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BARRY RENDER, Consulting Editor

DELIVERING CUSTOMER VALUE THROUGH PROCUREMENT AND STRATEGIC SOURCING

A Professional Guide to Creating a Sustainable Supply Network

Delivering Customer Value through Procurement and Strategic Sourcing

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Walter L. Wallace
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Introduction

In 1983, McKinsey & Co. consultant Peter Kraljic published a pioneering paper[1] advocating the active engagement of purchasing in supply management and the expansion of procurement organization roles to a more systematic and strategic management of the supply base. Back then, purchasing was primarily a back office activity focused on communicating and expediting purchase orders.

Fast-forward to today, over 30 years later, and things have certainly progressed. With the support of outside consultants, post-procurement professionals have both formalized and centralized their strategies and processes, with particular focus on strategic sourcing methodologies to help rationalize the supply base. The bargaining power of the buyer has become much more analytical, quantitative, and accountable to the organization.

Has procurement truly become a transformative agent of strategic supply management, leading to the redesign and orchestration of multitier supply organizations beyond their primary roles as negotiators, cost cutters, and contract managers? Unfortunately, in the supply chain, the answer is “no” in too many organizations. This sentiment is shared in the following quote:

> Despite well-publicized advancements in procurement for many high-profile firms, until recently “procurement” for the bulk of the marketplace has been perceived as a tactical organization without a “seat at the table.” As the strategic ability of procurement to impact earnings and to enhance the supply chain is more widely recognized, the spotlight is shining on this historic area of underinvestment. This has triggered rapid change in the role and makeup of procurement teams in many companies with mixed results. And big challenges remain as these organizations attempt to take their place at the table as a strategic function.[2]
>
> —Tom Beaty, President and CEO, Insight Sourcing Group
> “Strategic Procurement: Rapid Evolution and Continuing Challenges”

Companies of all sizes are seeking to transform their procurement and supplier relationship management processes, especially those activities that have a tremendous upside potential to improve supply chain effectiveness and efficiency. At the same time, these potential changes can be extremely disruptive. Strategic sourcing and procurement transformation impacts every internal and external supply management process and relationship and therefore requires a significant commitment in terms of resources, time, and energy by virtually every part of the organization.

As change management initiatives go, strategic sourcing, procurement, purchasing, and supplier relations are especially difficult due to how they are typically staffed. For instance, the core of the organization is often employees from the legacy purchasing infrastructure. To this nucleus, add those who may be transplanted in from other business units in a move to increase effectiveness and efficiency through consolidation. They may also add individuals from other functional areas such as marketing, operations, and accounting. Although these individuals may bring much needed analytical skills and knowledge of how things work in their functional arenas, they may be slower to see the bigger picture or appreciate how all these pieces fit together, from sourcing to funds settlement. Finally, it may be necessary to fill a few roles with people from outside the company who bring valuable subject matter expertise but need time to acclimate to their new organizational culture.

So under these circumstances, what actions might help fuel the success of the strategic sourcing and procurement processes? Here is a short list of what executive members should consider when building for a successful strategic sourcing team:

- Investing in the growth and development of the team members
- Breaking down barriers through coaching and cross-functionalizing the teams
- Maximizing product knowledge and negotiating skills of the team
- Expecting positive value creation, solutions, and outcomes from the team
- Communicating honestly and often with the supplier base
- Creating visibility as an attribute to becoming demand driven

The procurement function can and will play an important role in building long-term supplier relationships that, in turn, will advance the organization toward achieving higher objectives and create greater alignment with its supplier base. The procurement function in many organizations is still looked upon as a hard-cost negotiator rather than a builder of core competencies and a differentiator. With the advent of shorter product life cycles and the launch of new product offerings, the procurement function cannot settle for a weaker posture of hard bargaining, payment delays, and threats of shopping the business. Organizations need to remain invested and aligned with their Tier 1 suppliers, promoting greater shared profitability, sustainability, and alignment instead of offloading their inefficiencies.

Today's procurement manager must be able to put coalitions together and manage relationships for a win-win orientation. The following are the implications for tomorrow's procurement managers:

- Market understanding; customer insight
- Management of complexity and change
- Information systems and technology expertise
- The ability to define, measure, and manage service requirements by market segment
- Financial "IQ" (understanding of the true "cost-to-serve" and time-based performance indicators)
- Working across functional areas; team-based capabilities
- Relationship management and a "win/win" orientation through collaboration

Within the executive level, CEOs at U.S. companies are looking to strengthen their alignment with their companies' suppliers going forward. That was one of the key findings in the U.S. segment of the consulting firm PwC's 16th Annual Global CEO Survey.[3] Fifty-three percent of the 167 U.S.-based CEOs who took part in the survey stated they would strive to strengthen engagement with key suppliers in 2013 to both minimize costs and maximize supply chain responsiveness/flexibility and deliver performance. The research also found that 41 percent of CEOs were concerned about raw materials and energy costs. As a result, more CEOs are considering reshoring their operations and exploring new sourcing options. Forty-four percent of survey respondents also said they are making investments to increase the operational effectiveness of their organizations, which included outsourcing a function or business process (29 percent) and insourcing a previous outsourced business process or function (17 percent).

In a recent Deloitte Consulting Survey, supply chain executives are growing increasingly concerned about the risk to their organizations' supply chains and the costs associated with disruptions.[4] According to the 2013 survey, 53 percent of the 600 executives questioned said supply chain disruptions have become more costly over the last three years, and 48 percent said such occurrences had become more frequent. Margin erosion was cited by 54 percent of respondents as one of their two most costly causes of supply chain disruptions. The second most cited reason at 40 percent was "sudden demand change," reflecting shorter product life cycles, growing customer expectations, and competitive challenges.

A new paradigm of competition is emerging in which the supply chain network will increasingly provide a source of sustainable advantage through enhanced customer value. One thing is for certain: Companies that believe they can continue to conduct business as usual will find their prospects for success in tomorrow's marketplace declining dramatically. As Thomas Friedman has noted, the flattening of the world, effectively the rate of change we see today, "...is happening at warp speed and directly or indirectly touching a lot more people on the planet at once. The faster and broader this transition to a new era, the more likely is the potential for disruption...."[5] As Charles Darwin suggested more than a 150 years ago, "It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change."[6]

Notes

1. P. Kraljic, "Purchasing Must Become Supply Management," *Harvard Business Review* (September–October 1983): pp. 109–117.
2. T. Beaty, Global Logistics Roundtable presentation, Georgia State University, January 24, 2014.
3. http://www.pwc.com/gx/en/ceo-survey/index.jhtml.
4. Deloitte Consulting, *2013 Global Supply Chain Risk Survey*.
5. Thomas L. Friedman, *The World is Flat 3.0* (New York: Picador, 2007): p. 136.
6. Although this "quotation" is frequently attributed directly to Charles Darwin, it is a paraphrasing of a key theme from Darwin's *The Origin of the Species*. One suggested source of the paraphrase is Leon C. Megginson's "Lessons from Europe for American Business," *Southwestern Social Science Quarterly* 44, No. 1 (1963): 3–13, at p.4.

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Purchasing, Procurement, and Strategic Sourcing

Although some people may view interest in the performance of purchasing and supply management as a recent phenomenon, it was recognized as an independent and quite important function by many of the nation's railroad organizations well before 1900. Yet traditionally most firms regarded the supply function primarily as a clerical activity that fell to purchasing staff. During World War I and World War II, market demand was almost unlimited. Therefore, the success of a firm was not dependent on what it could sell. Instead, the ability to obtain the raw materials, supplies, and services from suppliers needed to keep the factories and mines operating was the key determinant of organizational success. Subsequently, attention was given to the personnel, policies, and procedures of the purchasing and supply function, and it emerged as a recognized managerial activity.

During the 1950s and 1960s, supply management continued to gain status as the number of people trained and competent to make sound supply decisions increased. Many companies elevated their chief purchasing officers to top management status. As the decade of the 1970s opened, organizations were faced with international shortages of almost all the basic raw materials and an escalating rate of price increases far above the previous World War II average. The world was faced with the Middle East oil embargo during the summer of 1973, which exacerbated both the shortages and the price escalation. Certain commodities being placed on allocation and rationing became a new factor to deal with. These events put the spotlight squarely on supply management to obtain needed essentials from suppliers at realistic prices. This series of events emphasized the importance of procurement and working with suppliers.

As the global era (late 1970s up through 1999) emerged, the impact on the structure, nature, and importance of purchasing was dramatic. Major structural changes were taking place around the world:

- The environment became intensely competitive, as global firms in Asia and Europe increasingly captured world market share beyond their American counterparts.
- The use of international data networks and the Web via intranets gave us the ability to coordinate worldwide purchasing activities.
- The rapid expansion of technology change was unprecedented, enabling the growth of supply chain management.
- Product life cycles became shorter, and outsourcing became a common business practice based on *labor arbitrage*.

Beginning in the 1990s, there was clear evidence that the motivation of many companies to seek low-cost labor solutions overseas resulted in a leaner, more complex, and vulnerable supply chain. Organizations began to take a more collaborative and integrated view of managing the movement of goods, services, funds, and information through the supply network. The procurement team began to view *supply chain management (SCM)* as a way to manage the new pressures of purchasing and deal with their extended supply network.

As the decade of the 1990s came to an end, it became quite apparent that companies would have to develop efficient supply functions if they were to compete in the global marketplace. Speed to market and cost efficiency became the holy grails of the 90s.

The early twenty-first century has brought with it new challenges in the areas of supply chain risk mitigation, extended and more complex supply chains, sustainability, and social responsibility.

The future will see a gradual step-change from a predominantly defensive strategy in sourcing to more aggressive strategies, in which organizations will seek out an imaginative approach to achieving supply objectives, solving more long-term strategic sourcing goals. The focus on strategic issues now includes an emphasis on the customer-centric processes of value creation and knowledge management. This text discusses what organizations should be doing to remain competitive as well as what strategic sourcing management will focus on going forward.

Logistics and supply chain managers are looking for ways and means to extract more value from their sourcing and procurement operations. Whether it is pressure from demanding customers, the emergence of lower-cost competition from foreign sources, or simply the complexity of today's extended supply chain, executives are no longer satisfied with a singular focus on low-cost purchasing of goods and services. It's just not enough to stave off margin erosion.

As a result, the topics of purchasing, procurement, and strategic sourcing are all receiving significant attention as organizations attempt to improve the overall efficiency and effectiveness of their supply networks. A better understanding of where the benefits can be obtained requires a thorough knowledge of some of the similarities, differences, and linkages between purchasing, procurement, and strategic sourcing. Many times these terms are used somewhat interchangeably, which does not allow for clarity or optimization of the buying decision. Here is how we see them:

- **Purchasing** is the *transactional function* or activity of buying needed goods or services. This involves placing and processing purchase orders or requisitions. Prior to these transactional activities are the formal sourcing decision and ultimate selection of the desire source supplier.
- **Procurement** is the management of a *broad range of processes* that are associated with an organization's desire to obtain the necessary goods and services needed for manufacturing a product, transforming inputs to outputs, or indirectly operating the organization. These processes include activities such as product and service sourcing, supplier selection, pricing and terms negotiation, transaction and contract management, supplier performance management, and supplier sustainability issues.
- **Strategic sourcing** is a broader, more *transformational process,* performed at a higher organizational level. Strategic sourcing takes the procurement process further, examining the whole supply network, its linkages, and how they impact procurement and purchasing decisions. The focus is more on the Tier 1 supply network, value creation, risk, and uncertainty in the supply chain and the overall responsiveness and resilience of the supply chain.

Finally, from our perspective, it is important to think of purchasing as an activity and procurement and strategic sourcing as processes. The next several chapters discuss the critical nature of strategic sourcing and provide a more comprehensive look at the following topics:

- Managing sourcing and procurement processes
- Strategic sourcing and delivering customer value
- The size of the organization spend and financial significance
- Understanding buyer-supplier relationships
- Global procurement competitiveness

Strategic Sourcing Methodology

As noted previously, strategic sourcing is a broader and more comprehensive process than procurement. We consider here a seven-step methodology that details the strategic sourcing process. Overall, the process begins with the development of the appropriate strategy, which provides direction for all ongoing organizational efforts. The appropriate strategy is influenced by the *value discipline*[1] of the organization. As highlighted next, Michael Porter[2] has persuasively argued that there are three generic competitive strategies for positioning the organization in the marketplace:

- **Overall cost leadership**—Requires efficient-scale facilities, tight cost and overhead control, standardized customer offerings, reduced network costs, and a low-cost operational model.
- **Differentiation**—Requires creating products and services that are unique and build customer loyalty.
- **Focus**—Requires serving a particular target segment very well by addressing its specific needs based on a clear understanding of the marketplace.

A properly defined and directed strategic sourcing process is guided by several core criteria that support the desired levels of value creation needed for success within a target market:

- **The inclusion of the C-level team**—Annual assessment and planning for procurement and strategic sourcing must include the input from the C-level team, with the understanding that they will have a definitive part to play in both of these areas.
- **The development of individual sourcing strategies**—Individual spending categories need customized sourcing strategies.
- **An evaluation of internal requirements**—Requirements and design specifications must be rigorously assessed and rationalized as part of the sourcing process.
- **An assessment of the total value**—Analysis must go beyond acquisition costs and evaluate total cost of ownership (TCO) and consider the long-term value the supplier relationship contributes to the organization.
- **A focus on supplier economics**—Suppliers' economics must be understood before developing buying tactics that will increase total value creation for the organization. These tactics include volume leveraging, price unbundling, frequent deliveries in smaller quantities, pricing points, and quality capabilities.
- **A focus on continuous improvement**—Strategic sourcing initiatives should run hand-in-hand with the organizational continuous improvement process for procurement and sourcing.
- **An understanding of the linkages between sourcing and the supply chain networks**—Supply networks are in effect a complex and frequently extended web of

interconnected nodes and links. The *nodes* represent the entities or facilities such as suppliers, distributors, factories, and warehouses. The *links* are the means by which the nodes are connected. These links may be physical flows, information flows, or financial flows. The vulnerability of a supply network is determined by the risk of failure of these nodes and links.

Finally, the following seven steps provide a brief understanding of the basic overall strategic sourcing process.

Step 1: Strategic Sourcing Team Meeting (Annual)

The first step in the process is the kickoff meeting for the upcoming calendar or fiscal spending year. Essential to the success of this meeting is the establishment of the strategic sourcing committee, which should include, at a minimum, the chief operating officer (COO), chief financial officer (CFO), and if used, the chief procurement officer (CPO). We also recommend the inclusion of other key stakeholders: design, R&D, operations management at a very high level, marketing management (to ensure the needs of the customer segments have a voice), manufacturing team members, quality assurance representatives, and transportation team members (assuming the organization has its own private fleet).

Companies with strong business partnerships between the CFO and supply chain leaders report better results than those with more traditional finance models. According to a global survey of CFOs and supply chain leaders conducted by EY, 70 percent of CFOs and 63 percent of supply chain leaders say that their relationship has become more collaborative over the past three years. Among business partner respondents, 48 percent reported that their company's earnings before income tax, depreciation, and amortization (EBITDA) grew by more than 5 percent over the past year, compared with just 22 percent of those with a more traditional relationship.[3]

The agenda of this first step should cover the scope and scale of the products and services that are purchased, an understanding of the requirements and specifications for needed products and services, plus any new sourcing opportunities. Among the procurement activities discussed in this first step are the three Ds as well as the components of the triple bottom line (TBL):

- **Define the current needs**—A procurement transaction is usually initiated in response to either a new or existing need with a recommended supplier. In the case of unacceptable on-time fulfillment or quality issues, there may be a request to change suppliers. In either case, once the need is identified, the procurement process can begin. The need can be identified by any of a variety of functional areas in the organization.

- **Define and evaluate internal requirements**—After the products and services have been identified, some type of measurable specification or set of criteria must represent each requirement. The criteria may be relatively simple; for example, steel reinforcement bars for a construction site might be specified as "#5 bar to ASTM A615 Grade 60 for standard deformed steel bars for concrete reinforcement made to 60ksi minimum yield strength." Using this specification, the sourcing professional can communicate the user's needs to qualified, potential suppliers.
- **Define whether to "make or buy"**—Before outside suppliers are solicited, the purchasing firm must decide whether it will make or buy the product or service. Today, in an effort to focus on the core competencies of the organization, more and more noncritical components and services are being outsourced. Before being made, such decisions require a complete understanding of the resources, capabilities, and processes available outside the firm.
- **Sustainability and the "triple bottom line"**—Sustainability planning and a review of where the organization is with its plan should be on the meeting agenda. Strategic sourcing describes how an organization intends to create and sustain value for its current shareholders. By adding sustainability to the agenda, we add the requirements to meet these current needs without compromising the ability of future generations to meet their own needs. The strategic sourcing team must consider the mandates related to the ongoing economic, employee, and environmental viability of the organization. Economically, the company must be profitable. Employee job security, positive working conditions, and development opportunities are essential. The need for nonpolluting and non-resource-depleting products and processes presents new challenges to supply managers as well as operations (refer to Chapter 9, "Creating a Sustainable and Environmentally Compliant Supply Network").

The first step should include a **strategic spend**[4] analysis. A frequently used definition of strategic spend is the dollar value of the goods and services critical to the mission of the organization. This analysis supports an understanding of the amount to be spent by category, supplier type, and internal user and will examine the current sourcing approaches being used by the purchasing team (e.g., annual rebate program versus traditional market-based pricing with no rebate allowances). Specific supplier recommendations made by the CFO and/or CPO on key product categories should be considered part of the scope for the strategic sourcing team meeting. The procurement team must honor these recommendations: They are contractual agreements made at the executive level and typically carry with them a financial remuneration provision based on some measurable criteria, such as volume or day's sales outstanding.

More often than not, the organization is unable to develop a comprehensive spend analysis due to a lack of centralized spend data. With the appropriate information, this assessment facilitates recommendations for improvements in the overall sourcing process and identifies any potential associated financial benefits that could be contractually obtained.

Step 2: Assessing the Supply Market

This second step in the strategic sourcing process involves making sure that all the potential sources of supply are identified and viable mechanisms are in place for comparing their capabilities to those of other potential suppliers. As the supply market is being assessed, special attention should be paid to the following issues:

- A comprehensive assessment of the supply market will include a thorough market analysis. The supply market might be a highly competitive market with many suppliers, an oligopolistic market with a few suppliers, or a monopolistic market with a single entity supplier. With a clear understanding of the market, procurement professionals will know the number of suppliers in the market, the bargaining power of the buyer and supplier, and which method of purchasing might be most effective.
- Whether or not they are currently being used, it is important to identify all possible suppliers that might be able to satisfy the user's needs. With all of today's foreign services, this can be a daunting task, particularly determining their capacity, process technology, quality, flexibility, and market effectiveness.
- The supplier assessment must include a prescreening of all possible suppliers. When developing and evaluating user requirements, it is important to distinguish between "needs" (demands) and "wants" (desires). The needs for a product or service are those dimensions that are critical to the user; wants are those that are not as critical and are therefore negotiable. Prescreening reduces the pool of possible suppliers to those that satisfy the user's needs. In our example of steel reinforcement bars, several suppliers will have them in stock in standard lengths and available for shipment within a 24-hour window. A "want" might be having them pre-cut to specific lengths and bent to specific dimensions for a contracted job. This "want" may require a series of tests by internal engineering staff to see whether the supplier is capable of meeting the desired specifications.

This second step should recognize the need to simplify purchasing complexity and, whenever possible, reduce the number of products or services needed. Simplification and standardization are the criteria for improving this step. Also, attention should be given to an understanding of pricing points and opportunities for consolidation of *the spend*. Doing so creates greater leverage for the user and enhances supplier relationships.

The enhancement of the supplier relationship is discussed in more detail in Chapter 5, "Understanding Buyer-Supplier Relationships."

Step 3: Developing the Sourcing Strategy

It is important to fully develop a sourcing strategy that defines the dimensions of the process and the steps to be followed. Due diligence is the cornerstone for developing a sourcing strategy. A key aspect of due diligence is the supplier portfolio screening process, which includes initial supplier research and screening, development of a request for information (RFI) and a request for proposal (RFP), site visits and follow-up discussions, and supplier selection. Although the strategic sourcing committee may not play an overt role here, it will play a key part in the ultimate selection of Tier 1 suppliers.

- The purpose of the RFI is to establish whether or not a supplier has the resources, capabilities, and processes to be considered for a more extensive analysis. It will request information on the company's background, financial stability, the locations of its manufacturing and distribution facilities' locations, markets served, its ability to provide R&D support to users, its quality systems, and cultural insight. No pricing information is requested in the RFI.
- The purpose of the RFP is to gather information relevant to the user company's needs and wants. Here the potential suppliers are asked for specifics on how they would respond to the request. The potential suppliers are requested to detail their manufacturing and distribution facility locations, lead times, capabilities, and grade and quantity pricing associated with fulfilling the required specifications.

The sourcing strategy should also include the quantitative and qualitative criteria for supplier selection to be used by the strategic sourcing committee. The selection criteria in Step 3 should directly relate to the issues addressed in Step 2. An outline of typical supplier selection criteria is shown in Table 1.1.[5] An alternative evaluation matrix (multiple weighted criteria) for final assessment in a product category is illustrated in Tables 2.1 and 2.2 in Chapter 2, "Managing Sourcing and Procurement Processes," making use of *Importance Scores* and *Achievement Scores* to assess the suppliers' capabilities for a particular product group.

Step 4: Executing the Sourcing Strategy

This step essentially begins with an evaluation of the suppliers that successfully passed the RFI and RFP screening process and concludes with the awarding of a contract. The pool of suppliers that have passed the screening criteria are deemed acceptable to provide the user's needs and wants. It is now possible, based on the prescreening in Step 2 and the final assessment of qualified suppliers in Step 3, to determine which supplier or suppliers can best meet the user's negotiated requirements. If the item or items are fairly standard and there is a sufficient number of potential suppliers, this activity may be accomplished through the use of competitive bidding. Without these basic conditions, a more elaborate evaluation may be necessary, as in our earlier example using an engineered specification of ASTM A615 Grade 60 for deformed steel bars.

Table 1.1 Supplier Selection Criteria

Area of Focus	Specific Criteria
Quality	Technical specifications Reliability (MTBF) Maintenance (MTTR) Product life Ease of repair Durability (life span) Dependability
Reliability	On-time delivery Performance history Warranty and replacement policies
Risk	Cost risk Potential for supply uncertainty Lead time risk and uncertainty
Capability	Production capability Technical capability Management style Operating controls; SQC Labor relations
Financial	Terms and conditions of purchase Financial stability of supplier
Ease of Doing Business	Vendor attitude and cultural compatibility Level of trust and collaboration Packaging Communications Supplier locations(s)

The selection of the ultimate supplier is key! The choice of suppliers determines the relationship that will exist between the organization and the supplying firms and the ultimate levels of collaboration, trust, intimacy, procedural justice, and cooperative norms. The levels of these relationship components are discussed in Chapter 5. They determine whether the relationship will be a routine partnership or a strategic alliance built over many years.

Step 5: Implementation and Integration of the Contractual Agreement

The key components of Step 5 are the finalization of the contractual agreement, planning the transition process (particularly if switching suppliers), and the receipt of the specified products or services. With the receipt of the order under a new contract, the procurement team begins the generation of performance data necessary to establish a vendor evaluation system. Another element of Step 5 is the implementation of a benchmarking system aimed at determining the savings generated by the contracted vender.

The proper receipt of goods and services is of vital importance. Many smaller and single-site organizations have centralized receiving in one department. If just-in-time (JIT) inventory management systems have been implemented, materials from Tier 1 suppliers or supplier partners bypass receiving (and inspection, if this function is in place) and are delivered directly into production. The prime purposes of receiving are as follows:

1. To confirm that the order placed has actually arrived.
2. To check the condition of the shipment.
3. To ensure the quantity ordered has been received.
4. To forward the shipment to its proper destination.
5. To ensure the proper documentation of the shipment is included.

Shortages may occur because material has been lost in transit, short-shipped and not reported by the supplier, tampered with in transit, or damaged in transit. Physical counts can be forced by blocking receiving from having access to the quantity ordered. If accurate amounts are entered into the system, the order is closed out, inventory records updated, and the invoice cleared for accounts payable to authorize payment based on the terms and conditions negotiated.

Step 6: Supplier Performance Measurement and Improvement

A critical and key step in the strategic sourcing process is the measurement and programmed improvement process for supplier performance. This involves the ability to provide "time, quantity, and place utility" in the form of goods and services for the benefit of the consuming organization. Because there is no value in the product or service until it is in the hands of the customer, the distribution and transportation functions of the supplier's business are all about making the product or service available. Availability is in itself a complex function, impacted upon by a number of factors. These factors might include delivery frequency and reliability, stock levels and order cycle, and lead time variability. Ultimate customer service is determined by the interaction of all those factors that affect the process of making products and services available to the consumer.

In practice, companies have varying views of supplier performance. LaLonde and Zinszer[6] in a study of supplier service practices and measurements suggest that service effectiveness can be reviewed under three headings:

- Pre-transaction elements
- Transaction elements
- Post-transaction elements

A more in-depth review of LaLonde and Zinszer's work is provided in Chapter 3, "Strategic Sourcing and Delivering Customer Value."

Step 7: Maintenance of Records and Relationships

The final step is to update records, including supplier performance scorecards developed in Step 6. Electronic files of the order-related documents are stored. Legal requirements, accounting standards, company policy, and judgment dictate which records are to be kept and for how long. For example, a purchase order is evidence of a contract. It may be retained much longer (normally seven years) than the requisition, which is an internal memorandum. The basic records to be maintained, either manually or electronically, are as follows:

- PO log, which identifies all POs by number and indicates the open or closed status of each
- PO file, containing a copy of all POs, filed numerically
- Commodity file, showing all purchases of each major commodity or item reflecting date, supplier, quantity, price, and PO number
- Supplier history file, showing all purchases placed with major (Tier 1) suppliers
- Outstanding contracts against which orders are placed, as required (proof of meeting the required volume stipulated in the contract)
- A commodity classification of items purchased
- A database of suppliers that have been used and are currently being used
- Savings generated by contracted supplier, by product category, by program type (JIT program, inventory turns improvement, or additional payment terms and conditions)

Additional records files may include:

- Labor contracts, giving the status of union contracts (particularly contract expiration dates) and the union involved.

- Tool and die records showing tooling purchased, date of purchase (put into service), useful life (or production quantity), usage history, price paid, ownership, and plant location (which facility site is using them). These purchases can be transaction-specific investments (TSIs) by the organization and are considered proprietary for a specific customer. The costs of the tooling are typically amortized over the useful life and charged back to the customer.
- Minority and small business purchases, showing dollar purchases from each. Any special contractual arrangements are noted.
- Bid-award history, showing which suppliers were ask to bid, amounts bid, number of no bids, and successful bidder, by major product category. This record file would include any reverse-auctions conducted and which outside firm conducted them.
- Rebate programs and awards earned by the organization and the particulars used to calculate the rebate and when it was collected. Also, any gainsharing programs the organization was involved in, the supplier involved, the payout, and the specific details of the program.

Supplier Relations and Performance

Managing supplier relationships is one of the most important components of the strategic sourcing process. Over the life span of a contract, the procurement team can drive world-class supply chain practices and sustained total cost of ownership results. Managing a supplier relationship and establishing a supplier scorecard does not begin once the contract is signed. It begins with initiating the supplier selection process in the early stages of the strategic sourcing process by focusing on purchasing performance results, not goods and services. Such a mindset not only saves time, but also allows your organization to be better aligned with its internal customers. It is for the benefit of our internal customers and meeting their needs that we are focused on performance, rather than just goods and services. When supply chain practitioners view their role as procuring goods and services rather than procuring performance results, they are more likely to encounter internal customer frustration and personal job dissatisfaction.

By discussing results and asking internal customers the right questions, procurement is helping to define the performance results they want during the contract period. This also allows the procurement team to design results-oriented metrics. These are the metrics that will be used to measure supplier performance after the contract is awarded. They are typically related to quality, service (timeliness), delivery, fill rate, responsiveness, agility, safety, sustainability, and costs.

Most procurement teams use a supplier scorecard at the front end of the strategic sourcing process instead of the back end. After the contract is signed, it is too late for these metrics to be introduced and have the same impact with the supplier as they would before the contract is signed.

Once the metrics are agreed upon, the scorecard and measurements become part of the statement of work, specifications, RFX,[7] supplier selection criteria, and the contract. Therefore, in the RFI or RFP documents, potential suppliers can review up front the performance results expected during the contract period. It is wise to ask suppliers during the RFP to submit two responses: One that provides exactly what was asked for per the specifications and a second response that details how the supplier believes it can best optimize the metrics and remedy potential failures. This second response becomes an extremely important document between the successful bidder and the organization.

Once the procurement team has solicited proposals and selected a supplier using the results-oriented metrics, contracted with the supplier, and predefined remedies for failure to achieve the metric targets, the stage is set for supplier performance management success. The supplier relationship understands what is required and expected of it. Goals and expectations have been clearly defined at the beginning and end of the supplier selection process. Now procurement can spend time in a supplier management and contract compliance role, rather than an expeditor and firefighter role.

The upfront investment in the strategic sourcing process made for each of the seven steps outlined pays long-term dividends. Engaging in supplier performance management supports the move to becoming a world-class supply management organization.

One final comment relating to the strategic sourcing process: All of the activities identified in this section will initially be subject to influences beyond the control of the procurement professional. These influences can determine how effectively each activity is performed. They include intra-organizational, inter-organizational, and external factors such as the geopolitical context. A change in marketing needs, manufacturing specifications, or the financial status of a potential supplier may require all or several of the seven steps identified to be repeated.

Notes

1. http://www.valuebasedmanagement.net/methods_valuedisciplines.html.

   Value discipline: A model created by Michael Treacy and Fred Wiersema describing three generic value disciplines companies can adhere to. These disciplines are 1) operational excellence 2) product leadership and 3) customer intimacy. In this model, the company is meant to choose one of these disciplines and act upon on that discipline as its primary value principle in going to market.

2. Michael E. Porter, *Competitive Advantage* (New York: The Free Press, 1985).
3. http://www.ey.com/cfoandsupplychain.
4. Strategic spend: A total of the purchasing disbursements or expenditures for goods and services critical to the mission of the organization.
5. Nigel Slack and Michael Lewis, *Operations Strategy,* 3rd Ed. (Upper Saddle River, NJ: Prentice Hall, 2011): pp. 47–54.
6. B. J. LaLonde and P. H. Zinszer, *Customer Service: Meaning and Measurement* (Chicago: National Council of Physical Distribution Management, 1976).
7. http://www.sourcinginnovation.com/glossary/RFX.php.

   RFX, which is one of the most common acronyms in the strategic sourcing and procurement landscape, is a catchall term that captures all references to request for information (RFI), request for proposal (RFP), request for quote (RFQ), and request for bid (RFB). The RFX process is probably one of the most difficult e-sourcing processes to define because it can range from a simple one-time RFQ to a complex multistage RFI/RFP/RFQ process, depending on the needs of the project. The complexity of the RFX process is determined by, among other factors, the completeness of the requirements, the number of suppliers that have been qualified, expected competition in the supplier base, inherent risk in the sourcing effort, and projected savings or cost avoidance opportunities.

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