Acquisition: Purchasing from a desirable supplier. Strategic partnership: Entering into an agreement with a selected supplier. Determining the right strategy for you will depend on the competitiveness of the supplier marketplace and the sourcing/outsourcing organization's risk tolerance, overall business strategy and motivation for outsourcing.

Step 5: Implement the sourcing strategy: Sourcing strategies that involve acquisition or strategic partnerships are major undertakings. In these cases, suppliers are likely to have the following characteristics: Involvement in activities core to the buyer, e.g. supply limited raw material for core product, access to highly confidential proprietary knowledge One of a limited number of available suppliers with specific equipment/ technology and skilled labour pool Part of the broader business strategy For a direct purchase, organizations may begin with an Expression of Interest (EOI), prepare an RFP or RFQ, and solicit bids from identified potential suppliers as part of a competitive bidding process. The RFP should include: detailed material product or service specifications delivery and service requirements evaluation criteria pricing structure; and financial terms.

Step 6: Negotiate with suppliers and select the winning bid: The strategic procurement team must evaluate responses from suppliers and apply its evaluation criteria. Bidding suppliers might request additional information in order to make the most realistic bid, and the organization should supply this information to all bidders and enable them to respond to the new information before making a final decision. The strategic procurement team will then evaluate the received proposals, quotes, or bids, and use the selection criteria and a process to either shortlist bidders to provide more detailed proposals (if reviewing EOIs) or select a first and second successful bidder (if reviewing RFPs or RFQs). After the evaluation process is complete, the strategic procurement team will enter contract negotiations with the first selected bidder.

Step 7: Implement a transition plan or contractual supply chain improvements: Winning suppliers should be invited to participate in implementing improvements. A communication plan must be developed and a system for measuring and evaluating performance will need to be devised using measurable Key Performance Indicators (KPIs). This is especially true in the early stages of using a new supplier. Transition plans are especially important when switching suppliers.

4.1 Contractual Supply Chain Improvements

When bringing on new suppliers, it is necessary to transfer information and establish linkages to logistics and communication systems, provide training and even specific physical assets, if required. The implementation of these transfers takes time and expertise to set and start up. Expectations during this time frame should be agreed upon during contract negotiations with time frames for full operations and deliveries.

4.2 Transition Plans

The transition from in-house provision of services to an outsourced service provider can be one of the riskier aspects of global outsourcing of services. How the transition to the outsourced service is handled and how it is perceived by staff and the public are very important. Transparency and preparation are key to this aspect of the sourcing strategy

5.0 CONSCLUSION

There are many misconceptions about training outsourcing. When should we outsource, when should we not? In a previous blog, I discussed ten reasons why companies are choosing outsourcing as a viable sourcing strategy for training services. But I'm finding many people still view training outsourcing as an either/or decision – either we outsource or we don't. I've said it many times, "all training organizations outsource some part of their training activities". So the better question is, "what outsourcing strategy should we use?" Outsourcing business models can be very complex. To understand them well, it is impossible to cover all the variations in a short blog. But what we can cover are some of the basic terms and concepts that will help you decide what strategy is best for you and your organization. Then depending on the complexity of the strategy you choose, you may want to seek an advisor to help you through the process. So let's start with the basics. There are four types of outsourcing strategies, or what some call engagement models for sourcing. The first two are considered business process outsourcing (BPO) engagements, and the other two are considered out-tasking models. The BPO models are comprehensive and selective. And the out-tasking models are licensing and contracting. And let's be clear, all four are forms of outsourcing.

A common question is "***what's the difference between BPO and out-tasking?***" The easiest way to explain it is to think about the training organization as an integrated group of business processes that must be managed by someone. We call these processes the Training Process Framework . The framework defines 26 business processes across the four functional areas of a training organization; administration, content, delivery, and technology. The number of processes a supplier manages, the complexity integrating those processes, and the duration of time a supplier is expected to manage those processes all help define the differences in outsourcing strategies. BPO refers to those engagements that are most complex, longer in duration, integrated across to the business. Out-tasking refers to the models that are less complex, fewer processes and limited to one functional area, more tactical, and more labor oriented.

Comprehensive BPO: this is the most complex, strategic, long term, and demanding relationship you can have with a supplier. A comprehensive outsourcing deal means that you are engaging with a training partner for a multi-year period to strategically manage a comprehensive set of processes across all four functional process areas of your training organization. Both parties are willing to commit dedicated resources to the deal which means you are both committing people and financials over an extended period of time. Comprehensive does not imply that the supplier does everything associated with training for your company. Even in a comprehensive engagement, you as the buyer still must manage some processes – like client relationship management or strategic planning. The idea that you give away all responsibility to the supplier is actually a myth, and NEVER happens in real life. BPO contracts are consist of a master services agreement (MSA), multiple service level agreements (SLA), and many statements of work (SOW).

Selective BPO: this is also a very complex engagement, but somewhat less than a comprehensive deal because of the reduced integration of functional processes. In selective outsourcing, you engage a training partner to manage multiple processes within one functional area of training (administration, content, delivery, or technology) but not processes across functional areas. Here you may contract with a supplier for the next three years to manage all custom content development activities for product e-learning courses. But the supplier would not deliver any courses, manage registration or admin services related to this training, nor host or support the courses online. Contracts for selective BPO deals are similar in that there is an MSA, SLA, and SOW's, but they are somewhat less complicated because there are fewer processes involved.

Licensing Agreement: these engagements are forms of out-tasking and used when sourcing a tangible asset, such as a technology or real estate for training. Licensing agreements for technology usually take the form of software as a service (SaaS) contracts. When the cost of implementation and set-up are high, these deals are often times multi-year. This allows the client to amortize costs over longer periods of time. When these costs are low, deals often take the shape of month to month. For example, licensing agreements for an LMS/LCMS tends to be multi-year because of the integration required in set-up, where licenses for authoring and delivery platforms tend to be month to month. Contracts for license agreements are generally purchase orders with defined terms and a unit price in the form of price per time.

Contracting: the second form of out-tasking engagements, and the most common form of outsourcing in the training industry. Some refer to it as a 'labor for hire' engagement. It's where we pay a contractor by the hour/day/week/month to perform a task. Contracting is commonly used when we source a supplier to manage a project, and we compensate them when the project is complete. The project can be consulting, instructional design, delivery of a course, etc. It is a tactical engagement when your objective is to limit the complexity and breadth of processes you expect the supplier to manage. It is transactional, which means the relationship ends when the activity is complete. It is the most flexible, least risky and easiest to manage relationship for the buyer. It limits your obligations to a supplier and allows you to easily terminate a contract when things are not going well. Contracts are generally purchase orders with defined terms of activities for a unit price for each deliverable. Unit prices are usually in price per time or price per project terms.

In reality, everyone does. It's my estimate that about 96% of dollars spent in the training outsourcing market is thru out-tasked agreements. Even companies that utilize comprehensive or selective outsourcing strategies have out-tasked something related to training. But sometimes it makes more sense to strategically engage with a partner so your cost of procurement and ongoing training management is lower. The benefits you get from effective sourcing can be much greater. Committing to a training supplier for multiple years may save your company a lot of money over an extended period of time. This is why it is still a very successful strategy depending on your business objectives.

The decision of how to source training is much about risk and reward. This is what makes selecting the right sourcing strategy a critically important decision. That's why there are consultants out there that are fully prepared to assist your organization in working through the complexities of sourcing – especially when you are dealing with millions of dollars.

Please know there are infinite variations to each of these, and infinite ways to structure any deal. Your procurement organization and legal counsel will help you in determining the best way to contract for services. But strategically your leadership team should determine the best relationship strategy you should have with sourcing partners.

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