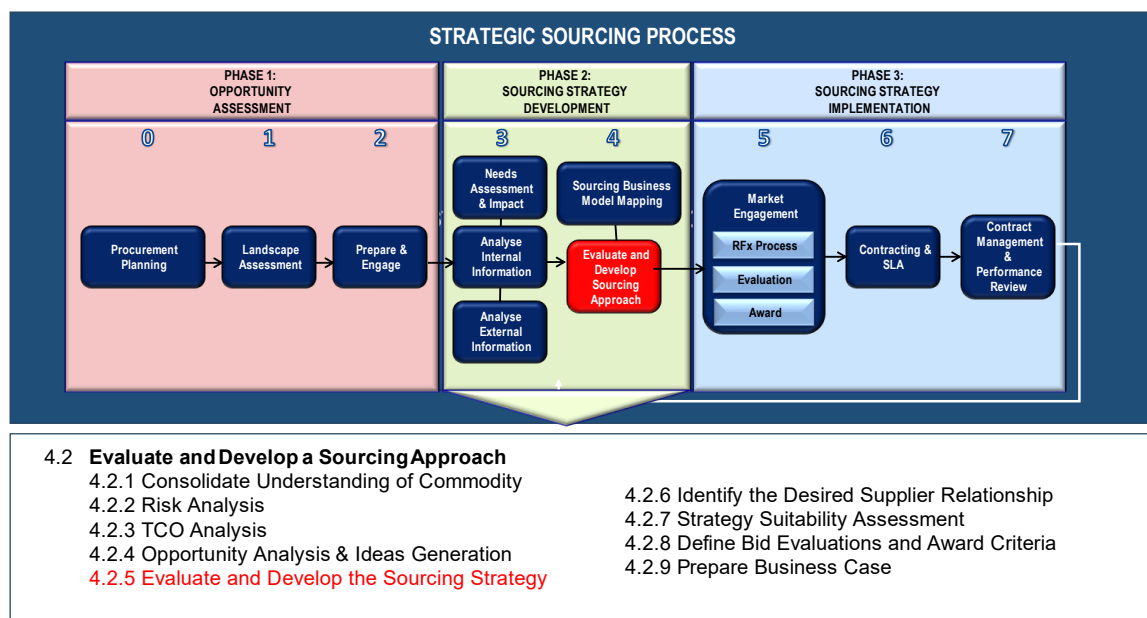


Using this guide

This guide accompanies the National Treasury's Strategic Procurement Framework (SPF) for Strategic Sourcing in the Public Sector. For more information, visit the National Treasury website at <http://ocpo.treasury.gov.za/>. Treasury SPF can be found here:

http://ocpo.treasury.gov.za/Resource_Centre/Documents/1A.%20Strategic%20Procurement%20Framework.pdf

EVALUATE AND DEVELOP THE SOURCING STRATEGY



1.0 Introduction

- i. The results from the supply market analyses conducted, i.e. Porter's Five Forces Model, STEEPLD and SWOT will give the practitioner an idea of the Supply Market Complexity and inform the development of the commodity sourcing strategy.
- ii. The following good practice guides apply to this stage of developing the sourcing strategy;
 - a. Re-assess the commodity positioning
 - b. Sourcing approaches
 - c. Commodity positioning as an input for strategy development
 - d. Pyramid of procurement solutions

1.1 The objective

- i. To develop a potential sourcing approach based on the outcome of your research and the placement of the commodity/service on the Supply Positioning Matrix.

1.2 Output

- i. “Best-fit” sourcing solutions and approaches

2.0 Good practice guides

2.1 Re-assess the commodity positioning

- i. The results from the supply market analyses conducted, i.e. Porter's Five Forces Model, STEEPLED and SWOT will give the practitioner an idea of the Supply Market Complexity.
- ii. Furthermore, the Government's Needs and Impact analysis will determine the impact the commodity has on the government's business.
- iii. With this information, the sourcing commodity/category can now be re-assessed, re-confirmed and re-positioned on the ‘Supply Positioning Matrix’.

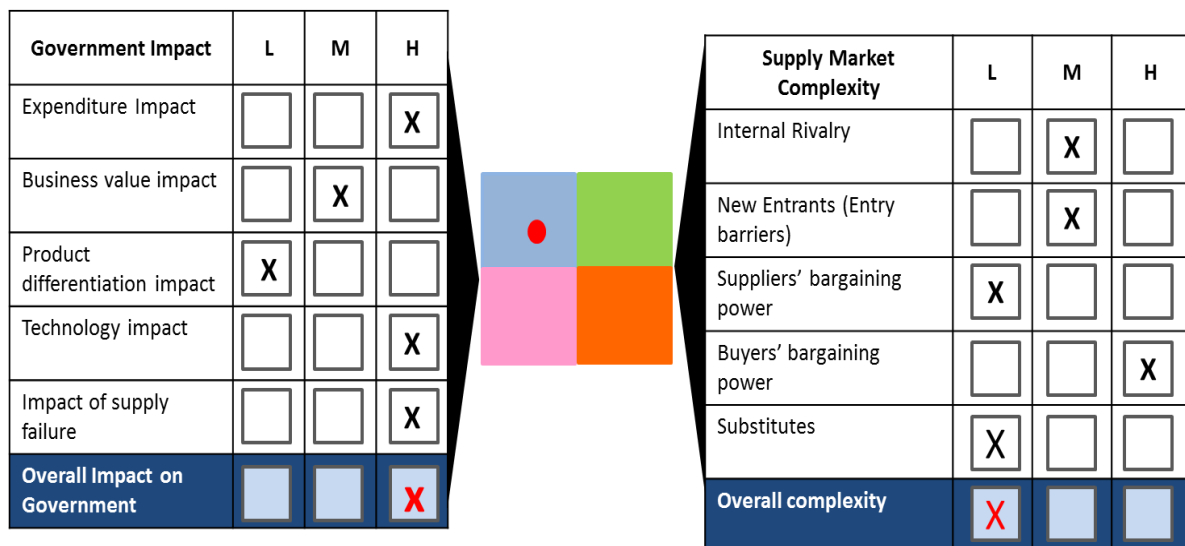


Figure 1: Assessing Commodity Positioning

- iv. By doing this the practitioner will confirm whether the initial positioning done in stage 1 is still valid (confirmed) or if it should be re-positioned as a result of the research conducted thus far.

- v. The correct positioning of the commodity in terms of the two criteria, i.e. (1) Business Impact, and (2) Supply Market Complexity, will determine the potential strategy approach.

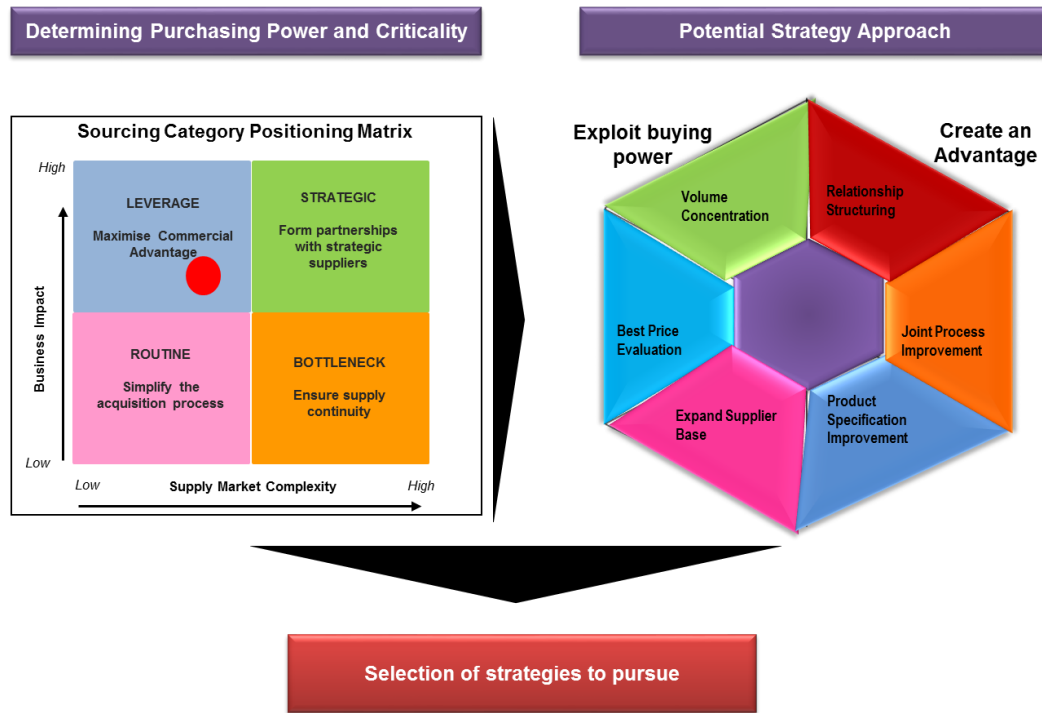


Figure 2: Determining the Potential Sourcing Strategy Approach

2.2 Sourcing approaches

- i. Sourcing approach can be divided into two main categories:
 - a. Exploiting purchasing power; and
 - b. Creating an advantage.
- ii. When exploiting purchasing power, the objective is to get an advantage from purchasing volume and consolidating purchases across the entire government.
- iii. Creating advantage looks at how the government or the individual department can position itself as a “customer of choice” with the supplier.
- iv. It is an innovation mindset, focussed on long-term relationships and alliances.
- v. The Sourcing Gemstone identifies six main Sourcing Techniques to explore when developing your Commodity Sourcing Strategy.

2.2.1 The sourcing gemstone

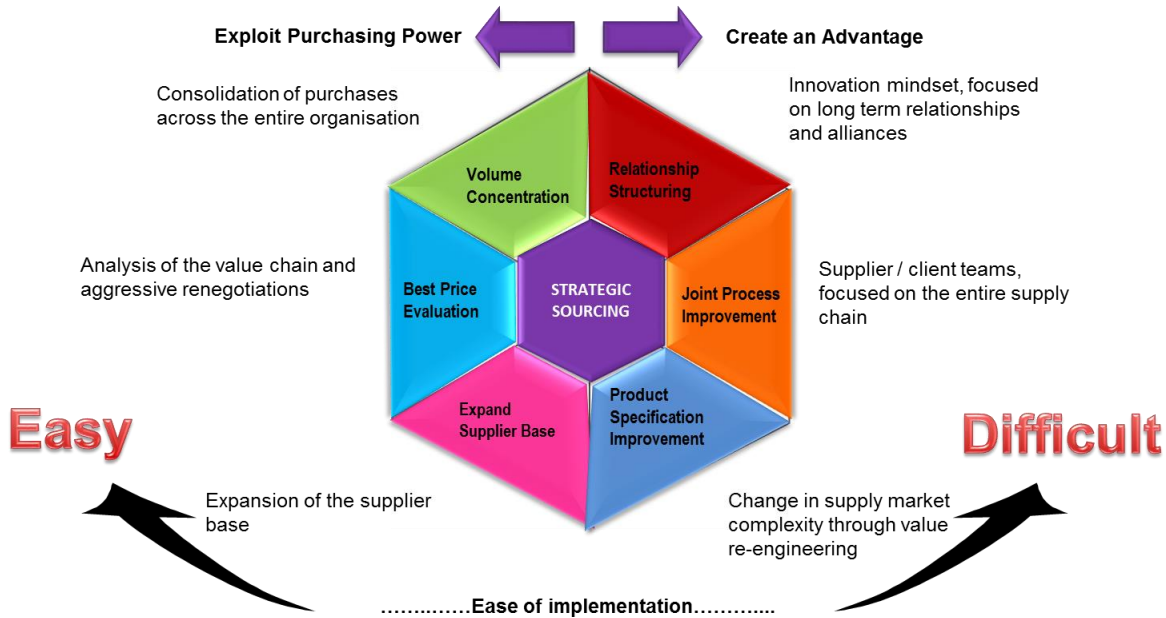


Figure 3: The Sourcing Gemstone

- i. **Volume concentration** focuses on economies of scale through organisational-wide leverage of spend, as well as other tactics that can be employed based on purchasing volumes. As part of volume concentration tactics, we also explore demand management which forms a seventh element of the overall sourcing strategy.
- ii. **Best price evaluation** involves targeting an acceptable price and determining the best supplier relationship to deliver it.
- iii. **Expand the supplier base** to identify more potential suppliers for the Commodity Group, including all opportunities that reduce the Total Cost of Ownership.
- iv. **Product specification improvement** looks at reduced TCO through optimising design by changing over-specification and new technology implementation.
- v. **Joint process improvement** requires a joint approach to solution development with the supplier for mutual gain.
- vi. **Relationship restructuring** explores alternate delivery options besides "in-house".



Figure 4: The Expanded Sourcing Gemstone

2.3 Commodity positioning as an input for strategy development

- There is usually a “best fit” set of approaches for each commodity positioning category.
- All options should be evaluated and considered irrespective of “best fit”.
- You might find that some techniques overlap with others or act as enablers for other techniques and/or approaches.
- Strategic sourcing category matrix quadrants will deliver varying levels of value (benefits) by applying the various strategic sourcing approaches.

2.3.1 “Best-fit” approaches per category

Type of Buy				
Strategic Sourcing approaches	Non-Critical	Leverage	Bottleneck	Strategic
Volume Concentration	3	5	1	2
Best Price Evaluation	5	5	2	2
Expand Supplier base	2	5	2	2
Product Specs Improvement	1	2	5	4
Joint Process Improvement	2	2	4	4
Relationship Restructuring	1	1	3	5

Figure 5: “Best-fit” Approaches per Category

2.3.1.1 Techniques for volume concentration



Tactic	Description
Supplier rationalisation	Reducing the number of suppliers is a common technique to maximise the volume on offer and allows resources to be focused on the few preferred suppliers.

Tactic	Description
Volume pooling	Pulling together the volume of business on offer through supplier rationalisation or consolidation of group-wide expenditure can leverage lower prices.
Volume redistribution	Re-allocating business from one supplier (or constantly switching) to another can maintain competitive conflict amongst the supply base.
Category consolidation	Identifying supplier synergies in the category base can allow greater volumes of business to be offered for tender. This approach will tend to support larger vertically, horizontally and laterally integrated organisations.
Standardisation	Is a tailored/customised product/service necessary? Standardisation opens up competition.

Figure 6: “Best-fit” Approaches per Category- Volume Concentration

2.3.1.2 Techniques for Best Price Evaluation

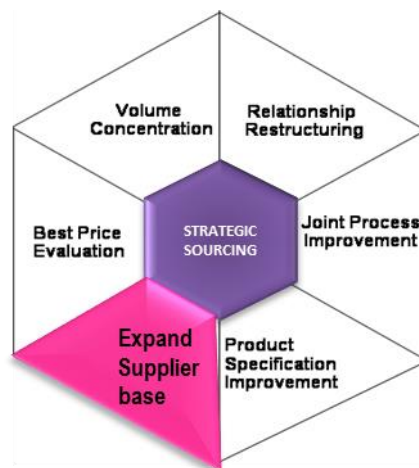


Tactic	Description
The lowest quoted price or lowest cost	Particularly when linked to total acquisition cost and supplier performance metrics/requirements.
Formula pricing	Pricing is linked to key input prices or influences such as volume usage.
Price indexing	Commodities can be measured against the highest, lowest and average prices paid in the marketplace.
Bundling & unbundling	Grouping commodities or de-constructing categories so that maximum price advantage is achieved.
Reverse engineering	This is a technique, also known as target pricing, which involves giving a supplier a fixed price to manufacture or supply a service.

Tactic	Description
Internal price benchmarking	In some cases, commodity comparisons can be made against in-sourcing.
Competitive bidding	Suppliers are invited to formally tender for the business.
Develop long-term contracts	May provide security of supply for buyers and preferential treatment in short-supply situations. The supplier has secured the business for competitive pricing.
Renegotiate contracts	Renegotiate prices with existing suppliers. Value/supply chain analysis and Purchase Price Cost Analysis are useful tools for challenging individual cost elements.

Figure 7: “Best-fit” Approaches per Category- Best Price Evaluation

2.3.1.3 Techniques for Supplier Base Expansion



Tactic	Description
Identifying more potential suppliers for the Commodity Group	Increasing the potential population of suppliers will often ensure suppliers with the lowest cost structure, advanced technologies and high-quality standards.
Market protection	<p>Dealing internationally exposes the buying organisation directly to currency markets and their inherent volatility. It is therefore preferable to purchase in the buyer's currency.</p> <p>Techniques such as:</p> <p>Exchange rate price indexing. This entails linking purchase prices to a currency range i.e. R1: \$ 11.3 +/- 5%. Within this range the price cannot change, once outside, the price will be re-negotiated.</p> <p>Exchange rate hedging. To eradicate concerns it is possible to buy foreign currency ahead at pre-determined rates. This</p>

offers a level of insurance but is paid for by less favourable exchange rates.

Figure 8: “Best-fit” Approaches per Category- Expand Supplier Base

2.3.1.4 Techniques for Product Specification Improvement



Tactic	Description
Rationalise / standardise	Evaluation of the complexity and diversity of products and services. To what extent can they be merged, simplified or standardised?
Piece part or assembly	Savings can be achieved by assessing the costs of differing levels of assembly. Services can be similarly de-constructed.
Engineering standards	Internal and external standards should be challenged and not considered set in 'stone'.
Part substitution	Technologies are moving at a fast pace, new and different parts can be cheaper and more efficient.
Concurrent engineering	Suppliers that will work closely with design engineers, as 'guest engineers' can offer significant competitive advantage in both time to market and cost.
Value engineering	Value engineering involves analysis of function and cost, suppliers can be the key to cost reduction whilst maintaining the market offering.
Examine the life cycle cost	By examining all the costs associated with purchasing and using the product/service, opportunities for redesign may become apparent. For, excessive maintenance and repair costs may signal a need for improved quality standards.
Develop long-term contracts	The length of the contract will depend on the supply market in question. Consider the length of the product life cycle and availability of supply. Long-term contracts offer the supplier some security and may increase willingness to enter into design/development initiatives.

Figure 9: “Best-fit” Approaches per Category- Product Specification Improvement

2.3.1.5 Techniques for Joint Process Improvement



Tactic	Description
Supply chain integration	Utilising information systems such as Electronic Data Interchange (EDI) and the internet/intranet to dramatically improve the flow of information and facilitate efficient order management, delivery and payment.
Consignee stock and supplier maintenance	Holding supplier stock on site, paid for on usage, and managed by the supplier's personnel on site can reduce overhead, and remove an administrative burden.
Simplified ordering	Purchases often carry a high overhead burden that is not commensurate with their worth (i.e. low-value items). Call-off contracts and purchasing cards help to minimise overhead.
Joint improvement opportunities	The supplier/buyer team can be engaged to define cost-reduction opportunities. These are then shared 50:50
Outsourcing	This can be to an outsourcing agency or by engaging existing suppliers to purchase a wider range of supplies (i.e. some that they do not deal in).
Optimise communication	Having a common message between appropriate people within the organisations will reduce confusion and mistrust.

Figure 10: “Best-fit” Approaches per Category- Joint Process Improvement

2.3.1.6 Techniques for Relationship Restructuring



Tactic	Description
Analyse core competencies	Identify the core competency of the organisation and potential suppliers.
Examine make versus buy decisions	Considering the current manner of sourcing, it may be more appropriate to buy a managed service rather than manage this in-house and vice versa. This may severely change the relationship with several suppliers.
Consider market entry alliances	Consider joint product design and development to maximise benefits for both parties with shared risk and exposure.
Strategic alliance	Long-term relationships focus on lowest cost vs competing supply chains, supplier prices reduced on a 1:1 ratio with costs, agreed level of ROI, reductions accelerate as risks and investment costs are shared, quality differentiation, concurrent engineering, and life cycle contracts.

Figure 11: “Best-fit” Approaches per Category- Relationship Restructuring

2.3.2 Ease of implementation

- i. Some strategies can be implemented with relative ease and little buy-in from stakeholders whereas others require significant buy-in from all relevant parties as can be seen in the illustration below.

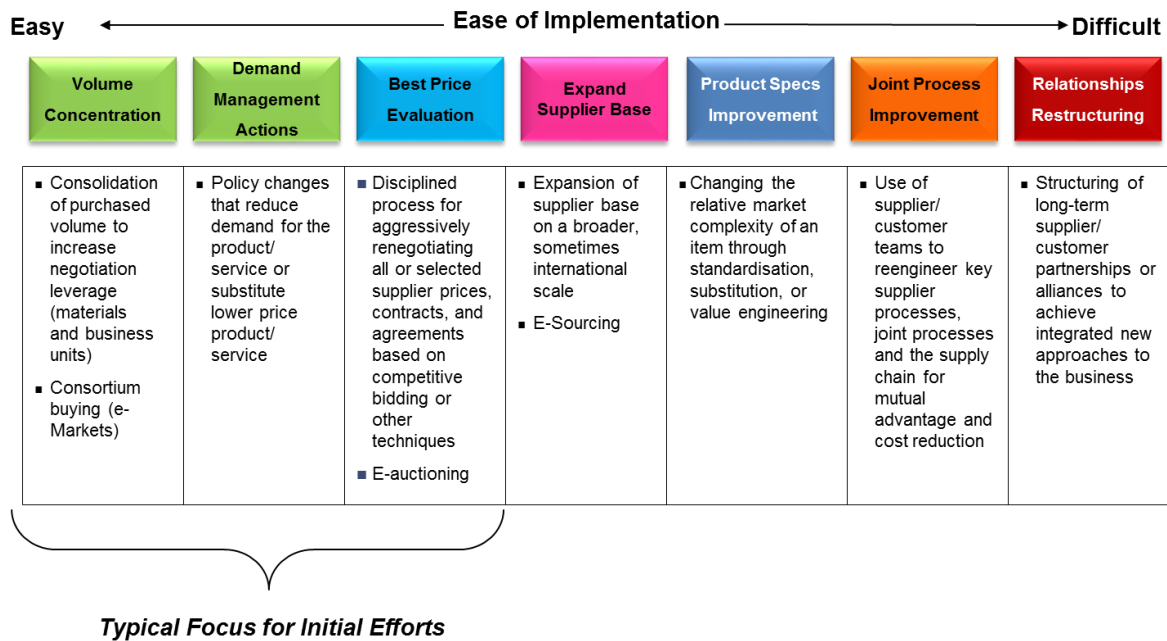


Figure 12: Sourcing Strategy Ease of Implementation

2.3.3 Additional aspects to consider when developing the sourcing strategy

- i. In the development of the Sourcing Strategy, consider all previous information that has been collected and analysed.

2.3.3.1 Current spend

- Are different institutions buying the same or similar goods/services from the same supplier (independently)?
- Are different regions buying the same or similar goods/services from different suppliers?
- Are the current contracts being utilised?
- Are orders placed in accordance with the contract?

- v. What type of control does the sourcing team currently have over the decisions regarding spend amalgamation?

2.3.3.2 Attention previously paid to the supply market

- i. To what extent has the strategic sourcing or the buying units previously focused its attention on the commodity?
- ii. What type of sourcing strategy was previously used? Was it successful?
- iii. Can this strategy be replicated across the entire organisation?
- iv. Cross-commodity synergy: Do overlaps or potential synergies exist between the commodities purchased? (Commodities with various buying opportunities exist – the capex, maintenance, repair, etc. opportunities)
- v. Does the supplier provide non-related commodities?

2.3.3.3 Impact on revenue

- i. What is the commodity's potential impact on revenue generation?
- ii. To what extent does the commodity impact the quality or reliability of services provided to our customers?
- iii. How critical are the commodities to the availability of services?

2.3.3.4 Impact on cost structure

- i. What is the overall cost implication associated with this commodity? Can we reduce this in any way?
- ii. Are there alternate sources of supply?
- iii. Are there any substitutes to consider?

2.3.3.5 Internal restrictions

- i. What limitations are imposed on sourcing? (e.g. quality, service requirements, business partner preferences or strategy)

- ii. How much stakeholder support do you have for the consolidation of spend?

2.3.3.6 Geographic dispersion of buying units

- i. To what extent are buying units geographically dispersed?
- ii. What does each buying unit purchase in terms of goods and services?
- iii. To what extent are the suppliers represented nationally / globally? Does this meet the current need?

2.3.3.7 Supply market competition

- i. What competitive forces exist that impact the supply market?
- ii. Are there too many competitors in a shrinking market? How difficult is it to enter the market?
- iii. Who has the upper hand: - the supplier or the buyer? What can we use as negotiation leverage?
- iv. What are the BBBEE capabilities associated with this market?
- v. What are the SMME capabilities associated with this market?

2.3.3.8 Externally imposed restrictions

- i. What restrictions are imposed by government, regulatory agencies or industry associations?
- ii. Consider PFMA policy restrictions including CIDB, BBBEE and SMME

2.4 Pyramid of procurement solutions

- i. The following graphic (The pyramid of procurement solutions) illustrates a strategic road map for cascading and implementing the various solutions, leading to a best-in-class procurement system that an institution must have.
- ii. As indicated, for strategic sourcing solutions to be sustainable, the institution must adopt a long-term view and approach.

- iii. The pyramid of procurement solutions indicates that there is no one-size-fits-all approach to commodity management.
- iv. Innovative ideas for certain commodities may come from the supplier – for example when adopting the Vested Model Approach, the suppliers may help the government institutions to drive responsive procurement solutions.

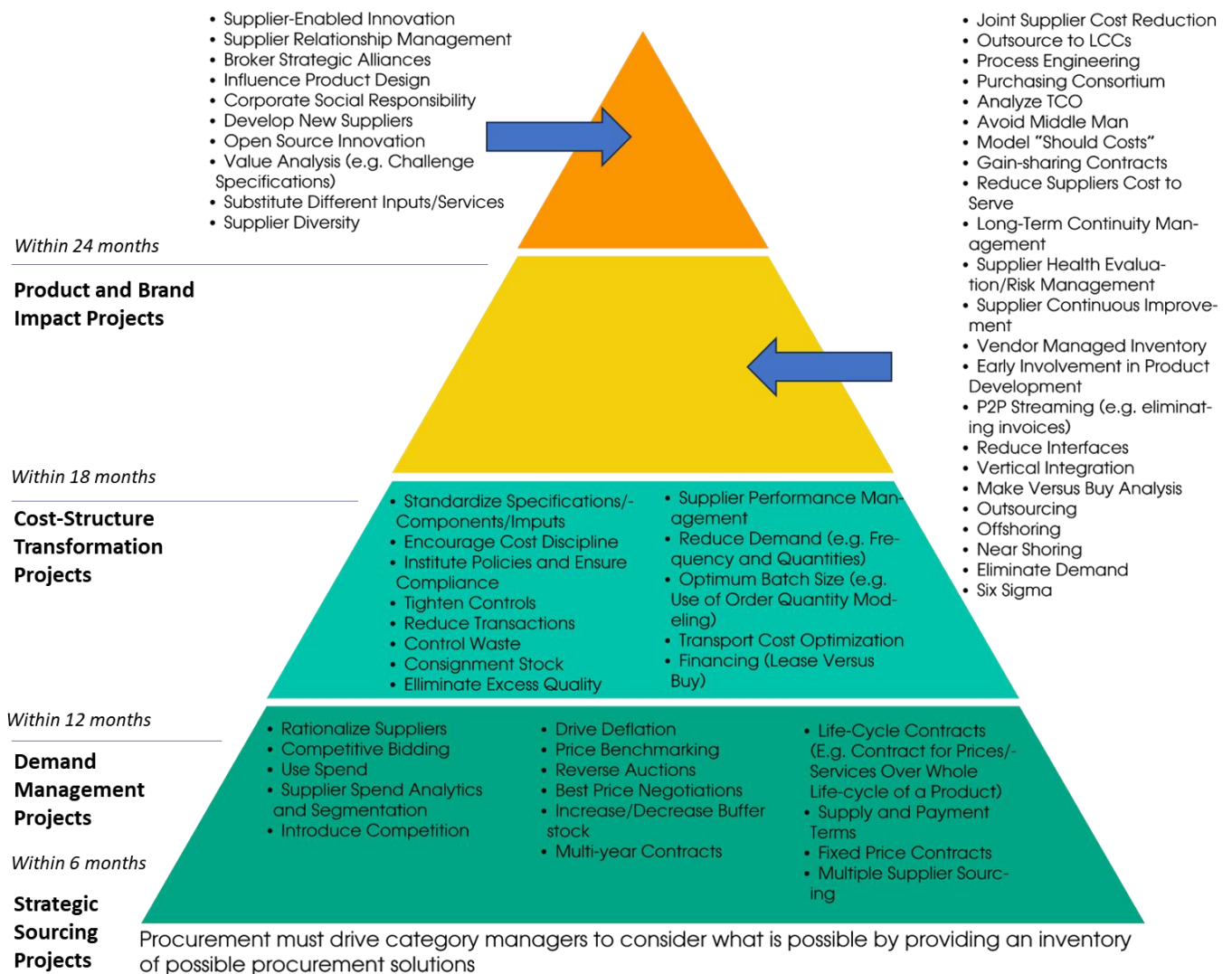


Figure 13: The Pyramid of Procurement Solutions

3.0 Templates

Not applicable