

E-Sourcing: Procurement's Leading Edge

<http://favre.ASCET.com>

Donavon Favre
Jeff Brooks
Accenture

E-Sourcing opportunities provide competitive advantage by significantly influencing the price and quality of purchased materials and services, as well as improving supply chain responsiveness.

Virtually every company is familiar with procurement – the sum total of activities associated with acquiring materials and services. Most organizations also are familiar with sourcing, although many think of it as synonymous with procurement. Actually, sourcing is a subset of procurement – its strategic context. Sourcing sets the stage for the entire company's purchase of direct and indirect materials, and involves high-level, company-wide approaches to:

- Obtaining materials and services
- Identifying and evaluating potential suppliers to meet those needs
- Negotiating and implementing contracts with selected suppliers
- Monitoring and improving ongoing supplier relationships

Another important differentiation is technology enablement. Although “procurement” is the overall term, traditional procurement software generally focuses only on tactical procurement processes (Figure 1). For example, ERP procurement modules typically address order planning and execution for direct materials. This capability can reduce the cost of order generation and provide data on supplier performance, but it does not help the user evaluate and manage supplier relationships. Similarly, the newer e-procurement applications facilitate indirect materials purchasing, but for direct materials the concerns that these applications address – fragmented internal demand, manual order-approval processes, rogue buying, etc. – already have been overcome by many companies.

In contrast, e-sourcing applications target strategic sourcing processes that most signif-

icantly effect the largest procurement value drivers – the price and quality of direct materials – and improve supply chain responsiveness. The unique capabilities provided by these applications include, among others, spend analysis, supplier risk analysis, raw material/component optimization, request for proposal/quote generation, and contract administration.

The E-Sourcing Opportunity

According to the Aberdeen Group, e-sourcing applications could save U.S. businesses more than \$690 billion per year.¹ For example, consider a company with \$3 billion in revenues; materials and sourcing costs that equal 50 percent of its revenues; and earnings before interest and taxes (EBIT) of \$400 million. If e-sourcing can reduce the company's materials and sourcing costs by five percent (a conservative estimate), then they should see \$50 million increase in earnings (all things being equal, and assuming a 33 percent corporate tax rate). Making a further assumption of a 20 to one price-to-earnings ratio, savings associated with e-sourcing will increase shareholder value 66 cents for every dollar spent on materials and sourcing, resulting in a total increase in shareholder value of \$1 billion.

In a wide variety of business environments, e-sourcing applications also:

- *Promote sourcing best practices.* E-Sourcing applications create and maintain a well-documented set of sourcing processes in the form of software templates. These templates capture a company's best practices, which then are available across all product categories.
- *Extend collaboration on sourcing activities.* Web-based sourcing applications can be made accessible to all appropriate individuals across departments, business units, and company or geographic boundaries. For example, RFP generation tools can solicit input from relevant functional areas and business units, and provide a platform for real-time collaborative teamwork. Later, these tools can deliver RFPs to appropriate suppliers and manage the iterative process of receiving and clarifying suppliers' responses.
- *Increase the efficiency of sourcing processes.* Automating the sourcing process speeds individual tasks, lowers error rates and rework, eliminates the need for data re-entry, and improves process flows. For example, e-sourcing tools can automatically collect and disseminate data from and to appropriate internal and external parties, thereby facilitating information flows and managing administration. Supplier reporting capabilities make it possible to track purchasing data and calculate supplier-performance metrics. E-Sourcing workflow engines organize work streams within and across product categories into a coherent sourcing effort.

Donavon Favre is a partner in Accenture's Supply Chain Management Service Line and co-leads the company's global procurement practice. He specializes in strategic sourcing, e-procurement, e-sourcing, and supply chain strategy, and can be reached at donavon.j.favre@accenture.com.

Jeff Brooks is a research fellow at the Accenture Institute for Strategic Change, where he focuses on e-commerce. He publishes frequently on virtual networks, supply chain management, and group dynamics, and can be reached at jeffrey.d.brooks@accenture.com.

- *Improve sourcing decisions.* The quality of a sourcing decision often depends on the completeness and accuracy of acquired sourcing information, and the depth of analysis done on that information. E-Sourcing solutions contribute to the completeness, accuracy and “assessability” of information by improving process efficiency, data organization and cross-organizational collaboration. For example, these tools often provide best-in-class decision support by enabling an organization to create company-specific tools, such as total cost of ownership (TCO) models.
- *Improve training.* Many e-sourcing applications can be adapted as off-line simulation engines, using a company’s own historical data to provide a highly relevant training environment.

Traditionally, sourcing processes have been manual, paper-based, and time consuming – taking an average of three to four months per product category or as long as six months.²

All in all, e-sourcing initiatives can reduce sourcing cycle times by more than 25 percent, cut time-to-market cycles 10 to 15 percent, provide access to better quality inputs, and create an overall supplier base that is more responsive to innovation and changing economic conditions.

Processes and Best Practices

The strategic front-end of the overall procurement process happens infrequently, while those activities focused on individual product categories generally are addressed in waves. Sourcing’s principal processes and activities – a “best practices framework” for sourcing/ e-sourcing – is shown in Figure 2.

Define Strategy

Assess opportunities. Sourcing initiatives should begin by assessing the company’s strategic and tactical procurement needs. Corporate priorities – such as cutting costs, increasing innovation, and enhancing flexibility – will shape how suppliers should be evaluated. Generally, a product-category analysis is needed to segment purchases into a workable number of differentiated groupings. The next step is to form cross-functional sourcing teams to manage the categories.

Some e-sourcing tools support product-

category analysis with frameworks and data collected from manufacturing IT systems. End-to-end e-sourcing solutions also can include workflow functionality to help manage the entire sourcing process.

Profile internally and externally. The sourcing team must validate the mission and scope of each product category in collaboration with individual departments (e.g., manufacturing, R&D). The team gathers historical spending information to profile the organization’s procurement practices in each category. They then capture business intelligence relating to the supplier’s industry to provide a picture of the market environment. E-Sourcing intelligence tools can automatically collect this third-party information and relate it to sourcing decisions.

Develop strategy. The mission of strategic sourcing is to minimize total cost of ownership, not just cut prices or reduce process costs. Thus, each product category needs its own TCO model, based on parameters such as price, quality, service needs, and expected lifespan. Armed with insights about the organization’s strategic priorities, the industry environment and the priorities revealed by the TCO model, sourcing teams establish specific contracts for specific product categories.

Certain e-sourcing tools support product-specific TCO models for accurate analysis of the drivers of strategic value in procurement.

Ratings), and often factor in actual performance data for suppliers already doing business with the company. Based on the relative importance of each factor, the team develops a short list of prequalified suppliers to compete for a specific contract.

E-Sourcing tools can help collect all of this data, and combine it in sophisticated ways to help sourcing teams rank potential suppliers.

Establish Contracts

Conduct auctions and RFPs. Depending on the characteristics of the product and the supplier industry, buyers have several sourcing options. For example, highly liquid commodities might be available through a B2B e-market, with an internal buyer serving as a liaison between the exchange and the rest of the company. Conversely, bulk commodities with relatively simple specifications may have their prices determined through reverse auctions. However, more complex materials, such as engineered products, usually require more thorough and iterative RFP activities that involve parallel negotiations or a reverse auction. Some large classes of products, such as office supplies, are available through catalogs; in such cases, the sourcing process may involve asking distributors to compete on the basis of corporate discounts.

E-Sourcing tools can automate RFQ generation, dissemination, and response. Auction

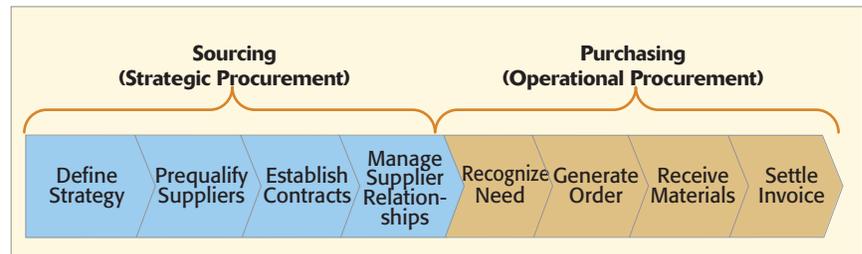


Figure 1 | High-Level Procurement Processes

Prequalify Suppliers

Screen suppliers and selection factors. During this activity, sourcing teams build out supplier information matrices that support the strategic and tactical procurement goals of each product category. Teams receive information from suppliers in response to submitted requests for information (RFIs), gather additional information from external data sources (e.g., Dun & Bradstreet, Open

software provides the ability to conduct auctions over the Web in real time.

Shape and negotiate value propositions. Companies may select one winner from the supplier competition; usually they choose to contract with a number of suppliers to mitigate supply risk and over-dependence on one company. Either way, most contracts require additional negotiations to finalize legal details and business processes (e.g.,

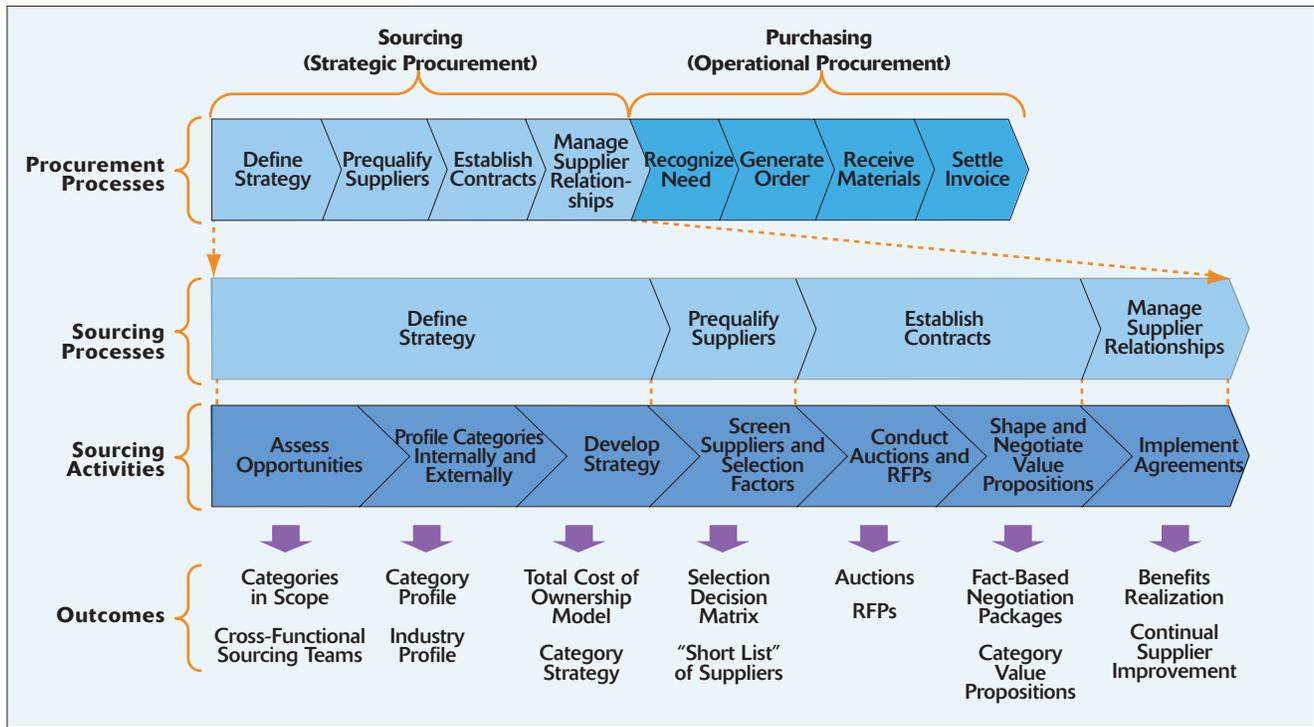


Figure 2 | Key Sourcing Processes and Activities

catalog versus supplier-managed inventory). E-Sourcing tools help clarify the relationship and create the most favorable terms by providing hard data on category spend, supplier performance and the like, and by analyzing trade-offs during negotiations.

Manage Supplier Relationships

Implement agreements. On an ongoing basis, procurement staff must be able to track the performance of suppliers to enforce compliance with contracts; identify and correct problems with products or delivery; and collect information for use when a contract comes up for renewal. E-Sourcing tools help collect this data, provide a repository for it, and analyze it when needed.

The Path Forward

Since every company performs sourcing functions, the task's complexity should not come as a surprise. After all, simply analyzing the offerings of only one supplier involves assessing and balancing price, quality, manufacturing specifications, forecasted demand and supply, strategic goals, cultural compatibility, etc. But, most compa-

nies deal with hundreds or even thousands of suppliers, which is why coordination and optimization are sourcing's most important missions. Thus, most sourcing initiatives work to reduce the number of contracts and suppliers by grouping products into categories and rationalizing the supplier base. But to capture the value of e-sourcing applications, most companies also need to:

Build out the technology infrastructure. Some benefits of e-sourcing can be achieved through individual applications. However, more significant and strategic benefits can require the integration of internal and external information systems.

Marshal key suppliers. E-Sourcing's benefits will be limited if suppliers do not participate fully in Internet-enabled sourcing processes. Suppliers often lag behind buyers because they see the new approach as a threat instead of an opportunity. Suppliers also must deal with the varied software, platforms, and processes of multiple customers.

Realign linkages and relationships. The higher-level benefits of e-sourcing often are achieved by removing barriers between purchasing and other functional areas.

Transform the procurement organization. To fully leverage the potential of e-sourcing, the procurement organization itself must evolve. Purchasing staff must expand their skill sets from order processing to supplier evaluation and selection, auctioneering, and negotiation management. People already skilled in these areas will then need to become more adept at working in cross-functional or inter-organizational teams.

Simply put, e-sourcing opportunities are worth pursuing (and e-sourcing challenges worth surmounting) because the competitive advantage they engender is real. E-Sourcing technology has indeed created a new and highly strategic opportunity for improving supply chain performance. ■

Endnotes

- ¹ Aberdeen Group, "Strategic E-Sourcing Could Save Business \$1.7 Trillion on a Global Basis," press release, April 3, 2001.
- ² Aberdeen Group, "Strategic E-Sourcing: A Framework for Negotiating Competitive Advantage," April 2001, as cited in Barlas, Demir, "e-Sourcing Still Promising, Says Aberdeen," Line 56, May 4, 2001.