

Chapter 13 Sourcing Materials and Services

Purchasing, procurement and strategic sourcing become critical as organizations improve the performance of their supply chains.

- **Purchasing:** The transactional function of buying products and services that involves the placement and processing of a purchase order.
- **Procurement:** The process of managing a broad range of processes that are associated with a company's acquisition of goods and services.
- **Strategic sourcing:** Strategic sourcing is broader and more comprehensive than procurement. It focuses on the supply chain impacts of procurement and purchasing decisions, and works cross-functionally to achieve overall business goals.



Unique Aspects of Strategic Sourcing

- Consolidate & leverage purchasing power
- Emphasis on best value instead of lowest product cost
- Stronger and more comprehensive supplier relationship
- Focus on process improvements
- Enhanced teamwork and professionalism



Strategic Sourcing Methodology

Five core principles are recognized as key drivers to achieve high levels of value:

- Assess the total (cost and value)
- Develop individual sourcing strategies
- Evaluate internal requirements
- Focus on supplier economics
- Drive continuous improvement



Seven key steps in strategic sourcing methodology:

Step 1: Project Planning and Kickoff, which suggests that a formal start to the strategic sourcing process is warranted.

Step 2: Profile Spend, to develop an accurate understanding of requirements.

- Identify or reevaluate needs
- Define and evaluate user requirements
- Decide whether to make or buy



Seven key steps in strategic sourcing methodology

Step 3: Assess Supply Market

- Critical step in the strategic sourcing process
- All potential sources of supply are identified
 - a thorough assessment of a supply market
 - identify all possible suppliers
 - prescreen all possible sources

Step 4: Develop Sourcing Strategy

- Develop a sourcing strategy
 - establish whether a supplier has the capabilities
 - RFP provides specific information as to what the buying company

Seven key steps in strategic sourcing methodology

Step 5: Execute Sourcing Strategy

- Begins with an evaluation of the suppliers that remain following the RFI and RFP processes and culminates in the award of a contract.

Step 6: Transition and Integrate

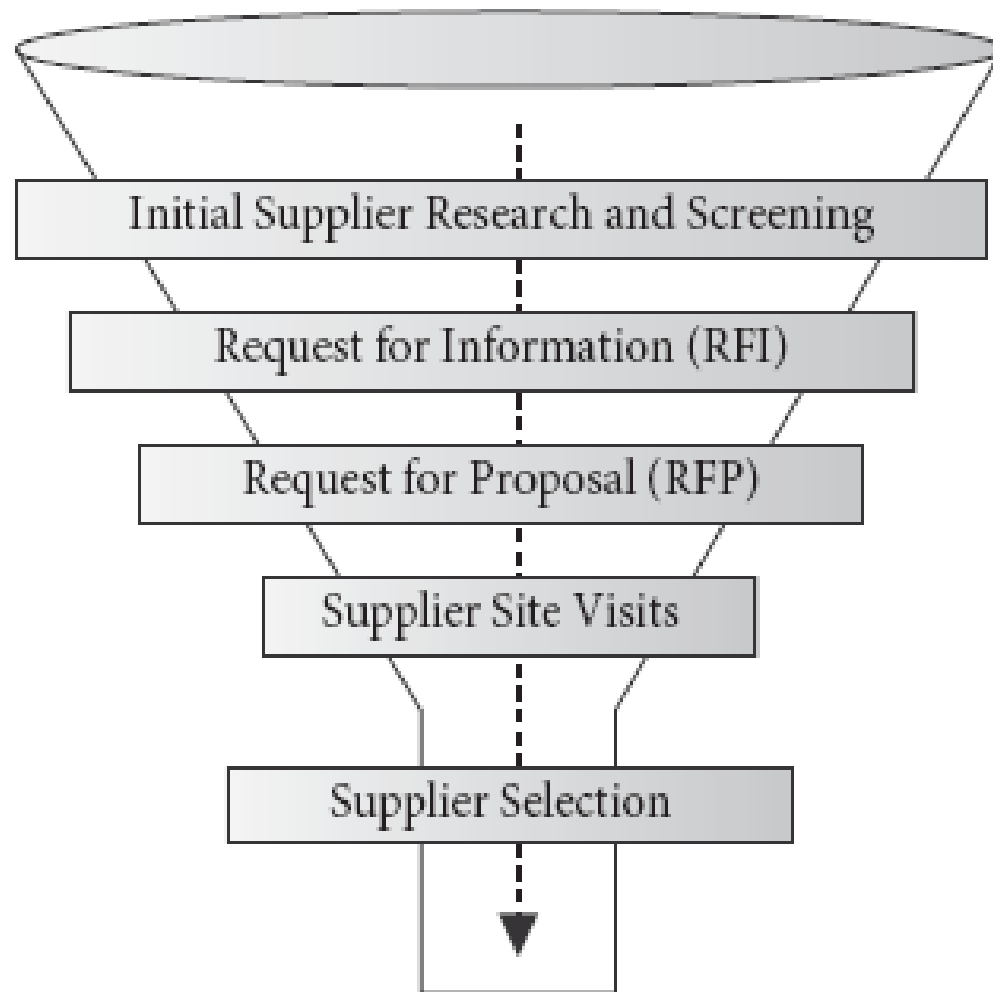
- Important elements of this step are the finalization of the contractual agreement, planning the transition process, and receipt or delivery of the product or service.

Step 7: Measure and Improve Performance

- Post purchase performance evaluation is very important.

Figure 13-6

Supplier Portfolio Screening Process





Managing Sourcing and Procurement Processes

- Determine the type of purchase
- Determine the necessary levels of investment
- Perform the procurement process
- Evaluate the effectiveness of the strategic sourcing process
 - Were the user's needs satisfied?
 - Was the investment necessary?



Types and Importance of Items and Service Purchased:

- **Generics** are low-risk, low-value items and services that typically do not enter the final product.
- **Commodities** are items or services that are low in risk but high in value. Basic production materials (bolts), basic packaging (exterior box), and transportation services are examples of commodities that enhance the profitability of the company but pose a low risk.
- **Distinctives** are high-risk, low-value items and services such as engineered items, parts that are available from only a limited number of suppliers, or items that have a long lead time.
- **Criticals** are high-risk, high-value items that give the final product a competitive advantage in the marketplace

Supplier Commitment to Quality - Certifications and Registrations

□ TQM

- a strategy in which entire organization focused on an examination of process variability and continuous improvement

□ Six Sigma

- is similar to TQM its approach involves training experts

□ ISO 9000

- making sure that companies have standard processes in place that they follow

Procurement Price

- Sources of Price
 - Commodity markets
 - Price lists
 - Price quotation
 - Negotiation

- The objective of the procurement process is to purchase goods and services at the “best” price, which may not be the lowest price per unit at the vendor source.

Figure 13-8

Hierarchy of Price Measurement Approaches

Strategic

Highest total value to the ultimate customer
of the final firm in the supply chain

Lowest total cost to the final firm in the
entire supply chain

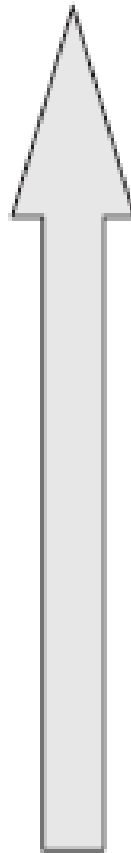
Operational

Lowest total cost to the firm

Lowest landed cost

Tactical

Lowest base/unit cost



Base cost and additional direct and indirect costs

- Traditional Basic Input Costs
 - the primary price of the product or materials as paid by the firm
- Direct Transaction Costs
 - costs of detecting, transmitting the need for, and processing the material flow
- Supplier Relational Costs
 - costs of creating and maintaining a relationship with a supplier
- Landed Costs
 - inbound transportation
 - actual transportation cost
 - FOB terms

Figure 13-9

Total Procurement Price

Traditional Basic Input Costs (Price)

+

Direct Transaction Costs

+

Supplier Relational Costs

+

Landed Costs

+

Quality Costs/Factors

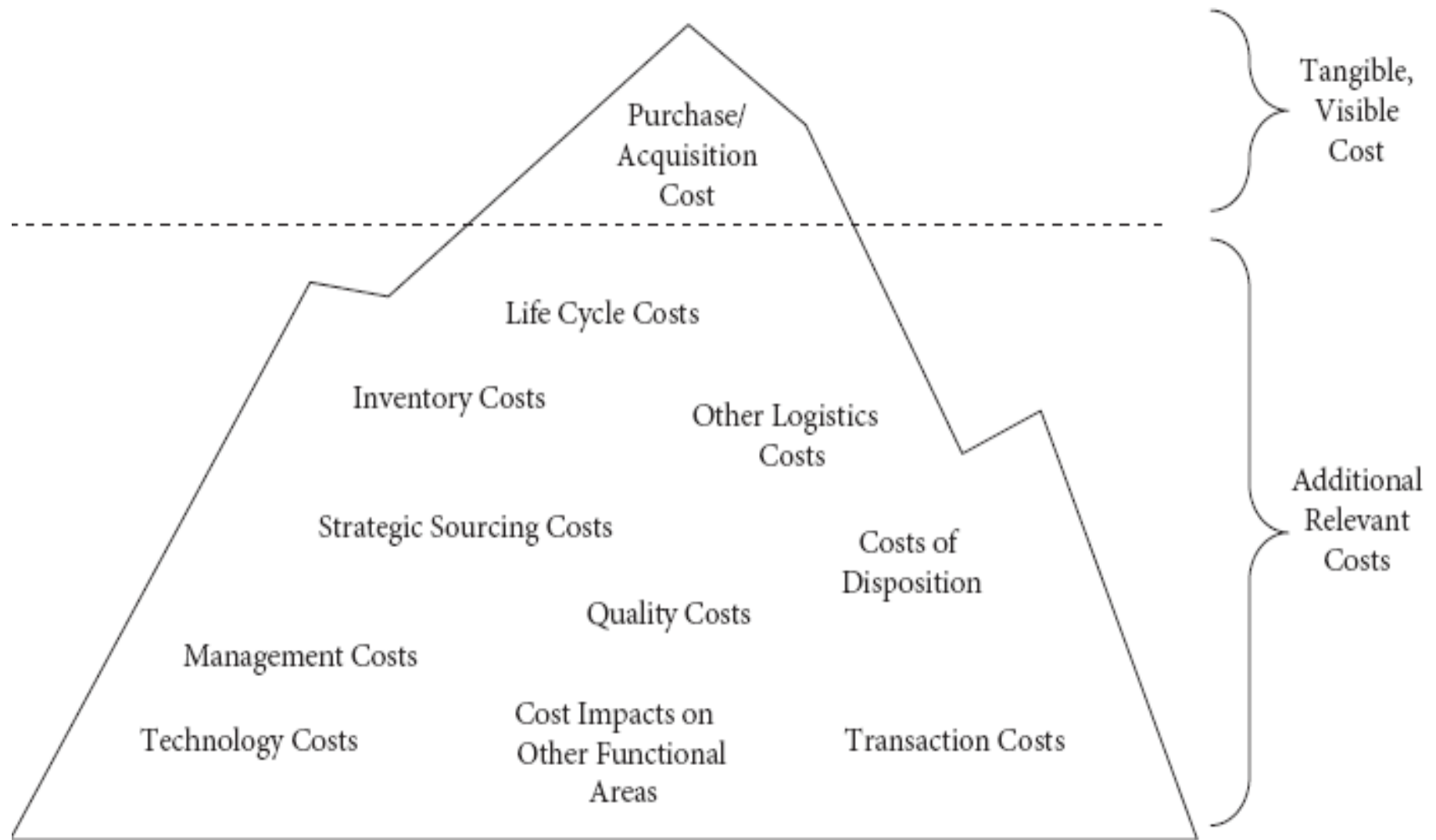
+

Operations Logistics Costs

Total Procurement Price

Figure 13-10

Understanding Total Cost of Ownership (TCO)





e-Sourcing and e-Procurement

- the use of electronic capabilities to conduct activities and processes relating to procurement and sourcing
- enhance the effectiveness and efficiency of traditional buying processes

Figure 13-12

Advantages of Electronic Procurement

Lower Operating Costs

- Reduce paperwork
- Reduce sourcing time
- Improve control over inventory and spending

Improve Procurement and Sourcing Efficiency

- Find new supply sources
- Improve communications
- Improve personnel use
- Lower cycle times

Reduce Procurement Prices

- Improve comparison shopping
- Reduce overall prices paid



e-Commerce Models

- Sell-side system:
 - Online businesses selling to individual companies or consumers
- Electronic marketplace:
 - Represents a seller-operated service consisting of electronic catalogs from vendors within a market
- Buy-side system
 - Buyer-controlled e-procurement or e-commerce service
- Online trading community:
 - Maintained by third-party technology vendor where multiple buyers and multiple sellers can conduct business