EVALUATE AND DEVELOP A SOURCING STRATEGY

Using this guide
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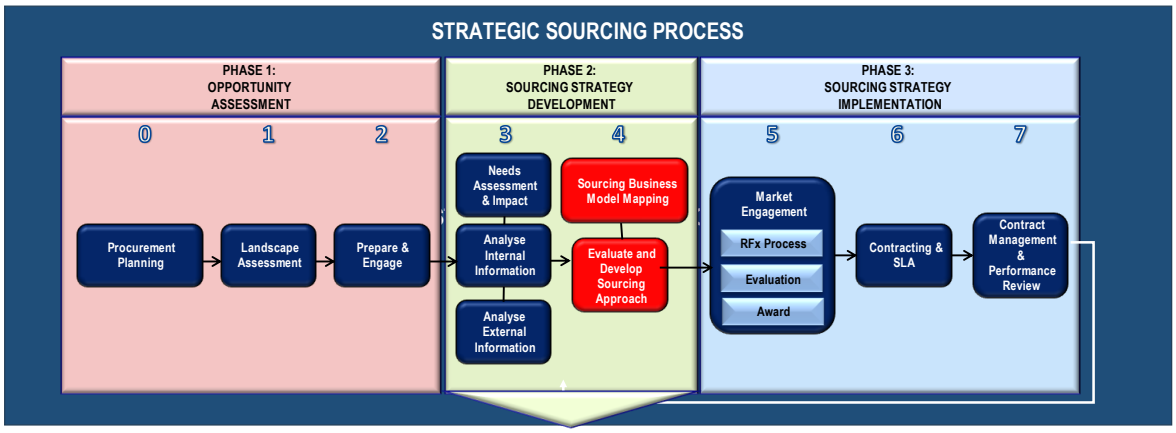

4.0 Evaluate and Develop a Sourcing Strategy

4.1. Sourcing Business Model Mapping Selection

4.2 Evaluate and Develop a Sourcing Approach

1.0 Introduction

i. At this stage, the collected data is used to inform the development of the sourcing strategy.

ii. The social values are prioritised and confirmed in line with the selected sourcing model.

1.1 Objective

i. The objective of this stage is to determine the most appropriate sourcing model that seeks to balance between the economic and contractual relationship models with the associated tools.

1.2 Output

i. Determine the most appropriate sourcing business model.
ii. Evaluate and develop a sourcing strategy that balances between economic and relational models.

2.0 The narrative

2.1 Sourcing business mapping selection

2.1.1 Determine economic and contractual relationship model

i. The Sourcing Business Model Mapping (SBMM) is a tool designed to find an optimum balance in a sourcing strategy between the economic aspects and the desired supplier relationship[1].

ii. Value is optimised when the supplier relationship (Sourcing Business Model) is managed with the appropriate relationship and economic models aligned.

iii. Likewise, if the relationship is managed with either the Relationship or Economic model "out of equilibrium", value is lost and perceptions clash.

[1] 2015 Public Sector Supply Chain Management Review: Creating a conducive environment for transacting between the public and private sectors. A few issues currently stand in the way of an efficient and cost-effective public sector SCM system. These range from fragmentation to complex bidding documents and procedures. SCM procedures and processes must be simple, cost-effective, inexpensive, quick to use, transparent and free of corruption.

iv. Understanding the level of dependency and expected value inherent in the supplier relationship is critical to determining the best sourcing business model for the category.

v. By completing an SBMM exercise, one can determine what sourcing business model is the "best fit" for the prospective relationship.

vi. The SBMM uses the two key decisions based on the relationship model and the economic model.

vii. The two decisions revolve around

a. What relationship model is needed to drive performance and value?

b. What economic model is required to meet business needs?

1. The economic model determines how the economics of the relationship will be managed and how one will measure and ultimately compensate the supplier.[2]

2. The relationship model determines how the relationship between the supplier and the procuring institution will be managed.

2.1.1.1 The relationship model

i. The are three choices for the relational model, these are;

a. Transactional-based approach

b. Relational-based approach

c. Investment-based approach

[2] Chartered Institute of Procurement and Supply (CIPS)

ii. The following questions help to determine the attributes that define the appropriate relationship:

a. What is the overall level of dependency associated with the spend category?
b. What is the strategic impact of the spend category?
c. Does this spend category provide the organisation with a core competency or competitive advantage?
d. What is the degree of risk associated with this spend category?

iii. Figure 1 below indicates the different types of relationships and how dependency and investment in the relationship change as the decision on the type of the relationship changes.

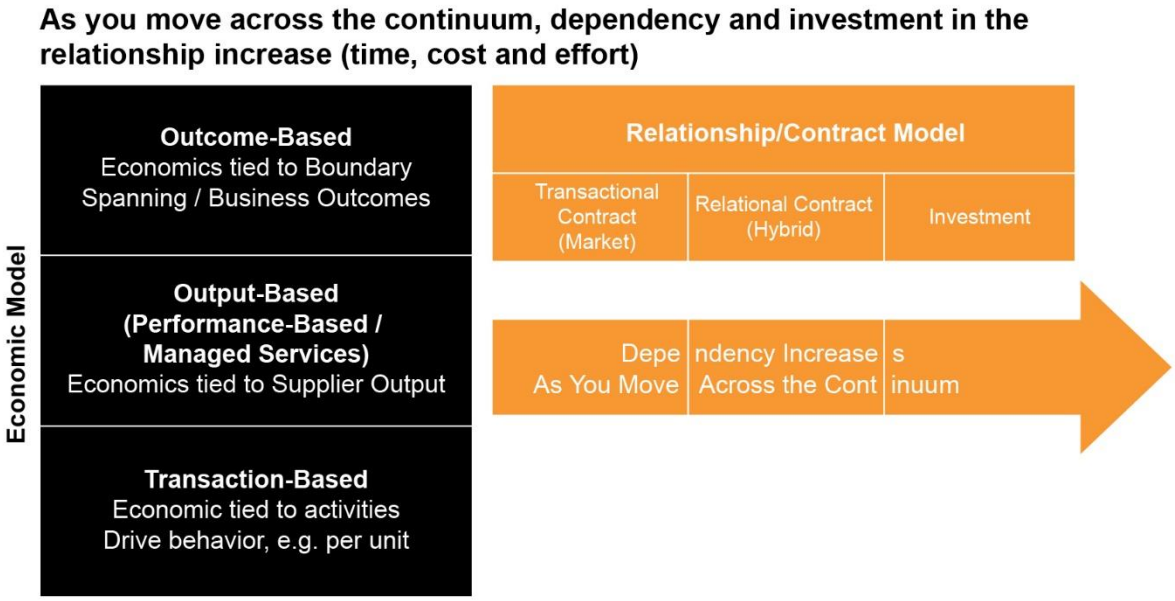

Figure 1: Relationship Model

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2.1.1.2 The economic model:

i. There are three choices for the economic model, and these are;

a. **Transaction models** – suppliers paid for every transaction.

b. **Output-based models** – the supplier's payment is tied to the achievement of pre-defined measures, such as managed services such as facilities management, consulting work etc.

c. **Outcome-based models** – these follow a more integrated approach, with shared risk.

ii. The typical questions help to determine the most appropriate economic model.

a. What is the potential to create mutual advantage by collaborating with the supplier?

b. What is the nature of the scope of work?

c. How critical is the work?

d. What are the risk tolerance preferences?

iii. Figure 2 indicates the different economic models and how the value increases as the economic model moves up the continuum.

- An organization can derive more value by thinking in terms of "outcomes" versus simply "transactions".

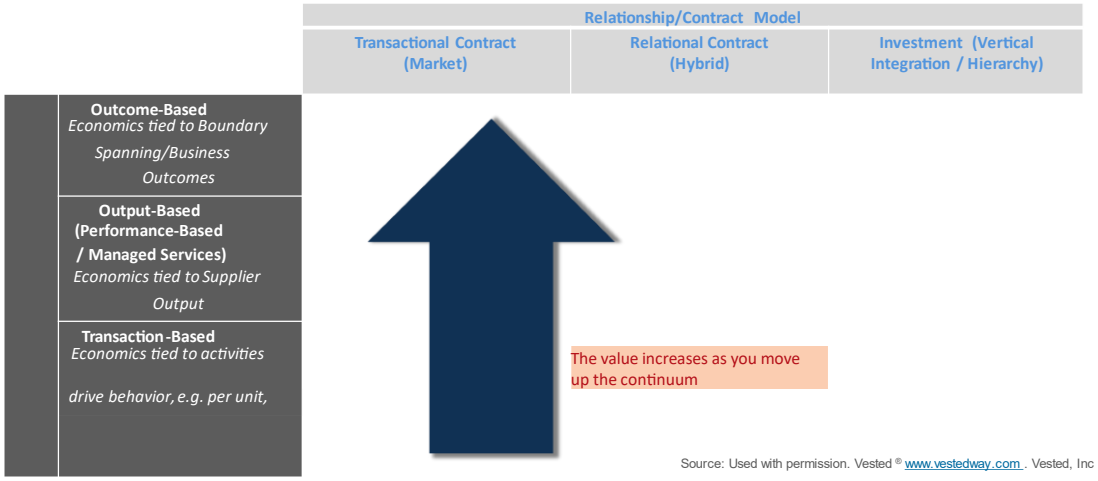

Figure 2: Economic Model

Source: Used with permission. Vested® www.vestedway.com. Vested, Inc

2.1.2 Select the sourcing business model

i. Since the introduction of the Kraljic model in 1983, strategic guidance and decision support tools have evolved as well.

ii. Contemporary companies have responded to economic changes, a global marketplace and more sophisticated business management objectives by recognising the impact of supply requirements and the value of supplier relationships in the business model.

iii. Whilst the Kraljic Matrix is still widely used as a tool to determine the commodity categories, the identified limitations are complemented by the Vested Model.

iv. The sourcing business model seeks to complement the limitations within the Kraljic Matrix.

v. Some of the notable limitations are classified as:

   a. Too many suppliers get classified as strategic when in fact they are not. A clear definition of a strategic supplier cannot be easily replaced without compromising the initial objectives of minimising risk and reducing costs.

   b. The result of this misallocation entails that the effort and resources are then misapplied.[3]

   c. Figure 1 (the progression of the procurement processes), illustrates how the ideas and concepts have evolved since Peter Kraljic introduced the Kraljic Matrix in 1983.

[3] The Chartered Institute of Procurement and Supply (CIPS)

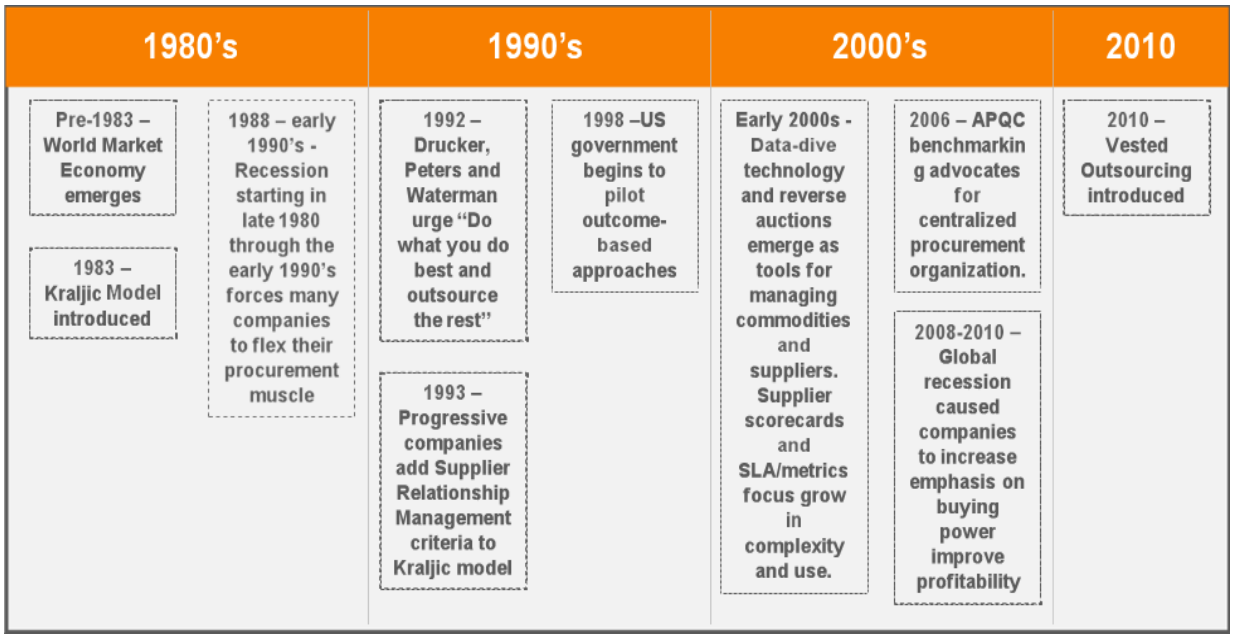

Figure 3: The progression of the procurement processes

Source: The Vested Model

vi. The conventional approach for developing a sourcing strategy is to use a segmentation tool such as the Kraljic model or supplier capability matrix to identify "strategic" focus areas.

vii. While this is a good approach for prioritising spend categories or suppliers, it falls short of ensuring the organisation is using the right sourcing model for the right job. It also does not include consideration for whether the work should be insourced or outsourced.

viii. Many organisations treat their procurement organisations as functional silos, and many procurement professionals perform detailed supply segmentation and develop strategies without important input from their internal stakeholders.

ix. The procurement practitioners complain that often business groups ignore their requests and do not spend enough time truly understanding the business needs and requirements.

x. The sourcing business model approach encourages procurement practitioners and other internal stakeholders to come together and review the overall competencies of the organisation as a key strategy for matching the right sourcing approach to the right business needs.

xi. The outcome of this consultation is a more holistic "Sourcing Business Model Mapping" decision framework that allows an organisation to align its business attributes with the most appropriate sourcing business model.

xii. The SBMM selection seeks to respond to the "What, Why, Who, How, and When" in the procurement process.

xiii. There are seven (7) sourcing business models that procurement can use in the acquisition of goods and services.

xiv. Under each sourcing model, there are specific tools that help in decision-making.

xv. Use procurement to support innovation.

xvi. The 7 sourcing business models are:

a. Basic provider
b. Approved provider
c. Preferred provider
d. Performance or output-based (managed services)
e. Vested
f. Shared Services
g. Investment (Private-Public-Partnerships)

xvii. The following questions can be applied in determining the most appropriate sourcing business model for a commodity.

a. Are there any specific economic outcomes that must be achieved with this sourcing strategy?
b. How can this economic outcome be sustained through the sourcing strategy?
c. How will this sourcing strategy enhance supplier innovation which can translate into value for money and a win-win- approach?
d. How, through this strategy will the SMMEs be brought onto the economic mainstream?
e. Which type of supplier relationship will best support the selected sourcing strategy?

xviii. Figure 4 below indicates how the above questions can be integrated into informing the most appropriate sourcing strategy that also integrates the specific social values that the procuring institution intends to achieve.

xix. The figure below uses an example of procuring school stationery which includes books versus the procurement of office stationery by the Education Department.

		Relationship/Contract Model		
		Transactional Contract (Market)	**Relational Contract (Hybrid)**	**Investment (Vertical Integration / Hierarchy)**
Economic Model	**Outcome-Based** *Economics tied to Boundary Spanning/Business Outcomes*	Mis-Match – Not a Viable Strategy	Vested (balance the social and economic aspects on a strategic and sustainable basis.) • **SCHOOL BOOKS & STATIONERY**	• Equitable Partner (e.g. Joint Venture, Subsidiary) • Vested Shared Services
	Output-Based (Performance-Based / Managed Services) *Economics tied to Supplier Output*	Mis-Match – Not a Viable Strategy	• Performance-Based-Managed (SLA) Agreement	• Equitable Partner (e.g. Joint Venture, Subsidiary, Co-Op) • Shared Services
	Transaction-Based *Economics tied to activities drive behavior, e.g. per unit, per hour, per*	• Basic Provider • Approved Provider • **OFFICE STATIONERY**	• Preferred Provider (Framework Agreements)	• Equity Partner (e.g. Joint Venture, Subsidiary) • Shared Services

Figure 4: Selecting a sourcing business model

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2.2 Evaluate and develop a sourcing approach

2.2.1 Consolidate understanding of commodity

i. To obtain the required outputs, source data is identified in the various systems (input). This data must be validated, transformed into preferred formats and loaded into the data store (sourcing cube/ database). The data is converted into information providing the required analysis reports (output).

ii. Figure 2 (Input-source cube-output) shows the stages of information flow in understanding the commodity dynamics.

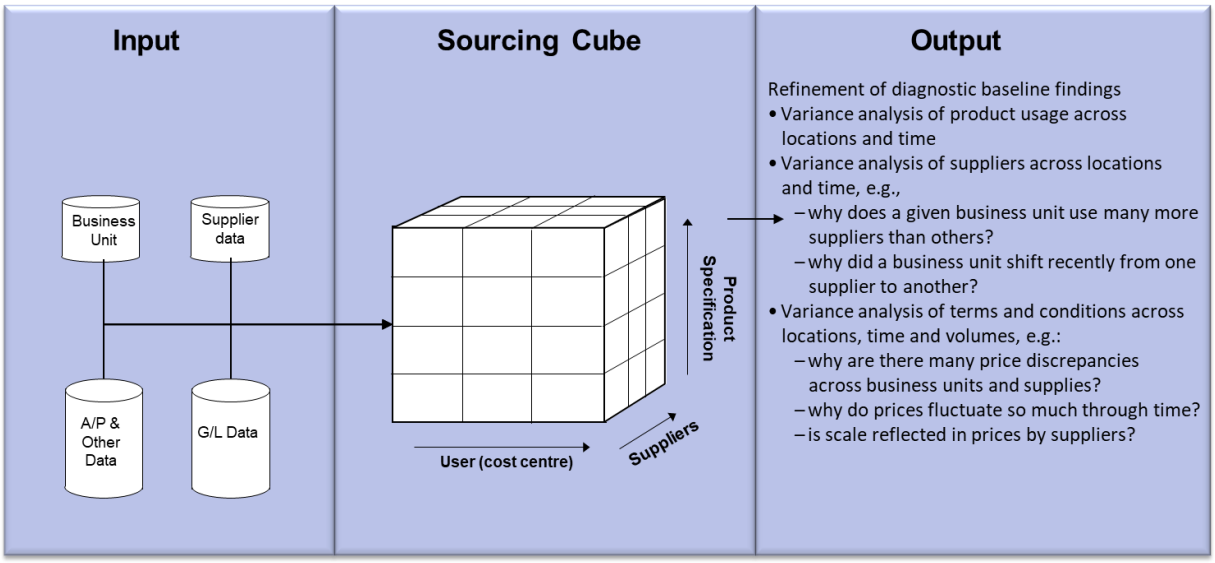

Figure 5: Input-source cube-output

2.2.2 Risk analysis

i. Definitions associated with risk, probability and impact:
   a. Risk is something with the potential to cause harm, loss, damage or delay.
   b. Probability is about the likelihood that any of the above is realised.
   c. Impact /Severity is the extent to which our customers, staff, business, suppliers, environment, etc., are exposed.

ii. Almost everything we do involves a risk of some kind. For example, stakeholders' needs change, new suppliers appear on the market and factors outside our control could delay the procurement or delivery under the contract.

iii. Formal risk analysis and risk management can help you assess these risks and inform what actions to take to minimise disruptions.

iv. It will also help you to decide whether the strategies you could use to control risk are cost-effective.

v. Whilst your department will probably have its risk management tool, here is a simple explanation of the process.

vi. The SWOT analysis you did earlier will assist in this process:
    a. The identification of weaknesses and threats will inform your assessment of risk.
    b. The identification of strengths and opportunities will inform solutions or approaches to managing the risks.

2.2.2.1 Risk Analysis Process

i. As a project manager or team member, you manage risk daily; it's one of the most important things you do.
ii. If you learn how to apply a systematic risk management process, and put the core 6 risk management process steps into action, then your projects will run more smoothly and be a positive experience for everyone involved.
iii. A common definition of risk is an uncertain event that if it occurs, can have a positive or negative effect on a project's goals.
iv. The potential for a risk to have a positive or negative effect is an important concept.
v. Why?
    a. Because it is natural to fall into the trap of thinking that risks always have negative effects.
    b. If you are also open to those risks that create positive opportunities, you can make your project smarter, streamlined and more effective.
vi. Think of the adage: "Accept the inevitable and turn it to your advantage."
vii. That is what you do when you explore project risks to create opportunities.
viii. Uncertainty is at the centre of risk:
    a. You may be unsure if an event is likely to occur or not.
    b. Also, you may be uncertain what its consequences would be if it did occur. Likelihood (the probability of an event occurring), and consequence (the impact or outcome of an event), are the two components that characterise the size of the risk.

2.2.2.2 Common risks in the SCM environment

i. The following are examples of key risks commonly found in the SCM environment.
ii. This is not an exhaustive list and is to be used to prompt thinking with the Institution.
iii. The list below can be used to understand the nature of the risks associated with the commodity.

2.2.2.2.1 Demand Management

i. Lack of demand management for goods and services resulting in unnecessary goods being purchased.
ii. Needs assessment may not be performed, resulting in the acquisition of goods and services not being aligned with strategy.
iii. Required goods may not have been budgeted for, resulting in over-expenditure.
iv. A procurement plan is not always used when goods are procured, resulting in over-expenditure.
v. Lack of market assessment to identify the reasonableness of prices, and failure to attract the right targeted groups, could result in over-expenditure and failure to support economic growth.
vi. Lack of knowledge of the requirements of preferential procurement objectives by senior management.
vii. Lack of commitment to the process by procurement practitioners.
viii. The department fails to define all goods and services it will require for the financial year.
ix. Emergency cases resulting from natural disasters, and urgent procurement needs required outside the plan.
x. Market assessment and industry analysis not conducted.
xi. Specifications were not approved and the institution failed to complete the procurement plan.
xii. Lack of capacity to document the procurement plan.

2.2.2.2.2 Acquisitions – Quotes

i. Lack of computer software to facilitate the rotation of suppliers could result in favouritism, and certain suppliers being utilised excessively.
ii. Placing orders with suppliers that cannot deliver on time, resulting in poor service delivery.
iii. Cover quoting could result in over-expenditure and fraud.
iv. Splitting of orders to avoid bid process, resulting in non-compliance with SCM policies, and abuse of power.
v. Minimum number of quotations may not be obtained, resulting in delays in sourcing goods and services, and non-compliance with SCM policies.
vi. Lack of understanding of SCM processes i.e. sourcing strategy, resulting in non-compliance.
vii. Abuse of financial delegations for opportune urgent cases may lead to irregular expenditure, and the concealment of fraud.
viii. Unplanned procurement can lead to over- or under-expenditure by the department.
ix. User components will not be able to perform their functions without the required goods or services.
x. The institution acquires goods or services from suppliers not listed on the supplier database, leading to irregular expenditure.
xi. Inaccurate specifications can result in incorrect goods or services.
xii. Incomplete information provided on the requisition forms.
xiii. Requisitions authorised without proper checking.
xiv. Requisition for items under contract is not forwarded to the ordering section timeously.
xv. Using suppliers not listed/registered on the supplier database.
xvi. Check whether bulk purchases have not been broken down into smaller pieces of work to avoid invitation of formal competitive bids.

2.2.2.2.3 Acquisition – Bids

i. Incorrectly prepared specifications and specifications prepared in the absence of the requisitioner could result in incorrect goods procured and delays in service delivery.
ii. Bid documents with poor content, resulting in inadequate information for service providers to work with.
iii. Non-responsiveness to suppliers due to insufficient notification and advertisements.
iv. Failure of bids to reach the targeted group.
v. Accepting late bids.
vi. Poor planning and stringent SCM processes could lead to delays in the processing of bids and poor service delivery.
vii. Bid evaluation processes and procedures not being followed.
viii. Leakage of information on the proceedings of the committee to potential suppliers, also, some members may have a vested interest in some bids.
ix. Bid adjudication processes and procedures not followed.
x. Amount of transparency in terms of bid evaluation and award.
xi. Bid processes not properly followed could result in litigation and loss of funds/wasteful expenditure.
xii. Bid awarded to the supplier that does not have the necessary capacity to execute the task.
xiii. Incorrect appeals procedure.

2.2.2.2.4 Contracts

i. Awarding bids to the contractors who were not present at the site inspection or briefing could result in litigation.
ii. Award to suppliers who could be blacklisted.
iii. Misunderstanding of expectations and responsibilities can lead to non-delivery.
iv. Contract documentation not stored in a secure environment.
v. Contract management section not being notified of negotiated contracts.
vi. Absence of legal representation in the formalising of contract.

vii. Contracts not being administered in terms of specifications and conditions contained in the contract.
viii. Non-renewal of contracts may lead to delays in acquiring goods and services.
ix. Fruitless and wasteful expenditure may be incurred when the department continues to pay for contracts that have expired.
x. Continuous extension of contracts.
xi. Lack of supplier performance information.
xii. Contracts may be re-negotiated continuously without verification of the supplier's performance.
xiii. Contracts may be granted to suppliers who are not targeted in terms of the procurement plan.
xiv. Using suppliers not listed on the supplier database.
xv. Variation orders not subjected to the evaluation process, resulting in over-expenditure.
xvi. Goods received may not be according to the specification, resulting in delays in providing service to the community and wasteful expenditure.
xvii. The lack of Supply Chain Performance processes and insufficient competitors in the market could lead to poor supplier performance and non-compliance not being detected.
xviii. Black Economic Empowerment programme benefiting companies who do not qualify.
xix. Inadequate storage of contract documents could result in loss, misplaced information and possible litigation.
xx. Poor planning in sourcing suppliers could lead to the non-responsiveness of suppliers due to delayed notification, resulting in delayed service delivery and fruitless expenditure.
xxi. Inadequate monitoring of contracts may lead to payment of goods that are no longer required. This results in fruitless and wasteful expenditure.
xxii. Shortage of staff and lack of segregation of duties may lead to irregularities, non-compliance with procedures and delays in identifying problems.

2.2.2.2.5 Conclusion

i. Risk is about uncertainty. If you put a framework around that uncertainty, then you effectively de-risk your project.
ii. Then you can move much more confidently to achieve your project goals.
iii. By identifying and managing a comprehensive list of project risks, unpleasant surprises and barriers can be reduced and golden opportunities discovered.
iv. The risk management process also helps to resolve problems when they occur, because those problems have been envisaged, and plans to treat them have already been developed and agreed upon.
v. By being prepared, you avoid impulsive reactions and going into "fire-fighting" mode to rectify problems that could have been anticipated.
vi. This makes for happier, less stressed project teams and stakeholders.
vii. The result is that you minimise the impacts of project threats and capture the opportunities that occur.

2.2.3 TCO analysis

i. What is the Total Cost of Ownership?
    a. Total Cost of Ownership (TCO) is an estimate of the total costs of goods, services or construction works over their whole life.
    b. TCO is a financial estimate that helps the organisation to determine the direct and indirect costs of a product, service or system.
    c. The analysis goes beyond the initial purchase price or implementation cost to consider the full cost of an asset over its useful life.
    d. It is the combination of the purchase price plus all other costs you will incur, less any income you receive to offset the costs incurred.
ii. For example: the initial purchase price plus installation costs, operating costs and ongoing maintenance less the residual value on disposal.

i. Why is TCO important?

a. The procurement principles encourage us to make balanced procurement decisions. This includes getting the best value for money. It means accounting for all costs and benefits over the lifetime of the goods or services.
b. Part of good procurement is achieving the right price. The best value for money is the lowest whole-of-life cost. This involves identifying the initial purchase price and estimating all future costs and returns.
c. A procurement decision based on the initial purchase price only, instead of the total costs over the whole-of-life, could fail to recognise the real costs to your department.

ii. Direct costs

a. Direct costs are attributed to a specific good or service.
b. In construction, the costs of materials used, e.g. wood, cement, doors, fittings and labour are all direct costs.

iii. Indirect costs

a. Indirect costs are not attributed to a specific good or service.
b. In manufacturing these include e.g. rent, taxes, maintenance of equipment.

iv. Figure 3 (The TCO model) shows how, through the TCO model, the price and the cost drivers that are normally hidden away from the buyer affect the overall price of a commodity.

Figure 6: The TCO Model

2.2.4 Opportunity analysis and ideas generation

i. Cost benefits and value opportunities are identified throughout the project for the identified commodity.

iii. The different stages in the project plan have been developed to assist the team in the systematic identification and rationalisation of opportunities as they progress.

iv. From the spend and TCO analysis, the depth and possible approach to sourcing strategies becomes apparent. However:

v. Beware of spending too much time trying to eliminate the last bit of uncertainty.

vi. Be cautious of historical information: by its nature, it is backwards looking and demand plans may change significantly depending on business strategy:

   a. Volume changes through aggregation
   b. Volume changes through product volume demand changes
   c. New categories as a result of emerging technologies

Team brainstorming has some simple rules…

Be creative and think outside the box

No war stories

Don't dump an idea

Use time wisely

No sacred cows

No complaining or griping

No one "owns" an idea

Evaluate ideas after brainstorming

Idea killers…

- ❑ "It won't work anyway'
- ❑ "We could never do that with…"
- ❑ "But that's much too expensive"
- ❑ "But we've already been rationalising"
- ❑ "That's my area: you don't understand anything about it"
- ❑ "Are you serious?"
- ❑ "What do you know about technology?"
- ❑ "Yeah, in theory…"
- ❑ "It's simply more difficult in our branch"
- ❑ "It's impossible to change the product (product mix)"
- ❑ "This has been agreed upon differently"
- ❑ "That's all been calculated"
- ❑ "I simply don't believe your figures"
- ❑ "I just know it won't work"
- ❑ "We thought about that 2 years ago"
- ❑ "I'm telling you it just won't work"
- ❑ "The time isn't ripe for that"
- ❑ "Have you ever tried that in another company?"
- ❑ "It's was too expensive to change that"
- ❑ "I know somebody that broke down with that"
- ❑ "We don't have time for that kind of thing"

2.2.5 Develop the sourcing strategy

i. Remember that there is no one-size-fits-all sourcing method.

ii. The development of the sourcing strategy is a combination of multiple models and processes.

iii. The models will integrate and consider the following:

   a. The nature of the relationship between the procuring entity and the supplier.
   b. The nature of the economic relationship and the levers to be achieved.
   c. The policy and regulatory framework.
   d. A balance between outcomes based on the government's social values and compliance with regulations, policies and the Acts.

2.2.6 Desired supplier relationship

i. As a result of reactive purchasing, relationships between suppliers and their buying counterparts were reasonably friendly, but confrontations occurred. The interaction between suppliers and buyers was often characterised by highly manipulative tactics by both parties designed to manoeuvre the other side into a position where one's gain would be the other's loss.

ii. The transformation from purchasing to strategic sourcing resulted in buyers and suppliers beginning to see the benefits of more collaborative relationships, where the outcome can result in a mutually beneficial relationship for both parties.

iii. The nature of the identified sourcing opportunities and selected sourcing strategies will indicate the most appropriate relationship, focusing on the commodity manager's time in a way that will deliver maximum benefit to the organisation.

2.2.7 Strategy suitability assessment

2.2.7.1 Assess and select strategic options

i. The suitability and feasibility of the selected "Best-fit" sourcing options identified in the previous exercise still have to pass a "government filter" that will look at the procurement legislative framework.

ii. Not all identified sourcing options are suitable for the government environment.

iii. Sourcing strategies should aim to achieve and/or enable overall government objectives, such as local procurement, achieving broad-based black economic empowerment, local economic development, upliftment of SMMEs, and many other socio-economic objectives.

iv. The following diagram summarises the process of sourcing strategy development as described in the previous guides.

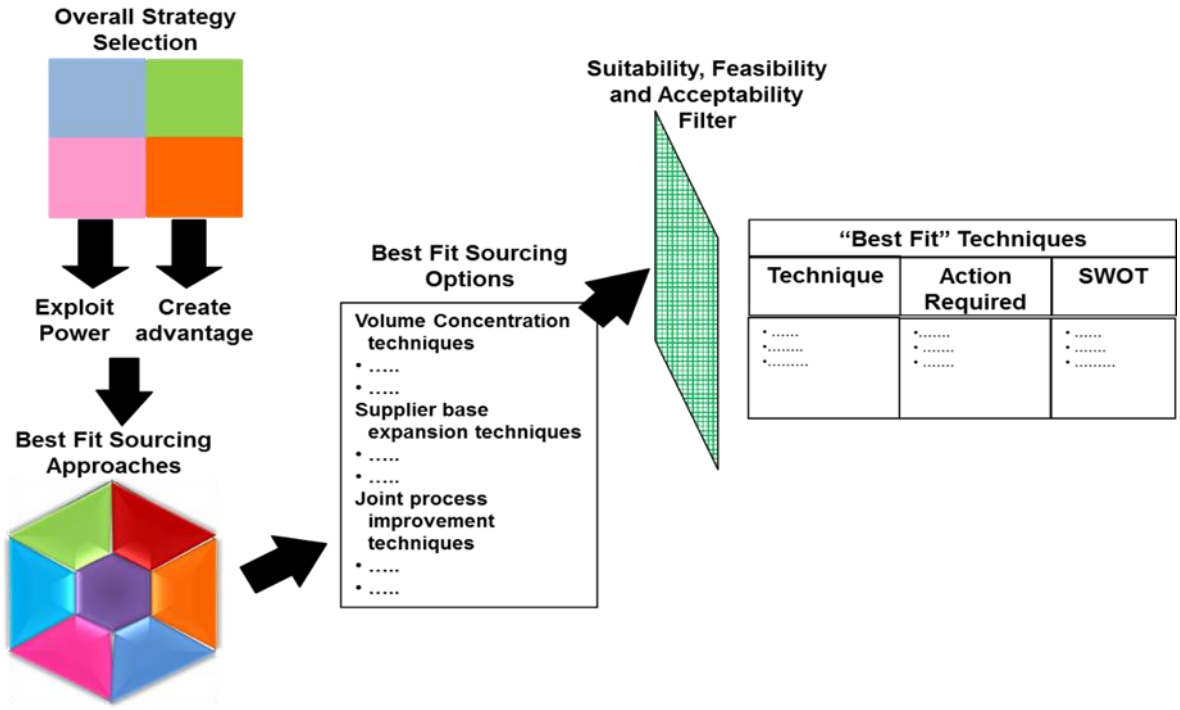

Figure 7: Selecting Sourcing Strategyl

2.2.8 Define evaluation criteria within the strategic sourcing process

i. Bids/Tenders are evaluated as per the requirements as set out in the tender document.

ii. Evaluation criteria, once set and upon publication of the tender, cannot be changed or amended. So, it is important to ensure that all evaluation aspects are addressed at this stage.

iii. A good evaluation criteria will include:

   a. Administrative requirements
   b. Functional requirements
   c. PPPFA requirements
   d. Social values requirements

2.2.9 Prepare business case and obtain approval

2.2.9.1 Creating the Sourcing Strategy Business Case

i. At this point you have done all the research work that is needed for your business case and have a very good understanding of how you want to proceed.
ii. Prepare your business case in such a way that the reader understands the methodology and approach you took to get to your final recommendations.
iii. You can prepare an "Outline / Template document" at the start of the project with the HEADINGS as set out in the methodology and fill in the blanks as you progress through the project.
iv. This will assist you in documenting the business case as you progress, instead of trying to document everything at the end.
v. The business case is the one document that pulls together all the key elements from all the stages so far.
vi. This should contain:
    a. A review of all the process evidence of stakeholder engagements, research, analysis findings, ideas generation, etc.
    b. A profile of the category with documented impacts and risks,
    c. Recommended sourcing approach
    d. Evidence of alignment with procurement plan and strategic objectives.

2.2.9.2 What is a business case?

i. A business case documents the information needed to decide whether to support a proposed sourcing strategy before significant resources are committed to its development and implementation.
ii. It assesses the cost and benefits of proceeding with a project.
iii. It assesses whether you need the procurement, the best way to conduct the procurement and how to achieve the best value-for-money outcomes.

2.2.9.3 Why do I need a business case?

i. A business case:
    a. Provides an audit trail of your decision-making process;
    b. Documents the scope of factors impacting the sourcing strategy; and
    c. Provides a template against which a sourcing strategy outcome can be monitored.

2.2.9.4 When do I need a business case?

i. Every sourcing strategy requires a business case, although the scope of the business case depends on the complexity of the procurement.
ii. For example:
    a. A simple, low-risk, low-value purchase may only need a description of the business need and price.
    b. A procurement activity with a clear business need, a well-understood, competitive market and a standardised good or service may require a few paragraphs on a procurement approval template.
    c. A highly complex procurement where the business need is less understood, with diverse levels of market capability and capacity, and varied options for goods and services, would need more in-depth documentation to justify the need and to present a range of detailed implementation options.