



Strategic Sourcing: How Automating Sourcing Helps Companies Remain Competitive



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INTRODUCTION

Strategic sourcing (often called e-sourcing) is a subset of Supplier Relationship Management practices. The main impetus for strategic sourcing is organisations' desire to reduce costs in the light of the current economic slowdown. Other drivers are the demands of customers looking for increased customisation of their products and services, reduced product development cycle times and the availability of new technology that allows increased collaboration between buyers and their suppliers.

The claims about the benefits of using web-based technology during the strategic sourcing cycle are compelling. They include:

- Shortened sourcing cycle times – by 25% – 30%
- Increased spend under management
- Reduced total cost of ownership – enabling negotiation of 5%-20% reduction in price
- Improved supplier relationships, including improved ability to identify and negotiate with multiple suppliers
- Lower operational costs

These collaborative e-sourcing solutions meet the end-to-end needs of purchasing direct and indirect materials and services and can deliver far beyond current standards of efficiency and provide decision support capabilities for dramatic cost savings.

SUPPLIER RELATIONSHIP MANAGEMENT AND STRATEGIC SOURCING

Gartner¹ defines Supplier Relationship Management (SRM) as "the practices needed to establish the business rules and the understanding needed for interacting with suppliers of products and services of varied criticality to the profitability of an organisation." Strategic sourcing is the process of identifying, selecting and developing the optimal mix of products and services with appropriate supply base under the optimal terms and conditions to lower the total cost of ownership.

SRM evolved out of the business process re-engineering in the early 1990s and by the mid- to late 1990s was seen as a competitive differentiator. Ad hoc

processes were replaced with well-defined methods to manage total product costs, build collaborative supplier relationships and analyse category-based spending. The nature of relationships was evaluated and tools were developed to quantify non-price factors such as delivery performance and partner financial viability, and apply those attributes to a total cost model.

Strategic sourcing, which is now regarded as an integral part of SRM, is made up of several components:

- Identifying spend analysis based on current patterns
- Evaluation of suppliers and sources of supply
- Building request for information (RFI), request for quote (RFQ) and request for proposal (RFP) (Collectively known as RFX)
- Event-based activities such as auctions and reverse auctions
- Negotiation based on multiple price and non-price elements and subsequent contract development and management

STRATEGIC SOURCING DRIVERS

The current business environment is driving companies to pursue lower costs, improved quality, shorter cycle times and enhanced customer value. Some of the critical forces contributing to this environment include:

1. The continuous drive for cost reduction

The link between purchasing dollars and company profitability and earnings per share is clear, and it has forced purchasing managers to make improvements in order to meet cost savings and time-to-market goals. The percentage of revenue spent on the cost of goods purchased can be as high as 70%.

As illustrated in Fig 1 (overleaf), an increasing proportion of manufactured product value comes from goods purchased from suppliers, which makes the case for enhanced strategic sourcing all the more compelling. If the average enterprise sampled by Gartner Inc. (See last line of Fig.1) could save just 0.5 percent of its total yearly purchasing dollars (\$10 billion) by engaging in strategic sourcing practices, it would save more than \$50 million each year.

1. Gartner Inc., "The Growing Importance of Direct Strategic Sourcing," July 2001

Industry Fortune 500	No. of Companies	1999 Revenue \$ in Millions	1999 Profits	Purchase \$ as Percent of Revenue	Average Purchased \$ in Millions
Metals	13	113,910	392	64.60	73,586
Chemical	13	257,477	13,886	61.30	157,833
Engineering, Construction	16	153,831	(726)	58.60	90,145
Beverage	30	85,629	8,348	51.70	44,270
Computers, Office Equipment	10	281,740	10,119	50.80	143,124
Motor Vehicle and Part	3	1,109,949	44,772	47.20	523,896
Electronics, Electrical Equipment	15	778,602	28,253	45.60	355,043
Railroad	10	102,437	1,381	42.40	43,433
Aerospace	10	184,426	7,716	42.10	77,643
Airline	6	119,800	5,038	40.00	47,920
Scientific, Photo, Control Equipment	9	39,676	3,125	40.00	15,870
Forest and Paper Product	3	85,800	3,005	36.20	31,060
Telecommunication	14	520,961	49,704	35.60	185,462
Mining, Crude Oil Production	20	53,665	(1,939)	34.30	18,407
Pharmaceuticals	19	204,400	35,402	34.00	69,496
Food	3	217,739	7,829	33.80	73,596
Petroleum Refining	19	748,439	26,883	25.50	190,852
Utilities, Gas and Electric	4	337,707	12,126	18.49	62,442
Total Companies	217	5,396,188	255,314	40.85%	2,204,078
Average Enterprises		24,867	1,177	40.85%	10,157

Source: Gartner Research and CAPS Research²

Fig 1. Sample Direct Goods Purchasing by Industry

If all of the savings could be delivered to the bottom line, that reduction in costs would increase profits by 4%. Many companies cite savings of 10% when they use strategic sourcing methodology.

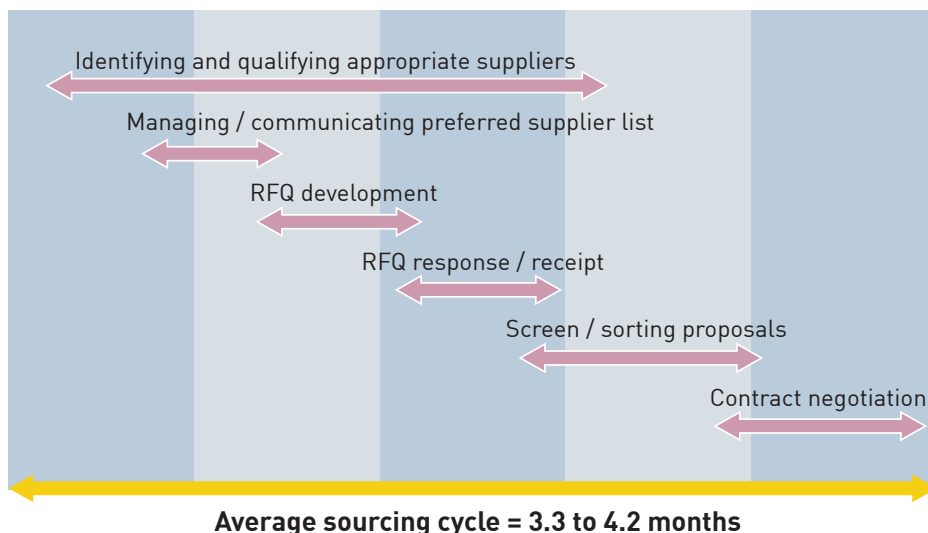
2. Product development, increasing product customisation and decreasing product lifecycles

Product development cycle time and product lifecycles are steadily decreasing, placing significant pressure on improving product development management capabilities. Technology advances are making new products obsolete even quicker, making time to market a key competitive differentiator. For example, reducing the development cycle of new car development, which can take up to three years, by even a number of months makes a huge difference to the bottom line.

Customers are demanding more customisation. The advent of Customer Relationship Management techniques has resulted in the concept of 'one-to-one'

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Aberdeen Group claims that a 2% reduction in costs from the initial sourcing cycle delivers a 14% reduction in the end cost of a new service or product, and a 25% reduction in the length of the sourcing cycle delivers product to the market 10-15% faster. According to the US Center for Advanced Purchasing Studies and A.T. Kearney, 73% of potential procurement savings comes from the sourcing cycle. Furthermore, a recent AMR report on strategic sourcing states that the Return on Investment (ROI) for e-procurement is predominantly delivered through improved sourcing.



2. Gartner Inc., "The Growing Importance of Direct Strategic Sourcing," July 2001

Fig 2. Current Sourcing Processes Are Time Consuming

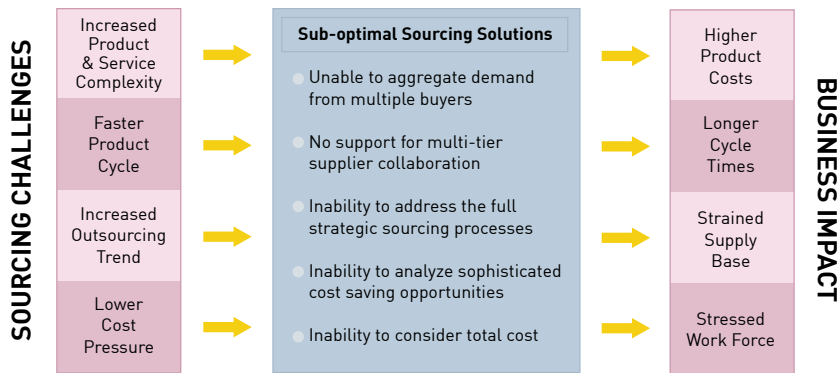


Fig 3. Current Sourcing Limitations Create Negative Business Impact

4. Current purchasing processes are out of step with market trends

Although purchasing decisions are critical to corporate profits, purchasing professionals face difficulties in terms of execution due to a lack of sophisticated decision tools. Identifying and evaluating products and suppliers means that buyers must gather information from many widespread yet incomplete sources. This process takes time.

Processes and best practice methodologies have advanced, but purchasing is still a largely manual process of researching markets and suppliers, generating lengthy RFP/RFQ documents, performing sophisticated bid analyses, conducting complex negotiations and managing contracts.

Negotiation is still done with suppliers using a mix of phone, fax and mail. Decision support has been limited to spreadsheet applications. By bringing direct procurement online, the issues become more challenging because buyers will need more capabilities to leverage and manage a larger pool of suppliers.

CURRENT SOLUTIONS

Currently, strategic sourcing is an inefficient, time-consuming, and complex process that involves multiple products and categories, multiple suppliers, multiple pricing structures, multiple procurement criteria and multiple performance metrics. Enabling better decisions – those determining how much business to give any one supplier at the lowest total cost – is very difficult. Evaluating a complex RFX has traditionally meant using skilled analysts and spreadsheet applications – a process that can take weeks as multiple scenarios are reviewed to determine the optimal recommendation.

Although some solutions have been introduced, to date they have been either purely price driven, single-item based or use rudimentary applications such as ranking-based decision support or reverse auctions.

marketing, which represents a significant shift away from the mass marketing techniques of the past. Marrying individual customer needs with back-end supply chain activities has enabled increased customisation. Companies must now learn to balance customer requirements and supply chain costs to engender loyalty where it matters.

The move away from vertically integrated companies to organisations that focus on core activities and emphasise outsourcing non-core activities has resulted in an increase in component, assembly and services outsourcing.

3. Changes in technology

Large corporations have benefited from online commerce for years through electronic data interchange (EDI) software and private communications networks. Now the relatively cheap access and connectivity of the Internet makes web-based procurement applications available to a much wider range of companies than EDI and allows buyers to collaborate with suppliers, customers and business partners in real-time.

The introduction of web-based trading platforms, including catalogues, auctions, RFQ/RFP systems and exchanges can greatly simplify transactions for both buyers and suppliers. This process started with the introduction of e-procurement software in the late 1990s. The next phase goes beyond indirect e-procurement to address the complexities of purchasing direct materials and services over the Internet. Suppliers of direct purchases are seeking better ways to compete on overall value and to maximise that value through collaboration. On the buyer side, companies wish to add such steps as contract negotiation and supplier analysis and consolidate all of their supplier data within a single platform.

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Reverse auctions are the only web-based solution that has been accepted by a large part of the marketplace. They are an effective mechanism for one-to-many solution for single-item based purchases, and back-up the case, especially during a trial period, for more complex direct materials procurement over the Internet. However, only a small percentage of procurement spending applies to reverse auctions because they do not accommodate the multi-variable complexities of an RFX with support for analytical decisions. Many suppliers view reverse auctions as commoditising their products, resulting in a price-only focus. Similarly, like reverse auctions, bid/ask exchanges are gaining traction but do not offer the multi-item advantages of RFQs/RFPs.

NEW SOLUTIONS

Most new sourcing solutions simply can't handle the complex needs of purchasing high value direct and indirect goods and services and fall short of meeting the complex requirements of strategic sourcing.

For example, a buyer could be faced with evaluating multi-line item RFXs across multiple suppliers, both local and international. Add to that multiple performance metrics including price and non-price factors for each item across multiple suppliers. Factor in multiple pricing structures that may include volume discounts and bundled bids. Finally, the buyer may have to incorporate company purchasing policies and priorities into the bid analysis.

What is required is the ability to address the complex negotiation and evaluation factors that can simultaneously evaluate the complete range of interdependent objectives, variables and constraints required for effective purchasing decisions. This means that new technology must provide all the efficiency benefits of doing business online while dealing with the realities of how business is done offline.

Today, a new range of solutions has begun to address the strategic sourcing issues faced by purchasing managers in SRM. These solutions now attempt to support complex strategic sourcing activities, such as RFX construction, reverse auctions, bid response, bid analysis and bid reward mechanisms, ranking systems, negotiation-based systems and optimisation-based systems.

New technology must provide all the efficiency benefits of doing business online while dealing with the realities of how business is done offline.

Ranking systems are common among existing sourcing technologies. These systems include price and non-price factors and often a value score that ranks each bid on how well it matches buyer preferences. They typically offer multi-parameter bidding, which is an important benefit, but cannot cope with volume discounts or overlapping bundled bids among multiple suppliers. In addition, they do not help buyers incorporate purchasing policies into bid analyses or enable optimal award allocation across items and among suppliers.

Negotiation-based systems may include multi-parameter bidding and ranking functionality. These provide an extension of RFX workflow between buyer and supplier. Again, bid analysis is still a mostly manual process with no true decision support.

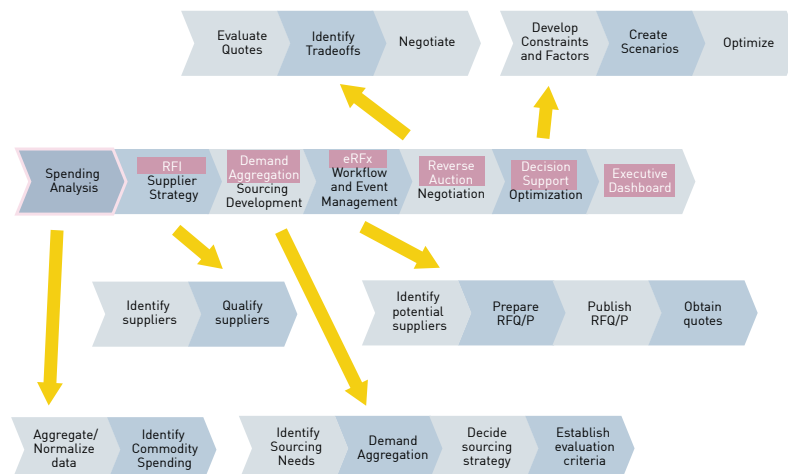


Fig. 4 Marrakech Sourcing addresses each area of the strategic sourcing cycle

MARRAKECH SOURCING

Through the Marrakech Sourcing Portfolio, Marrakech provides the first end-to-end collaborative strategic sourcing solutions that add significant value to each step of the strategic sourcing process and meet the real world sourcing needs of both buyers and suppliers. It is the suite of sourcing software that has been engineered from its inception to incorporate in-depth strategic sourcing knowledge with the latest Web-based software and optimisation technologies.

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The Marrakech Sourcing Portfolio is designed to meet the demanding and sophisticated needs of managing the complex sourcing process for production materials, industrial and MRO goods, capital projects and service agreements. Marrakech Sourcing is designed to meet the most demanding and sophisticated needs of buyers and suppliers through the following unique set of features:

- Automated workflow that streamlines the procurement process, including all bidding-related communications
- Optimisation technology that helps purchasing managers make the best decisions faster and empowers your suppliers to bid the way they want to and compete on non-price factors
- Customisable business rules that can exactly mirror your organisation's purchasing policies for each RFX

The key areas that Marrakech Strategic Sourcing technology affects are cycle time, cost reduction, supplier relationships and speed of decision making.

Cycle time

Traditionally, purchasing direct goods and services (those used by a company for distribution or sales) has been a complex and time-consuming process that involves generating lengthy RFPs/RFQs, performing sophisticated bid analysis and conducting complex negotiations. Marrakech Sourcing simplifies this process by automating and streamlining the entire sourcing cycle.

Take for example RFX construction, supplier selection and bid response and analysis:

RFX construction - allows automated ERP/ MRP data entry, which can be imported seamlessly from back-end systems. The

category/item hierarchy in Marrakech Sourcing mimics bills of materials to accommodate the most complex requisitions and there is a template feature that allows for instant RFX creation.

Supplier selection – an automated search feature identifies suppliers to participate in the RFX. In addition, supplier profile data and performance ratings can also be imported and stored in Marrakech Sourcing for easy review. Once the buyer opens bidding, suppliers are notified by e-mail and can access RFX information online.

Bid response – suppliers can review buyer requests and submit bids online, which also reduces errors. Suppliers can invite subcontractors to bid on pieces of the RFX without restarting the RFX process.

Bid analysis and award – determining how much business to give any one supplier is one of the most difficult aspects of sourcing. Instead of taking weeks to analyse all bids from all suppliers, Marrakech Sourcing generates the best possible purchase recommendations in seconds.

Cost reduction

Lowering purchase costs is definitely on the short list of corporate mandates. Anything less than the best purchase decision means that money is being 'left on the table.' Marrakech optimisation technology allows greater and more sustainable product cost savings – without hurting strategic relationships. Unlike reverse auctions, which provide only one-time savings, Marrakech Sourcing offers ongoing cost savings without competitive bidding events by employing advanced mathematical algorithms to guarantee the best way for buyers to allocate RFP/RFQ awards among their supply base, based on the lowest total cost.

True optimisation can save an additional 5%-15% on product costs beyond competitive price bidding. By placing the RFX on a central, secure web site with automated workflow to streamline buyer/supplier communications, Marrakech Sourcing offers significant efficiency savings over the traditional fax/mail process. In addition, bid analysis is reduced from weeks to less than one day – which adds to process savings.

Improved buyer/supplier relationships

Historically, bringing your direct sourcing activities online has been equated with sacrificing the quality of supplier relationships. Marrakech Sourcing addresses the requirements of buyers by building in huge flexibility.

From RFx construction to supplier response, buyers can articulate their needs more clearly and suppliers have more options to meet those needs. For example, suppliers can submit multiple bid types – including single item, volume discount and bundled bids – within the same RFx, thus allowing suppliers to protect profit margins and increase revenue potential. Suppliers have access to more bidding alternatives by specifying ‘all or none’ or substitution rules on categories within the RFx. Marrakech Sourcing allows detailed award analysis, so suppliers clearly understand the reasons behind buyer purchase decisions and are in a position to make necessary adjustments to win business (or more of it) the next time.

Collaboration is the bedrock of Supplier Relationship Management. The Marrakech Sourcing Portfolio runs on a platform built to enable collaboration between enterprises and their suppliers, which speeds decision-making and increases supply chain efficiency. With this collaboration functionality, buyers and suppliers better manage sourcing processes and workflow, share information, handle sequenced events and proactively respond to changes in a dynamic web environment.

Users quickly gain access to time sensitive information from virtually anywhere in the world. Communication through a globally accessible integrated messaging system provides updates and alerts via internal messaging and third party e-mail. Through file sharing, suppliers obtain additional sourcing documentation such as part specifications, engineering drawings and regulatory guidelines. A robust analytical reporting engine provides up-to-date views of operational information needed to manage all sourcing events.

Speed of Decision Making

Today, there are three choices in determining the best supply base allocation award for complex RFx sourcing:

- Spreadsheet-based analysis – can take weeks with limited ability to analyse sophisticated pricing such as bundled bids and volume discounts or purchasing policies
- Ranking systems limited to item-by-item analysis with no ability to evaluate sophisticated pricing plans or purchasing policies
- True optimisation-based solutions – a scientific approach using advanced mathematical algorithms that looks at all types of bids across all items and suppliers to guarantee the single the lowest total cost solution.

Marrakech Sourcing solution offers true optimisation technology that can simultaneously look at literally every combination of bids across all suppliers (which can total thousands or even millions of possibilities) and select the lowest total cost solution while complying with the buyer’s purchasing policies and priorities. ‘What-if’ scenarios, under varying business rules, to determine the absolute best possible solution, can also be applied. For example:

- Multi-items RFPs/RFQs – with dozens, hundreds, or even thousands of items/sets of items, including Bill of Materials
- Multi-parameter bidding – that takes both price and non-price factors into account, with weightings assigned to each category (e.g., quality, delivery, etc.)
- Multiple pricing structures – including sophisticated pricing plans such as volume discounts and bundled bids
- Split awards – often no single supplier can satisfy all of a buyer’s demand requirements for an entire RFP/RFQ
- Purchase policies and priorities – such as budget or capacity constraints, hedging risk among a buyer’s supply, capping the number of suppliers for a given contract

Marrakech Sourcing runs on a platform built to enable collaboration between enterprises and their suppliers.

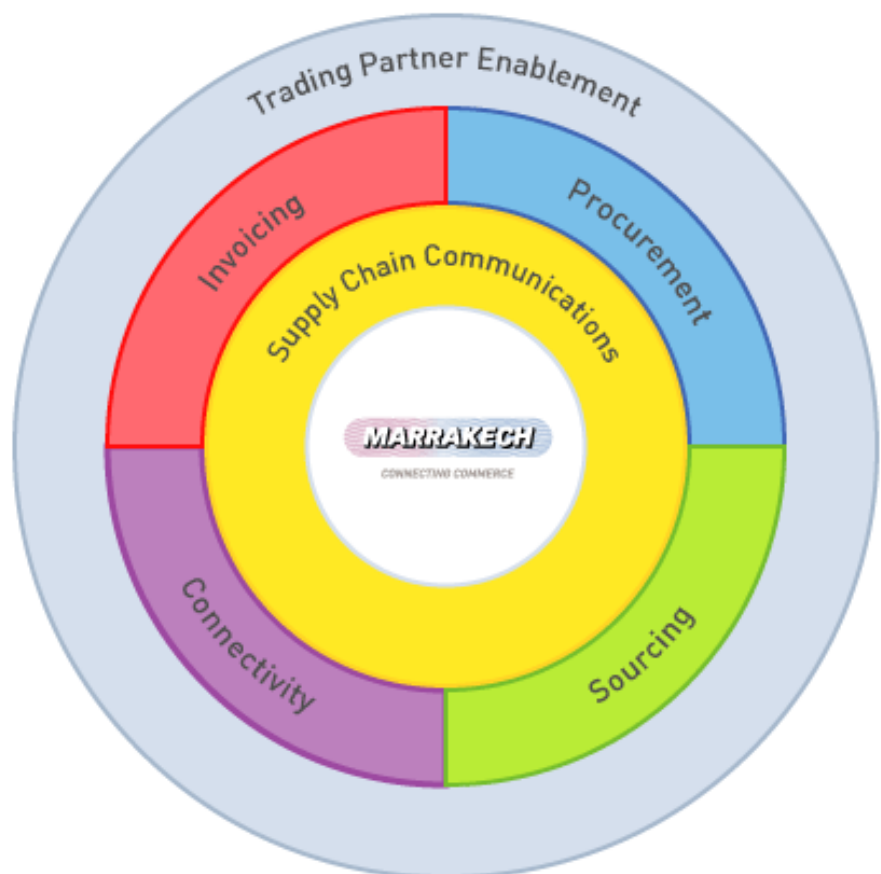
SUMMARY

Marrakech Sourcing technology solves many of the Supplier Relationship Management issues facing organisations today: cost reduction, the ability to deliver increased customisation of their products and services, reduced product development cycle times and increased collaboration between buyers and their suppliers.

Marrakech Sourcing technology solves many of the Supplier Relationship Management issues facing organisations today.

The real benefits can be articulated as follows:

- Achieve hard savings of up to 20% through volume purchasing, competitive quoting and optimisation-based decision support
- Dramatically cut sourcing cycle times by 25-30% by collaborating online, automating processes, streamlining communication and rapidly comparing sourcing alternatives
- Capture, access and update key supplier and commodity information throughout the sourcing process
- Improve relationships with strategic suppliers
- Capture greater overall cost savings by addressing a larger portion of the overall purchasing spend
- Gain multi-tier supply chain visibility by capturing and analysing strategic information regarding the cost structure and capabilities of the supply base



The Marrakech Solution



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