The Ultimate Guide To Strategic Sourcing

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Strategic sourcing is the process a business uses to allow procurement to take the lead in satisfying business needs. With it, procurement can find ways to save money while also adding value. It involves internal collaboration with stakeholders and suppliers, as well as critical analysis of spend, and supplier risk management.

Benefits of strategic sourcing include increased profit as every dollar procurement saves directly affects the bottom line. In strategic procurement, you're systematically looking for ways to save throughout your entire supply chain, which gives your company a competitive advantage.

You'll also find it makes it easier to manage supply risks because current suppliers are evaluated for availability risks, quality risks, financial risks, and cooperation level. After identifying risks, you can develop a plan to mitigate them or avoid them altogether and seek new suppliers when and where necessary.

Because strategic procurement is an ongoing cycle of sourcing activities, you'll find it is easier to sustain the business, because every category of spend will have a dedicated manager keeping an eye on things and looking for ways to add more value to the company with each cycle.

When you opt for a strategic sourcing approach, you're going beyond looking for quick ways to reduce costs, trying to find ways to add more value at the same cost, decrease operational costs, or increase operational speed.

This guide to strategic sourcing walks you through the nine steps you must take to change your approach and reap the benefits it has to offer.

Step One: Research

At this point, your main focus is collecting data about your company, analyzing the data, and building the framework you'll need to complete the rest of the process.

You'll start with categorization, where you'll divide the entire supply chain into various categories – each of which will have a manager assigned to monitor activity. The way you do this is entirely up to you – starting with high-level categories such as: direct/indirect, materials/services, critical/non-critical, or domestic/import. The important thing is to go deep – starting with a group, then dividing everything into subgroups, and assigning each subgroup to a category code with a description.

For example, your groups could look like this:

Group		Subgroup		Category Code			
Code	Description	Code	Description	Code			Description
1	Raw Materials	1A		1	A	A	
2	Electrical Parts & Components	2A	Electrical Components	2	A	A	
				2	A	B	
3	Systems & Equipment	3A	Systems				
4	Direct Services						
5	Indirect Materials & Services						

No matter how you choose to categorize your spend, maintain it in the ERP material master. IF you haven’t created that yet, you should still have your spend separated into different cost accounts. If you lack master data, speak with accounting to see if you can use their spend data as the starting point.

Make sure you involve your team throughout the entire process if you’re building your categorization from scratch. Start at the highest level and work your way down, involving design and engineering teams to get answers to more technical questions. It’s up to you as to how many levels you want to take it and how detailed you want to get, though the more detail the better in terms of data analysis. Categorization is something you need to do with the big picture in mind, because it’s not something you want to change often. If you change your categories too much, you won’t be able to compare spending from quarter to quarter.

Once your categories are in place, you’ll conduct a risk analysis, separating your categories into baskets – based on their profit impact and their supply risk.

From here, you’ll work with your team to choose your scope. If you choose a category level that's too high, you could end up with few or no suppliers being able to address your need. In situations where you have a single highly critical competent, you may define it as your scope of sourcing work. On the other hand, if you choose a single product as your category, you could find yourself spending too much time and energy on the strategy for each product, so the key is finding a spot in the idle.

At this point, you'll conduct a spend analysis with historical data – and the more detailed, the better. If it's not already stored in your ERP, talk to accounting to get the spend data – and in cases of despair, reach out to your suppliers. Once the data is compiled, analyze it with Excel's PivotTable so you can sort and filter the data as needed and drill down into many levels of detail.

Now, do a cost structure analysis on the items you purchase, and then look at the total cost of ownership. Once you're done with this, you can move on to the next step.

Step Two: Supply Market Analysis

In this step, you begin your supplier market research to find suppliers and identify the ones you want to send requests to. There are four parts to this process: the supplier market analysis, demand analysis, supplier interviews, and category risk level analysis.

Determine the scope for your market – global, regional, by country, or local supplier. Collect data for the supplier base that could potentially supply each category. Go beyond the suppliers that you're already working and research them all. Record supplier data in an Excel spreadsheet.

Now, look at your spend in the category. Split your spend by supplier. Then, determine how strong of a player you are by comparing your spend to the supplier revenue. When you see how much of your spend covers the total demand market, you'll know how valuable you can be to the supplier.

Next, conduct supplier interviews. Send requests for information from potential suppliers and look at data from current suppliers to know costs and such for what you're buying. This will help you determine if you want to stay with your current suppliers or if you can get better deals from other companies.

Finish this step by conducting a category risk assessment to determine whether working with this supplier is worth the risk or not. Evaluate each supplier based on availability, quality, finances, and cooperation level.

Step Three: Analyze Your Current Sourcing Process

In this step, you'll determine how to find benchmarks for suppliers and products, and how to identify knowledge gaps to create a list of opportunities.

> *By looking at your current process you'll be able to identify areas for improvement. Without this benchmark, your efforts are wasted.*

Talk with your stakeholders and ask open-ended questions to get as much insight as possible as to why they are using certain products compared to cheaper alternatives. You may find ways to cut costs because people didn't realize their choices were making the end product more expensive, and you don't have to sacrifice quality.

Find similar or alternative components to benchmark against your current ones. Think beyond price and consider how easy they are to work with and how efficient they make your process. Evaluate potential suppliers against your current ones. Consider the hidden costs associated with changing suppliers.

Benchmark suppliers and products on the global level, even if you don't intend to source from overseas, so you have the data from a global point of view.

Now, conduct a supply chain analysis, looking at the geographic reach of your supply chain. Compare local suppliers with overseas suppliers by looking at factors beyond procurement price. Transit time may increase so you'll have to buy larger batches to make up the difference and save on logistics – but increasing your stock level. Compare total supply chain costs to make sure you're getting the best deal. Benchmark your existing chain with local and global alternatives, including delivery and transit times, batch order size and stock levels.

Take the new information you gather and note anything that seems off – such as buying bigger volumes from suppliers that are more expensive. Asking questions about any illogical data can help you find the gaps you need to look for opportunities.

Once you have those gaps and opportunities, present them to your team. Work together to confirm they are indeed gaps and not misinformation that needs to be clarified. Then, get ready to develop the strategy to bridge the gaps in the next step.

Step Four: Choosing Your Sourcing Strategy

There are two common strategies you can use as a base for your strategic procurement: Porter's Five Forces and A.T. Kearney's Purchasing Chessboard.

The five forces model looks at industry competition, potential of new entrants into the industry, supplier power, consumer power, and threat of substitute products to help determine the best way to work with a supplier.

The Purchasing Chessboard relies on four purchasing strategies and 16 levers to give you a total of 64 methods to use based on your needs and where you stand. It's a bit more complex but is good for high-level theoretical analysis.

Once you have an idea of what you need and who you want to work with, you can use these strategies or a combination of the two to negotiate the best possible deal with the vendor you choose in the next step.

Step Five: Vendor Selection Process

After self-evaluating the vendors, send each one you're interested in working with an RFI or an RFP so you can benchmark everything. Clearly define your requirements, and ask detailed questions to help you address management, sustainability, the product, processes, continuous improvement policies, and cost. Once you get the questionnaire back from each potential supplier, you can create a scorecard to benchmark their scores against your requirements, and set a threshold to determine what level they must score to qualify a vendor.

Step Six: RFQ Management Process

Now that you have the short list of qualified companies who could become vendors, challenge your existing supplier by sending an RFQ, or a request for quotation. This adds an element of competition, so you can be sure to get the best value – whether in terms of cost savings or added value.

There are four steps: preparation, tender, awarding, and closing. Spend half your time in preparation, and the remaining half of the time on the other three phases combined. Prepare documents for each vendor, including a description of your company, the project, and background information.

Attach general terms and conditions to provide a framework to follow when the supplier makes a bid. The clearer you are here; the less time you can spend in negotiation should you decide to close the deal.

Include a pricing template so you can compare the quotes in the same format. Also include the prequalification requirements and questionnaire if you haven't already run an RFI.

Keep your process transparent and include the awarding selection criteria and weights so everyone knows how the winner will be chosen. Share the same information with everyone to keep everything fair.

Once you get everything back, you can decide who to award the project to, based on the price template and awarding criteria. After you've chosen a winner, set a meeting with the vendor to close the deal and sign the contract.

Once you've signed the contract, you can announce the winner publicly and close out the RFQs with the other vendors you did not choose.

Step Seven: Sustained Improvements

At this point, you have everything you need to keep the cycle running. Keep working to find additional improvements in the next round and beyond. Prepare to analyze and reflect on everything you've done and how it's helped the company and look for ways to keep that momentum going.

What went according to plan? What didn't? How can you adjust your strategy next time?

Step Eight: Strategic Sourcing Tools

Make sure you have adequate powerful tools for spend analysis, requisitioning, RFX events, and supplier relationship management. All of this can and should be managed in your ERP.

Your spend analysis tools need to make it easy to determine what you're buying and at what price, whom you're buying it from, the volume you're buying, and how you're buying.

The requisition is the first step in the P2P process, which should be completely automated for highest efficiency.

You'll have a number of RFX events to deal with, which means you'll need to either use email, develop your own solution in-house, or purchase a license from a SaaS provider. Because email is inefficient and developing an in-house solution is both time-consuming and expensive, it's best to opt for a SaaS solution.

SRM tools can be integrated in your ERP system and is designed to serve as a supplier contract lifecycle repository with advanced features.

Step Nine: Category Team Selection

The final step involves selecting the team members for each of your categories so everyone on the team is responsible for something, and no single person on the team has to do too much work to keep the strategic sourcing process in place.

Choose team members based on their geographic location, their business and functional area the category scopes you developed early in the process cover. Once the team is in place, agree on the rules and working guidelines. Have document sharing platforms in place to make it easy to share information across time zones and departments. Allow team members to play a role in the decision-making process and encourage everyone to keep the lines of communication open at all times.

Strategic procurement processes are ongoing and should aim to serve the business in the long run. A single category manager cannot and should not go through the process alone. Though it can take some time to go through all the steps we outlined in this step-by-step guide to strategic sourcing, it is well worth it for your business.

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