Leading Edge

3 Strategic Sourcing

Strategic Sourcing
through Private
E-Marketplaces

E-procurement systems and reverse auction-based services
have proved the validity of applying technology to purchasing
and sourcing.

ODScommerce

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Introduction

Business leaders continually evaluate new methods to improve the profitability of their companies. They achieve these improvements by increasing revenues and decreasing costs. This paper analyzes how companies can significantly increase their profitability by implementing a strategic sourcing solution to reduce costs.

Strategic sourcing focuses on improving how companies purchase the goods and services they rely on to remain competitive. It is a cost saving measure that can dramatically improve profitability by exerting downwardpressure on sourcing costs. The value proposition of strategic sourcing is that it enables buying organizations to obtain the highest quality of goods and services needed, with a predictable supply at the lowest total cost. Total cost is defined as more than just the cost of a good or service. It also includes ancillary costs that vary based on the buying organization's industry and the type of demand being fulfilled. Examples of these ancillary costs include: shipping, holding, and cost of capital. The results that this type of program can have on a company's bottom line are quite compelling.

Table 1 demonstrates how a relatively small percentage savings on sourcing can have a significant effect on a company's profitability. In contrast, companies attempting to match this improvement by increasing revenues would have to increase their sales volume dramatically in a very short time. This example is illustrated below with real case studies.

Strategic sourcing is a robust methodology that defines a complex buying process. As with any intricate process, further value may be derived by automation through a best of breed software tool.

Modeling the strategic sourcing process in a private electronic marketplace enhances the value delivered to both buying and selling entities through clearly defined processes, reduced cycle times and objective decision support. As case studies below demonstrate, a ODScommerce customer saved over $100 Million (15% of spend) in less than a year of production with this type of sourcing solution.

This paper discusses:

- Buy side and sell side strategic sourcing e-marketplace value propositions
- Trends in the strategic sourcing space
- Strategic sourcing solution options
- Characteristics of a strong strategic sourcing solution
- Real-world case studies

This paper covers the entire spectrum of strategic sourcing. The value proposition for buying and supplying organizations is covered first, explaining why this phenomenon is important for companies. Then, trends in the sourcing space are covered to add context to future models and requirements. The paper then covers strategic sourcing solution deployment options, serving as a guide for how companies can implement a solution. Following this description is a detailed inves - tigation of the requirements for a system that can be used to power a sourcing e-marketplace, defining what companies should be addressing when choosing a solution. Finally, real-world case studies are provided with indepth analyses of actual savings achieved from strategic sourcing initiatives.

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Demand Side Value Proposition

The most compelling aspect of the strategic sourcing value proposition is the reduction in costs for the buyer sourcing goods and services. These savings come from increased information on market pricing for products being sourced, informed supplier selection and supply aggregation. The Aberdeen Group believes that companies leveraging a strategic sourcing process will save between 5% and 20% on all commodity types. As detailed in case studies below, these percentages can translate to hundreds of millions of dollars in savings. Table 1 illustrates the significant potential for savings in a strategic sourcing e-marketplace and the resultant impact to companies' bottom-line profitability.

In addition to the direct cost savings achieved through strategic sourcing, companies that automate the Request for Quote (RFQ) creation and negotiation process find further savings in the reduction of administrative overhead and process costs associated with sourcing. In many purchasing organizations today, RFQ creation, distribution and review is a tedious process that requires a manual, paper-based human-intensive effort. Much of this tactical work is performed by purchasing professionals who are experts in the products and services being sourced, as well as the process to extract the best value from the supply base. Shuffling, revising and routing paper takes time from these individuals that could be better spent working with new suppliers or increasing their knowledge of a particular sourcing need within their organization. Companies can save a significant amount of time and money by automating these processes and freeing up purchasing professionals to perform their most value-added tasks. The Harvard Business School found that automating the Request for Proposal (RFP) creation and negotiation process has saved companies 15% of the total amount of spend (HBS whitepaper #9-598-109, February 1998). A great deal of this savings is due to the additional time available for the purchasing professionals, which increases their ability to manage more suppliers throughout the negotiation process. Software applications that automate the sourcing process are a tool to help the purchasing manager. By managing much of the creation and routing of RFQs and bids, they allow the purchasing manager more time to analyze new prospective suppliers. In addition, the inherent scalability of such a system allows the purchasing manager to invite appropriate new suppliers to bid on a particular RFQ. These types of systems not only scale in the invitation and negotiations with suppliers, but also assist in evaluating competitive bids. An online sourcing solution provides an easy mechanism to manage more suppliers than was previously possible, which aggregates supply, reduces reliance on individual suppliers and leads to lower total costs.

Buyers find further value by reducing the time required to complete the RFQ creation and negotiation cycle for a particular sourcing need. This reduction arises from implementing and automating the strategic sourcing process. The entire sourcing process is accelerated (for both the buying organization and the suppliers) by implementing a system that centralizes the administration, standardizes the content of an RFQ and (optionally) publishes the decision-making criteria. Cycle time can be reduced by more than 50%, providing purchasing managers with opportunities to focus on their core responsibilities.

Supply Side Value Proposition

Strategic sourcing and its automation provide a strong value proposition to the suppliers who sit on the other side of the negotiation table as well. Many supplying organizations have heard stories of suppliers being beat up on price through an automated reverse auction. In a strategic sourcing e-marketplace, more complex bidding enables the supplier to prevent this price only comparison, and provides a host of compelling benefits to suppliers.

Suppliers must understand and believe in the value of such an offering before they become willing to participate. This is especially important when rolling out a private electronic marketplace-based sourcing implementation, which can turn the one-toone, human-to-human negotiation process into a one-to-many, human-to-marketplace negotiation. It is typically the responsibility of the buying organization to communicate the value of such an e-marketplace to

its suppliers before implementation. As with buying organizations, suppliers' sales representatives find process efficiency improvements in an automated strategic sourcing event. In a manual negotiation, the supplier has to accept, prepare and return RFQ documents by phone, fax, and mail. In an automated sourcing e-marketplace, RFQs, bids and responses are all centralized in one location, and prepared through a structured interface. Suppliers are thus able to focus their energy on executing their sales strategies, dealing with new prospects and increasing competitiveness, rather than wasting precious time 'pushing paper.' Often times the buying organization will publish the negotiation rules and process flow into the e-marketplace for each type of product or service being sourced. This information may encompass what parameters will be negotiated on, what the minimum levels are for certain parameters, and how decisions will be made. The supplier may then use this information to formulate asales strategy. This enables all suppliers to compete on a level playing field and

formulate their sales strategy based on the same information. Concerns over collusion and partiality based on non-business related factors can thus be eliminated. Rules for negotiation must focus on more than just price: these are not just reverse auctions. Complex real-world negotiations that touch on subjects such as quality ratings, conformance to standards and delivery terms must also be implemented in a strategic sourcing emarketplace. This non-trivial negotiation enables sup-plying organizations to differentiate themselves based on their core strengths, rather than just on the cost of products and services, and helps prevent commoditization, which often leads to rapid price decline.

Strategic Sourcing Saving Potential

	Percent savings through strategic sourcing eMarketplace		
	Baseline $1000M	5% $1000M	10% $1000M	15% $1000M
REVENUE GROSS MARGINS	$550M	$523M	$495M	$468M
NET INCOME (pretax)	$225M	$225M	$225M	$225M
Percent increase in net income	$225M	$252M	$280M	$307M
OPERATING EXPENSES	$125M	$125M	$125M	$125M
COGS-Materials	$100M	$127M	$155M	$182M
COGS-Labor/Off		27%	55%	82%

E-Procurement and Strategic Sourcing

E-procurement systems that manage the process of requisition-to-purchase were among the first successful applications of Internet technology to improve the sourcing process. By increasing efficiency, eliminating maverick buying and reducing manual workload, companies greatly reduced the cost of generating a purchase order. In recent times, it has become increasingly apparent that e-procurement systems focus primarily on non-strategic, indirect materials. While still significant in their contribution in driving process efficiencies and reducing tactical cost, these systems unfortunately failed to address the more significant half of the sourcing paradigm that represents the greater savings opportunity: sourcing vendor contracts.

Strategic sourcing solutions focus on the initial part of the purchasing process that traditional e-procurement systems do not address; they facilitate reducing the total cost of goods and services that a company requires. In a 1999 survey conducted by Aberdeen, it was found that nearly 80% of the cost of an end product is established during this period. The core value proposition of these systems is to create significant cost savings that help drive companies' profitability as well as fuel the complete development of an end-to-end, sourcing-to-requisition- to-pay solution.

The diagram above illustrates the entire sourcing process, with strategic sourcing activities on the left and e-procurement on the right. While both types of sourcing applications offer different paths to achieving significant savings, there is an obvious synergy between them.

Once a negotiation tool has driven down the total cost for a good or service, and the terms have been captured in a contract, that contract can populate an e-procurement catalog. Users across the enterprise may then order products and services against that catalog.

Market Trends in Strategic Sourcing

The notion that the world is becoming increasingly smaller, faster and smarter is not a new concept, especially when it comes to business. Technology has been a major factor and the Internet is fueling the trend. Unlike expensive private networks, the ubiquity and ease of Internet access provides an unprecedented, low-cost channel of communication between trade partners. As a result, corporations have been given the power to exchange large amounts of information in real-time, which makes possible the coordination of design, distribution, production and selling activities across many companies, whereas only a few years ago this type of collaboration was extremely difficult even within the confines of just one company.

These trends apply equally to strategic sourcing. Once constrained by geographic reasons to ally strategically with localized vendors, corporations are now able to source directly from global vendors. With trade partners aligned more closely and sharing information electronically, cycle times for corporate decision-making and transactions are compressing. Materials and services that used to take six months or more to source are now taking half that time to source. In addition, corporations are continuously improving
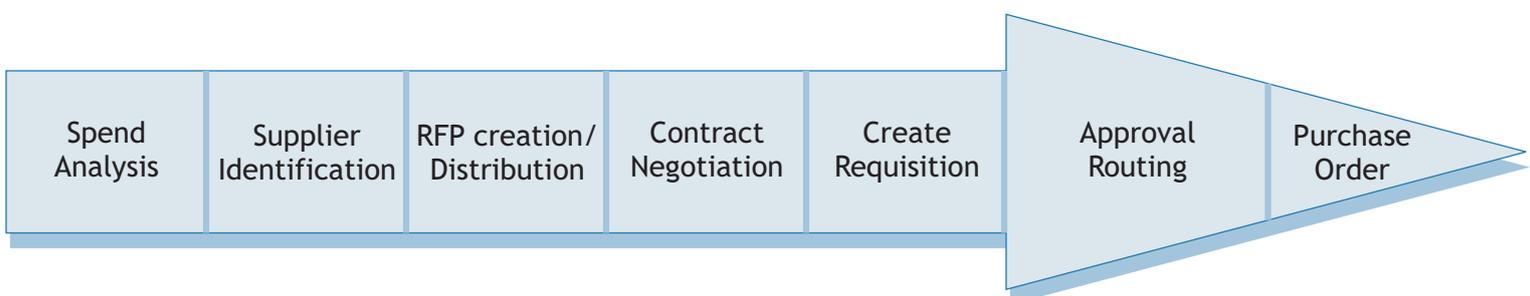
Spend Analysis	Supplier Identification	RFP creation/ Distribution	Contract Negotiation	Create Requisition	Approval Routing	Purchase Order

Figure 1 – The entire sourcing process, with strategic sourcing activities on the left and e-procurement on the right.

upon and getting smarter about their sourcing activities. Over the past five years, companies have invested heavily in rationalizing vendors, aggregating demand across disparate business units and evaluating the total cost of purchasing goods and services before selecting which vendors to award with contracts. These programs are all aimed at the same objective: making smarter and more cost effective sourcing decisions, and they have proven to be very successful.

The common misperception of online structured negotiation is that it is a new type of procurement program to replace the requisition-to-pay process. The reality is that structured negotiation is a tool that recognizes that strategic sourcing programs represent the greatest opportunity for savings in the supply chain. Viewing structured negotiation as a decision support tool that enables sourcing professionals to make better informed decisions on what to purchase, in what proportion and from which vendor(s) is a helpful way to understand the opportunities.

As little as five years ago, when a company had a desire to source a material or service, the process was labor consuming and time intensive. Essentially, a procurement professional would sit at a table across from a sales representative from a potential vendor and they would negotiate, face-toface, all the specifics of their relationship. Eventually sourcing professionals improved on the process and began to implement more fact-based negotiations. In fact-based negotiations, sourcing professionals sought to understand all aspects of their spend and the cost structure of various suppliers. Armed with this data, they were in a far superior position to negotiate better terms. The process, however, remained face-toface. Today, sourcing professionals can publish all information regarding a potential sourcing contract and interact with numerous trade partners synchronously across vast geographic areas.

Strategic Sourcing Solutions

Sourcing solutions have evolved to meet the changing needs of purchasing professionals and suppliers. The first sourcing solutions focused on the corporate-wide MRO procurement process. These solutions were designed to effect process savings in repeated non-strategic buys. In contrast, strategic sourcing solutions focus on the initial phases of the sourcing cycle where potential savings are greatest, as outlined above. More information on the differences between these types of solutions may be found in Figure 1.

From Reverse Auction to Structured Negotiation

True strategic sourcing applications began with reverse auction powered e-marketplaces. A reverse auction is a supply-aggregating event that lowers the price of goods for a buyer. The initial push in automating the direct materials negotiation process was with highly standardized products, or near commodities. Typically, these offerings differ little from one vendor to the next, and there are usually a large number of vendors from which to choose. Given the highly competitive dynamics, these products tend to be price and time sensitive commodities. As a result, reverse auctions are an effective tool to implement price control by aggregating demand and increasing competition among suppliers.

As powerful a tool as reverse auction has proven to be, not all sourcing events can be reduced to a single decision factor such as price. For most strategic spend categories the deciding criteria depend on the strategic needs of an organization, such as the continuity and consistency of supply, collaboration in product design and/or willingness to make relationship-specific investments to improve the supply chain. This multiplicity of decision factors does not diminish the relevance and importance to a firm in lowering costs. Companies require a solution that allows them to balance real world requirements such as creating close strategic relationships with key sourcing (or trade) partners with the ability to negotiate for the best possible "total cost" for strategic materials and services.

Until recently, the constraint had been trying to map the complexity of real world sourcing issues to an online negotiation capability. Standard reverse auctions are relatively easy events to manage and tend to be very good at price discovery. However, they tend to be less successful when buyers and sellers also

need to agree on shipping logistics, payment terms, quality tolerances and so forth. A new type of negotiation isneeded: structured negotiations.

The core capability of a structured negotiation is enabling purchasing professionals to define how they want to buy, and then use a strategic sourcing e-marketplace to centralize negotiations. In these e-marketplaces invited suppliers participate by joining in structured negotiations with buyers. More information on the definition of structured negotiations may be found in "Structured Negotiations" sidebar below.

Deployment Options

Purchasing professionals, business managers and IT architects are presented with a wide array of strategic sourcing solution deployment options. Should they outsource, partner or purchase technology? Currently, many companies are hedging their bets and doing all three. Table 2 outlines the advantages and disadvantages of each strategic sourcing solution deployment option available today.

Solutions

To deliver on the promise of online strategic sourcing, a solution must support existing negotiation practices while streamlining processes and adding value through technology. Across all industries and deployment models, the following high-level tasks must be supported:

- Analysis of a company's spend
- Supplier selection
  Developing a Request for Quote or Request for Proposal (RFQ/RFP) with specifications of what goods or services are needed and points of negotiation
- Approving the requirements and amount of spend from one or more managers within the organization
- Selecting new and existing suppliers to participate in the negotiation and distribution process
- Negotiating back and forth with the qualified suppliers

Structured Negotiations

Structured Negotiation features mirror existing purchasing and sales negotiation practices and provide a mechanism for buyers and sellers to interact effectively. The successful use of structured negotiations lowers the costs of goods purchased, shortens the cycle time to source, reduces administration costs and improves overall supplier performance.

They accomplish these benefits by moving online the practices that sourcing organizations already perform in negotiating for complex goods. The three main functional areas that enable this transition are:

- Multi-parameter bidding – supports the evaluation of suppliers on a variety of criteria deemed relevant by the buyer; quality, delivery and payment terms, among other criteria, can be negotiated in addition to price.

- Threaded interactions – Actual negotiation still occurs on a one-to-one basis as buyers and sellers adjust their offers to reach satisfying terms for both parties. By threading this iterative negotiation together, while tracking progress and documenting results, a structurednegotiation increases efficiency and enables data analysis.

- Multi-staged negotiation – To further improve the supplier evaluation process, individual threaded negotiations can be aggregated into stages where supplier bids can be compared against each other. This action enables a buyer to screen a large group of suppliers based on specific criteria at each stage. By the last stage, the supplier(s) with the lowest total cost are determined and rewarded.

o Deciding which suppliers "win" the business and how to distribute the spend among one or more suppliers

o Mining data from the negotiation event and integrating event results with other applications after the negotiation is complete.

Each of these steps can be improved upon by using an effective strategic sourcing solution. Selecting the best application involves determining which solution meets purchasing professionals' requirements in each step; the best of breed solution will address each of these.

Analysis of Spending Patterns

The first step to effective strategic sourcing is gaining a thorough understanding of company spending. With potentially multiple departments sourcing independently, and most likely using many of the same vendors, there are inherent inefficiencies that develop. Online sourcing solutions provide better visibility into total company spend on specific goods, total spend with a given supplier, and are flexible enough to provide a number of views and reports to understand spending patterns. Gaining insight into these aggregated spending habits provides buyers much better leverage when sourcing new goods.

Development of an eRFQ/eRFP

When strategic materials or services are sourced, a detailed requirements document must be created and distributed to prospective suppliers. This document helps suppliers understand what is needed and how to plan their negotiation strategy. Online strategic sourcing solutions can streamline this document creation and distribution process.

In the ideal solution, RFQ/P "wizards" provide significant time-savings in creating requirements documents. Wizards direct buyers through a series of selections and questions that are then used to automate the creations of the final requirements document. For example, when multiple negotiation points need to be included such as delivery time,

quality of goods, or financing options, the document author simply selects the appropriate parameters along with any specific criteria (such as acceptable delivery times). These selections will be included in the requirements document.

For materials that are repeatedly sourced, or for sourcing events that are similar in nature, templates can be created that include specifications from pre-existing RFQs. Effective solutions also allow uploading of a complex Bill of Materials (BOM) to quickly input sourcing information for multiple line items and additional supporting documents such as images or complex engineering documents.

RFQ document creation may also be facilitated through integration with information from online catalogs. For frequently sourced items listed in standard catalogs, detailed information on the goods can be transferred out of the catalog into an RFQ document automatically, saving significant time in reinputting that information.

By replacing a traditional fax or mail distribution mechanism with an Internet based strategic sourcing solution, buyers can circulate the eRFP/Q documents to suppliers quickly and easily. This automated activity saves buying organizations substantial amounts of both time and money and provides a practical means of reaching global suppliers.

The combination of wizards, templates and effective upload tools, along with faster distribution mechanisms reduces the amount of time to create and circulate the requirements documents. Using an online sourcing solution, the US Army reduced the time to negotiate computers to 13 days, a significant improvement over the 30 to 60 days the process historically took to receive the same goods. (Business 2.0 article, Oct. 10, 2000)

Workflow

Within purchasing departments, typically one or more managers must review and approve the RFQ to either confirm the specific requirements or give approval over certain spending levels. An effective online sourcing solution provides facilities to route documents based on business rules for approval. For example, once an RFQ is completed and submitted, a purchasing manager may receive an email containing a link back to the document. The manager simply clicks on the document link to review, edit, or approve the request. At this point the next manager in the chain is notified as needed. This type of document approval workflow streamlines the authorization process providing considerable time-savings, and also ensures that approvals are enforced before items or services are sourced.

Supplier Management

The next step in sourcing involves choosing which suppliers should be invited to bid and negotiate on the selected products or services. Supplier selection is another activity where companies benefit by implementing their own private e-marketplace with suppliers, rather than turning to a third party emarketplace. Maintaining relationships with key suppliers is critical for corporations whose vendor relationships provide competitive advantage in the e-marketplace.

Feature rich online sourcing solutions provide a number of ways to manage suppliers. A company will generally have supplier information already available in its existing systems, such as a database or directory of suppliers. Companies should require that the strategic sourcing solution integrates with existing supplier databases.

In addition to the selection of suppliers, notification and security are key considerations. An effective solution provides a number of means to notify selected suppliers that a negotiation event is going to take place. At a minimum, customized emails should be sent to suppliers automatically and include relevant information and a link to the e-marketplace where the negotiation will take place. There should

also be a straightforward integration path to more advanced technologies such as notification via wireless devices that are becoming increasingly prevalent, as well as legacy technologies, such as facsimile. To ensure that only selected suppliers may participate in the negotiation, a security model must be part of the system that controls which participants can view information and bid.

Effective Online Negotiations

The most significant product differentiation in an online strategic sourcing solution is the ability to model complex negotiations that encompass factors beyond price. These capabilities are defined in the "Structured Negotiations" sidebar on page 133.

Here again, a company that creates its own e-marketplace for suppliers gains an important advantage over participating in an independent e-marketplace. By operating its own online sourcing market, a company can completely customize the parameters that will be used in negotiation, how many stages of negotiation, how long the event will take place and more. This control allows the buying company to continue using its existing sourcing methodology, rather than settle for a constrained system that puts it on equal ground with competitors.

Communication between buyers and sellers is also facilitated through online tools such as chat software for real-time communication either before or during the sourcing event, and discussion forums where suppliers post questions and purchasing department personnel post answers for all suppliers to review. A full-featured solution also should provide tools for monitoring and graphing bids and negotiated parameters while the negotiation event is occurring. These mechanisms provide immediate feedback to the purchaser while negotiations take place.

Post Negotiation Functionality

Once a negotiation is complete, a number of useful tools exist for evaluating bids and mining information from the e-marketplace. With complex negotiations or multiple lines of bidding, decision support tools provide a means of evaluating the tradeoffs between

Strategic Sourcing Saving Potential

Option	Advantages	Disadvantages	Example
Public E-Marketplace	o Industry expertise o Existing supply base	o Little to no ability to model existing negotiation practices o Risk of exposing key suppliers to competitive entities with the e-marketplace o E-Marketplace viability o Exposure of strategic spend	VerticalNet
Hosted Service	o Existing supply base	o Little to no ability to model existing negotiation practices o Risk of exposing key suppliers to competitive entities with the e-marketplace o Flexibility of the underlying technology	Freemarkets Ariba Sourcing
Private E-Marketplace within a company's IT infrastructure	o Complete control over the sourcing process o Complete control over the supplier access	o IT resource training	ODScommerce
Hosted Private E-Marketplace	o Complete control over the sourcing process o Complete control over the supplier access o Industry expertise o Sourcing expertise		Accenture Dynamic Pricing Services

supplier offers. For example, a buyer can assign weighted scoring to each parameter in a negotiation. Price could be assigned as 60% of the decision, delivery time 30%, and quality of goods 10%. The weighting of each negotiation parameter is based on the buyer's priorities, which can include the total cost of working with a supplier as opposed to just the cost of goods. Once all the bids are entered, an online sourcing solution automatically sorts the bids based on this custom defined total cost for each bid.

Online strategic sourcing events provide a wealth of data on supplier behavior, product and service costs, and supplier performance. Reporting tools should be included that allow graphing and mining based on a variety of factors. This data can then be used to set the starting point for future negotiations or to understand changes in the cost of goods over time. The access to data is another area where ownership of the e-marketplace is a valuable asset to a corporationthe buyer maintains ownership of the important market and supplier information, rather than an independent third party.

The other major aspect of post negotiation functionality that online strategic sourcing must support is integration with existing backend systems. Ideally the solution supports industry standard interfaces such as XML and/or Java API's. This support allows a company's IT resources to quickly understand how to integrate the online strategic sourcing solution into their existing infrastructure. Often times Enterprise Application Integration (EAI) tools can be used to accelerate this process. Integration points include moving order information into Supply Chain Management applications or using the negotiation terms to provide input into contract development applications.

Case Studies

Across industries, companies are realizing the vast cost savings and process efficiency improvements possible in the implementation of a strategic sourcing solution like the example discussed in the previous section. Internally run, private e-marketplace solutions are helping companies reduce the total costs of the products and services that they depend on to operate, while also strengthening their supplier relationships. The following three success stories detail how Global 2000 companies have leveraged inhouse strategic sourcing solutions to save money and improve their purchasing processes.

Fortune 50 manufacturer saves over $100M and strengthens supplier relationships with a private strategic sourcing solution

A manufacturer of industrial power products wanted to reduce its purchasing costs without adversely affecting its critical supplier relationships. With 80% of its $1B annual spend coming from direct goods, the company saw the potential savings inherent in adding efficiency to its direct purchasing process but did not want to forgo control of its supplier relationships to a third party hosted e-marketplace. After realizing 80% cost savings through an internally-run, trial online structured negotiation to source fasteners (nuts and bolts), the manufacturer established a permanent organization dedicated to online strategic sourcing with ODScommerce's solution, and has saved $110M to date!

On average, supplier contracts range from 1 to 3 years and involve the intricacies of dealing with both domestic and international suppliers. As a result, price is only one of many variables considered in negotiations. Because the direct materials sourced are integral to the end products that are manufactured, quality concerns and time of delivery are also critical to the purchasing process.

The existing sourcing process required time and resources dedicated to complex negotiations with an average of seven suppliers for each product. Negotiating offline with seven suppliers demanded time-consuming phone calls and faxes that hindered the sourcing process. To add efficiency to its sourcing process, the company elected to utilize a private online e-marketplace, limiting participation to pre-approved suppliers. With its highly customized solution, the buyer lowered its costs and was able to allocate its spend across more suppliers than before, thus decreasing the risk associated with supplier dependence. The online structured negotiations allowed the manufacturer to determine what

percentage was allocated to each supplier based on the overall competitiveness of each bid.

In the first online negotiation event, the price of fasteners fell from $1.4M to $280,000 as a result of competitive bidding; the company achieved 100% ROI on its first event! This first-time savings of 80% has leveled out to 15% across all products. To date, the company, which now holds 25-30 negotiation events each week, has put about $750M in spend through the e-marketplace, equating to direct savings of over $100M.

Global Airline maintains supplier relationships while saving over 30% on purchases of PCs and stationery through a private exchange

Strategic sourcing in service-based industries is often focused on products that are classified as indirect materials. When sourcing for a $64 billion global airline, for example, the cost of indirect goods quickly adds up and can severely impact a company's bottom line.

Looking to improve its overall procurement process, one global airline sought to:

- Reduce costs of Personal Computers (PCs) and stationery purchases
- Simplify negotiation for tactical, indirect goods
- Increase time spent on core competencies and strategic activities

With the help of Accenture, the airline altered its purchasing process by automating the time-consuming steps that reduced efficiency, while also educating suppliers as to how the new process worked.

The revamped process included the following steps:

- Identify product to source
- Communicate bidding process to internal sourcing team
- Distribute RFP to selected suppliers with description of negotiation process electronically
- Train suppliers on sourcing system

- Hold negotiation event
- Select winner(s) based on total cost

The key changes to the existing process came in automating the negotiation and selection steps of the procurement process. By keeping the entire process in-house with an online negotiation software tool, rather than outsourcing it to a public e-marketplace, the airline maintained its key supplier relationships, while also finding the best market prices available for PCs and stationery.

For its first online negotiation, the airline sent out an RFP to its existing supplier base (8 suppliers) for the purchase of stationery. The bidding started at $1.4M. After one hour, 49 bids had been made, with each bid declining an average of $46,000. At the end of the auction, the airline paid $920,000 for stationery that previously cost $1.29M. By automating their strategic sourcing process, the airline saved 30% compared to the historic price that they paid for stationery.

Using the same mechanism, the airline also ran a negotiation for PCs . In this event, 9 suppliers were invited to bid. During the one-hour process, 46 bids were placed, with each bid declining an average of $106,000. Historically, the airline paid $2.6M for similar PC purchases; this time, it paid only $1.6M, saving 37%.

In both of these events, the airline eliminated the time-consuming phone calls and faxes that it previously employed to source products. As a result, its purchasing managers could focus on more strategic activities such as finding additional ways to improve the company's purchasing processes.

European construction e-marketplace uses best of breed strategic sourcing solution with existing MRO focused e-procurement application.

E-procurement initiatives such as online catalogs have helped many companies streamline and gain control over their MRO purchasing activities. The associated time and cost savings have demonstrated exactly how the Internet can be utilized to cut costs by adding efficiency to basic purchasing processes.

Today, companies are beginning to explore the potential savings available through online direct materials sourcing, which are significantly greater than the returns for MRO process changes. However, direct sourcing is also much more complex than MRO procurement and, as a result, requires a more sophisticated solution for success. While MRO purchasing can often be moved online via a fixed-price, electronic catalog, direct sourcing negotiations are often characterized by complex specifications that include parameters such as delivery time and cost, payment terms, product or service quality, as well as price. In addition, dynamic pricing and negotiation capabilities are often required in order to reach a final agreement for direct materials and services.

One European construction e-marketplace supplemented its existing MRO solution with a best of breed strategic sourcing solution to provide a comprehensive e-procurement and eSourcing platform for its customers. Rather than using a "one-stopshop" solution, the e-marketplace realized that it could only achieve the complex features and functionality it required by using separate, best-of-breed solutions for MRO and direct materials.

As a result of its e-procurement and eSourcing initiatives, this European construction firm established the first comprehensive online platform in its industry, offering transactions and services that encompass the entire range of construction industry purchasing needs, including direct and indirect materials and services. Buyers and sellers benefit from online negotiations and auctions for construction materials and equipment, while also eliminating the time and money consuming processing tasks of indirect material procurement.

Direct materials and services can be negotiated for through the site's eRFP service, which allows for bidding on complex specifications including construction plans and schedules, not to mention supplies. If a contractor needs to build a brick wall, both the bricks and the labor can be acquired through the e-marketplace.

Conclusion

Early attempts at applying technology to companies' sourcing needs have provided quantifiable returns. e-procurement systems and reverse auction-based services have proved the validity of applying technology to purchasing and sourcing.

New tools that address the complex requirements of the strategic sourcing process are now available that extend and enhance these initial benefits. These tools facilitate business processes that are inherently more strategic and challenging. Through the implementation of a private marketplace enabled with structured negotiations for strategic sourcing, companies may source faster and smarter.

For more information about the strategic sourcing space, please see
http://www.ODScommerce.com/solutions/stratsource.htm

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