



Strategic Sourcing

**Leveraging the Power of Your Strategic
Suppliers**

Written by

Dan Chenoweth

MBA, CPA

Dan@ExecutiveEducationInc.Com

www.ExecutiveEducationInc.Com

STRATEGIC SOURCING TABLE OF CONTENTS

APPENDICES

- Appendix A:** Glossary of Terms
- Appendix B:** Reasons for Outsourcing
- Appendix C:** Expense Categories Most Widely Outsourced
- Appendix D:** The Balance of Measures
- Appendix E:** Product Family Examples
- Appendix F:** Examples of Procurement Process Metrics
- Appendix G:** Strategic Outsourcing Model
- Appendix H:** E-Sourcing Vendor Checklist
- Appendix I:** E-Sourcing Solution Checklist
- Appendix J:** Partial List of E-Sourcing and E-Procurement Vendors

BIBLIOGRAPHY

SUPPLEMENTAL INFORMATION

- Spray Paint International Procurement Process Flow Diagram
- Manufacturing Process Flow Diagram
- Supplier Expectations: Tier I, II and III

APPENDIX A GLOSSARY OF TERMS

Balance of Measures: Measuring the multiple dimensions of process performance rather than only focusing on one measure such as cost. This measurement approach recognizes that a business serves the needs of multiple stakeholders (customers, owners, employees) who have a broad range of expectations.

Chief Resource Officer (CRO): Senior level executive position generally reporting to a company's CEO or CFO. This position is responsible to create, store and broadly communicate benchmarks, processes and insights on how to develop and refine relationships with strategic suppliers.

Cost Driver: The factors or triggers that cause costs to be incurred or resources to be consumed. In order to reduce the costs of a particular activity, one must first understand the various drivers of those costs.

Core Competencies: The knowledge based know-how, technology, research, market access and other resources which add value in the eyes of an organization's customers. The collective learnings in an organization, especially ways to coordinate and integrate diverse skills and technologies. In layman's language: things you are really, really good at that customers value, and that you would be unwilling to delegate to outside suppliers.

Complimentarities: A term coined by the strategy guru, Michael Porter, of the Harvard Business school. His premise is that the key to success and sustainable competitive advantage is the connectivity or integration of all activities in the value chain, defined as "complimentarities." If activities are complimentary it means they mutually reinforce each other, creating synergy. Competition cannot easily replicate the entire chain of complimentarities. Thus, the more processes a company can excel at, the more difficult for competitors to replicate.

Cycle Time: The elapsed time it takes for an activity or a process to transform an input into an output. Cycle time, or how quickly companies can translate customer needs into products or services, has been touted as a key competitive advantage in most industries.

Delivery: Providing customers with products or services in the right amounts, in the right place, at the right time, in the right package, and at the right price.

Direct Spend: Items / components / materials that go into a company's final product and are things the customers ultimately see, feel, hear, or use. Example: Raw materials.

E-Procurement: Managing existing suppliers and transactions more efficiently using technology. The focus is on automating today's procurement process by linking a supplier's existing product catalog to a buyer's administrative system.

E-Sourcing: Using Internet technology, plus specialized methodologies and expertise to make the discovery, qualification and selection of suppliers more efficient and competitive. Ultimately, e-sourcing is about creating competitive advantage by opening an organization up to potentially a wider array of new suppliers. E-sourcing solutions are not so much decision-makers as decision enhancers and accelerators.

Gantt Chart: A horizontal bar chart that graphically displays the time relationship of the steps in a project. When completed, the Gantt Chart shows the flow of activities in a sequence as well as those that can be undertaken at the same time.

Indirect Spend: All the expenses which support the purchase, manufacture and distribution of a company's final product or service but which are NOT part of the final product. Examples: general and administrative expenses, utilities, freight, packaging, etc.

Mission: The reason an organization exists. What the organization is in business to do. A well-defined mission statement provides the direction for establishing strategies and goals for an organization.

Outside Contributors: Those organizations, functions, work groups, teams or individuals that are NOT legally connected to the organization. There are three types of outside contributors: strategic allies / joint venture partners, strategic suppliers, other suppliers.

P-Cards / Procurement Cards: The use of credit cards to help manage and control small expenditures with many suppliers. Partnering with an outside financial services company, the organization specifies who is authorized to receive such cards, what types of expenditures they can be used for, which vendor locations are pre-approved, and a maximum dollar limit per transaction or per spending period. P-cards enable employees to make small, but necessary purchases, while eliminating the need for the same rigor as larger, more strategic purchases. Excellent for Tier III Supplier transactions.

PERT Diagram: Program Evaluation and Review Technique Diagram. A more sophisticated form of planning than a Gantt Chart. A PERT Diagram is used for projects with many interactive steps showing the relationship among various steps in a project.

Pareto Chart: A bar graph where categories of information are arranged in descending order from left to right. Used to identify the most important causes or

effects so that corrective action can be directed where it will have the most impact. The Pareto Principle, commonly called the 80-20 rule, states that 80% of the effects are caused by 20% of the problem. Examples: 80% of waste is caused by 20% of errors, 80% of time is spent on 20% of tasks, 80% of spend is with 20% of suppliers.

Performance Management: The process of translating strategic goals into action, monitoring progress and rewarding results.

Process Flow Diagram: An objective representation of individual steps in any cross-functional process, process segment or activity shown in the order in which the step occurs. Standard symbols are used to differentiate activities or steps in the process from decision points and start and end points. Depicting the cycle time from start to finish can be an important tool in understanding where bottlenecks exist in a process and areas for improvement.

Product Families: A means of grouping similar product or service purchases into logical categories based on how those purchases help an organization accomplish its strategic goals and objectives.

Purchase Price: Amount of money initially paid to a supplier for a product or service. Sometimes called “first cost.”

Purchasing / Procurement: The process of using the help and resources of outside contributors to produce an organization’s products or services. This process includes researching who the best outside contributors are to meet the organization’s needs, developing a sourcing strategy, communicating Requests for Proposals (RFPs) to most likely outside contributors, negotiating final contract terms and conditions, and managing and developing relationships with outside contributors selected.

Quality: Consistent conformance to customer expectations. Quality is always defined from the customer’s perspective and always represents a moving target in a competitive marketplace.

Relationship: “A connection, association or involvement; an emotional or other connection between people; dependence alliance, kinship, affinity.” *Per Webster’s Dictionary.* Relationships generally require three attributes:

- (1) They yield current and future benefits for the partners.
- (2) They are collaborative --- new value is created together which could not be created individually.
- (3) They require interpersonal connections and internal infrastructures that enhance joint learning.

Request for Information (RFI): Blanket request issued by an organization to current or potential outside contributors asking for information about a particular component, material or service that the outside contributor may be able provide.

Request for Proposal (RFP): Blanket request issued by an organization to current or potential outside contributors asking for a specific response from that contributor to a specific organization need.

Request for Quote (RFQ): A targeted request to specific outside contributors who responded favorably to an RFP to now provide even more information on the exact nature of product or service they could provide in response to the RFP and at what cost, including any special terms and conditions.

Stakeholders: The parties who have an interest in the process and how well it performs. This includes customers, internal management, shareholders, employees and suppliers. The customer is the highest priority stakeholder.

Strategic Allies / Joint Venture Partners: An alliance that creates an independent business entity and allocates ownership, operational responsibilities, and financial risks and rewards to each member, while preserving the separate identity/autonomy of the original partners.

Strategic Plan: A road map that translates the organization's vision and mission into things people can do.

Strategic Sourcing / Outsourcing: Making a conscious decision as an organization to determine which outside contributors can provide the best products or services that meet the organization's needs as well as determine which products, services, processes, activities and tasks currently performed internally could be provided by an outside contributor, usually as an arms length supplier.

Strategic Suppliers: Organizations, groups or individuals who, under contract or agreement, provide products or services to the organization which it defines as vital to success. Significant time and attention should be spent with these suppliers to develop joint values, shared understanding of strategic direction, and joint problem solving methods.

Strategy: The framework that guides those choices that determine the nature and direction of an organization. The goal of strategy is to help a company position itself for the long-term future by concentrating on what it does best. The search for, and the defense of, competitive advantage lies at the heart of leadership's responsibilities. The strategic plan defines a unique and valuable position, makes clear trade-offs and builds the appropriate integration of activities to deliver on that position. The essence of strategic positioning is to choose activities that are **different** from the competition

Supplier Base: The list of all suppliers with whom an organization currently has transactions / dealings or has had dealings in the past few years.

Supplier Management Teams (SMTs): Cross-functional teams created for the primary purpose of selecting suppliers, jointly determining goals and objectives with those suppliers, providing the single point of coordination for the suppliers in a particular product family, and on-going supplier management.

Supplier Tiers: Suppliers can be divided into three tiers:

- **Tier I:** The few suppliers who are critical to the company's success; few other suppliers can provide the product or service in the required quantity or quality. Generally relationships with Tier I suppliers are long-term partnerships.
- **Tier II:** Suppliers who are not critical to the organization's strategic success; other suppliers could provide the same product or service in the same quantity or quality. However, spending with Tier II suppliers is typically very large. Relationships with Tier II suppliers are generally long-term but transactional only, whereby contracts are negotiated and the relationship is put on "automatic pilot" governed by the terms and conditions of the contract.
- **Tier III:** Suppliers who are not critical to the organization's strategic success; many other suppliers could provide the same product or service in the same quantity or quality. Spending with Tier III suppliers is generally small and strictly transactional in nature. Consequently, many employees may be authorized to deal with Tier III suppliers following the company's stated policies and procedures within the boundaries of good judgement and common sense.

Supply Chain: The entire stream of activities from suppliers' supplier to customer's customer that delivers value to the ultimate end user of a particular product or service.

Total Cost of Ownership: The entire cost of a particular product or service over its life cycle. The Total Cost of Ownership includes the following components:

- **First cost savings** – Quoted price for the product or service per unit delivered
- **Process cost savings** – Cost to deal with this vendor.
- **Cost avoidance savings** – Warranty / guarantee cost, additional installation or repair and maintenance costs not necessary for the competitors' products.
- **Value add** – Additional value that the supplier may bring to the relationship, e.g. constantly scanning the horizon for new technological advances in the area in which they are the subject matter expert.

Values: The organization's "guiding stars," norms and principles about how people in the organization will treat one another and interact with others inside and outside the organization.

Vision: A picture of the expected future impact of the organization in the long term. A vision answers the question: "Why do I want to be involved with this organization long term?"

Work Breakdown Structure: A project management technique that divides a project into sub-units or work packages. Outcome: All elements required to complete the project are identified. Benefits: Reduce the chances of neglecting or overlooking an essential step. A Work Breakdown Structure is typically constructed with two or three levels of detail, although more levels may be required for very complex projects. Start by identifying logical sub-divisions of the project, then break each of these down further. Keep in mind that the goal is to identify a unit of work that is discrete and that advances the project toward completion.

APPENDIX B REASONS FOR OUTSOURCING

Survey results, percent of those responding citing each reason as a “very important” rationale for their outsourcing efforts: ¹

- Focus on core competencies: 67.3%
- Save money: 61.1%
- Tap vendor domain expertise: 55.5%
- Focus on strategic growth: 37.4%
- Maintain / reduce head count: 34.6%
- Redirect capital budget: 22.7%
- Reduce assets on books: 7.6 %
- Other: 2.8%

APPENDIX C EXPENSE CATEGORIES MOST WIDELY OUTSOURCED

Most widely adopted forms of outsourcing (% of respondents):²

- Travel services: 46.3%
- Employee benefits: 43.9%
- Payroll: 43.9%
- Tax advice / processing: 37.6%
- Insurance administration: 37.1 %
- Collections: 18.5%
- Recruitment: 18.0%
- Cash management: 16.6%
- Internal audit: 16.1 %
- Human resources: 14.1%

¹ Banham, Russ, “Cut to the Core,” *CFO Magazine*, October 1, 2001, *CFO Magazine* and AMR Research

² Ibid

APPENDIX D THE BALANCE OF MEASURES

“Balance of Measures” is a performance measurement approach which considers the multiple dimensions of a company’s performance from the different perspectives and needs of its stakeholders. It recognizes that excessive attention to any one dimension at the exclusion of others will inevitably lead to problems.

- Measures should be aligned with the organization’s strategies and goals.
- There should be a “balance of measures” around the following categories: Quality, Cost, Delivery (on-time rate), Cycle Time (turnaround time) and Morale of the workforce.
- Quality and Delivery focus on and create customer satisfaction.
- Morale focuses on and creates employee commitment.
- Cost and Cycle Time focus on and create outstanding financial performance.

Quality: Quality is always defined from the customer’s perspective. The three-step process to convert customer requirements into measurements:

- **Step #1:** Gather and analyze information about customer wants and needs and the associated expectations.
- **Step #2:** Understand the chain of processes that meet and exceed the expectations around customer wants and needs, from supplier’s supplier through internal processes to the customer’s customer.
- **Step #3:** Set targets for each process so that customer expectations around his/her wants and needs are met and exceeded.

Cost

“Results to Resources Ratio” Defined

The “Results to Resources” principle is important when developing cost measures. This means that displaying results in terms of percentages is more informative than displaying raw numbers only. A ratio helps answer the question “What effort was expended to achieve the final result?” Example: Return on Investment. How much did I invest and what interest did I earn on that investment? If one were to look at the interest earned on an investment over one year (e.g. \$1 million), one may assume that the earnings were extraordinary. However, if \$100 million had been invested to earn the \$1 million, the Return on Investment rate was only 1% --- NOT an extraordinary return.

Some “Results to Resources” measures for procurement may include the following:

- Cost per check written: Total Accounts Payable Department cost (wages, fringe benefits, other costs) divided by number of checks written per year.
- Cost per invoice processed: Total Accounts Payable Department cost divided by number of invoices processed from outside vendors / year.
- Percentage of invoices processed which require more than one pass through the system (a measure of poor quality and errors that lead to additional cost).

Benchmarking

Tracking costs alone is not very meaningful unless there is something to compare those costs against. Benchmarking is a methodology for a company to track its own progress over time as well as making comparisons to others inside or outside their industry. There are two types of benchmarking:

- **Internal Benchmarking:** Identifying the most meaningful cost ratios (examples per above) and monitoring procurement’s track record over time: weekly, monthly.
- **External Benchmarking:** Comparing internal metrics against industry averages as compiled by trade or professional organizations.

Cost Drivers

There are three ways to improve the Results to Resources ratio:

- (1) Reduce the numerator (resources consumed, or cost) while holding the results or denominator constant.

Example: Process the same number of invoices with **fewer** Accounts Payable staff.

- (2) Increase the denominator or results achieved while holding the numerator or costs constant.

Example: Process **more** invoices with the same number of Accounts Payable staff.

- (3) Reduce the numerator and increase the denominator **SIMULTANEOUSLY**, commonly called “doing more with less.”

Example: Process **more** invoices with **fewer** Accounts Payable staff.

One way to “do more with less” is to determine what the underlying factors are that drive costs. In the case of procurement, those factors include the total number of suppliers to be paid and managed and the complexity associated with the contract terms and conditions with those suppliers.

Total Cost of Ownership

Even though a supplier may initially provide a cheaper first cost for a product or service, the entire cost over the life cycle of the product or service should be examined. The Total Cost of Ownership includes the following components:

- **First cost savings** – Quoted price for the product or service per unit delivered
- **Process cost savings** – Cost to deal with this vendor. Are there any extraordinary circumstances which would add costs: e.g., prepayment required? Extended / protracted negotiation process? Additional legal fees?
- **Cost avoidance savings** – Will the vendor adequately cover any warranty returns for defects? Will the supplier guarantee the useful life of this product longer than the competitors’ guarantees? Are there additional installation or repair and maintenance costs with this product that are not necessary for the competitors’ products?
- **Value add** - Will the supplier add value to the relationship by automatically replenishing stock? Providing monthly usage reports? Scanning and monitoring the competitive environment for new technology or new emerging needs? Will the supplier proactively be involved in new product development?

Delivery / Cycle Time

Delivery: The customers must receive what they want, in the right amount, in the right place, at the right time. In order for this to occur, quality driven systems must align the entire supply chain around a common focus: complete satisfaction of the customer at the lowest total cost in the shortest amount of time. **Cycle time** is the elapsed time it takes for the company to transform an input (customer order) into an output (completed product or service). Some examples of Delivery and Cycle Time measures related to procurement:

- **Delivery:**
 - Response time to inquiries
 - Timeliness of information provided to customers
 - Number of unanswered phone calls
- **Cycle Time:**
 - Number of unprocessed invoices
 - Number of disbursement packages processed per person per day

Morale of the Workforce

Strategies can only be implemented and converted to action through people. Ultimately, the competitive effectiveness of an organization comes down to whether its people are better at thinking and implementing than the competition. Morale is a function of the competence and commitment of individuals in the organization. **Competence:** defined as the experience, skills, training and education employees have to accomplish the department’s purpose. **Commitment:** defined as the willingness of employees to do whatever it takes to accomplish the department’s goals.

Factors Leading to Competence	Factors Leading to Commitment
<ul style="list-style-type: none"> • Quality of work life • Multi-skill jobs • Quality of supervision • Work methods • Education and training systems • Selection process • Reward process • Management’s expectations • Safe working conditions • Work layout • Tools to perform work effectively • Performance appraisal and feedback • Promotion systems • Socialization, orientation and entry processes 	<ul style="list-style-type: none"> • Selection process • Equity sharing / profit sharing programs • Personal security to “tell it like it is” without fear of reprisal • Goal setting • Reward, recognition and celebration systems • Belief in a shared future • Creating strong self-images: employees identify with the company and perceive the company as successful now and in the future • Design of jobs so that the work is enjoyable, meaningful and satisfying • Career paths • Work groups to build the organization • Communication systems / information sharing • Involvement systems • Systems which encourage personal choice, e.g. broadly distributed leadership, empowering employees to do the right thing on behalf of the organization

Characteristics of Good Measures:

Following are characteristics of good measures:

- Indicator can be expressed quantitatively (in time, dollars, customer specifications, etc.)
- Indicator is readily accessible to the individuals performing the work
- Indicator is based on objective criteria and is verifiable (observable and auditable)
- Indicator is cost effective to obtain
- Indicator is used to improve, not punish individuals

To assure that measures are being appropriately monitored and used for decision making, ask and answer the following questions:

- How will we measure results?
- Who will compile the metrics?
- Who will they provide the results to?
- What will that person do with the results?

The best measures are those that align with the organization's performance management system. In other words, individuals are measured against criteria which is consistent with the criteria on their performance evaluation and which may result in wage increases, promotions or other recognition.

Attributes of an Ideal Measurement System

- The activities being measured, when taken together, are the foundation for a cost-effective, quality output.
- All employees receive the right information at the right time to support decisions.
- The measurement system focuses all activities on customer requirements.
- The best measures are few in number, simple, and easily understood.
- Measurements motivate the staff to continually improve against customer expectations and are not used to punish individuals or groups of employees.
- Measurements shift the focus of the organization from vertical hierarchy and bureaucracy to a more responsive, horizontal business system viewpoint.
- One system incorporates the entire balance of measures to be reviewed together.
- Measures are used to provide bottom-up feedback rather than top-down control.
- Targets increase and evolve over time to encourage continuous improvement and flexibility to changing process needs.
- The system includes a feedback loop for correction of problems and improvement.

Procurement Process Measures of Success - Examples

Opportunity Measures:

- Total number of suppliers
- Number of suppliers assigned to a Supplier Management Team
- Total dollars spent
- Total dollars spent managed by a Supplier Management Team

Feedback Measures:

- Supplier Management Team satisfaction measures around the process, structure, tools training and support received.

- Supplier feedback on the relationship itself, the ordering process, and the payment process.

Monitoring Measures:

- Number of Request for Proposals (RFPs) issued (Note: A decrease is favorable in that it indicates longer-term relationships have been established with vendors).

Supplier Churn:

- Number of suppliers added
- Number of suppliers deleted and reasons why: technology, supplier consolidation, poor relationship / performance, other reason

Balance of Measures Applied to Individual Suppliers - Examples

Quality:

- Commitment to ISO-9000 Quality Programs
- Joint root cause analysis between the supplier and the Supplier Management Team
- Minutes of outage
- On-time delivery failures
- Defect rates
- Customer satisfaction measures
- Supplier performance measure / corrected / rewarded
- Quarterly technical calibration meetings to ensure customer / supplier needs are being met

Cost:

- First cost savings: e.g. through “kitting” of products
- Process cost savings: e.g. reduced number and complexity of contracts, Electronic Data Interface, Electronic Fund Transfers
- Cost avoidance savings, e.g. use of new materials or processes
- Win/Win pricing
- Total solution pricing
- Capital cost avoidance

Cycle time:

- Expedited response time to address customer issues
- Mean time to repair
- Pre-production process cycle time
- Order interval
- Time to market for new product development

Value Add:

- Technology transfer
- Early supplier involvement in new product development
- Enhanced participation by Women / Minority Owned Enterprises
- Ability to grow the relationship beyond current boundaries, e.g. through strategic management of sub-contractors
- Enhanced global access to technology and R&D
- Uniform training
- Standardization of processes and process documentation
- Continued improvement programs around the manufacturing processes
- 24/7 technical support hot line
- Early involvement of supplier in annual budgets and forecasts for product needs
- Greater understanding by supplier of customer's needs and requirements and strategic direction
- Long-term business agreements
- Sharing risk: e.g. obsolete technology buyback
- Comprehensive product performance reports
- Initiate benchmark surveys in the industry
- Loaned equipment program in event of problems with purchased equipment
- Identifying standardized platforms
- Capacity planning
- Consulting service discounts
- Training discounts
- Co-location of customer in supplier facility
- Claims resolution on site

**APPENDIX E
PRODUCT FAMILY EXAMPLES**

FOOD MANUFACTURER

Direct Spend	Contract Pricing	<ul style="list-style-type: none"> ● Canned Goods ● Dry Goods ● Emulsifiers ● FG Chemicals ● Gums 	<ul style="list-style-type: none"> ● Icings ● Leavenings ● Meat ● Poultry ● Produce
	Packaging	<ul style="list-style-type: none"> ● Aluminum ● Corrugated ● Drums ● Film ● Labels 	<ul style="list-style-type: none"> ● Multi Wall Bags ● OPS/PET Containers ● Paper Liners ● Pure Pacs ● Rigid Plastics
	Commodities	<ul style="list-style-type: none"> ● Dressings ● Flour ● Grains 	<ul style="list-style-type: none"> ● Oils ● Sweeteners
Indirect Spend	Other	<ul style="list-style-type: none"> ● Building Repairs ● Cleaning ● Communications ● Dry Ice ● Equipment Rent ● Express Mail ● Fuel ● Office Supplies 	<ul style="list-style-type: none"> ● Other ● Temporary Labor ● Travel ● Uniforms ● Utilities ● Vehicle Maintenance ● Vehicle Rent ● Waste

**APPENDIX E
PRODUCT FAMILY EXAMPLES
(Continued)**

TELECOMMUNICATIONS PROVIDER

Direct Spend	Capacity Provisioning	<ul style="list-style-type: none"> • Data Communications • Outside Plant End-to End (Media-Copper-Miscellaneous) • Media-Fiber 	<ul style="list-style-type: none"> • NB Switch • SONET / ATM • Transmission
	Information Technology	<ul style="list-style-type: none"> • CSDB Platform • DSS Platform • Mainframe Technology 	<ul style="list-style-type: none"> • RDBMS • UNIX Application Server Requirements
Indirect Spend	Other	<ul style="list-style-type: none"> • Logistics – Transportation • OIM- Document Management 	<ul style="list-style-type: none"> • Real Estate – Building Services

DIRECTORY PRINTING COMPANY

Direct Spend	Paper	<ul style="list-style-type: none"> • Rolled Paper Stock <ul style="list-style-type: none"> • White • Yellow • Blue 	<ul style="list-style-type: none"> • Sheet Paper Stock
	Inks	<ul style="list-style-type: none"> • Black 	<ul style="list-style-type: none"> • Colors
Indirect Spend	Pre-Press	<ul style="list-style-type: none"> • Film 	<ul style="list-style-type: none"> • Plates
	Other	<ul style="list-style-type: none"> • Equipment Repairs & Maintenance <ul style="list-style-type: none"> • Binder Equipment • Sheet Fed Presses • Solvents / Cleaners • Warehouse Equipment • Web Presses 	<ul style="list-style-type: none"> • Pallets • Shrink-Wrap • Transportation <ul style="list-style-type: none"> • Incoming • Outgoing

APPENDIX F EXAMPLES OF PROCUREMENT PROCESS METRICS

Overall Procurement Process Measures

- Opportunity Measures
- Feedback Measures
- Monitoring Measures
- Supplier Churn

Guidelines for Supplier Management Team Measures

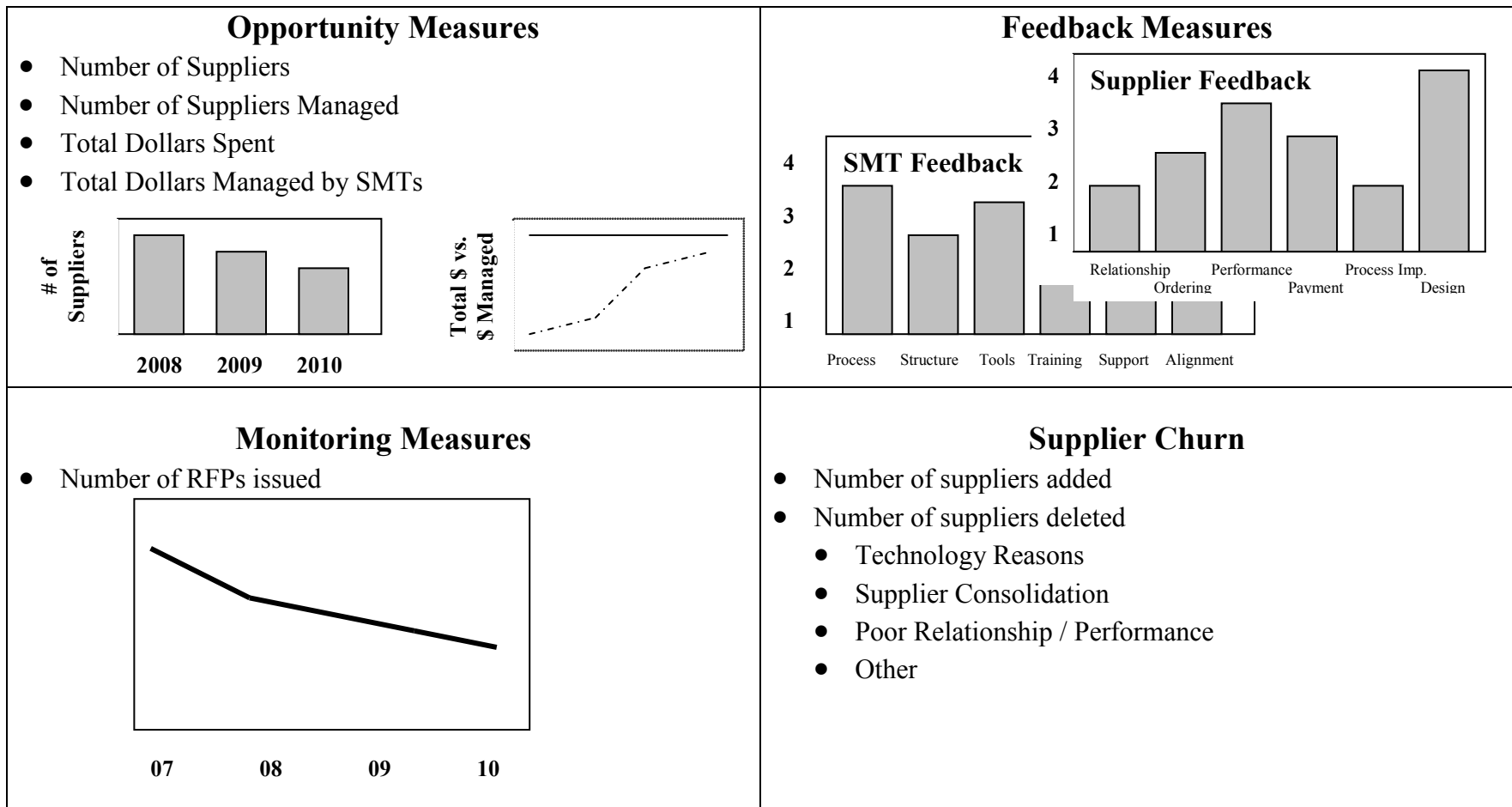
- Quality Measures
- Cost Savings
- Cycle Time Measures
- Value Add

Specific SMT Tracking Examples:

- Logistics - Transportation
- Miscellaneous Category, administered by one supplier, multiple sub-suppliers
- Real Estate – Building Services

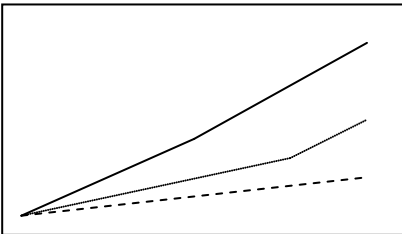
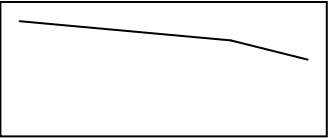
SEE EXAMPLES ON NEXT PAGES

OVERALL PROCUREMENT PROCESS MEASURES (Illustrative Purposes Only)



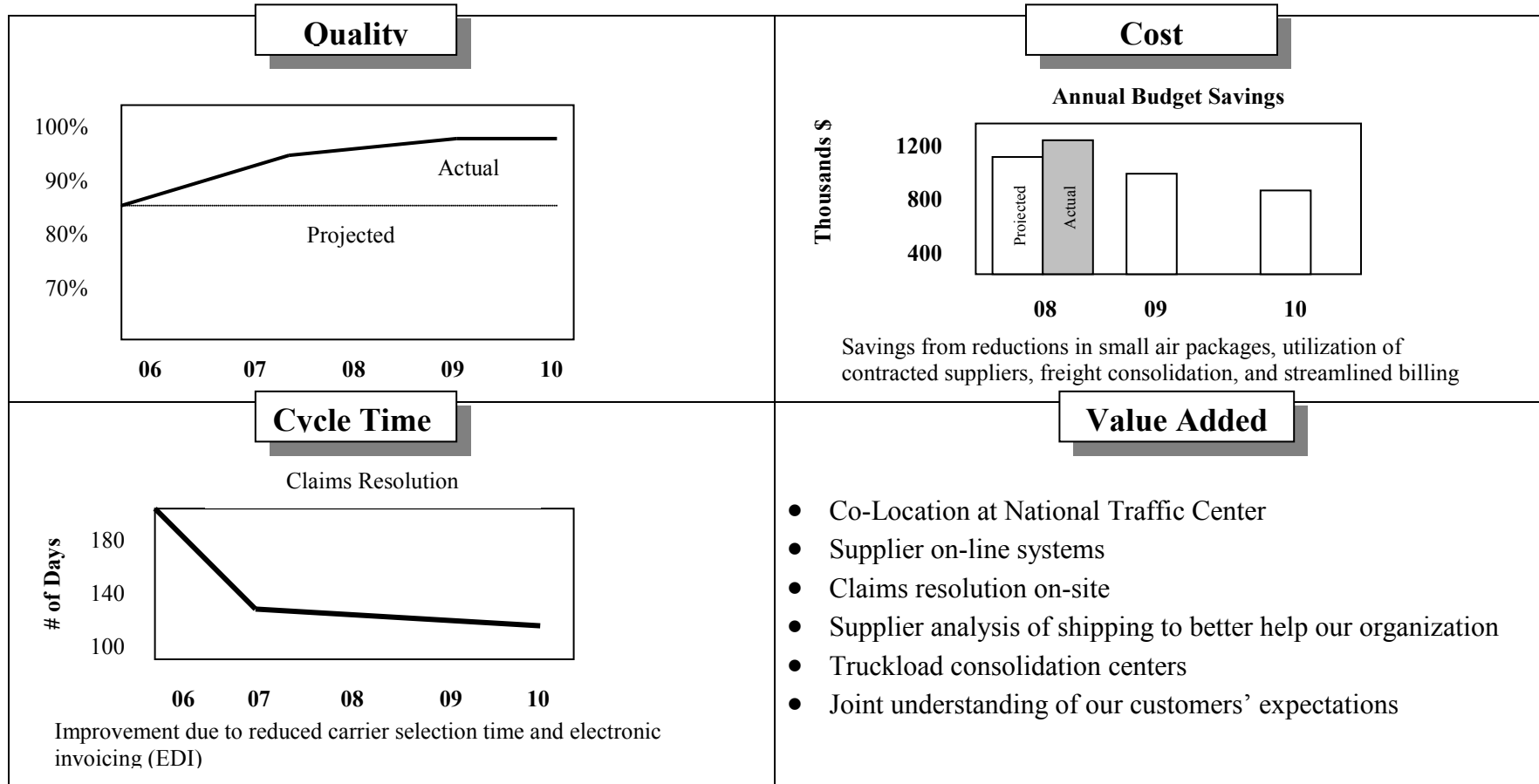
GUIDELINES FOR SUPPLIER MANAGEMENT TEAM (SMT) MEASURES

Measuring the Results (Illustrative Data Only)

<p style="text-align: center;">Quality Measures</p> <ul style="list-style-type: none"> ● Each SMT will have one or more measures in parts per million for quality. Examples: <ul style="list-style-type: none"> ● Minutes of outage ● On time delivery failures ● Repeated reports of problems ● Defect rates ● Some SMTs will also have customer satisfactions measures 	<p style="text-align: center;">Cost Savings</p> <ul style="list-style-type: none"> ● First cost savings ● Process cost savings (identified and documented) ● Cost avoidance savings <div style="text-align: center; margin-top: 20px;">  <div style="border: 1px dashed black; padding: 5px; width: fit-content; margin-left: auto; margin-right: auto;"> <p>First Cost</p> <hr style="border: 0; border-top: 1px solid black;"/> <p>Process Savings</p> <hr style="border: 0; border-top: 1px solid black;"/> <p>Cost Avoidance</p> <hr style="border: 0; border-top: 1px dashed black;"/> </div> </div>
<p style="text-align: center;">Cycle Time Measures</p> <ul style="list-style-type: none"> ● Each process will have at last one cycle time measurement. Examples: <ul style="list-style-type: none"> ● Response Time ● Mean Time to Repair ● Pre-production Process ● Order Interval ● These will not be added since bases are different. However, specific examples / impacts will be given each report period. Example: New Product Development team measures time to market: <div style="margin-top: 20px;"> <p style="display: inline-block; transform: rotate(-90deg); transform-origin: left top; white-space: nowrap;">NPD Cycle Time</p> <div style="display: inline-block; border: 1px solid black; width: 150px; height: 80px; vertical-align: middle; margin-left: 10px;">  </div> </div>	<p style="text-align: center;">Value Add</p> <ul style="list-style-type: none"> ● These will be documented. Where possible, results will be valued and shown under cost avoidance or cycle time. ● Others will be highlighted for each report period and might include: <ul style="list-style-type: none"> ● Minority / Women Owned Business involvement ● Technology transfer examples ● Early supplier involvement in new product development ● Supplier providing benchmark information based on industry in which they operate ● Supplier providing ideas on new technology in their industry

SMT METRICS EXAMPLE: LOGISTICS – TRANSPORTATION

(Illustrative Data Only)

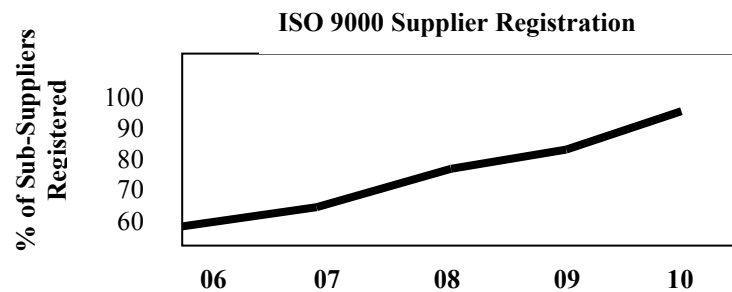


SMT METRICS EXAMPLE: MISCELLANEOUS CATEGORY (Illustrative Data Only)

- One Key Supplier selected to handle procurement of all products and services in this Miscellaneous Category from a number of sub-suppliers
- Total Miscellaneous Category estimate annual spend for 2002 = \$300 million

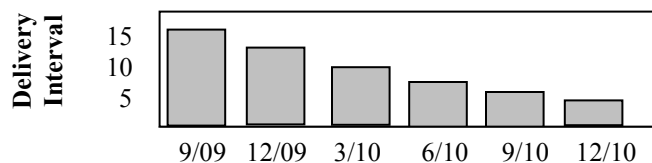
Quality

- Commitment to participate in shared risk
- Initial benchmarks will be on combinations of our own experience with the Supplier
- Enhance global access to technology, research and development, consistent training and technological advice



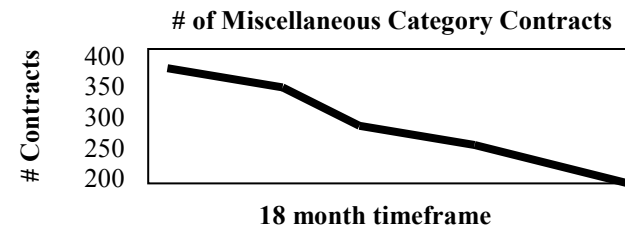
Cycle Time

- Tracking orders to develop / establish a base
- Average time for all Miscellaneous Category products 5 days by 12/31/10
- Expedite customer complaint resolution, decrease # calls - order tracking



Cost

- Reduce costs via supplier by kitting of products and overall uniform management of Miscellaneous Category products by a focal source (Key Supplier). A 1% (\$3 million) first cost savings based on \$300 million realized for 2003.
- Projected cost avoidance realized by reducing number of contracts. Based on average contract negotiation cost of \$7500, projected savings of \$2.85 million are possible over the next 3-5 years



Value Added

- Future cost avoidance through uniform process flow functions performed by Key Supplier (i.e., order tracking)
- Key supplier to provide full time technical support / training
- Ability to grow relationship with Key Supplier through strategic management of sub-suppliers
- Standardization of processes and documentation for tracking and measurement of Key and sub-suppliers
- Key Supplier as an integral part of planning and development in the early stages of our growth strategy development

SMT METRICS EXAMPLE: REAL ESTATE – BUILDING SERVICES

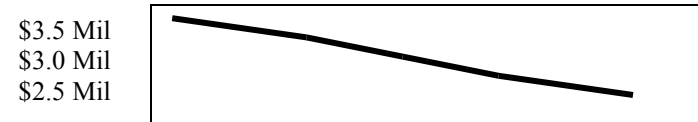
(Illustrative Data Only)

Quality

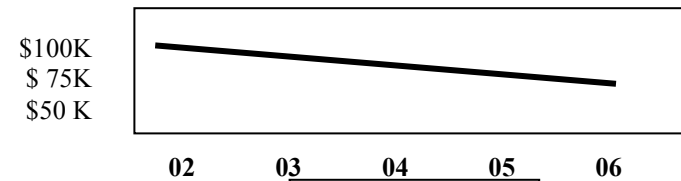
- Customer Satisfaction driven standards
- Consistent management and processes
- Enhanced communications (SMT, supplier, customer)
- Consistent supplier performance measurement
- Increased responsiveness to our organization’s objectives / needs

Cost

Annual Expenditures – 1st Cost

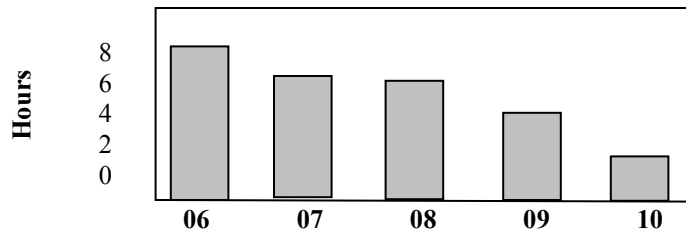


Process Savings



Cycle Time

Problem Resolution



Improvements from eliminating supplier selection process, reduced communication time, better bill paying efficiency

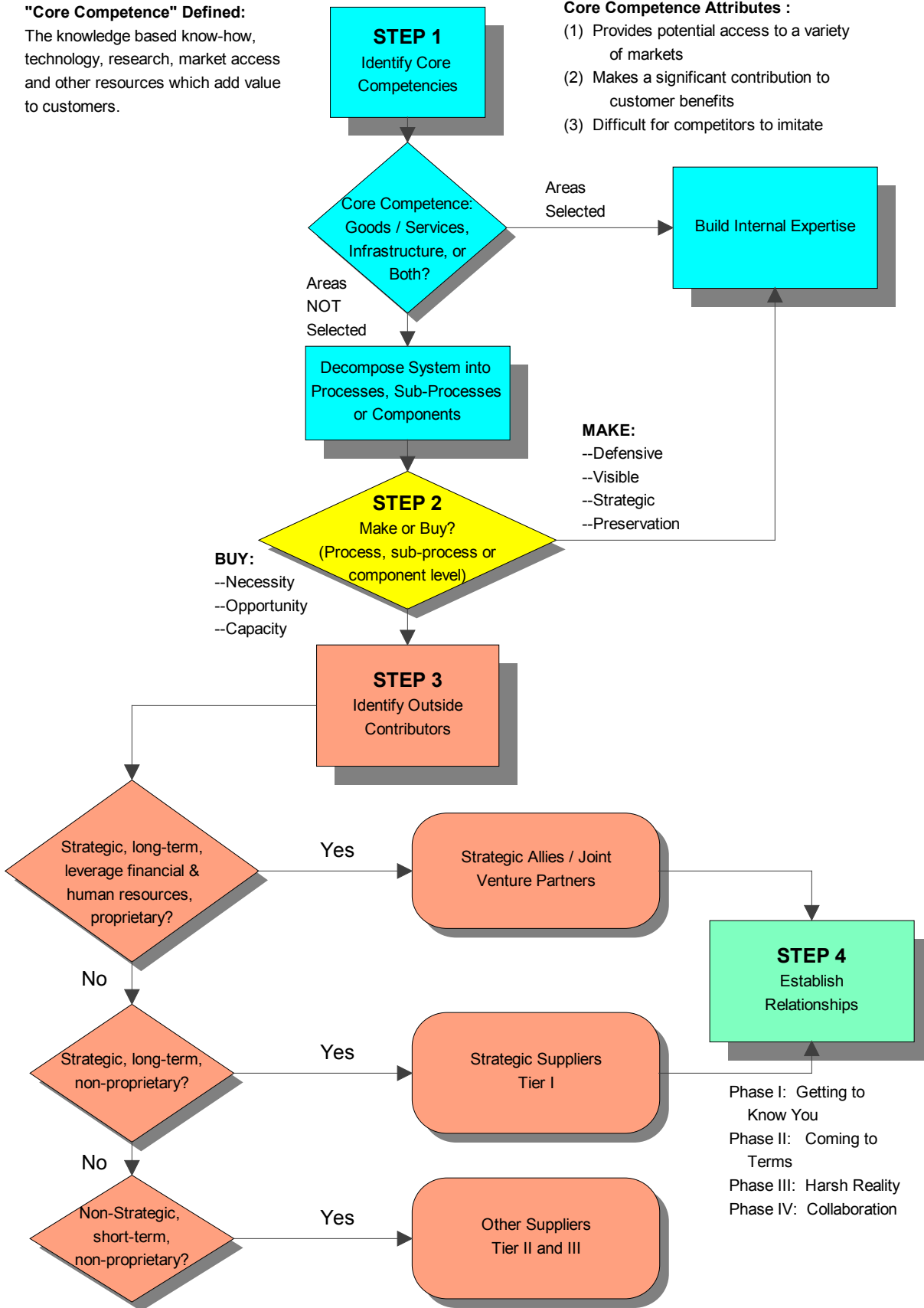
Value Added

- Ability to grow relationships through additional responsibilities / services
- Consistent training based on our customer’s needs
- Focus managers on customers and assets, not suppliers
- Minority / Women Owned Business program enhancements

APPENDIX G: STRATEGIC OUTSOURCING MODEL

"Core Competence" Defined:
The knowledge based know-how, technology, research, market access and other resources which add value to customers.

- Core Competence Attributes :**
- (1) Provides potential access to a variety of markets
 - (2) Makes a significant contribution to customer benefits
 - (3) Difficult for competitors to imitate



APPENDIX G: STRATEGIC OUTSOURCING MODEL

A study of over 150 procurement improvement initiatives indicates that significant savings are possible:

- (1) “Shining the spotlight” on a given product category can generate 3%-5% savings of annual purchases.
- (2) Challenging specifications and modifying product and package designs using a cross-functional approach can generate savings of 7%-15% of annual purchases.
- (3) Completely rethinking the way business is done with suppliers using a cross-functional approach, partnering with strategic suppliers, can generate savings of 30%-50% of annual purchases.

BOTTOM LINE: Typical savings are 10-12% of total spend over a 3-4 year period. Few, if any, other activities an organization undertakes can have this same bottom line impact. Strategic outsourcing and supply chain excellence represent “low lying fruit” and yet many organizations don’t recognize its importance or don’t know HOW to proceed. This paper outlines a methodology by which organizations can make informed outsourcing decisions and accomplish the advantages of outsourcing while avoiding the pitfalls.

INTRODUCTION

There is much discussion today about “outsourcing.” Outsourcing means taking products, services, processes, activities and tasks that were previously performed internally in a company and paying someone else, usually an arms-length supplier, to provide the same services. Some organizations are outsourcing specific activities such as payroll processing or certain human resources activities. Other organizations are outsourcing entire processes. One sound reason to outsource is to focus the organization’s time and resources on things that really matter to its customers.

However, many companies are NOT seeing the benefits of outsourcing. Why? They are rushing to jump on the outsourcing bandwagon without really understanding the underlying processes which support the organization **before** outsourcing decisions are made. Many of these companies are enamored with eliminating the headcount associated with the outsourced activities but soon find that they may have “given away the store” in valuable expertise and brainpower in the process. They failed to understand outsourcing systemically in the context of their strategic goals and objectives. Steps in the Strategic Outsourcing Model are as follows.

STEP 1- IDENTIFY CORE COMPETENCIES

More than ever before, an organization's leaders must focus on what the organization's strategy is today and what it needs to be tomorrow in order to succeed. Part of this process includes identifying the organization's core competencies. Core competencies can be defined as the knowledge based know-how, technology, research, market access and other resources which add value in the eyes of an organization's customers. Core competencies are the collective learning in an organization, especially regarding ways to coordinate and integrate diverse skills and technologies. The three identified attributes of core competencies:¹

- (1) A core competence provides potential access to a wide variety of markets.
- (2) A core competence should make a significant contribution to the perceived customer benefits of the end product.
- (3) A core competence should be difficult for competitors to imitate.

So why is it important to identify core competencies? Because in order to have sustainable competitive advantage, an organization must nurture its competencies. This means that certain activities will be given priority over others. Those activities with the lowest priority or value to the external customer become very good candidates for outsourcing. Why perform these activities at all if they are not leading to sustained competitive advantage for the company? Taking this idea one step further indicates that a company should outsource unless they are, can be, or must be "best in class" in a certain area.

STEP 2: LEADERSHIP DETERMINES WHAT SHOULD BE OUTSOURCED

Organizations can no longer "be all things to all people." They must make strategic decisions on which areas they will focus on internally ("make"), and which they will outsource ("buy"). Make-buy decisions may be made in two areas:

- (1) **For goods and services that the organization provides to customers.** Some organizations chose to outsource production, viewing the integration of the product and the organization's infrastructure as its competitive advantage.
- (2) **For the organization's business infrastructure:** support functions like HR, MIS, Finance, Public Relations, etc. which are important to the organization's success but are NOT a tangible part of the organization's products or services. Some organizations chose to outsource major pieces of their infrastructure in order to focus on their core business, viewing their products / services as their competitive advantage.

¹ C.K. Prahalad and Gary Hamel, "The Core Competence of the Organization," *Harvard Business Review*, May-June 1990.

Any major system can be decomposed into processes, sub-processes and components and outsourcing can occur at any of these levels.

GUIDELINES FOR MAKE-BUY DECISIONS

Buy what you can't make (necessity)

Buy what is **NOT** your core competence but **IS** someone else's (opportunity)

Buy to optimize resources (capacity)

Make in areas where the organization cannot afford to be "at risk" (defense)

Make what matters most to your customer (visibility)

Make what matters most to the company's competitive advantage (strategy)

Make to retain core competence (preservation)

STEP 3: IDENTIFY OUTSIDE CONTRIBUTORS

Now that the decision has been made to outsource certain activities, how do you know who to deal with? How do you begin to establish relationships with these outside contributors to your organization's success? "Outside contributors" can be defined as those organizations, functions, work groups, teams or individuals who are NOT legally connected to the organization. There are three types of outside contributors:

Strategic Allies / Joint Venture Partners: Significant time may be spent with these groups to develop a shared understanding of values, strategic direction, purpose, and goals. These relationships should create a "win/win" situation where the organization and its partner can **both** accomplish their objectives. Relationships of this sort should generally be created around strategic activities critical to the organization's success.

Strategic Suppliers: Organizations, groups or individuals who, under contract or agreement, provide products or services to the organization which it defines as vital to success. Significant time and attention should be spent with these suppliers to develop joint values, shared understanding of strategic direction, and joint problem solving methods.

Other Suppliers: Organizations, groups or individuals who, under contract or agreement, provide products or services to the organization which it defines as NOT vital to success. Deal with these suppliers primarily on a transaction basis with little attention to relationship development. Commodity suppliers are an example.

STEP 4: ESTABLISHING RELATIONSHIPS WITH STRATEGIC ALLIES AND STRATEGIC SUPPLIERS

Per *Webster's Dictionary*, "Relationship" can be defined as "a connection, association or involvement; an emotional or other connection between people; dependence, alliance, kinship, affinity." Relationships generally require three attributes:

1. They yield current and future benefits for the partners.
2. They are collaborative --- new value is created together which could not be created individually.
3. They require interpersonal connections and internal infrastructures that enhance learnings.

There are four phases in forming or developing relationships:

Phase I - "Getting to Know You": Start with a self-examination of your company's purposes and objectives to understand what is needed from a partner to be successful. Some degree of good personal rapport is also essential during this phase between the leaders of each organization. Finally, there needs to be some compatibility based on common values, principles, expectations, or history.

Phase II - "Coming to Terms": Identify the specific project or transactions that the organization will conduct with the outside partner. Negotiate logistics, terms, and conditions to begin the process.

Phase III - "Harsh Reality": When actual work and interaction begins between two parties, conflicts may develop. Our experience indicates that, in most cases, the root cause of these conflicts is due to differences in values, unclear expectations, or contradictory reward and recognition systems.

Phase IV - "Collaboration": Assuming that the parties see sufficient value in the relationship to continue AND the differences in their values are not insurmountable, organizations will find a way to work together for mutual benefit in the long term. How?

- **Communication:** Opportunities are provided for constant communication between the top leaders as well as the middle managers.
- **Involvement:** People doing the work are provided multiple ways to access information, resources and people to accomplish tasks.
- **Personal relationships** between individuals in the different organizations. A nameless, faceless person on the other end of a phone call is much easier to brush aside than someone with whom you have had a shared personal experience.
- **Empathy:** Be aware of the other party's culture and reward systems and approach individuals from that organization on their terms. Understand what motivates them and what their "hot buttons" are.

**APPENDIX H
E-SOURCING VENDOR CHECKLIST¹**

	Poor		Excellent		
	1	2	3	4	5
<p>1. Does the vendor have the maturity and depth of management to make wise strategic decisions?</p> <p>Indicators: Managers come from diverse, relevant backgrounds, are seasoned, have proper long-term incentives, are of equal depth across different company functions (technology, finance marketing, sales, HR, etc.) and have worked together for a relevant period of time (low turnover).</p>					
2. Does the vendor have a list of partners and customers which provide confidence that they're able to deal with complex corporate sourcing challenges?					
3. Can this vendor make the same commitment to you and your business as you are making to them?					
4. How important is E-Sourcing to the vendor's overall business?					
5. Can the vendor implement a solution that scales to your needs today?					
6. Can the vendor conduct training for you and your prospective suppliers on a scale and timeline sufficient to meet your needs?					
7. Is the vendor capable of doing business in the same regions and countries that you do?					
8. Can the vendor handle the subtleties of complex negotiations and RFQs particular to your industry?					
9. Is the vendor healthy financially and appears to be a long-term player in the e-sourcing industry?					

¹ Hutchinson, Art, "Industrial E-Sourcing – What Customers Need to Know," Cartegic Group, Inc., October 2001

APPENDIX I E-SOURCING SOLUTION CHECKLIST¹

	Poor		Excellent		
	1	2	3	4	5
<p>1. Can this e-solution delivery measurable results for organizations like your?</p> <p>Indicator: References from previous satisfied customers, independent 3rd party ROI studies.</p>					
<p>2. How soon were customers able to justify their investment in a particular solution?</p> <p>Indicator: References from previous satisfied customers, independent 3rd party ROI studies.</p>					
<p>3. How well does the solution fit with your needs? In other words, is the solution too light or too cumbersome for your situation?</p>					
<p>4. Is the solution easy to use?</p> <p>Indicators:</p> <ul style="list-style-type: none"> ● How quickly can the solution be up and running the first time? ● Is specialized training required / how is it provided? ● What are the service and handholding capabilities of the vendor and how much do they cost? ● How stable are the key features and the overall environment? ● Who is responsible for maintaining and tuning the application? ● What is the vendor's future timetable for improving ease of use? ● How much do suppliers need to know to participate effectively in sourcing events? 					
<p>5. Are the technical features of the solution bug free and well integrated into the vendor's total solution?</p>					
<p>6. Are the technical features fully supported by sufficient infrastructure, methodology and expertise to make them useful in saving you money?</p>					
<p>7. Do the technical features provide value or ease of use directly relevant to your organization and your unique spending patterns, including adaptability to your processes?</p>					
<p>8. Product Evolution: Does the vendor have a proven history of regularly releasing new, reliable, functionality that customers need and use?</p>					

¹ Hutchinson, Art, "Industrial E-Sourcing – What Customers Need to Know," Cartegic Group, Inc., October 2001

APPENDIX J

PARTIAL LIST OF E-SOURCING AND E-PROCUREMENT VENDORS *

Enterprise system vendors who offer e-procurement within an integrated product suite:

- SAP – www.sap.com
- Oracle – www.oracle.com
- PeopleSoft – www.peoplesoft.com

Other vendors who offer e-procurement, e-sourcing or inventory management software solutions:

- Ariba – www.ariba.com
- B2eMarkets – www.b2emarkets.com
- Broadvision – www.broadvision.com
- Core Harbor – www.coreharbor.com
- Direct Sourcing Solutions – www.directsourcing.com
- FreeMarkets – www.freemarkets.com
- Frictionless Commerce – www.frictionless.com
- i2 Product Sourcing – www.i2.com
- Manugistics – www.manugistics.com
- Mercator – www.mercator.com
- Palmas – www.palmasdev.com
- Prime Vendor, Inc. – www.prime-vendor.com
- Procuri – www.procuri.com
- PurchasePro – www.purchasepro.com
- Rocky Soft - www.rockysoft.com
- Verian Technologies – www.procureit.com

* These companies and their web sites are listed strictly for information purposes. Neither the CPA Society nor Chenoweth & Associates endorses any of the products / services offered by these organizations.

BIBLIOGRAPHY

Aberdeen Group, "e-Sourcing: Negotiating Value in a Volatile Economy," Aberdeen Group, Inc., April 2001.

Agnew, Marion, "Travel & Expense Management," Business Finance Magazine, January 6, 2001.

Agrawal, Mani K. and Minsol H. Pak, "Getting Smart About Supply Chain Management," McKinsey Quarterly, 2001 Number 2.

Asmus, David and John Griffin, "Harnessing the Power of Your Suppliers," McKinsey Quarterly, 1993 Number 3.

Balchin, John, "The Re-Emergence of Strategic Sourcing," ASCET Volume 3, April 15, 2001.

Banham, Russ, "Cut to the Core," CFO Magazine, October 1, 2001.

Bhote, Keki, Strategic Supplier Management, American Management Association, 1989.

Chapman, Timothy, Jack Dempsey, Glenn Ramsdell, and Trudy Bell, "Purchasing' Big Moment - After A Merger," McKinsey Quarterly, 1998 Number 1.

Coonradt, Charles, The Game of Work, Liberty Press, 1984.

Crockett, Roger, "Going to the Source, on the Web," Business Week, May 13, 2002

Doig, Stephen J., Ronald Ritter, Kurt Speckhals, and Daniel Woolson, "Has Outsourcing Gone too Far?" McKinsey Quarterly, 2001 Number 4.

Ellram, Lisa, "Activity Based Costing and Total Cost of Ownership: A Critical Linkage," Cost Management, Winter 1995.

Fisher, Marshall, "What is the Right Supply Chain for your Product?" Harvard Business Review, March-April 1997.

Fitzgerald, Kevin R., "Best Practices in Procurement," ASCET Volume 4, May 15, 2002.

Gabrielle, Michelle, "Outsourcing's Marriage Counselor," CFO.com, August 1, 2001.

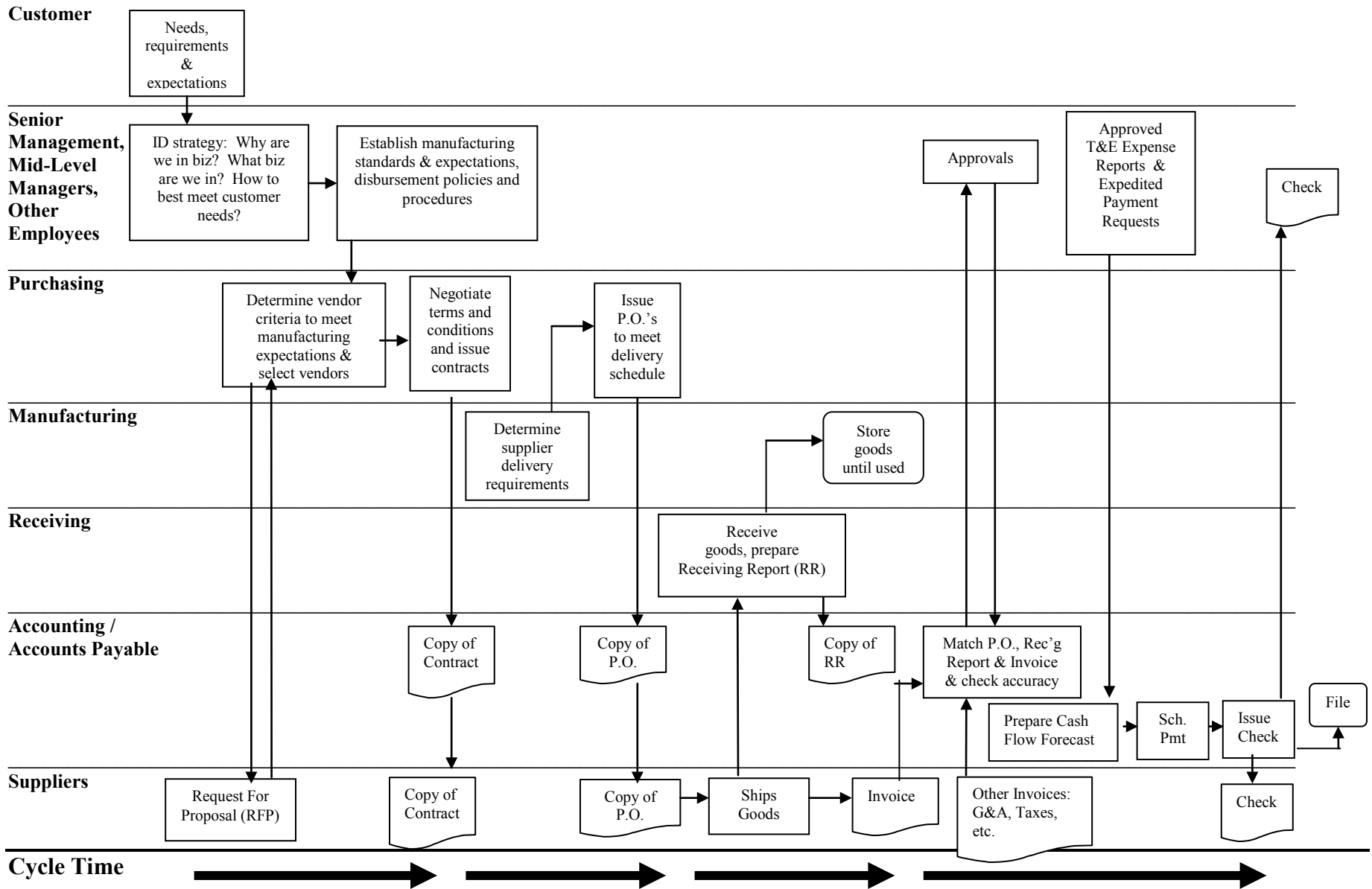
Gamble, Richard H., "P-Card Trade-Off," Controller Magazine, July 1998.

BIBLIOGRAPHY (Continued)

- Harrington, H. James, Business Process Improvement, McGraw-Hill, 1991.
- Hutchinson, Art, "Industrial E-Sourcing --- What Customers Need to Know," Cartegic Group, Inc., October 2001.
- Kanter, Rosabeth Moss, "Collaborative Advantage: The Art of Alliances," Harvard Business Review, July-August 1994.
- Kaplan, Robert S., Measures for Manufacturing Excellence, Harvard Business School Press, 1990.
- Keough, Mark, "Buying Your Way to the Top," McKinsey Quarterly, 1993 Number 3.
- Kyte, A., "E-Procurement: Employee Self-Service is the Real Benefit," Gartner Group Insights, May 3, 2001.
- Maskell, Brian H., Performance Measurement for World Class Manufacturing, Productivity Press, Inc., 1991.
- McKie, Stewart, "Redefining Accounts Payable," Business Finance Magazine, May 1999.
- Mello, John P. Jr., "Fly Me to the Web: The Latest T&E Software Runs on Internet Based Networks," CFO Magazine, March 1, 2000.
- Monczka, Robert and Robert Trent, "Cross Functional Sourcing Team Effectiveness," Center for Advanced Purchasing Studies – Michigan State University
- Paul, Laren Gibbons, "To Outsource or Not to Outsource," CFO Magazine, August 1, 2001.
- Prahalad, C.K. and Gary Hamel, "The Core Competence of the Organization," Harvard Business Review, May-June 1990.
- Schmidt, David, "Planning the P-Card Charge," Controller Magazine, August 1997.
- Tully, Shawn, "Purchasing's New Muscle," Fortune, February 20, 1995.
- Venkatesan, Ravi, "Strategic Sourcing: To Make or Not to Make," Harvard Business Review, November – December 1992.

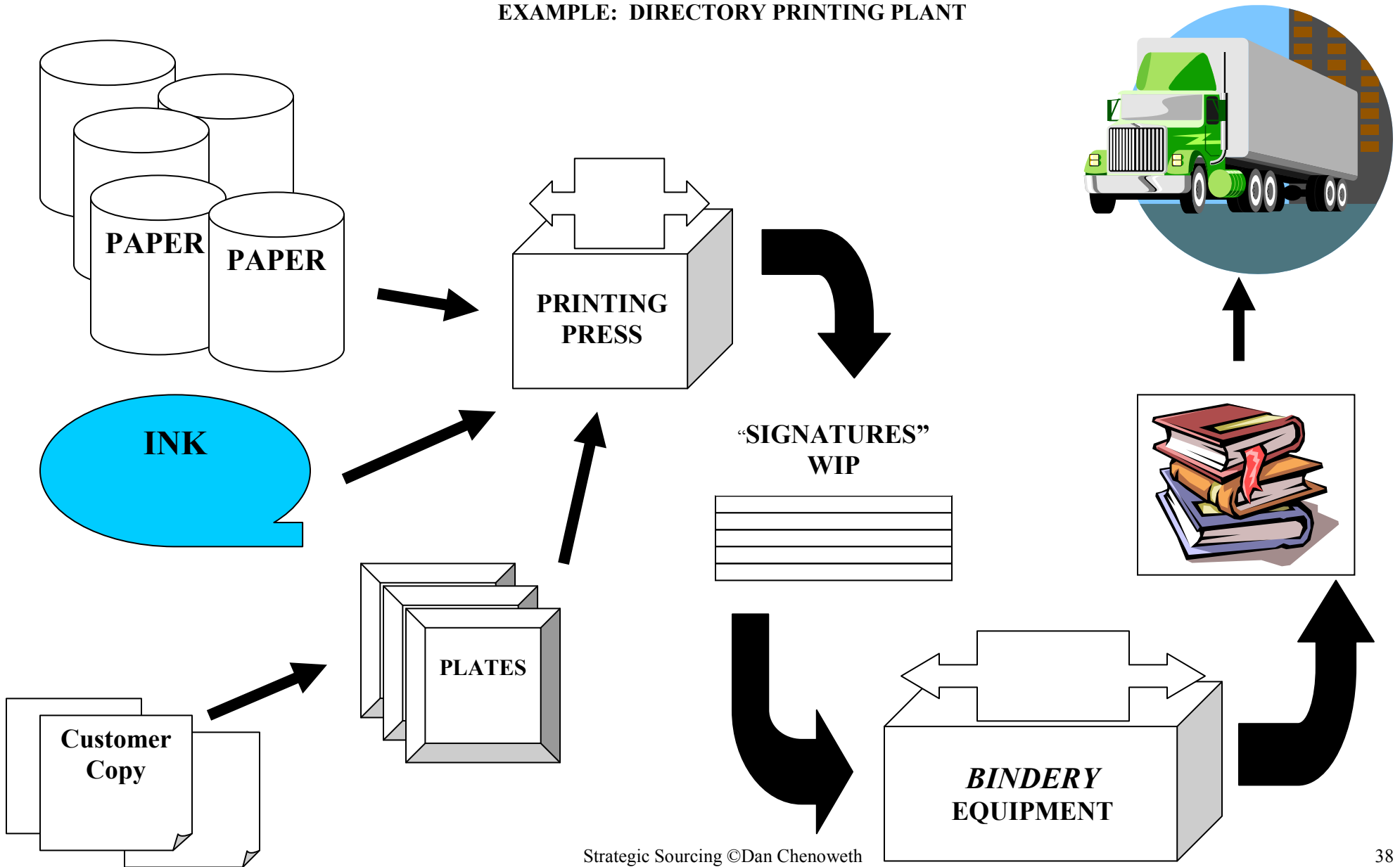
Bibliography – Page 2

SPRAY PAINT INTERNATIONAL: PROCUREMENT PROCESS FLOW DIAGRAM



MANUFACTURING PROCESS – PROCESS FLOW DIAGRAM

EXAMPLE: DIRECTORY PRINTING PLANT



SUPPLIER EXPECTATIONS

Based on Business Needs / Risk

