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This book is much more than a recollection of previous experiences; it is about taking everything I learned in the past and combining it with what I know now into a story that makes sense to others. Many anecdotes came from my experience executing several consulting projects with leading companies in the USA over several years. It definitely isn't something that I could have done alone. I am extremely grateful to all people who I had contact with during my tenure at Booz, Allen & Hamilton and AT Kearney. Although I faced some difficult and challenging moments along the way, the knowledge gleaned from interacting with many great individuals has more than made up for the tough times. All of you have lifted my capabilities to a new plateau that I could never before imagine. It is difficult to know whom to acknowledge by name, because there are no clear linkages or cutoff points. However, I am extremely grateful to all who helped my professional growth.

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PREFACE

For many businesses, the quest to increase shareholder value is a never-ending journey. As companies strive to generate a superior financial performance, they are scrambling for new ways to increase a customer's willingness to pay while lowering costs. Profit is king. This makes it much harder to create customer value and lower costs simultaneously. What's worse, once a firm achieves an advantage, others find ways to take it away. It's getting increasingly difficult to differentiate products, including Intel's chip technology, Wal-Mart's new store formats or Starbucks' premium coffee in an inviting environment. Many imitators can quickly match any "unique" product or service. Should a company then focus on bear-hugging each customer? Sorry, everyone's doing that. What about finding new markets instead? Honestly, is there any market a company's competitors cannot and will not follow? All of these leading companies, which dominate their fields, face new challenges to stay ahead of the pack and boost profitability.

As new sources of value creation are getting scarce, many leading companies are looking beyond the four walls of their operations for new sources of value creation. By looking downstream, leading companies begin to realize that long and lasting relationships with existing customers present a promising source of profit that is difficult to imitate. Many firms are rushing to learn more about their customers with the use of Customer Relationship Management (CRM) to sell more products to existing customers. Looking upstream, leading companies are looking to suppliers as new sources of value creation.

For years, suppliers represented cost centers, and managing them was all about hard-nosed bargaining. They were a group of sellers who were untrustworthy and deserved to be treated as adversaries. Now, many companies have found that a more robust relationship with certain suppliers is better for the bottom line than a more aggressive approach.

So, how can a company forge a productive relationship with its suppliers? This book takes a process approach of identifying, evaluating, selecting, managing and developing suppliers to create more value for customers, which should in turn create more value to shareholders. The book begins by outlining the mental shift necessary to build robust relationships with suppliers. This includes:

- The relationship that shifts from an emphasis on cost reduction to enhancing each other's competitiveness.

- A strategic procurement process that takes a team-based and cross-functional approach to developing a sourcing strategy for each purchasing category.

- The total-cost-of-ownership concept to facilitate both sides to pinpoint areas for achieving a win-win outcome that goes beyond price.

- The negotiation process that focuses on taking costs out of the supply chain, instead of from suppliers.

The second part of this book details strategic sourcing methodology: a step-by-step approach for creating productive relationships with key suppliers. The methodology consists of four distinct stages, from an expenditure category analysis (a purview of total spending), category strategy formulation (assessing the strategic implications of expenditure categories and procurement options), supplier strategy formulation (determining how suppliers should be selecter and how to maintain solid relationships with suppliers), and fact-based negotiation (a systematic approach for business negotiations). Illustrations and examples from the author's experience are provided throughout.

The third part of this book provides details of a comprehensive process developed to arm the negotiation team with all facts necessary to reach desired outcomes. This detailed step-by-step process consists of negotiation strategy and case building, supplier response and positioning, negotiation planning, discussions and resolution, and supplier evaluation. In addition, the book highlights "best practices" in strategic sourcing representing tactics for buyers to leverage their buying power to ensure they attain full value. These best practices are drawn from several strategic sourcing projects carried out for leading companies in the USA over several years.

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Strategic Sourcing
Introduction

nce a narrowly defined administrative function commonly referred to as purchasing, strategic sourcing has turned into the rock upon which a company builds a competitive advantage. eading companies realize they can reach beyond the four walls of their operations to build strategic relationships with business partners such as suppliers and logistics service providers , and leverage these relationships to achieve the firm's strategic objectives. Adopting this new strategic approach for the procurement process re uires management to elevate and expand the scope of purchasing to better align it with business objectives beyond simply focusing on minimizing the purchase price . This book uses a strategic sourcing model to identify the strategic

Tim A. Minahan, Strategies for High- erformance rocurement, Supply Chain Management Review, September importance and financial impact of procurement activities. The model provides a framework to determine how internal procurement processes can be realigned and streamlined to support a company's goals. This strategic approach can result in lower total costs, greater revenue and improved competitiveness.

urchasing usually refers to the buying activities of employees in the finance or treasury departments. The activities are administrative in nature, designed to achieve the lowest possible purchase prices in all expenditure categories. The term procurement is generally broader, covering not just purchasing transactions but also materials management and ensuring that the purchased materials and services meet uality re uirements. The term strategic sourcing takes on a different meaning. It focuses on developing channels of supply at the lowest total cost, not just the lowest purchase price. This goal re uires cooperation across many other departments besides purchasing to assess the impact of procuring specific items and services from outside, especially if some of these procured materials and services are essential to maintain a company's competitive edge. For example, in the automotive industry, riginal E uipment Manufacturers EMs such as Toyota, Ford and GM, must consider more than simply buying a commodity like upholstery when purchasing seating since passenger comfort is a way they can differentiate their products from competitors. For this reason, Toyota Boshuku Japan spent .

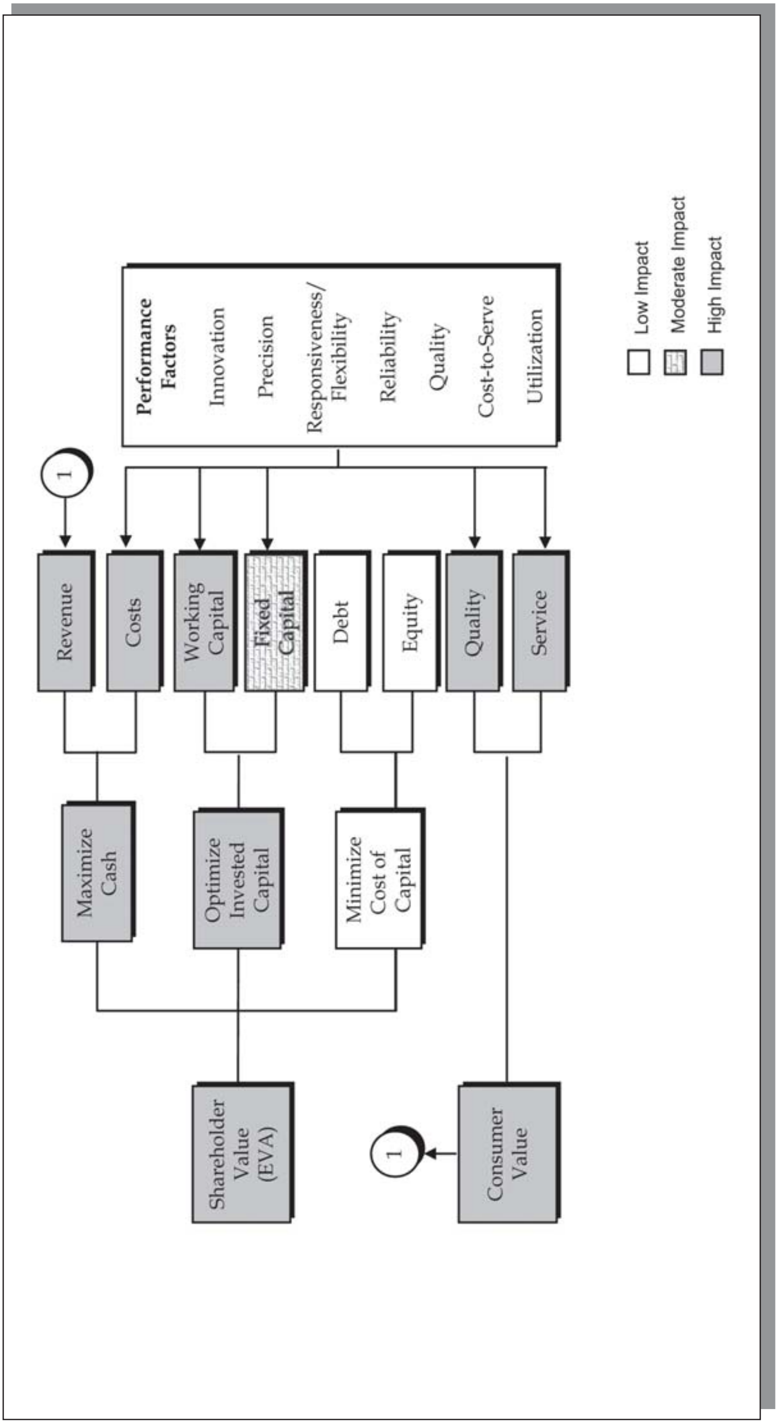
billion baht in to ac uire local firm Thai Automotive Seating and Interior Design TASI after holding a stake for many years.

Strategic sourcing forces a company to focus the most time and energy on strategic purchases that can provide advantages in uality, speed or cost effectiveness. In many cases, strategic sourcing plays a key role in the total cost of goods and services, which has a tremendous impact on net income and market value. In addition, strategic sourcing also helps develop long-term relationships that provide a company with multiple benefits. Both companies in the relationship can build trust and have a better understanding of how each company can mutually benefit. This often results in the deployment of best practice supply chain processes, improved customer service and company credibility as a company's product uality and service can surpass those of competitors. Costs also decline over the long run as both companies contribute to product design and jointly invest in streamlining communications and automating administrative tasks.

Strategic sourcing is a very powerful lever of internal and external company performance. It significantly improves company profits through reducing the supply chain cost of purchased goods, including sourcing, inventory management and transaction costs. It also helps customer relationships when a company can exceed service and uality expectations. rganizations that have implemented strategic sourcing see savings that range between to of the total purchase price . The savings gained from strategic sourcing vary according to the nature of goods, and the degree of change proposed. Changes can include revising purchasing practices and supplier relationships, challenging product speci– fications and designing to radically rethink the way of doing business. Increasing the scope of change increases the size of potential benefits see Figure . .

The magnitude of cost savings derived from this process leads to a substantially amplified result in bottom-line performance. Consider the following example see Figure .

Chet Hirsch and Marcos Barbalho, Toward World-Class rocurement, Supply Chain Management Review, November December,



Strategic Sourcing erformance Impacts

Before

Revenue		$1,000
COGS	Materials	700
	Labor/OH	125
Gross Margin		175
	Operating Expenses	75
Net Income		$100

5% decrease in material cost ($35m)

After

Revenue		$1,000
COGS	Materials	665
	Labor/OH	125
Gross Margin		210
	Operating Expenses	75
Net Income		$135

The alternative to achieve this increase in net income is to increase revenue by 12%*

* COGS increases by 12%

rofit Impact of Reducing Sourcing Cost

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Strategic Sourcing Concepts, Principles & Methodology

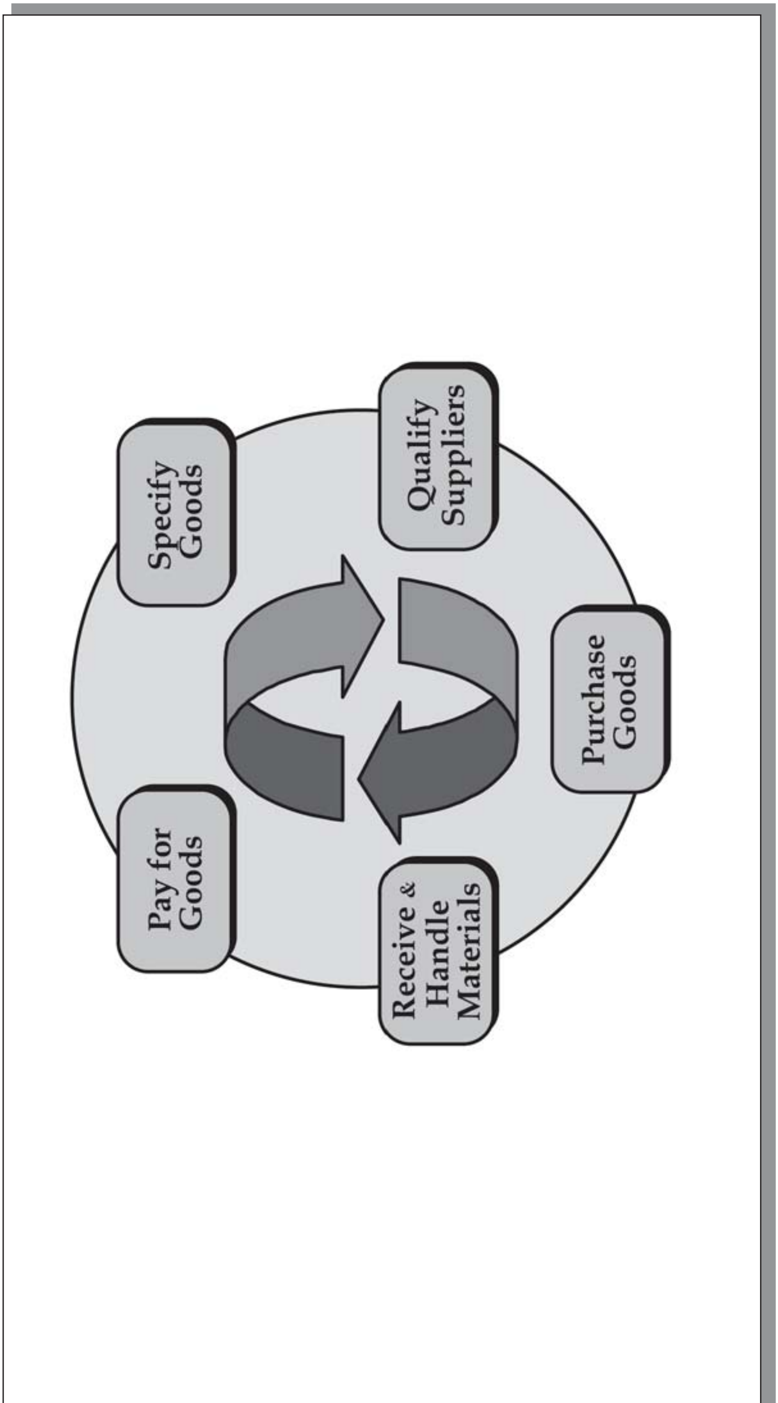
o successfully implement strategic sourcing, companies must know their most important goods and services and determine how vital they are to day-to-day operations, as well as to achieving longer-term business goals. This chapter outlines strategic sourcing concepts, principles, and methodology for executing the sourcing strategy.

Strategic sourcing is the process of developing channels of supply at the *lowest total cost*, not just the lowest purchase price.

It expands upon traditional purchasing activities to embrace all activities within the procurement cycle, from specification to receipt and payment of goods and services (see Figure .). Although strategic sourcing focuses primarily on reducing costs, its foundation is building longer term, win-win relationships with key suppliers to give buyers a competitive advantage . The nature of the relationship underscores the success of strategic sourcing initiatives. It is critical that both buyer and supplier work together and share information to identify opportunities that will significantly increase savings over time.

In most companies, procurement operations are loosely coordinated. It's common to find different units within the same firm buying the same product with a different buying method that results in a different price and service level. The challenge facing a company is to obtain an optimally integrated enterprise-wide strategic procurement that allows it to leverage the purchase to achieve the most cost-effective strategic procurement of quality products at the highest level of customer service.

ouglas A. Smock, Robert A. Rudzki, and Stephen C. Rogers, Sourcing Strategy: The Brains Behind the ame, Supply Chain Management Review, May une



F Procurement cycle

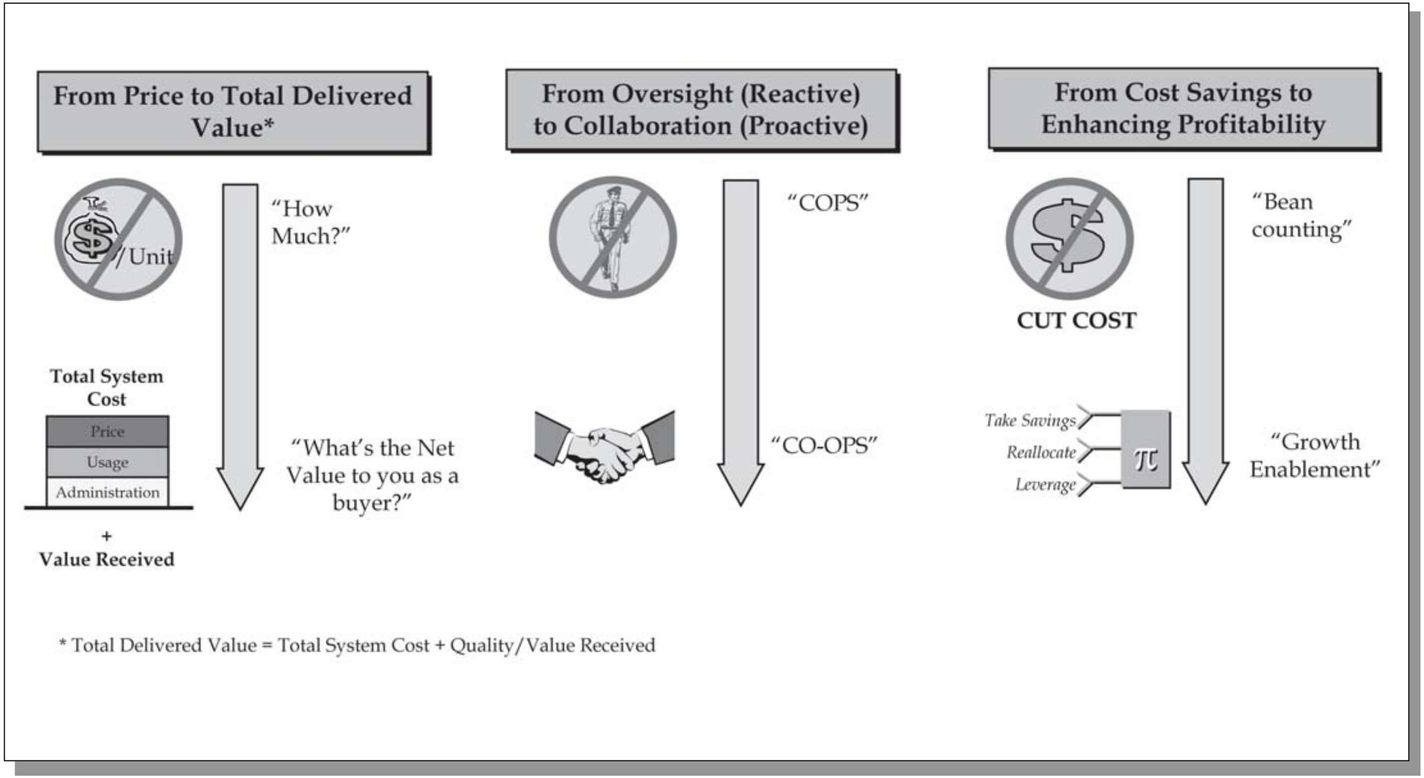
The transformation from traditional purchasing methods to a strategic-sourcing focus requires three fundamental philosophies that drive the strategic elements and also the infrastructure required to support the procurement process. These include:

- Focus on the total delivered value, not the purchase price
- Collaborative approach to dealing with suppliers, rather than oversight
- Focus on enhancing profitability, rather than cost savings.

The above fundamental philosophies (as shown in Figure .) often result in fewer supplies. This creates economies of scale and long-standing relationships with suppliers . Both the supplier and purchaser gain an advantage: they can both leverage core competencies to focus on increasing market share and improving market position.

The move from purchasing to strategic sourcing developed amid the far-reaching market changes during the s. New production models based on just-in-time delivery and total quality management as well as outsourcing, commoditization and globalization had a profound impact on the way goods should be

oug Smock, eere Takes a iant Leap, Purchasing, September ,



F Fundamental Philosophies of Strategic Sourcing sourced, and on the relationship between suppliers and customers. Companies that wished to remain competitive had to shift their focus from a narrow transaction-based view of purchasing to a wider, more strategic view of how the supply chain could be configured to achieve broader corporate goals.

A procurement strategy's overall objective is to support the ultimate goal of achieving and sustaining a company's competitive advantage. Hence, any procurement strategic initiative must be designed to support profit growth targets. This means a firm must seek ways to maximize the return on total delivered value of purchased materials, which is different from ensuring that the needed material is available at the lowest possible purchase price. The three prevailing principles in formulating and executing strategic sourcing are as follows:

A product or service's strategic importance is determined by whether it has an impact on a company's core business and future competitiveness. Certain expenditure categories contribute differently to a company's success, so different strategies should be deployed depending on the goods or services that are procured. Formulating an expenditure category strategy requires a company to assess how important a resource is to the company's competitive position. However, critical