



Strategic sourcing – A lever to address Supply Chain disruptions and create significant value

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Executive Summary

Organizations across the world are grappling with the impact of COVID-19, which has not only disrupted the global supply chains, but also tested the effectiveness of existing business continuity plans. For many companies, weaknesses in planning manifested into painful losses. Since the initial days of the pandemic, most organizations have adjusted their budgets and developed recession contingency plans. However, as this crisis continues, companies must move to the next step: realigning the way they operate to sustainably navigate instability.

With our owner-operator legacy of managing plants across the globe over last 200 years as part of dss+, one thing that various economic downturns have taught us is that cost reduction and short-term contingencies can backfire if sustainability is not an inherent piece of the program.

This new economic reality requires flexibility and companies showing the highest level of agility in adapting fast to new demand patterns will win. Strategic sourcing is a lever companies should focus on to reduce cost, sustain operations and thrive as a successful business in the future.



Current supply/demand disruptions create a need for an alternative sourcing approach

With most parts of the world in varying degrees of lockdown and the movement of goods and people remaining limited, the operating models of most companies have experienced extreme strain. Shocks to supply and demand as a result of COVID-19 have threatened business continuity, introduced new risks and added new inefficiencies to operations.

Figure 1 illustrates the varying levels of supply and demand shocks across multiple industries and the current reality enforced on them as a result of that. COVID-19 has exposed the unreliable sourcing strategies of many organizations.

The situation has highlighted several factors that should be considered before contracts are put in place, including:

- Local vs. global vendor: Heavy reliance on low cost countries like China hasn't helped many global players. A diverse sourcing approach is required to manage supply risks

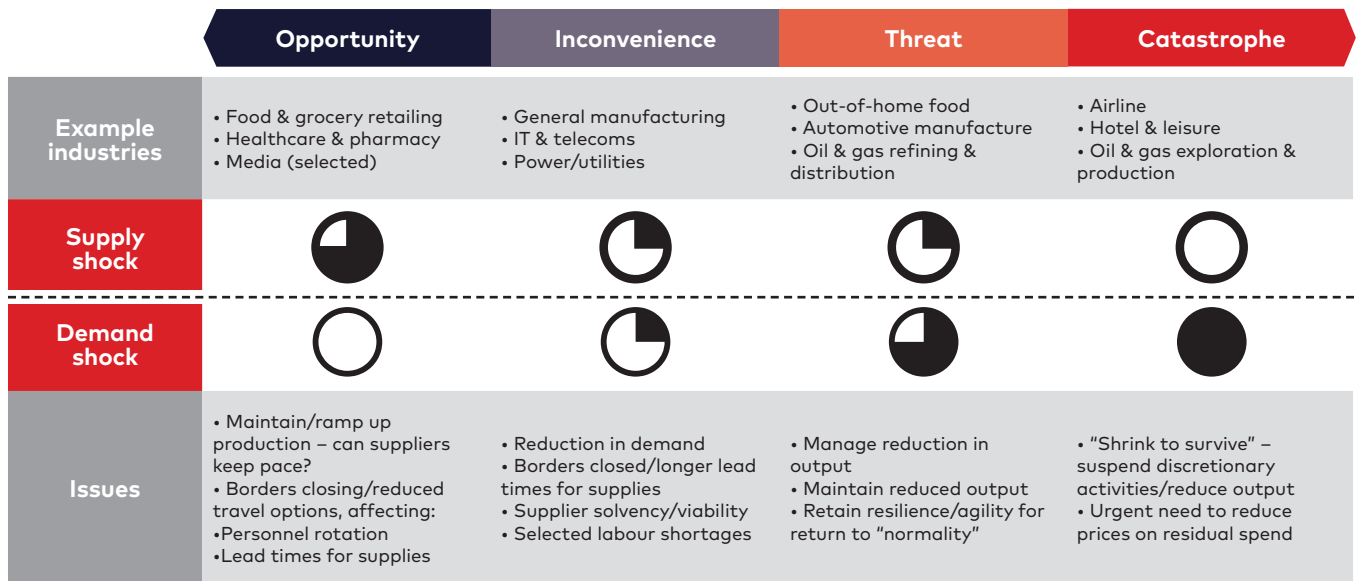


Figure 1: Supply and demand shocks across multiple industries

Such shocks have been observed across multiple industries with extremely different supply chains. Indeed, healthcare, pharmaceuticals and some food & beverage companies have seen an opportunity for growth with high demand, but face challenges of in-time availability of raw material. On the other end of the spectrum, airlines and oil & gas companies are suffering with low demand for their goods & services and are embarking on rigorous cost optimisation exercises.

- Terms and conditions: Sharing the pain by dealing with disruptions together as strategic partners should benefit all parties rather than contributing to collapse.
- Alignment with business continuity plans: Planning for and storage of emergency stock to ensure business continuity.
- Transparency: The visibility of supply network risks and capacity constraints should be clear.

Sourcing is a fundamental aspect of a resilient and mature purchasing organization

The ability of an organization to respond effectively to external supply/demand disruptions depends heavily on its internal procurement value chain.

There are two fundamental pieces of the procurement value chain that represent the starting point of a strong set-up: Analysis and Sourcing (Figure 3). It is essential to have a structured, analytical approach to scope identification, spend analytics, supplier and business risk management and supplier review and selection. Sourcing lays the foundations for effective category and vendor strategies and improved long-term value and contract performance.

triggers e.g. for raw materials, organizations won't be able adapt price or volume. If warehouse management system is not transparent enough organizations won't be able to make the right arbitrage between reducing your stock levels and business continuity risks

A mature sourcing and procurement organization is more than ever a key success

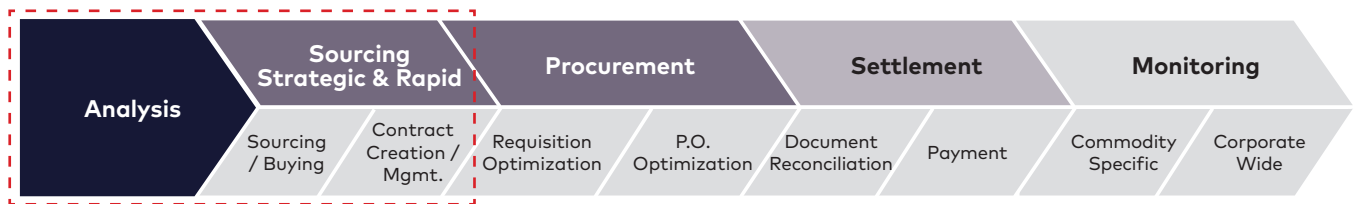


Figure 3: Procurement Value Chain

Even though the first procurement function was established in 1800s and has evolved through several rounds of transformations, organizations continue to face basic sourcing challenges that under-leverage the ability of purchasing departments to contribute to an organization's competitiveness:

- Analysis: Incorrect understanding of demand and specification needs as well as spend patterns, often resulting in a restricted vendor ecosystem, characterized by higher than necessary cost and bloated working capital.
- Sourcing Strategy: Single source situation with no backup, no prequalified product alternatives for key purchases. If the purchasing organization is not reactive, the organization will find it hard to quickly address supply issues and negotiate solutions with vendors.
- Procurement Process: If process compliance is low, it will lead to high off-contract spend and in-effective demand management measures.
- Contract Management: If contracts don't include the right

factor to respond rapidly and effectively to disruptions, like COVID, to manage risks and protect value.

Effective sourcing practices can create significant value

Effective sourcing of goods and services represents one of the largest cost saving opportunities, with rapid measurable impact on organizations. It is a highly effective tool which reaps benefits over a reasonably short period of time with a comparably low pain level, while also balancing riskreturn tradeoffs and targeting wider improvements such as a) reduction of operational risks, b) improved operational efficiency, c) minimized supply chain risks and d) business continuity and sustainability.

Figure 4 provides an illustrative example of the value of a successful sourcing intervention. Based on a typical manufacturing environment where purchased goods and services represent 60% of revenues, the impact of a sourcing initiative is equivalent to a 15% reduction in workforce or 15% increase in revenue. Sourcing is one of the quick win value levers and represents an attractive area for optimization during a period like the COVID-19 crisis.

A typical savings objective for strategic sourcing would be around 15% to 20% (Figure 5) and sometimes more. This also depends on the structure of the supply market and category.

- Very competitive, low margin industries like road transport, for example, have streamlined process flows with little opportunity to further optimize cost base .
- On the other end, highly specialized technical services and goods can yield very significant savings if a competitive situation can be created and demand is re-specified.

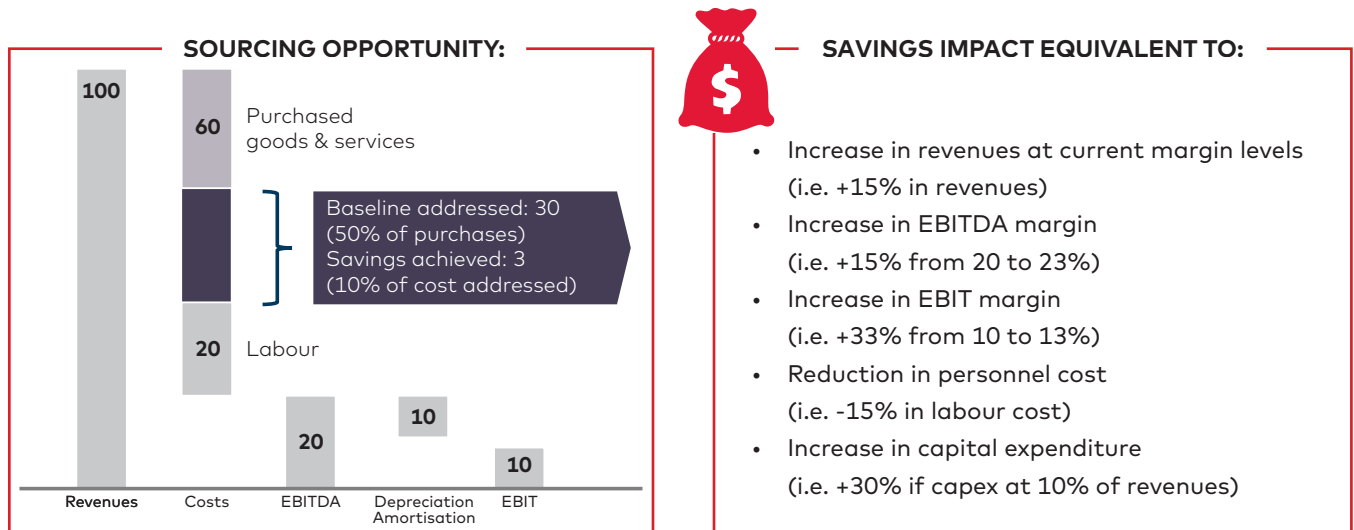


Figure 4: Potential savings impact from exploring sourcing opportunities (illustrative)

Companies can target both strategic and rapid sourcing as levers for cost reduction.

Strategic sourcing targets high spend / high risk categories, and its impact on the organization is of higher significance. Strategic sourcing is a highly bespoke, category specific approach that guarantees a high impact on cost and supply chain risk while at the same time providing an opportunity to upskill the existing purchasing organization.

A similar savings potential applies to indirect purchasing categories that represent large opportunities, including IT, Telecoms or Facilities management through the use of sale and leaseback or renegotiated rental agreements.

Rapid sourcing takes on smaller categories in parallel through a more standardised approach to cover a broad range of several hundreds of vendors and improve unit prices. It is used to address the remaining categories and vendors at the lower end of the pareto curve, and typically has a lower percentage savings impact due to the nature of the approach. During current times, every penny counts and savings of higher than the average of 6% is probable as suppliers are keen to cultivate and maintain long-term client relationships.

Strategic Sourcing – Direct Categories

Category	Expenses Reviewed*	% Savings	Category	Expenses Reviewed*	% Savings
Raw materials	509	21	Shutdown services	92	15
Maintenance parts	223	15	Packaging	82	24
Maintenance services	183	26	Temporary labour	80	26
Road transport	180	5	Engineering consultancy	74	18



16% Total savings across all categories

Strategic Sourcing – Indirect Categories

Category	Expenses Reviewed*	% Savings
Telecommunications	549	17
Facilities	348	20
Distribution	75	19
Software	73	18



17% Total savings across all categories

* \$ millions

Figure 5: Example of strategic sourcing cost savings across different categories

Organizations have focused their initial efforts on addressing the immediate supply network constraints and managing the supply disruptions to re-start operations. Now business executives need to turn their attention to the medium-term security of the supply base, unlocking working capital intelligently and building future-proof resilience strategies. This approach will not only help manage the immediate COVID-19 emergency, but also build stronger and more resilient businesses ready to thrive as economies return to growth.

Strategic Sourcing is an effective lever for organizations to not only minimize supply chain risk by securing goods & services and optimizing spend, but also by adopting a true Total Cost of Ownership (TCO) approach aimed at operational risk reduction,

enhancing operational efficiency and driving sustainability. This is what we call the 'balancing act' to achieve business objectives (Figure 6).

This need was also echoed by the attendees of a recent executive webinar, where 44% of executives responded that achieving continuity and sustainability of their operations is their top priority. This shows that organizations want to drive sustainable improvements to their business beyond ad-hoc cost savings and quick wins.

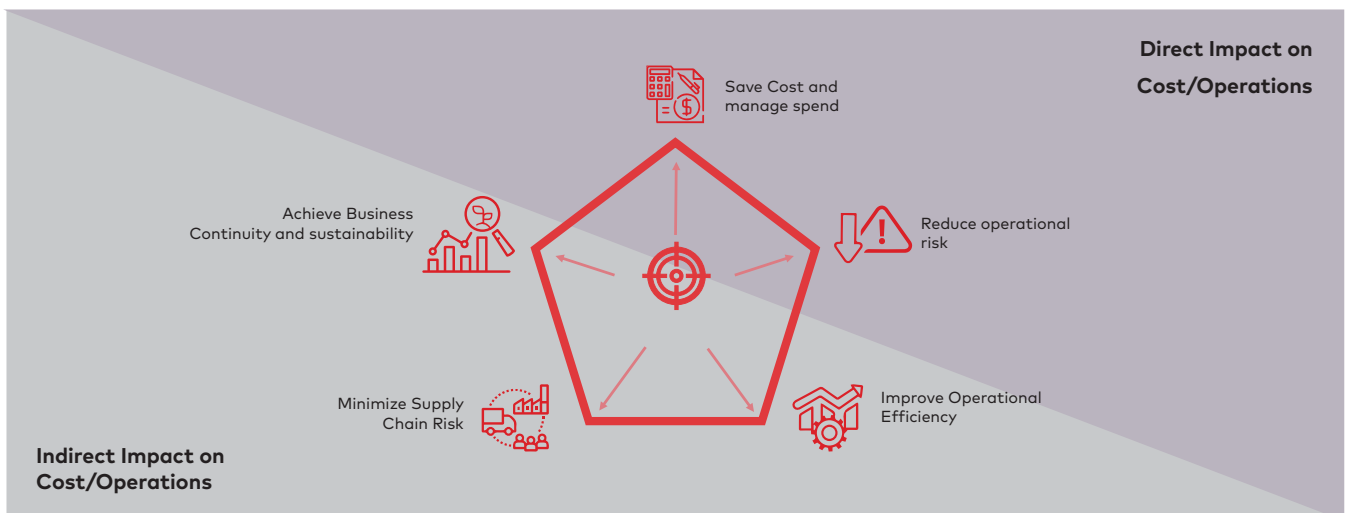


Figure 6: Benefits of effective implementation of strategic sourcing

To achieve this, every outsourced scope of work and contractual agreement needs to be reviewed by procurement and technical teams to question the norm, better understand risk trade-off's, find better ways of delivery to reduce effort, improve accuracy/quality and ensure stable supply to navigate shocks and size future opportunities.

Through our successful sourcing interventions across various industries, we have defined 7 key levers which should be used by procurement & technical functions to create transparency, options and competitive situations so that companies can build a strong ongoing position for a negotiation process.

Seven levers to unlock sourcing value



Figure 7: Seven savings levers spanning the procurement value chain

There are many examples of situations in which striking the right balance of risk-return trade-offs is of great significance. Often, companies get into situations where they find an alternative vendor who can supply a certain product or service at a lower cost. This triggers a switch which is driven by cost but also brings specific risks during the transition period. It is thus essential to build approaches that factor in all these different elements and to carefully manage such transition periods. Another example relates to decreasing stock levels of maintenance parts or finished products during challenging times and its trade-off with increased downtime risks. An effective strategic sourcing approach needs to be adopted while structuring such a trade-off.

the specifications to move away from 'gold plating' (utilizing product or service specifications higher than industry standard or higher than really required) and aiming for fit for purpose.

3. Pricing Basis Benchmarking: The commercial teams should have a clear understanding of 'should be cost' to have a good understanding of cost levers which could be leveraged for negotiation.

4. Competitive Leverage: It is often observed that various contractual agreements are heritage and have been continued for years and never been questioned. There should be special emphasis on increasing the number of bidders to increase competition to get the best value of money spent.

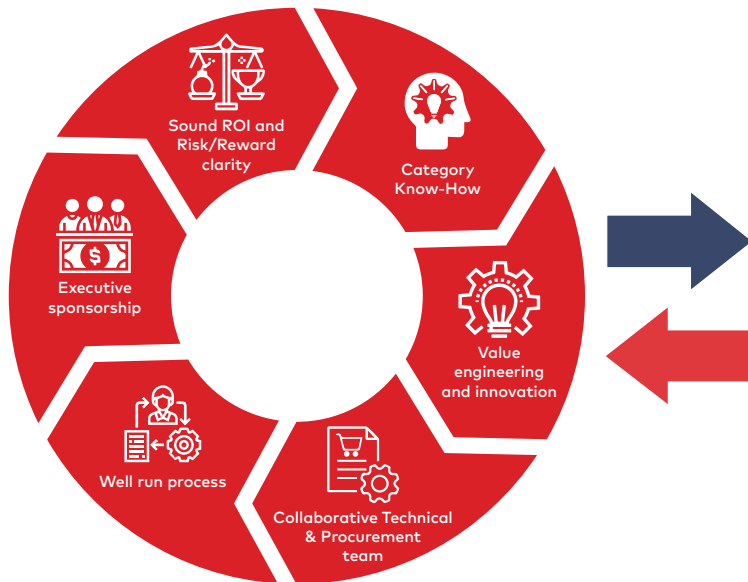
5. Understanding of Vendor Economics & Strategies: Leverage vendors' supply chain configurations and conduct benchmarking analysis to figure out the best fit for your organization

6. "Intensive" Negotiation: Negotiation is a skill and should only be carried out by qualified professionals with a clear understanding of risk-value trade off's and BATNA (the best alternative to a negotiated agreement)

7. Rigorous Tracking & Monitoring to avoid contract leakage: Post contract management is as important as the pre-award stages. Organizations need to allocate specific resources to ensure execution effectiveness and contract performance is monitored to address emerging issues and any contract leakage.

Six guiding principles to enable Sourcing success

In order to achieve success during a sourcing initiative, companies need to adopt a resilient approach with a well-defined set of guiding principles that can maximize the output from such initiatives.



KEY ENABLERS:

1	Demand & Specification Management
2	Price and service unbundling and transparency
3	Volume and supplier consolidation
4	Optimized workflow and process models
5	Aggressive Bidding and Negotiation
6	Effective performance monitoring and compliance

1. Category Know-How: There are often core purchasing and raw material categories where each organization has a longstanding intricate knowledge, and then there are areas where contribution to domain knowledge is required. This can be in the form of a vendor list of several hundred suppliers of chemicals products, rate cards for specific products & services or RFX templates and bid grids.

2. Value Engineering and Innovation: Working within the existing specification is often only the second-best solution. So, while casting the net wide, it is essential to include and test product alternatives and consider innovation. Question the current standards and find 'different ways of working' to improve operational efficiency, including use of the new digital tools.

3. Collaborative Technical and Procurement Team: To effectively innovate and challenge specifications, purchasing needs to be on an equal footing with the technical teams throughout the organization. Constructive discussions and inter-team dialogues should take place to ensure that evolution in specifications is not only driven by technical or production considerations, but also supply chain implications.

4. Well-Run Process: A sourcing process involves several internal departments including, R&D, technical, production, logistics, marketing and numerous vendors. Accordingly strong project management is key to achieving timely results.

5. Executive Sponsorship: Sourcing often leads to opportunities, but also to risk/return tradeoffs. Executives sponsorship, clear accountability and decision making are preconditions to harvest and lock in the potential improvement.

6. Sound ROI and Risk/Reward clarity: Companies need to define the right scope and sequencing of the initiative upfront to keep the resourcing in line with the opportunity and ensure a healthy return on investment.

dss+ works closely with client teams to rapidly define and implement their sourcing objectives, to achieve sustainable value. Figure 8 presents a dss+ case study for a rapid cost reduction project for an oil and gas operator in Asia Pacific, providing insights into the project approach and key results achieved (including more than a 20% reduction in baseline spend).

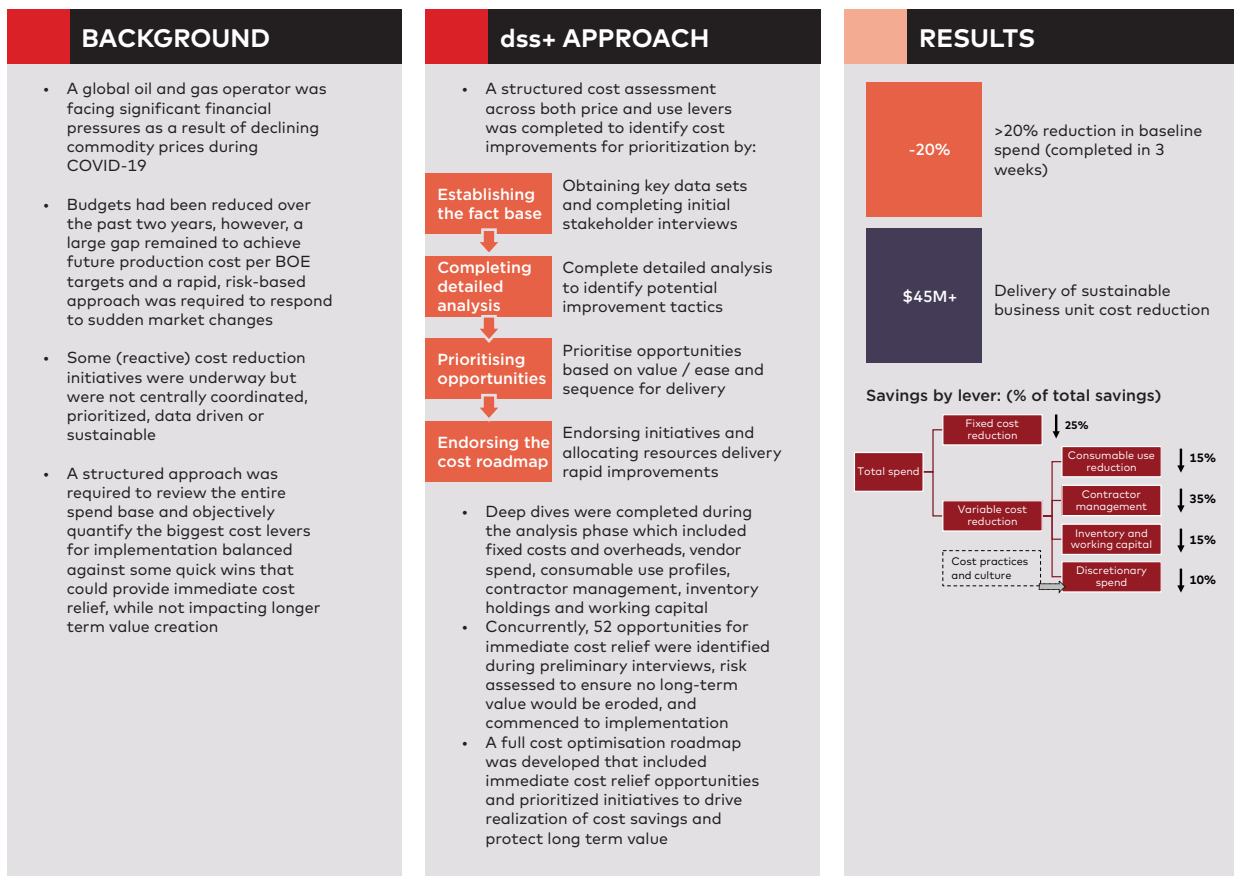


Figure 8: Rapid cost reduction case study for an oil and gas operator in Asia Pacific

Conclusion

Within the current economic context, strategic sourcing represents a great opportunity and lever for organizations to achieve its cost saving objectives, address sustainability factors along the supply chain and maintain the balance of trade-offs between its strategic objectives. dss+ –

through its focus on risk, a robust approach and past experience – supports strategic sourcing initiatives by working closely with client teams to rapidly define and implement their sourcing objectives, and to sustain this value through improved management systems and effective upskilling of organizations. Such efforts can not only help companies to navigate the current challenges presented by the pandemic, but also to maximize flexibility and agility in a post-COVID world.

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