

# Seven Habits

## of Effective Sourcing Organizations

“Strategic sourcing is only for large spend categories.”

“All categories can be sourced online.”

“Close relationships with key suppliers are a pipe dream.”

At one time, these were the types of realities that defined popular thinking in strategic sourcing. Today, though, emerging processes and technologies are beginning to turn these notions inside out, creating tremendous opportunities for additional—and sustainable—savings.

More and more, companies are realizing that sourcing is an ongoing, iterative process with interdependent steps that work together to enhance performance and results. To take advantage of these new opportunities, advanced procurement organizations have begun to move beyond sourcing point solutions (e.g. eRFX) and are starting to implement broader platforms that automate the full spectrum of sourcing processes. As a result, these organizations have begun to realize sustainable savings and efficiencies that were previously not attainable.

Want to learn more? In the next few pages, we will start to reveal the secrets that leading procurement organizations are employing to create these tremendous savings opportunities, leveraging the latest processes and technologies to drive results.

# 1

## ▶ Always start with a thorough opportunity assessment and BUILD AN ONGOING PIPELINE

**POPULAR THINKING:** “We can identify the low hanging fruit to source with just a quick glance at our spend.”



Automated tools and processes have begun to enable companies to address spend visibility in a repeatable, real-time and proactive fashion.

### Use Cases

**ExxonMobil**, the world’s number one integrated oil and gas company, shares category knowledge within an online tool connected to over 130 global locations in 65 countries, allowing category leaders to monitor and advise on sourcing activities and push relevant strategic and commodity specific information in real time. Category teams have the capability to collaborate on matters such as aggregation of demand, implementation of strategies, supplier selections, cost models, and other new ideas for innovative sourcing in their category. Endorsement and approval requirements are automated within the tool. In 2004 the tool will be enhanced to include (among others) supplier performance and associated improvements and contract management.

**A top European energy provider** recently implemented an analytical software tool to gain better insight into their €4 billion annual spend. This application imports and cleanses spend data collected from the multiple ERP and other source and legacy systems the conglomerate has implemented over the years. Since implementation, the company’s more than 200 sourcing professionals have been able to identify opportunities for spend leverage as well as pinpoint the root causes of savings leakages due to non-compliance.

As a Director of Sourcing, it is critical to understand the details behind the spend in your enterprise. For example, can anyone at your company list the top ten suppliers by spend amount or category? And, if you included Pcard spend in your evaluation, would you be surprised to learn that Wal-Mart is likely on the top supplier list?

Producing such a list, though, has never been easy. Organizations must take into account a range of factors to gain better visibility into categories. This includes breaking down spend by business unit or geography, understanding off-contract spend and the related requisitioners, and examining the specific breakdown of costs based on key drivers in the category.

Before the advent of electronic tools, such clarity could only be achieved with sporadic consulting engagements that would take between three to six months with backward looking and stagnant results—offering only short term ability to prioritize sourcing and compliance opportunities.

But today, fortunately, automated tools and processes have begun to enable companies to address spend visibility in a repeatable, real-time and proactive fashion. By gathering together the spend data into a single system, and cleansing and normalizing in an automated way, these tools provide immediate visibility into critical aspects of spend, enabling users to identify new opportunities for savings on a monthly, weekly or even daily basis.

Achieving this level of automation and visibility does, however, require strong planning, best practices guidance and implementation support. In many cases, service providers can help in defining the right processes for data collection and normalization, and the right reports and views that will lead to effective ongoing opportunity assessment.

The results are worth the effort. Indeed, companies often receive a jolt the first time spend data has been integrated and thoroughly analyzed, surprised by the level of maverick spending that is going on, or how significant a seemingly innocuous category really is. In this new light, what was once assumed to be “low hanging fruit” can be reprioritized based on the real-time data at hand.

Evaluating internal spend, however, is only the first step. Companies must also consider a category holistically. Shifts in supply markets and other external dynamics—such as tracking material indices, supplier news, earnings reports, technological changes and the entrance of new global suppliers into a particular field—provide ripe opportunities to go after additional categories and savings.

In such cases eSourcing tools can be indispensable, enabling category managers to monitor developments and benchmark new industry standards and pricing more regularly, enabling the proactive identification of new opportunities based on this data.

## USE THE APPROPRIATE SOURCING STRATEGY and cost model for the category in question

**POPULAR THINKING:** “All categories can be sourced online.”

Strategic sourcing is not just about focusing strictly on goods and services strategic to a business. Rather, it is about rigorously applying sourcing methodologies to all externally purchased goods and services.

However, on a category-by-category basis, the underlying analytical tools and approaches can vary tremendously. In some situations, online auctions make a great deal of sense. In other situations, though, it is better to negotiate with suppliers face-to-face, discarding the convenience and potential savings of technology in favor of relationship-building.

For these reasons, companies should analyze every spend category and determine the correct sourcing strategy for that category. In certain spend categories with a large supply base—and enough volume to get the attention of suppliers—the optimal strategy may be to employ leverage. In other categories with highly engineered components—and industries with short product lifecycles—collaborative processes and tools that bring together product design, engineering, procurement, and operations groups with suppliers may deliver the best value across the extended supply chain.

Regardless of situation, however, sourcing professionals should develop a holistic cost model for each category to arrive at a better understanding of total landed cost, not just unit cost. When procuring service parts, for example, delivery and warehousing costs can be significant cost drivers. For many direct materials (e.g. stampings, forgings, etc.) companies must factor in fixed costs such as tooling to arrive at a total landed cost for a part. And, in the case of global sourcing, tax, tariff, freight and other charges can dramatically impact the total landed cost of a part.

Even indirect goods and services can have significant total cost implications. Take the case of temporary labor. One organization saved millions of dollars by negotiating the “temp to permanent” costs charged by temporary agencies, after it came to realize these comprised a significant portion of their spend. Before this insight, the focus had been on the hourly rates and overtime charges.

To create effective cost models, the organization must first understand all of the details behind the spend category—this takes both time and a structured approach. In developing a total cost model, sourcing professionals should understand the full lifecycle of the good or service, from source to pay, to quality and warranty implications, to activity-based costs. The good news is that once an agreed-upon model is in place, it only requires maintenance and can continually support the organization in assessing category performance and ongoing savings opportunities. Want added incentive? Once the model is captured and refined, sourcing professionals without deep category knowledge can take over the management of the category in less time with better results.

Of course, for very specialized or non-core categories, a third party that has in-depth industry-specific knowledge of the category might be best-suited to develop such a cost model and related strategy.

Sourcing professionals should develop a holistic cost model for each category to arrive at a better understanding of total landed cost.



### Use Case

**Saks, Inc.**, uses eSourcing tools to build total cost models for its sourcing of all private label clothing and goods in Southeast Asia. By modeling the country of origin, delivery fees, agents’ fees and tariffs, as well as design alternatives that affect the size and weight of the apparel, Saks is able to consider the full total cost of their award decisions.

# 3

## ▶ ENGAGE STAKEHOLDERS every step of the way

**POPULAR THINKING:** “As long as the rest of my organization (e.g. operations, design, engineering) gets some say in the supplier selection, they’ll be happy.”



Stakeholders contribute critical value to the sourcing effort in areas such as business requirements, demand management, total cost modeling, category strategy, and supplier performance management.

Too many organizations fall into the trap of looking at procurement as a mere opportunity to cut costs, and do not fully consider the impact of sourcing decisions across business functions. To avoid this pitfall, enterprises must undertake an opportunity assessment process, validate requirements, and develop a strategy that crosses functions and operational silos. Given the amount of upfront planning that must occur, procurement must take the lead in involving key stakeholders across the organization from the start.

When outside stakeholders are only invited to become involved at the RFP stage or when a contract is the process of being drafted, there is a good chance they will feel disconnected from the process. Eventually, such “lack of ownership” leaves little incentive for them to agree with new supplier contracts and the end result is that compliance suffers. And perhaps worst of all, failing to engage these stakeholders hinders their ability to contribute critical value to the sourcing effort in areas such as business requirements, demand management, total cost modeling, category strategy, and supplier performance management.

How does one begin to solve the “team” integration challenge? The procurement organization’s internal clients—those individuals who will be directly interfacing with the supply base and have a vested interest in the delivered good or service—must get involved early and often throughout the process. Coordinating such communication can be unwieldy and time-consuming—especially in large corporations with numerous locations—requiring multiple meetings, duplicate emails and haphazard document reviews and revisions. Fortunately, new sourcing tools and platforms allow for a more regimented team-based approach, enabling cross-functional collaboration and coordination between sourcing professionals and category stakeholders.

Some companies engage stakeholders by including them in a category-based Center of Excellence program. Others achieve buy-in by involving stakeholders during the opportunity assessment phase, so that the spend data is validated from key personnel in the category. Just as importantly, relationships are formed that last throughout the project and beyond.

### Use Case

**Airbus**, Europe’s €19 billion leading aircraft manufacturer, uses sourcing software to engage in cross-plant and cross-country collaboration at the beginning of each sourcing project. This ensures not only appropriate demand aggregation, but also that the correct requirements are identified and managed early in the process, reducing complexity and confusion and supporting shorter project cycles and lead times.

## ▶ SOURCE EVERYTHING that can be strategically sourced and follow through on all sourcing decisions

4

**POPULAR THINKING:** “Strategic sourcing is only for large spend categories.”

It is easy to see why many firms find the thought of sourcing every good or service required by internal clients overwhelming. After all, procurement groups have limited resources and a large workload. The accompanying increase in supplier interactions brought by sourcing additional categories can prove to be daunting to even the most advanced organizations, ultimately detracting from strategic areas of spend.

However new developments have made it possible for firms to extend the sourcing function’s reach within its internal client base, by pushing technology—and process—to the edges of the enterprise. The result? By empowering end-users, companies can achieve better costs on smaller categories—which would traditionally been overlooked as they fall outside of the company’s strategic areas of spend.

The good news is that many new sourcing technologies have become very user friendly and require little if any training to get started on the basic level. Take the case of online auction tools. These applications no longer require a PhD in game theory—or an external expert third party—to operate and administer. For spot sourcing, internal customers can seamlessly use a sourcing tool to issue an RFQ and solicit three quick bids on their own without draining the sourcing department’s resources. Other tools, such as templates and online training, can also broaden adoption and drive results. These capabilities create at least a minimum level of competition that drives incremental savings for each small sourcing activity. When aggregated, these can then add up to a significant corporate savings at a level equivalent to more major initiatives.

Automated sourcing technology supports—and indeed has led to—the development of a new best practice, which is, simply put, to source everything possible for maximum savings and efficiency. Firms that follow this dictum typically run more than 300 projects per month—many of which are basic RFPs and auctions—sourcing all projects over \$5,000 or \$10,000.

Once the sourcing event is complete, it is essential that there is follow-through with both internal clients and the suppliers themselves. Suppliers who have participated in good faith deserve to understand the outcome of a sourcing exercise within a reasonable amount of time and as important, to understand the criteria the buyer used to award the business. In addition, the internal clients and stakeholders who contributed to the project should be involved in and/or notified of the final decisions. All too often, projects make it to the post-RFP or RFQ stage, then falter and take months to come to completion. Key stakeholders then lose touch with projects in which they were once intimately involved, resulting in dissatisfaction on all sides. Effective technology features that streamline these processes include team scoring and decision support tools such as post-bid optimization, which can assist in decision-making. Timely team reviews and sign-offs can be facilitated by workflow tools, which also maintain an audit trail of agreement.

Another typical bottleneck is the back and forth process between the buyer and seller over the finalization of terms and conditions. At this phase, numerous teams on both sides are typically involved, including legal, procurement and sales, making the process burdensome. To address this problem, tools such as online contract authoring and ‘smart’ workflow can assist in expediting the contract and pushing the project savings to realization.

### Use Cases

**General Dynamics**, a Fortune 150 diversified aerospace and defense manufacturer, has rolled out a sourcing tool to each of its 18 business units, comprised of over 160 sourcing professionals, who “source everything sourceable”. By taking this approach, the company is running approximately 3,500 sourcing projects annually, achieving average savings of 11 percent on the vast majority of their direct material and operating services spend

**A Fortune 500 technology manufacturer** has 12,000 strategic sourcing projects in the past year, and heavily utilizes team scoring and optimization tools to support the award decision among stakeholders. In doing so, the sourcing team is able to let suppliers and stakeholders know the outcome of the award within two weeks of the RFP or RFQ, and suppliers are willing to participate in future projects due to the fair and timely process.

# 5

## ▶ DRIVE AN UP FRONT COMPLIANCE PLAN for realized savings

**POPULAR THINKING:** “We’ll figure out compliance after the negotiations are finished.”



Consider compliance at the beginning of a sourcing initiative, and include compliance requirements in the RFP and negotiations process.

### Use Case

**Merrill Lynch** recently sourced a local transportation service, a category in which both end-user and supplier compliance were historically problematic. In order to ensure compliance to new prices and usage parameters, the Merrill Lynch team narrowed the supply base to those vendors who could accept Pcards—for integrated travel and expense tracking—and who were willing to submit detailed invoices electronically for automated three-way matching. The new process instantly reveals compliance issues and kicks off the appropriate exception management processes.

**One major US state government** recently implemented an electronic contract management tool that allows it to create and implement a contract immediately upon final agreement of terms and conditions. With instant integration to an execution platform for requisitioning, statewide compliance is institutionalized within minutes as POs reflect correct contract pricing and volume discounts.

One of the critical components of an overall sourcing strategy is establishing policies for contract compliance that set terms and procedures for both buyers and suppliers to follow. Such elements may include building awareness and notification for new contracts or supplier changes, evaluating changes to the end-users’ procurement process, examining different procedures for travel and expense management, enabling real-time payments, or modifying supplier invoicing procedures.

By its nature, compliance occurs at the end of the sourcing cycle. Sourcing professionals, however, must consider compliance at the beginning of a sourcing initiative, and include compliance requirements in the RFP and negotiations process to ensure that suppliers are able to accommodate their needs.

While this sounds simple, it’s not always easy to accomplish. Compliance is oftentimes the responsibility of specific teams within the procurement department, while category managers perform their sourcing work independently. For organizations looking to improve their compliance processes, external consultants and service providers can provide guidance to improve the processes and collaboration between category managers and compliance teams.

There are also a number of electronic tools that help sourcing professionals bake compliance into the beginning stages of the sourcing cycle, as well as the end. For example, analyses can highlight category-specific compliance opportunities prior to sourcing activity. Another capability integrates data between sourcing and contracts, ensuring that the negotiated terms and conditions are accurately incorporated into the contracts. At the point of requisition, another capability applies the contract terms during the requisition process itself, so that the correct pricing and service levels are specified on purchase orders that suppliers receive. As a final safeguard, companies can use electronic tools to enable a three-way match via automated invoicing, giving suppliers the ability to ‘flip’ a purchase order or contract terms into an invoice—eliminating manual errors in paperwork which all too often erode savings.

## ▶ WORK WITH SUPPLIERS for performance assessment and new savings ideas

**POPULAR THINKING:** “Close relationships with key suppliers are a pipe dream.”

Sourcing does not end with the contract and compliance activities. As supplier and buyer begin to build their relationship, both parties need to remain satisfied with the other’s performance. For suppliers, this means maintaining service levels, committed timelines and quality metrics. For buyers—especially in the case of direct materials procurement—this means living up to promised levels of quantity and accurate and timely demand forecasting.

By bringing together both qualitative and quantitative performance data, buyers and suppliers can engage in meaningful reviews and planning sessions. More advanced buying organizations are driving further collaboration by encouraging new cost-cutting techniques and more efficient joint processes that a sourcing professional may not have considered during negotiations. Suppliers, for their part, can often bring a new perspective to the situation. They are more familiar with their own cost drivers, of course, and sometimes even have a more intimate understanding of their customers’ supply chain practices.

Suppliers can help drive costs out of the supply chain in a range of areas including logistics improvements (such as packaging/handling, warehousing and inventory management), better resource utilization (this would include long-term planning, forecasting and production planning), better transactional interaction (ordering, tracking and payment) and better product cost management (such as NPI co-development and design).



Suppliers can help drive costs out of the supply chain in a range of areas including logistics improvements, better resource utilization, better transactional interaction and better product cost management .

### Use Case

**At a Fortune 100 transportation company**, the executive team recently directed the procurement organization to cut all costs by a significant percentage across the board—despite the fact that they had just completed a several-year strategic sourcing engagement with a consulting firm. Instead of trying to re-source all categories, the team solicited—via electronic surveys—specific cost-savings ideas from suppliers in high spend categories. Now they are implementing some of their suppliers’ ideas to meet the cost objective.

# 7

## ▶ MEASURE AND MARKET FOR MOMENTUM

**POPULAR THINKING:** "Sourcing is just a cost center."



Results tracking tools can help call attention to the procurement organization as a bottom line enabler.

Measuring progress and tracking results is essential to the success of any sourcing endeavor. Yet this key step has not always been easy. After complex global sourcing initiatives—sometimes with hundreds, if not thousands of parts or items—it can be a significant challenge to measure performance and realized savings. Even the relatively simple process of making sure optimal resources have been assigned to the projects and programs has proven difficult for previous generations of sourcing teams.

Fortunately, new tools and processes are making project management and performance tracking easier. A range of organizations have begun to implement program and project management tools that allow team leaders to monitor and gain visibility into day-to-day activities, project results and team performance throughout the sourcing lifecycle, supporting strategic resource reallocation when necessary. This real-time visibility also assists in managing project bottlenecks and the associated risks, such as the interruption of goods and services to the company. Additionally these tools can help aggregate and convey overall savings results to the rest of the organization.

Results tracking tools can help call attention to the procurement organization as a bottom line enabler, boosting morale while also creating new opportunities for influence and savings in such sensitive categories as marketing and engineering. By proactively marketing the results the sourcing team has achieved to the rest of the organization, sourcing professionals are able to bring even further corporate spend under management. Vehicles that help sourcing teams communicate their results include corporate dashboards, regular management reports, targeted email programs, internal newsletters and intranet portals.

### Use Case

**A Fortune 100 entertainment conglomerate** is challenged to cut costs worldwide to meet earnings goals. Over 300 sourcing professionals are managing diverse savings initiatives around the world, while a centralized management team is tasked with overseeing resource allocations and results. In order to market their corporate contributions in a credible way, the team standardized the process for calculating realized savings across categories and globally. Facilitated by electronic tools, the process and the results are automatically captured and reported to management via analysis dashboards.

## BONUS HABIT: Utilize a single strategic sourcing solution

Whether it's streamlining sourcing processes, proactively engaging suppliers, seeking third-party subject matter expertise, getting to know spend data more intimately, or discovering more about your supply markets, there are always new opportunities to learn about, and incorporate, best practices throughout the sourcing process. Thanks to the advent of new technologies that can support and automate these processes, it has never been easier to enhance sourcing performance.

Over 300 corporations have turned to Ariba for sourcing expertise and technology enablement to drive over \$225 billion in annual sourced spend.

But the great news for procurement organizations is that these technologies and enabling platforms are becoming mainstream, reducing deployment complexity and minimizing implementation risk. Several years ago, procurement organizations were forced to cobble together solutions from best of breed sourcing vendors, with one company providing the technology and/or services for spend analysis,

another for RFX and yet another for contract management—all disconnected without visibility across the entire sourcing process. Now, though, integrated solutions that manage the end-to-end sourcing process can help organizations gain full project visibility across all steps in the sourcing process. The simplicity and effectiveness of a single platform approach is helping leading procurement organizations drive savings and results that were previously unattainable.

Above all, it's critical for procurement organizations to seek out a partner who can help them realize the benefits of an integrated sourcing platform. Leading procurement organizations should seek out a solutions provider with both a track record of success and proven capabilities and expertise. To date, over 85 corporations have turned to Ariba for sourcing expertise and technology enablement to drive over \$50 billion in annual sourced spend. In fact, all of the case studies presented above are stories about unique Ariba sourcing customers who are gaining unprecedented value and return on investment from their sourcing solutions.

Ultimately sourcing is an ongoing journey, not a one-off initiative. With its combination of technology and services that spans the sourcing process end-to-end, Ariba is well positioned to help sourcing professionals at every step along the way.

# CHECKLIST

## for Seven Effective Sourcing Habits

Maintaining a lean and mean supply chain is a corporate best practice—and sourcing is an integral part of that process. But as supply chains grow ever more complex, so do the sourcing strategies. Companies that wish to maintain best in class sourcing processes must continually refine, rework and re-evaluate their operations as market conditions, technologies and even internal corporate goals evolve.

But some fundamentals do apply to everyone. Below are seven quick questions all sourcing professionals should ask themselves as they strive to improve sourcing activities.

### **1 Do you have visibility into your spend and operations as you begin to conduct opportunity assessments?**

No matter how complex a sourcing project may be, the first step is always the same: a thorough opportunity assessment. But without visibility into spend across divisions and systems, savings will always be limited.

### **2 Are you using the appropriate sourcing strategy for the category in question?**

The process for procuring a complex engineered component is vastly different from that of temporary labor or MRO. Always do a deep dive into the category in question before determining and executing on a sourcing strategy.

### **3 Have you engaged all the right stakeholders in the process, at the right time?**

Get buy-in from stakeholders from the beginning of an initiative onward. You must also give cross-functional stakeholders—from product design to operations—an efficient means to contribute to the sourcing process, to drive process improvement and maximize savings.

### **4 Are you sourcing everything in your organization that can be strategically sourced *and* following through on all sourcing events?**

Once firms are able to move beyond the typical sourcing pattern of focusing solely on strategic categories and the obvious low hanging fruit, the strategy of sourcing as many categories as possible can reap considerable savings. However, it is essential that sourcing professionals maintain communications and follow up with both stakeholders and suppliers before, during, and after the sourcing event.

### **5 Do you have a compliance plan in place?**

Compliance is critical to realizing negotiated savings. A recent AMR Research report notes that companies that implement targeted contract management projects find they deliver a 150 percent to 200 percent payback within a year. Make sure compliance planning is baked into sourcing initiatives from start to finish.

### **6 Are you working with your suppliers to continue to drive savings?**

Suppliers can be a strategic partner in the ongoing effort to engineer costs out of the supply chain. Ongoing collaboration and communication with suppliers can often unearth new opportunities for savings and efficiencies.

### **7 Are you tracking your progress? More important, are you marketing the results to the organization?**

Measuring progress and tracking results is important to any corporate discipline. And getting the message out to the organization not only enhances the reputation and influence of the procurement organization, but also fosters a culture of sustainable savings and improved supply chain efficiency.

## About Ariba

Ariba, Inc. is the leading Spend Management solutions provider. Ariba helps companies develop and leverage spend management as a core competency to drive significant bottom line results. Ariba Spend Management software and services allow companies to align their organizations with a spend-centric focus and deploy closed-loop processes for increased efficiencies and sustainable savings.

For more information on procurement outsourcing, visit [www.ariba.com](http://www.ariba.com) or call 1-866-772-7422.



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