The Hackett Group

Revisiting the Core Principles of Strategic Sourcing: Best Practices for Success

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Kurt Albertson, Principal – Procurement Advisory

Kurt Albertson is a Principal with The Hackett Group with program responsibility for North American Strategic Advisory programs focusing on client relationships, business development, research and program delivery. Mr. Albertson works with over one hundred Global 1000 companies leveraging research and thought leadership to provide strategic direction and best practice business advice within Procurement and Finance.

Prior to joining the Hackett Group Mr. Albertson spent six years as a management consultant in Sourcing and Procurement during which he worked with executives from dozens of large corporations on sourcing, business and technical strategies, organizational and business process design, and cultural change.

Mr. Albertson also has five years of automotive experience working in manufacturing, quality, and operations. In this role he designed and implemented global manufacturing processes and supervised production operations.

Mr. Albertson has been quoted in the Wall Street Journal and other major publications, has been the key note speaker at many national events, and travels globally to support client objectives.

Contact Information:
770-225-7570
kalbertson@thehackettgroup.com
Session objectives

- Review the core steps of the strategic sourcing process and deliverables
- Review some of the critical enablers for success
- Understand the key tools associated with strategic sourcing and a review on how to apply TCO and Porter’s Analysis
Procurement’s Strategic Sourcing Process
Definition of strategic sourcing

**Strategic sourcing** is an approach to supply chain management that formalizes the way information is gathered and used so that an organization can leverage its consolidated purchasing power to find the best possible values in the marketplace.

Source: whatis.com
Top ten priorities for state procurement in 2017 - NASPO

1. Strategic role of state central procurement
2. Procurement workforce professionalization
3. E-procurement/ ERP solutions
4. Measuring performance
5. Effective sourcing strategies
6. Staffing and talent management strategies
7. Information technology
8. Contract management
9. Cooperative purchasing
10. Procurement reform and state-wide centralization
For Procurement organizations there’s room to be more strategic in their sourcing approach

How strategic is your strategic sourcing process?

- ** Truly strategic;** we create business advantage through category management, innovation support, and beyond (3%)
- **We don't have a strategic sourcing process** (2%)
- **Tactical at best** (e.g., reactive late-stage negotiations) (10%)
- **Good n-step sourcing process on paper, but biased to easy savings and shortcuts** (5%)
- **Pockets of excellence, but no standardized process.** Multiple approaches and templates/tools. (25%)
- **Well-implemented for many categories, but not pushing boundaries** in demand mgmt, complex categories, globalization, and extended supply chain (53%)
## What occurs within 7 stages of procurement’s strategic sourcing approach

<table>
<thead>
<tr>
<th>S1 Need Identification</th>
<th>S2 Pre-Solicitation</th>
<th>S3 Solicitation Preparation</th>
<th>S4 Solicitation Process</th>
<th>S5 Evaluation Process</th>
<th>S6 Award</th>
<th>S7 Contract</th>
</tr>
</thead>
<tbody>
<tr>
<td>You receive a requisition and/or a request for product or service</td>
<td>Deciding on which Purchasing Methodology to use</td>
<td>Create Specifications</td>
<td>Acceptance of Bids/Proposals</td>
<td>Analyze Supplier’s Responses</td>
<td>Handle Protest(s)</td>
<td>Complete Contract Assessment and Supplier Performance Report</td>
</tr>
<tr>
<td>Meet with End-User to gather information</td>
<td>Considering the number of contract renewals to use</td>
<td>Development of Sourcing Strategy</td>
<td>Conduct Pre-Bid and/or Site Visits</td>
<td>Consider Reciprocal Preference Law</td>
<td>Issue Notice of Intent Award (NOIA)</td>
<td>Renewal of existing contract</td>
</tr>
<tr>
<td>Decide on specific category (IT, Goods, or Special Services)</td>
<td>Determine which Solicitation Tool that will be used</td>
<td>Deciding whether to use Open or Fixed Contract</td>
<td>Posting of Bid</td>
<td>Solicitation has closed, no additional bids/proposals will be accepted</td>
<td>Document and store contract/purchase details</td>
<td>Create contract administration plan</td>
</tr>
<tr>
<td>Review Order of Precedence</td>
<td>Review Delivery Requirements</td>
<td>Writing Specifications</td>
<td>Determine Posting Timeline</td>
<td>Select supplier to award solicitation</td>
<td>Issue Notice of Award (NOA)</td>
<td>Sustain Results</td>
</tr>
</tbody>
</table>

Source: DOAS Strategic Sourcing Process
### A generic 7-step Strategic Sourcing process: Key objectives and activities

<table>
<thead>
<tr>
<th>Key Objective</th>
<th>Key Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profile Category</td>
<td>1. Understand internal spend and external supply market</td>
</tr>
<tr>
<td>2. Develop Sourcing Strategy</td>
<td>- Structure &amp; Mobilize Sourcing Team</td>
</tr>
<tr>
<td>3. Identify Suppliers</td>
<td>- Evaluate profiles and develop sourcing strategy</td>
</tr>
<tr>
<td>4. Evaluate Suppliers</td>
<td>- Profile Demand</td>
</tr>
<tr>
<td>5. Negotiate with Suppliers</td>
<td>- Finalize Sourcing Strategy &amp; Align Stakeholders</td>
</tr>
<tr>
<td>6. Transition Suppliers</td>
<td>- Prepare Supplier Assessment</td>
</tr>
<tr>
<td>7. Manage Suppliers</td>
<td>- Execute Supplier Evaluation</td>
</tr>
</tbody>
</table>

### Key Activities

1. **Profile Category**
   - Evaluate profiles and develop sourcing strategy

2. **Develop Sourcing Strategy**
   - Establish selection criteria and conduct supplier assessment

3. **Identify Suppliers**
   - Conduct & evaluate supplier evaluation and finalize sourcing plan

4. **Evaluate Suppliers**
   - Develop negotiations plan & select supplier(s)

5. **Negotiate with Suppliers**
   - Execute supply agreement & supplier transition

6. **Transition Suppliers**
   - Monitor market and supplier performance

7. **Manage Suppliers**
   - Develop Scorecards

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A generic 7-step Strategic Sourcing process: Key deliverables

1. **Profile Category**
   - Team Members and Stakeholders List
   - Work Plan
   - Demand Profile
   - Supply Profile
   - Draft Cost Model
   - SWOT Analysis
   - Initial Supplier List

2. **Develop Sourcing Strategy**
   - Sourcing Strategy
   - Risk Assessment

3. **Identify Suppliers**
   - Supplier Assessment Matrix
   - Prerequisite Supplier Documentation
   - Supplier Assessment Package
   - Evaluation Supplier List

4. **Evaluate Suppliers**
   - Supplier Evaluation Matrix
   - Updated Cost Model
   - Sourcing Plan
   - Stakeholder Alignment Checklist

5. **Negotiate with Suppliers**
   - Draft Tenets of Agreement (TOA)
   - Negotiation Plan
   - Finalized TOA
   - Draft Transition Plan
   - Business Award Plan
   - Stakeholders Approval Checklist
   - Signed Supply Contracts

6. **Transition Suppliers**
   - Supplier Scorecards
   - Finalized Transition Plan
   - Key Learnings Report

7. **Manage Suppliers**
   - Supplier Management Plan
We spend the bulk of our time in defining requirements, evaluating suppliers and negotiating contracts.

Distribution of time spent across sourcing processes:

- Requirements definition: 16%
- Development of sourcing strategy/documents: 13%
- Supplier identification/discovery: 6%
- Supplier qualification: 9%
- Supplier evaluation and selection: 19%
- Supplier regulatory/risk assessment: 6%
- Contract creation: 6%
- Contract negotiation: 6%
- Contract approval and signature: 19%
Critical Enablers of the Strategic Sourcing Process
While strategic sourcing skills are critical the most widely needed skills in procurement are business skills

Critical procurement skills

- Relationship management and interpersonal
- Strategic sourcing process expertise
- Problem-solving
- Strategic thinking and analysis
- Specific supply market/commodity expertise
- Business acumen
- SRM expertise
- Group collaboration/facilitation
- Organizational know-how
- Data analysis and modeling

Scale:
Low = A critical skill for <25% of positions
Medium = A critical skill for 25-50% of positions
High = A critical skill for 51-100% of positions

Source: Skills and Talent Outlook, The Hackett Group, 2014
To be viewed by stakeholders as more strategic (e.g. trusted advisor) we need well developed category strategies

Capabilities that will help the most to achieve a Trusted Advisor status

- Consistently deliver on the basics: 77%
- Hire and retain high-caliber staff: 64%
- Increase agility: 61%
- Develop category management strategies: 57%
- Deliver high-quality market insights and research: 53%
- Build better awareness of procurement’s services: 47%
- Discover and recommend innovative suppliers: 36%
- Prove value through small projects: 35%
- Improve the overall buying experience: 35%
- Other: 5%
- N/A: 4%

Working cross-functionally is an important enabler for the strategic sourcing process

**Strategic Sourcing Cross-Functional Stakeholders**
- Senior Management
- Sourcing & Procurement
- Finance
- Legal
- Research & Development
- Operations
- Marketing
- Supplier Diversity

**Core Team**
- **Team Lead**: Responsible for the day-to-day direction of and involvement in all stages of Sourcing Team
- **Team Member**: Responsible for representing key stakeholder interests

**Sponsorship & Subject Matter Experts (SME)**
- **Sponsor**: Responsible for general oversight of strategic sourcing process.
- **SME**: Responsible for providing expert level input (e.g., legal, quality, operations, etc.) as requested by the Sourcing Team.
What is the relevance of Crowdsourcing within the strategic sourcing process?

In 1906 there was a county fair where attendees were invited to guess the weight of a large ox. Excited at the chance to win the cash prize, over 800 people took a guess. Not one guess was right, but afterwards a statistician took a look at all of the answers and discovered something remarkable: the average of all the guesses was 1 pound less than the actual weight of the ox. The take away: a crowd can be much smarter than any one of its members, even if they aren't working together.
Critical Tools for Taking a Strategic Approach
Tools that help drive a successful strategic sourcing process

- Spend Analysis (Demand Profile)
- Market Analysis
- Strengths, Weaknesses, Opportunities, and Threats (SWOT)
- Total Cost of Ownership (TCO)*
- Risk Assessment
- Porters Five Forces (Quadrant Analysis)*

*We will walk through an exercise

These tools build upon one another to arrive at the category strategy and are best applied through facilitated exercises with stakeholders.
Spend analysis looks at who is buying what from whom?

A spend cube is a multi-dimensional view of all external vendor spend categorized by commodity, supplier, and a regional/organizational component.

### Potential Data Sources
- General Accounting Ledger
- Accounts Payable Files
- Historical Payment Records
- P-Card Records
- Functional or Business Unit databases
- Supplier invoices and summary data
- Purchase Orders
- T/E Systems
- Suppliers

### Key Activities
- Clean supplier data (e.g., IBM = I.B.M. = International Business Machines)
- Eliminate any redundancy or overlap of data sources
- Define all dimensions of the spend data as needed (e.g., Business Unit, Customer, Geography, Sub-Category, Sourcing Group)
- Establish rules to align source data with each dimension of the spend cube
- Compile spend cube
- Validate spend cube output with internal users

### Desired Output

**Business Unit / Geography**
- Who?

**Sub-Categories / Sourcing Groups**
- Buys What?

**Suppliers**
- From Whom?

**Spend Cube ($$$)**

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Market analysis seek to understand key aspects of the external supply market that provides the category

1. **Industry Level Analysis** – explores the trends, technologies, cost drivers, etc. of the supply market

2. **Supplier Level Analysis** – identifies key and niche suppliers, profiles capabilities, strengths, and weaknesses of suppliers

3. **Sourcing Strategy Best Practices** – document sourcing strategy levers being used by other companies with supply market
Industry Level Analysis: Higher demand for integrated facilities management is expected to outpace overall outsourced growth

- Worldwide total outsourced FM market valued at $535 billion in 2011; market expected to grow to more than $640 billion in 2017

- I-FM market generated revenue of $64.2 billion in 2011, which is 12% of the total outsourced market. It is expected to grow to $96.2 billion in 2017.
  - Both mature and emerging economies will see rising demand for I-FM services mainly because of its high cost-savings potential
  - Mature economies like North America and Europe make up the major share of the global I-FM market and are expected to contribute more than two-third of the market in 2017
  - Despite high growth rates, total contribution to global market by emerging economies like India and China remains low*
  - Service providers differentiate their service offerings by providing value-added services like energy management

* Note: See appendix for additional data on I-FM on a regional basis
Supplier Level Analysis: In-depth analysis of each major supplier in a category helps identify potential opportunities and sources.

**Supplier Cost Structure**

- **Revenue (Rev)**: 14,045
- **Exp (Exp)**: 11,778
- **3,158 -22.5% Operating Income**
- **2,267 -16.1%**
- **Cost of Service and Products**
- **Selling & Gen Admin**
- **Dep & Amor**

<table>
<thead>
<tr>
<th>Supplier Key Financial Indicators</th>
<th>2006</th>
<th>2007</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>12,765.1</td>
<td>14,044.7</td>
<td>10.0</td>
</tr>
<tr>
<td>Long Distance</td>
<td>7,277.4</td>
<td>8,302.1</td>
<td>14.1</td>
</tr>
<tr>
<td>Local and Other</td>
<td>4,719.4</td>
<td>5,166.1</td>
<td>9.5</td>
</tr>
<tr>
<td>Emerging Business</td>
<td>0</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>Product Dist. &amp; Dir. Pub.</td>
<td>1,148.0</td>
<td>1,225.9</td>
<td>6.8</td>
</tr>
<tr>
<td>Other</td>
<td>(379.7)</td>
<td>(649.9)</td>
<td>(71.2)</td>
</tr>
<tr>
<td>Net Income</td>
<td>395.3</td>
<td>1,183.8</td>
<td>199.5</td>
</tr>
<tr>
<td>Assets</td>
<td>15,195.9</td>
<td>16,953.0</td>
<td>11.6</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>6.3</td>
<td>7.4</td>
<td>17.5</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>8.6</td>
<td>17.97</td>
<td>109.96</td>
</tr>
<tr>
<td>Return on Revenue</td>
<td>3.1</td>
<td>8.4</td>
<td>170.97</td>
</tr>
<tr>
<td>Operating Expense</td>
<td>10,930.8</td>
<td>11,777.5</td>
<td>7.7</td>
</tr>
<tr>
<td>Employees</td>
<td>48,265</td>
<td>48,000</td>
<td>(0.5)</td>
</tr>
<tr>
<td>Stock price per share</td>
<td>32.69</td>
<td>39.88</td>
<td>22.0</td>
</tr>
</tbody>
</table>

**Key Business Issues**

- High level of customer defection
- Poor integration of X
- Consolidation of industry players

**Geographical Scope**

Nationwide and 290 countries worldwide

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Sourcing Strategy Best Practices: Examine the practices that other organizations have leveraged to deliver value in the category

- Development of long-term collaborative relationship with facility service providers to reduce cost
- The degree of integration with service provider should depend on the complexity of services, not on the volume of purchase
- Rationalize unnecessary service requirements for cost savings
- Leverage suppliers that are able to service the entire enterprise to receive favorable pricing
- Establish Key Performance Indicators (KPIs) to manage overtime paid and productivity levels
- Perform predictive modeling to forecast and plan for events, ensuring budgeting execution

Source: The Hackett Best Practices
A Strengths, Weakness, Opportunities and Threats (SWOT) analysis helps uncover potential value levers around the category

<table>
<thead>
<tr>
<th>Internal (Within the Buyer)</th>
<th>External (Outside the Buyer)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Strengths</strong></td>
<td><strong>Opportunities</strong></td>
</tr>
<tr>
<td>▪ Buyer characteristics that create or enhance the Buyer’s power in the market</td>
<td>▪ External market influences that present a potential benefit to the Buyer</td>
</tr>
<tr>
<td><strong>Weaknesses</strong></td>
<td><strong>Threats</strong></td>
</tr>
<tr>
<td>▪ Buyer shortcomings that reduce or eliminate the Buyer’s power in the market</td>
<td>▪ External market influences that pose a risk to the Buyer</td>
</tr>
</tbody>
</table>

Facilitate a discussion with stakeholders around their perspectives for each of the four areas and then think about how strategy will leverage
Total cost of ownership analysis models all relevant costs associated with a sourcing decision for a material or service

- **Supplier Price and Terms**
  - Unit price charged by a supplier to create a material or service ready for delivery and transaction terms for payment

- **Delivery Costs**
  - Cost to deliver a completed material or service to its internal point of use

- **Operations and Quality Costs**
  - Operational cost and supporting infrastructure implications associated with purchasing a material or service from a supplier
  - Quality cost implications of purchasing a material or service from a supplier

- **Other Costs**
  - Miscellaneous standard and situational costs associated with purchasing a material or service from a supplier

By understanding the overall cost of a category we can align our strategy to deliver on a broad set of stakeholder business objectives
The first step of the TCO is to breakdown the total supplier purchase price into the supplier’s cost elements.

Supplier Costs Allocated to the Unit

<table>
<thead>
<tr>
<th>Total Purchase Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Margin</td>
</tr>
<tr>
<td>SG&amp;A</td>
</tr>
<tr>
<td>Capital Expenses</td>
</tr>
<tr>
<td>Amortization</td>
</tr>
<tr>
<td>Overhead</td>
</tr>
<tr>
<td>Manufacturing Expenses</td>
</tr>
<tr>
<td>Direct Labor</td>
</tr>
<tr>
<td>Direct Materials</td>
</tr>
</tbody>
</table>

Cost Element Definitions

- **Margin**: Gross profit charged by supplier in excess of their costs for the part.
- **SG&A**: Sales, general, and administrative expenses – expenses related to sales activities and costs to manage the ongoing business activities of the supplier.
- **Capital Expenses**: Accounting cost of fixed asset investments that are spread across the life of the asset.
- **Amortization**: Expense group necessary for business function that does not usually contribute to profits—insurance, permits, rent, utilities, etc.
- **Overhead**: Non-labor expenses to fabricate and assemble a part—energy, packaging, etc.
- **Direct Labor**: Cost of labor that can be directly attributed to fabrication and assembly of the part.
- **Direct Materials**: Cost of materials that can be directly attributed to fabrication and assembly of the part.

Understanding supplier’s cost elements as an allocation against the total purchase price helps develop our strategy and focus discussions.
The second step is to identify and estimate the other cost component related to the category – Material Example

<table>
<thead>
<tr>
<th>Supplier Price and Terms</th>
<th>Delivery Costs</th>
<th>Operations and Quality Costs</th>
<th>Other Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Supplier Unit Price</strong></td>
<td><strong>Logistics Costs</strong></td>
<td><strong>In-Plant Material Inventory</strong></td>
<td><strong>Standard</strong></td>
</tr>
<tr>
<td>Direct Material</td>
<td>In-Country Transportation</td>
<td>Intra-Plant Demand</td>
<td>Risk</td>
</tr>
<tr>
<td>Direct Labor</td>
<td>Ocean / Air Freight</td>
<td>Safety Stock</td>
<td>Qualification</td>
</tr>
<tr>
<td>Indirect Labor</td>
<td>Destination Transport</td>
<td><strong>Region / Country-Specific Costs</strong></td>
<td><strong>Situational</strong></td>
</tr>
<tr>
<td>Management</td>
<td><strong>Cost of Quality</strong></td>
<td><strong>In-Plant Material Handling</strong></td>
<td>Procurement Staff</td>
</tr>
<tr>
<td>Overhead</td>
<td>Quality Validation</td>
<td>In-Plant Handling</td>
<td>- Domestic</td>
</tr>
<tr>
<td>Capital Amortization</td>
<td>Quality Comm'ns.</td>
<td>Plant Warehouse</td>
<td>- Foreign</td>
</tr>
<tr>
<td>Local Taxes</td>
<td>Performance Impact</td>
<td>Operations and Overhead</td>
<td>Broker Fees</td>
</tr>
<tr>
<td>Manufacturing Expenses</td>
<td>Incremental Remedies</td>
<td><strong>Supply Chain</strong></td>
<td>Infrastructure</td>
</tr>
<tr>
<td>Local Regulatory</td>
<td><strong>Terms</strong></td>
<td><strong>Inventory Maintained in the Supply Chain</strong></td>
<td>- Technology</td>
</tr>
<tr>
<td>Compliance Costs</td>
<td>Net Payment Terms</td>
<td>Satellite Warehouse</td>
<td>- Facilities</td>
</tr>
<tr>
<td><strong>Terms</strong></td>
<td>Volume Discounts</td>
<td>Operations/Overhead</td>
<td>Exchange Rate Differentials</td>
</tr>
<tr>
<td></td>
<td>Free Goods</td>
<td><strong>In-Plant Handling</strong></td>
<td>Tooling / Molds</td>
</tr>
</tbody>
</table>

- In-Plant Material Inventory
  - Intra-Plant Demand
  - Safety Stock
- Region / Country-Specific Costs
  - Customs Duties
  - Value-Added Taxes
- In-Plant Material Handling
  - In-Plant Handling
  - Plant Warehouse Operations and Overhead
- Supply Chain
  - Inventory Maintained in the Supply Chain
  - Satellite Warehouse Operations/Overhead

**Other Costs**

- Risk
- Qualification
- Procurement Staff
  - Domestic
  - Foreign
- Broker Fees
- Infrastructure
  - Technology
  - Facilities
- Exchange Rate Differentials
- Tooling / Molds
The second step is to identify and estimate the other cost component related to the category – Services Example

<table>
<thead>
<tr>
<th>Supplier Price and Terms</th>
<th>Delivery Costs</th>
<th>Operations and Quality Costs</th>
<th>Other Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Supplier Unit Price</strong></td>
<td><strong>Logistics Costs</strong></td>
<td><strong>Service Integration</strong></td>
<td><strong>Standard</strong></td>
</tr>
<tr>
<td>- Direct Material</td>
<td>- Freight / shipping for supporting materials and media</td>
<td>- Business support staff</td>
<td>- Risk</td>
</tr>
<tr>
<td>- Direct Labor</td>
<td>- Electronic delivery cost</td>
<td>- Requirements gathering</td>
<td>- Qualification</td>
</tr>
<tr>
<td>- Indirect Labor</td>
<td></td>
<td>- Training</td>
<td></td>
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<tr>
<td>- Management</td>
<td></td>
<td>- Implementation</td>
<td></td>
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<tr>
<td>- Overhead</td>
<td></td>
<td>- Additional hardware / software</td>
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<tr>
<td>- Capital Amortization</td>
<td></td>
<td>- Internal testing</td>
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<tr>
<td>- Local Taxes</td>
<td></td>
<td>- Roll-out costs for process change</td>
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<tr>
<td>- Local Regulatory</td>
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<tr>
<td>Compliance Costs</td>
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<tr>
<td>- Telecom</td>
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<td>- Software / Hardware</td>
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<td>- Travel and Expenses</td>
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<tr>
<td>- R&amp;D</td>
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<td>- Development Expenses</td>
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<tr>
<td><strong>Terms</strong></td>
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<tr>
<td>- Net Payment Terms</td>
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<tr>
<td>- Volume Discounts</td>
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<tr>
<td><strong>Region / Country-Specific Costs</strong></td>
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<tr>
<td>- Customs Duties</td>
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<tr>
<td>- Value-Added Taxes</td>
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<tr>
<td><strong>Cost of Quality</strong></td>
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<tr>
<td>- Quality Validation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Quality Comm’ns.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Performance Impact</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Incremental Remedies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Supplier Price and Terms</strong></td>
<td><strong>Delivery Costs</strong></td>
<td><strong>Operations and Quality Costs</strong></td>
<td><strong>Other Costs</strong></td>
</tr>
<tr>
<td><strong>Cost of Quality</strong></td>
<td><strong>Service Integration</strong></td>
<td><strong>Situational</strong></td>
<td></td>
</tr>
<tr>
<td>- Business support staff</td>
<td>- Risk</td>
<td>- Procurement Staff</td>
<td></td>
</tr>
<tr>
<td>- Requirements gathering</td>
<td>- Qualification</td>
<td>- Domestic</td>
<td></td>
</tr>
<tr>
<td>- Training</td>
<td></td>
<td>- Foreign</td>
<td></td>
</tr>
<tr>
<td>- Implementation</td>
<td></td>
<td>- Broker Fees</td>
<td></td>
</tr>
<tr>
<td>- Additional hardware / software</td>
<td></td>
<td>- Infrastructure</td>
<td></td>
</tr>
<tr>
<td>- Internal testing</td>
<td></td>
<td>- Technology</td>
<td></td>
</tr>
<tr>
<td>- Roll-out costs for process change</td>
<td></td>
<td>- Facilities</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Exchange Rate Differentials</td>
<td></td>
</tr>
</tbody>
</table>
Example of breaking down the “Supplier Price” for staff augmentation services

**Example Markup Breakdown**

<table>
<thead>
<tr>
<th>Markup Component</th>
<th>Average Adder</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Statutory Payroll Burden</strong></td>
<td>11.3%</td>
</tr>
<tr>
<td><strong>Company Payroll Burden</strong></td>
<td>5.8%</td>
</tr>
<tr>
<td><strong>Company Pension</strong></td>
<td>1.9%</td>
</tr>
<tr>
<td><strong>Vacation/Holidays</strong></td>
<td>5.1%</td>
</tr>
<tr>
<td><strong>Insurance</strong></td>
<td>3.4%</td>
</tr>
<tr>
<td><strong>Bonus/Stock Options</strong></td>
<td>2.1%</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td>2.3%</td>
</tr>
<tr>
<td><strong>Overhead and Profit</strong></td>
<td>22.4%</td>
</tr>
<tr>
<td><strong>Overhead</strong></td>
<td>13.9%</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td>8.5%</td>
</tr>
<tr>
<td><strong>Total Markup</strong></td>
<td>39.6%</td>
</tr>
</tbody>
</table>

Understanding the price paid breakdown helps us with strategy, negotiations and collaborating with suppliers and stakeholders on value opportunities.
Example of breaking down for other TCO elements for staff augmentation services

<table>
<thead>
<tr>
<th>Delivery Costs</th>
<th>Operations and Quality Costs</th>
<th>Other Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Onboarding Costs</td>
<td>Workspace Costs</td>
<td>Loss of Knowledge</td>
</tr>
<tr>
<td>Acquisition Costs</td>
<td>Productivity Ramp</td>
<td>Co-Employment Risk</td>
</tr>
<tr>
<td>Background Check</td>
<td>Off-Boarding Costs</td>
<td>Data Security Risk</td>
</tr>
<tr>
<td>Drug Testing</td>
<td>Rework/Quality Costs</td>
<td>Retention Costs</td>
</tr>
<tr>
<td>Training</td>
<td>Management Costs</td>
<td>Over Spec. Costs</td>
</tr>
<tr>
<td>Travel/Moving Costs</td>
<td>Invoice and Payment</td>
<td></td>
</tr>
</tbody>
</table>

Cost Impact

Sign – Significant  Mod – Moderate  Min – Minimal

We generally fail to understand the true impact of these other cost elements leading to internal stakeholder dissatisfaction or other long-term problems.
A risk assessment identifies risk and then assesses the probability of occurrence and the impact.

<table>
<thead>
<tr>
<th>Business Impacted</th>
<th>Risk Probability</th>
<th>Commodity Risk Profile</th>
<th>Risk Statement</th>
<th>Risk Mitigation Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>H</td>
<td>H</td>
<td>Risk #3</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>L</td>
<td>Risk #4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>L</td>
<td>L</td>
<td>Risk #1</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>H</td>
<td>Risk #2</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Risk #5</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Risk #6</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For all high risk/impact factors we must identify the risk and then develop a risk mitigation strategy that can be addressed thru the sourcing strategy.
Porter’s analysis is a formal approach to understanding the category’s supply market and business impact.

### Five Market Forces Analysis

- **Supplier’s Power (2nd tier)**
- **Rivalry Among Competitors**
- **New Entrants**
- **Substitutes**
- **Buyer’s Power**

### Business Impact Analysis

- **Expense Base Impact**
- **Customer Value Impact**
- **Product Differentiation Impact**
- **Leading Technology Impact**
- **Failure Impact**

Impact Scale:
- Low (1)
- High (5)
The results of Porter’s analysis identifies where on a two-by-two sourcing matrix a category most closely aligns.
Categories within each of the quadrants generally have similar characteristics

**Leverage**
- High-expenditure area
- Many existing alternate products and services
- Many qualified supply sources
- Goods and services are readily available
- Commercial involvement can significantly impact price

**Routine**
- Many existing alternate products and services
- Many sources
- Low value
- Small individual transactions
- “Anyone” could buy it
- Unspecified items for everyday use

**Strategic**
- Strategic to profitability and operations
- Few qualified supply sources
- Large expenditures
- Design to quality critical
- Complex specifications

**Bottleneck**
- Very complex specifications requiring complex manufacturing or service process
- Few alternate products available
- Few qualified sources of supply
- May have a big impact on ongoing operations or maintenance
- New technology or untested processes involved in provision of the product or service
And therefore, similar opportunistic value levers for optimizing the category sourcing strategy

<table>
<thead>
<tr>
<th>Sourcing Matrix Quadrant Placement</th>
<th>Purchase Demand Management</th>
<th>Supply Base Management</th>
<th>Total Cost Management</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Reduce Consumption</td>
<td>Consolidate Spend</td>
<td>Optimise Specification</td>
</tr>
<tr>
<td>Leverage</td>
<td><img src="image" alt="Circle" /></td>
<td><img src="image" alt="Circle" /></td>
<td><img src="image" alt="Circle" /></td>
</tr>
<tr>
<td>Routine</td>
<td><img src="image" alt="Circle" /></td>
<td><img src="image" alt="Circle" /></td>
<td><img src="image" alt="Circle" /></td>
</tr>
<tr>
<td>Bottleneck</td>
<td><img src="image" alt="Circle" /></td>
<td><img src="image" alt="Circle" /></td>
<td><img src="image" alt="Circle" /></td>
</tr>
<tr>
<td>Strategic</td>
<td><img src="image" alt="Circle" /></td>
<td><img src="image" alt="Circle" /></td>
<td><img src="image" alt="Circle" /></td>
</tr>
</tbody>
</table>

- **High Opportunity**
- **Low/No Opportunity**
An example output of five-forces market analysis from the corrugated industry

**Entry Barriers**
- Current participants have very low manufacturing costs
- Medium capital requirements for converting plant (<10 MUSD)
- Generally low profitability in industry, deterring possible entrants
- High threat of forward integration

**Supplier Power (2nd tier)**
- Large players in highly capital intensive industry
- Profitability in industry very dependent on raw material price and capacity utilization
- Paper suppliers are under pressure to increase value added through forward integration
- Some suppliers, like IP, Smurfit and Georgia Pacific have strong presence in the paper and wood pulp market

**Intensity Of Rivalry**
- Mature product, relatively slow industry growth, intense competition
- Undifferentiated product, competition is based on cost and geographical location
- Concentration movement in the last 5 years, top 5 companies hold 73% of the production volume in the U.S.
- Integration level is high, practically top 5 corrugators also dominate linerboard and corrugate medium market

**Pressure From Substitutes**
- Plastic is still a viable threat for fast-moving, non-branded goods in “re-usable” applications, although currently growing at a slower pace than corrugated
- Chipboard is losing market share to corrugated in heavy-duty segment

**Buyer Power**
- Fragmented customer base – except by the Food/ Dairy industry, responsible for 40% of the corrugated material consumption
- Recent mergers, created room for specification deproliferation (SKU rationalization)
- High pricing transparency – most models depend on Linerboard prices
- Largest FMCG firms generally more globalized than corrugated producers, driving consolidation in corrugated industry, e.g. Smurfit-Stone
- Largest customers are driving product development in corrugated, aiming to reduce total use of packaging material and make it more environmentally friendly
Let’s go through an example: IT Outsourcing Infrastructure

• The reasons for outsourcing IT infrastructure
  – Reduce costs, improve service quality, and keep technology up-to-date while spreading upgrade costs over the life of the contract

• Market overview
  – Globally, the IT outsourcing (ITO) industry was estimated at $251.7 billion in 2012, and the market is expected to grow at a CAGR of 3.3% for the period 2011-2015
  – IT infrastructure outsourcing constitutes 81.9% of the overall ITO market

• Keys to IT infrastructure outsourcing success
  – Establish an operational baseline and clear business objectives prior to outsourcing
  – Select the appropriate sourcing model
  – Manage the risk associated with outsourcing more-critical operations
  – Govern the end-to-end outsourcing life cycle within a structured framework
## Market Force 1: Rivalry among competitors within supply market

<table>
<thead>
<tr>
<th>Market Competition Is High If…</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Numerous or equally balanced competitors within supply market exists</td>
<td>★</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Slow industry growth is occurring in supply market</td>
<td></td>
<td>★</td>
<td></td>
</tr>
<tr>
<td>High fixed or storage costs exists within the supply market</td>
<td></td>
<td>★</td>
<td></td>
</tr>
<tr>
<td>Lack of differentiation or low switching cost exists between suppliers</td>
<td>★</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capacity additions to the supply market must be made in large increments</td>
<td></td>
<td>★</td>
<td></td>
</tr>
<tr>
<td>High exit barriers exists for suppliers to leave the industry (e.g. environmental, regulatory)</td>
<td></td>
<td>★</td>
<td></td>
</tr>
</tbody>
</table>

Overall Rating: Rivalry among competitors

- **High** (5)
- **Low** (1)
## Market Force 2: Barriers to new entrants within supply market

<table>
<thead>
<tr>
<th>Barriers To Entry are high if…</th>
<th>No</th>
<th>Yes</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Economies of scale (i.e., computer industry) exist within supply market</td>
<td></td>
<td>⭐</td>
<td></td>
</tr>
<tr>
<td>- Differentiation of products enabled by supplier (i.e., cosmetics)</td>
<td></td>
<td>⭐</td>
<td></td>
</tr>
<tr>
<td>- Significant capital requirement are needed for suppliers (i.e., oil extraction)</td>
<td></td>
<td>⭐</td>
<td></td>
</tr>
<tr>
<td>- Switching cost to new supplier are high (i.e., chemical industry)</td>
<td></td>
<td>⭐</td>
<td></td>
</tr>
<tr>
<td>- Access to distribution channel are limited (i.e., food industry)</td>
<td></td>
<td>⭐</td>
<td></td>
</tr>
<tr>
<td>- Cost disadvantages independent of scale</td>
<td></td>
<td>⭐</td>
<td></td>
</tr>
<tr>
<td>- Product know-how or design characteristics exists</td>
<td></td>
<td>⭐</td>
<td></td>
</tr>
<tr>
<td>- Favorable access to raw materials by suppliers</td>
<td></td>
<td>⭐</td>
<td></td>
</tr>
<tr>
<td>- Favorable locations for suppliers exist</td>
<td></td>
<td>⭐</td>
<td></td>
</tr>
<tr>
<td>- Government policy (i.e., regulated industries, railroads, trucking)</td>
<td></td>
<td>⭐</td>
<td></td>
</tr>
</tbody>
</table>

### Overall Rating: Barriers to new entrants

- Low (1)
- High (5)
Market Force 3: Opportunity for substitution supplier products or services

<table>
<thead>
<tr>
<th>The opportunity to substitute products/services</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Is the relative price of a substitute product/service low compared to existing?</td>
<td>★</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Is the cost of switching to the substitute low?</td>
<td>★</td>
<td>★</td>
<td></td>
</tr>
<tr>
<td>• Is the buyer’s propensity to switch low?</td>
<td>★</td>
<td>★</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>For the most likely substitute products/services</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Subjected to trends improving their price value ratio (i.e., catalytic converters…)</td>
<td>★</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Produced by industries earning high profits encouraging new entrants (i.e., computers)</td>
<td>★</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Overall Rating: Threat of Substitutes

- High (5)
- Low (1)
## Market Force 4: 2nd Tier Supplier’s power over Buyer

A Supplier Group Is Powerful If The Following Apply

<table>
<thead>
<tr>
<th></th>
<th>No</th>
<th>Yes</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is dominated by a few suppliers and is more concentrated than the industry it sells to</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>It does not have to contend with other substitute products/services for sale to the industry</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The industry is not an important customer of the supplier group</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The supplier group’s product is an important input to the buyer’s business</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The supply group has built up switching costs (product/service differentiation)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The supply group poses a credible threat of forward integration</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Overall Rating: Suppliers Power**

- **Low** (1)
- **High** (5)
## Market Force 5: Buyer’s power relative to supply market

<table>
<thead>
<tr>
<th>A Buyer Is Powerful If…</th>
<th>Yes</th>
<th>No</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is concentrated or purchases large volumes relative to the supplier’s sales</td>
<td>★</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The product/service purchases from the industry represent a significant fraction of the buyer’s spend</td>
<td>★</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The product/service it purchases from the industry are standard or undifferentiated</td>
<td>★</td>
<td></td>
<td></td>
</tr>
<tr>
<td>It faces few switching costs to move suppliers</td>
<td>★</td>
<td></td>
<td></td>
</tr>
<tr>
<td>It earns low profits leaving little opportunity for suppliers to aggressively increase price</td>
<td>★</td>
<td></td>
<td></td>
</tr>
<tr>
<td>It poses a credible threat of backward integration (make/buy) into supply market</td>
<td>★</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The supply industry’s product/services is unimportant to the quality of its products/service</td>
<td>★</td>
<td></td>
<td></td>
</tr>
<tr>
<td>It has full information about supply market</td>
<td>★</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Overall Rating: Buyer’s Power | High (5) | Low (1) |
Business Impact analysis looks at the impact of the category on our overall business/organization

- Does the total purchase cost for the Category represent a major part of the company’s total external expenditures? (Expense Base Impact)
  - No
  - Yes

- Do customers perceive that the Category provides significant value? (Customer Value Impact)
  - No
  - Yes

- Does the Category differentiate the end product in an important way? (Product Differentiation Impact)
  - No
  - Yes

- Does the Category provide access to leading technology critical to the value your customer perceives? (Leading Technology Impact)
  - No
  - Yes

- Would a Category’s failure or shortage affect your customer’s satisfaction? (Failure Impact)
  - No
  - Yes

Overall Business Impact: Low (1) | High (5)
Changes in the business environment: Assess to insure no major changes that would impact analysis

<table>
<thead>
<tr>
<th>Business Requirements/Trends</th>
<th>New End Products/Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Redistribution of the value-added component of the value chain (integration/de-integration)</td>
<td>• New market segmentation</td>
</tr>
<tr>
<td>• Cross business integration</td>
<td>• New market entry</td>
</tr>
<tr>
<td>• Globalization</td>
<td>• Changing customer needs</td>
</tr>
<tr>
<td>• Shifts in supply chain leadership (e.g., from manufacturing to retailers)</td>
<td>• New functions of use</td>
</tr>
<tr>
<td></td>
<td>• Product/service extension and bundling</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Technology Changes</th>
<th>Macroeconomic/Regulatory Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Product/process technology breakthrough</td>
<td>• Safety regulation changes</td>
</tr>
<tr>
<td>• Technology transfer from different business</td>
<td>• Anti-pollution legislation evolution</td>
</tr>
<tr>
<td>• Complementary product/process technology improvements</td>
<td>• Trade regulation changes</td>
</tr>
<tr>
<td></td>
<td>• Political environment uncertainty</td>
</tr>
</tbody>
</table>

It is always good to make sure there are no expected changes to the market or category usage that would significantly impact analysis.
Plot results of Business Impact and Market Complexity on Two by Two

<table>
<thead>
<tr>
<th>Business Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expense base impact</td>
</tr>
<tr>
<td>Customer value impact</td>
</tr>
<tr>
<td>Product differentiation impact</td>
</tr>
<tr>
<td>Leading technology impact</td>
</tr>
<tr>
<td>Failure impact</td>
</tr>
<tr>
<td>Overall Business Impact</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Market Complexity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competition among suppliers</td>
</tr>
<tr>
<td>Rivalry among competitors</td>
</tr>
<tr>
<td>Barriers to new entrants</td>
</tr>
<tr>
<td>Opportunity for of substitutes</td>
</tr>
<tr>
<td>Supplier’s power</td>
</tr>
<tr>
<td>Buyer’s power</td>
</tr>
<tr>
<td>Overall Market Complexity</td>
</tr>
</tbody>
</table>

Leverage
Create an Advantage
Leverage the Spend
“Strategic” category objectives are around product/service differentiation and “Best of Breed” suppliers

**Emphasis**
- Partnership / alliance or compensating strategy
- Internal intelligence of product/service cost drivers and market
- Continuity of supply
- Supplier / customer cross functional integration
- Total cost approach
- Significant joint cost reduction and performance improvement initiatives

**Supplier Characteristics**
- Technology / market leader
- Sophisticated support systems
- Financially stable
- Compatible business strategies
- Managed supply chain

**Leading Practices**
- Long term / service life agreements
- Joint product/ process design
- On-site representation
- Seamless supply chain processes between companies i.e. integrate supplier and customer processes
- System linkages
- Supplier manages product / service
- Prepare contingency plans (back-up supply and exit strategies)
“Leverage” is about minimizing total cost

**Emphasis**
- Total cost reduction / value enhancement:
  - Process improvements
  - Design changes e.g. standardization, consolidation
  - Procurement process e.g. spot-buying, competitive tendering, trade
- Internal and external intelligence of product/service cost drivers, market trends, new entrants
- Rationalization (‘right-size’) of the supplier base while maintaining multiple qualified sources
- Co-ordination of requirements to maximize buying power

**Leading Practices**
- Competitively bid agreements
- Establish leverage position
- Create consortium procurement
- Break-out transportation costs/manage separately
- Pursue value-added services from suppliers that reduce cost e.g. supplier managed inventory
- Use flexible agreements (within qualified supplier base)
- Respond rapid to market changes

**Supplier Characteristics**
- Comprehensive Sourcing Group coverage
- High, consistent quality levels
- Electronic ordering capability
- Supplier services provided e.g. inventories, maintenance
“Routine” is about minimizing cost of acquisition and supplier consolidation

**Emphasis**
- Directionally correct / common sense decisions
- Speed-to-implementation
- Supplier consolidation
- Flexible agreements
- Minimal investment in inventory / eliminate safety stock
- Streamlined and simplified processes (procurement, A/P, receiving):
  - Elimination of paper and electronic paper equivalent
  - Automation
  - Minimization of approvals
  - Periodic audits vs. detailed reviews
  - Supplier provided usage reports

**Supplier Characteristics**
- Comprehensive Sourcing Group coverage without substantial inventory investment
- Efficient order to delivery process
- High service ratings
- Flexible automated support systems

**Leading Practices**
- Long-term, competitively bid / negotiated supplier agreements
- Suppliers own specifications
- Supplier incentive to substitute / standardize; use industry specifications
- Reduce inventory e.g. supplier managed inventories
- Outsourcing
- Consortium procurement
- Budget holder empowerment e.g. end-user release and decentralization
- Electronic catalog ordering
“Bottleneck” is about minimizing items and ensuring supply continuity

**Emphasis**
- Research opportunities to eliminate, substitute or standardize
- Research alternatives or ability to extend to other products
- Reduce life cycle costs
- Integrate with other agreements
- Aligned with proactive suppliers
- Reduce maintenance and operating costs
- Service level agreements

**Leading Practices**
- Life of product / long-term agreements
- Provide to supplier reason to become ‘preferred’
- Knowledge/ technology transfer
- Market exposure
- Expand relationship
- Process improvement
- Product development
- Ownership stake
- Managing the whole supply chain
- Development of new suppliers

**Supplier Characteristics**
- Niche market/ product supplier
- Advanced design/ technology
Key take-aways

- Strategic sourcing provides a formal approach to optimizing value of a sourcing approach
- In addition to a foundational understanding of the strategic sourcing approach, relationship management skills are a critical enabler
- The power of the strategic sourcing process is in facilitating fact-based discussions with a cross-functional team using proven tools that drive towards recommended strategies
- Understanding the total cost of ownership for a category will help deliver greater overall value to stakeholders as well as understand where greater cost reduction opportunities may exist
- Porter’s analysis is a powerful tool for driving towards a recommended category strategy in a thoughtful and fact-based approach helping create buy-in from internal stakeholders
Contact information

Kurt Albertson

Principal – Procurement Advisory
770-225-7570
kalbertson@thehackettgroup.com