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Strategic Sourcing as key success factor in business success

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Abstract

Decisions on sourcing are no longer an option, but how organisations make these decision is. In order to face the challenges of today's dynamic business market, organisations need to make strategic decisions about the sourcing of their organisational activities. Are the business processes that we engage in essential in our business mission or do we need to decide to outsource them? Focus on the core business, costs, availability of the expertise and business strategy are elements that should guide their choices.

In this white paper we examine the characteristics of sourcing and present a model for 'make or buy' decision making. Types of sourcing are explained and a way of working to determine and anchor sourcing decisions as a continuous strategic process. The presented framework is generic and applicable to all organisations and all business or service processes (finance, human resource management, operations etc). The framework will be illustrated in the context of the IT domain. A literature list is attached for further reference.

Introduction

Sourcing is no longer optional, and a strategic approach has become a precondition for business success and in some lines of industry even survival. The challenge of modern organisations, however, is to integrate sourcing as an integral part of the business strategy. Decisions on how to source business activities are often not getting the attention they deserve, are based on the wrong sourcing scenario and are often addressed too late. A pro-active and structural approach strengthens the competitive position of the organisation in the market through reduction of costs, the increase of quality of service or product and the ability to concentrate on the primary processes and core activities. Over the past years many organisations have experienced the benefits as well as the pains of outsourcing and insourcing of business processes. Although the value of individual sourcing transactions has declined over recent years, the number of transactions is increasing strongly. It is expected that the use of external suppliers will double in the next few years, with offshore sources accounting for 27% of the typical company's supply base by 2008. Disappointing results in the outsourcing has led to a number of organisations that back-source business processes that we outsourced before. Traditionally, the reduction of costs was the main driver to consider different sourcing possibilities. However, this has changed. Many modern organisations outsource activities in order to be able to concentrate on their core activities in order to excel. An other strong motivator is the opportunity to get access to new and specialised expertise and services. The services and skills of specialised firms are added to improve the overall service levels of the organisation, in terms of increased innovation and business continuity. Outsourcing is mostly associated with the IT market. Although this market may be the most mature market, presently the sourcing of the Human Resource function is the fastest growing segment. At least 80 percent of the companies now outsource at least one HR activity (like salary administration). Market analysts predict a strong growth in the Finance and Accounting segment.



The market for sourcing, both from the customer and the supplier perspective, is growing. For customers there are excellent opportunities now that the supplier side expertise and skills have matured. However, in order to take advantage of these changes, the organisations need to develop sourcing strategies that will enable to maximise the benefits. In this paper we will explain and illustrate some of the basic concepts and practices that pave the road to successful sourcing of organisational activities.

Strategic Sourcing

Although the research on Strategic Sourcing is rapidly growing, there is not one clear definition. More often we find that the phenomenon is described through its characteristics:

- It is a systematic and on-going activity
- It is a corporate level strategy
- It concerns all activities and services in the organisation - including the core activities
- Its focus is to identify activities that are sourced within the organisation and activities that are sourced outside the boundaries of the organisation.

When these characteristics are combined we may define Strategic Sourcing as:

“the continuous and on-going evaluation whether to source organisational processes and activities internally or externally, guided by maximising the achievement of the business strategy and business goals.”

Strategic Sourcing therefore requires an ongoing assessment of the value of internal and external activities, services and knowledge and their relevance in the context of the business function, processes, and activities. A sourcing strategy that is supported by the top management forms an important foundation in the establishment of business success.

A research recently conducted by Erasmus University in the Netherlands and Kirkman Company Research reveals that the relevance of sourcing is often well understood, but that it receives relatively little strategic and continuous attention. The issue of Strategic Sourcing is put on the agenda in an ad hoc basis and only when financial indicators demand action.

The research also revealed that few organisations approach sourcing in an integrated manner. Sourcing initiatives are taken by separate business units or departments and limited by the business functions at that level. Strategic Sourcing however, requires the design of integrated and flexible sourcing strategy at the corporate level. This means that overall vision needs to be translated into an integrated Strategic Sourcing strategy.

Sourcing variants

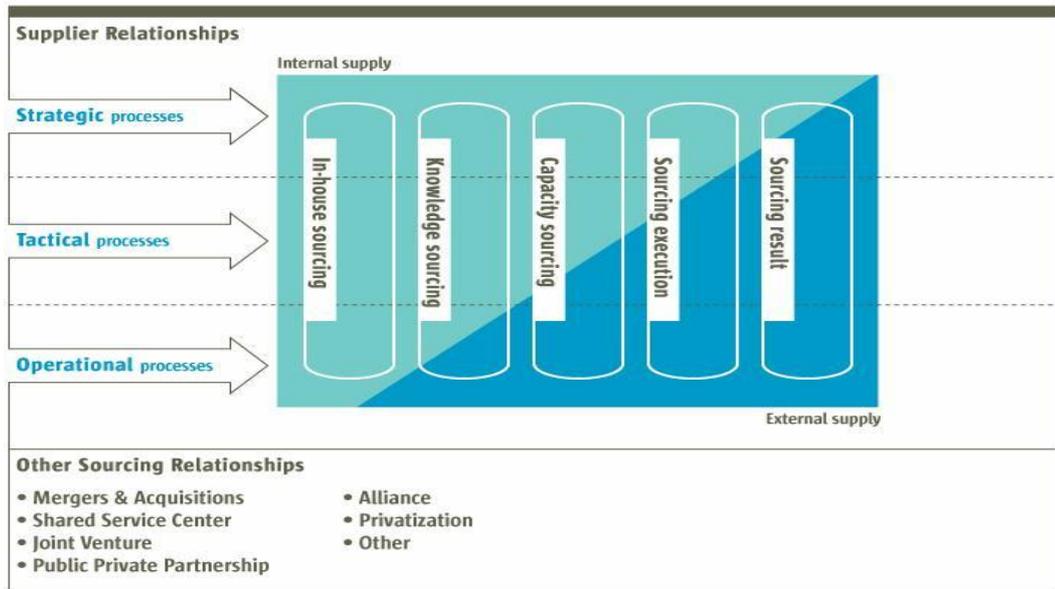
Every process or activity in an organisation needs to be sourced. The organisation may use their own resources, external resources, or a mix of both. In most cases a hybrid form is used where internal and external resources are used to execute the activities. We distinguish between total and selective sourcing. The term total sourcing is used when an organisation performs all or at least 80% of the processes and activities themselves (total insourcing) or at least 80% of the activities are performed by a supplier (total outsourcing). Also here, total sourcing is relatively rare and most organisations select suppliers for specific and carefully selected activities or processes. This is called selective sourcing.

In the area of selective sourcing we identify four variants:

1. Knowledge sourcing: the organisation hires specific knowledge and skills on an ad-hoc basis
2. Capacity sourcing: the organisation hires knowledge and skills on a more permanent basis



3. Execution sourcing: the organisation hires capacity and make them responsible for the solution of a specific organisational problem
4. Result sourcing: the organisation defines the problem and a supplier determines how, and with what people the problem of the organisation may be solved.



(OBJ)

In the execution of a sourcing strategy for an organisation, several of these sourcing variants can be executed alongside of each other. For example, the HR department may use capacity sourcing for specific processes, the finance department uses knowledge sourcing for specific periodic challenges, while the ICT function is totally outsourced through the result sourcing variant.

In order to determine the optimal sourcing variant, sourcing feasibility (source-ability) of the process or activity needs to be determined in the organisational context. This means not only that the nature of the task will have to be assessed, but also the maturity and strengths/weaknesses of the organisation. Careful financial, situational and risk analyses need to be prepared to ground the sourcing decisions and propose sourcing scenarios.

Implementing Strategic Sourcing

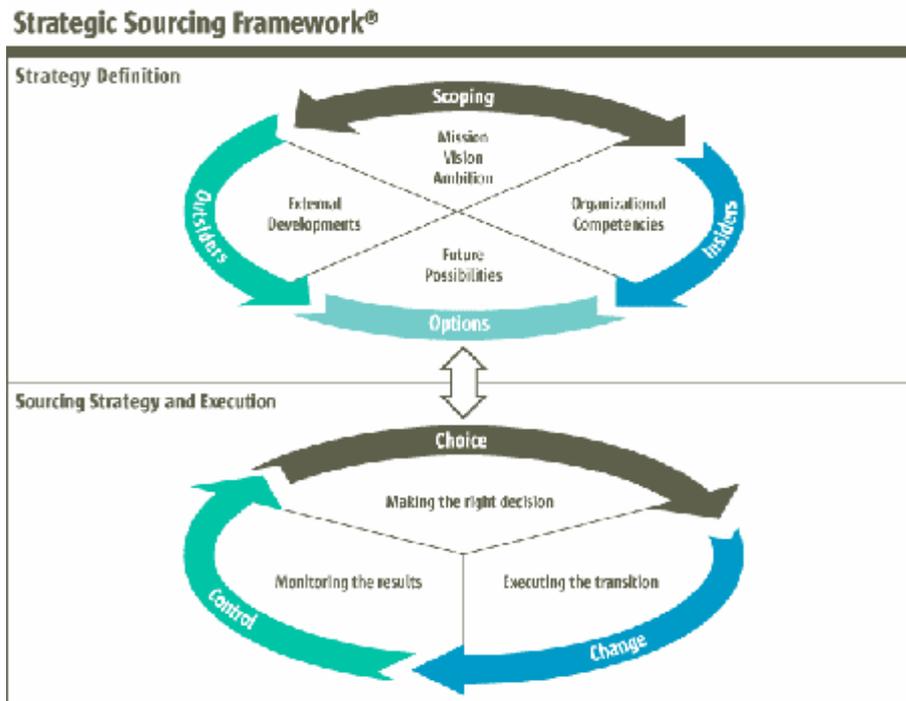
Implementing or optimising Strategic Sourcing is done in a two phased approach. In the goal of the strategic definition phase is to determine the organisation's current situation against the background of the vision, mission and ambition of the organisation. This involve analysing external developments of the environment in which the organisations operates, but at the same time this phase is used to identify the possibilities, opportunities in the context of the organisational competencies.

The strategy definition phase naturally evolves in the second phase in which the sourcing strategy and execution is started. The second phase is based on the results of the first phase and aims to develop and implement a suitable sourcing strategy. The implementation of Strategic Sourcing develops through three interrelated activities: Choice, Change, Control.

- *Choice* involves the identification and analysis of possible sourcing strategies and decides on the best sourcing strategy for the organisation.
- *Change* focuses on finding, rating and advising on best-fit vendors, transforming the organisation to fully embrace the new possibilities that sourcing offers.



- *Control* is essential to ensure that the choices and changes continue to pay off for the organisation. This implies that internal and external suppliers' performance need to be monitored and improved where needed.



(O&B)

Sourcing Governance

Sourcing Governance addresses capabilities needed to regulate and support multiple service providers, including management methods and processes, organisational roles and responsibilities, and service delivery rules and agreements. An effective governance model must cross traditional enterprise boundaries and become not only an integrated part of the business, but also part of the business' internal functions and the external providers themselves (including even subcontractors and the supplier's partners). Establishing effective Sourcing Governance is critical to the success of any sourcing strategy.

Strategic Sourcing of the IT function

The market for external sourcing of the IT function in organisation has grown rapidly in the last 20 years. At present almost 50 percent of the total global outsourcing market is established by IT services.

Sourcing of the IT function needs to be integrated in a corporate sourcing strategy that is developed and supported at the strategic level of the organisation. The integration of the IT sourcing in an overall sourcing strategy enables management to align the different initiatives. This alignment provides the key to success.

IT sourcing initiatives that are not backed by a corporate sourcing strategy risk to become isolated in the organisation, lead to a suboptimal performance of the IT function and eventually result in negative effects on the performance of other (core) business functions. Where the IT function is expected to support the business, it easily becomes an obstacle to continuity and growth.

A corporate sourcing strategy is also an important instrument to ensure the right levels of maturity for the IT function from both a client and supplier perspective. We often



encounter the situation that expectations of the clients, i.c. other business functions, are unrealistically high, while at the same time they fail to specify their needs properly. Poor specifications, not fully tested and/or accepted systems that are forced to be put into the production environment, or vague support requests provide a negative image of the IT function. However, outsourcing will not provide an answer if the client organisation does not mature. When the IT function become part of the corporate sourcing strategy, the issue of maturity of clients and suppliers needs to be addressed to ensure success. A word of caution needs to be provided when the IT function is selectively sourced. Selective sourcing with several suppliers can easily lead to many and complex communication. Project-based sourcing (instead of structural, or Strategic Sourcing) leads to sub optimization at best. As no structural measures are taken for unilateral management of suppliers, contract management and SLA management towards these suppliers is fragmented. Worst case scenario is that no contract management or SLA management even exists. When Strategic Sourcing principles are applied decisions will be taken on:

- Sourcing strategy (what to do yourself, what to outsource and in what fields to ally)
- Deciding on optimal sourcing scenario's
- Implementing a DSO (demand-supply organization)

Examples in Strategic Sourcing

When Strategic Sourcing is considered, decisions need to be based on a thorough analysis of cost, technical and organisational disentanglement of the business processes, assets and personnel, propositions of suppliers, and possible added value to the business.

Below two small scenarios are presented where Strategic Sourcing provided an answer to the situation that an organisation is confronted with.¹

Example 1

The understanding at the strategic level in the organisation that sourcing may provide an answer to the growing need of high quality IT services is an essential precondition for a successful sourcing strategy. The management of Quest, a large organisation in the amusement industry, realises that more capacity and expertise is needed in the IT function. In stead of directly contracting IT service providers, the organisation decides to develop an integrated sourcing strategy with the focus on the IT function.

By using a business case approach for the entire organisation a careful and well informed decision could be made by the board and management on the role and expectations of the sourcing of the IT function. In order to control the sourcing strategy, an organisational function was created to manage the supplier selection and monitor the performance of the suppliers as well as the internal clients.

With the development of a corporate sourcing strategy the organisation regained control over a business function that gradually went astray.

Example 2

When organisations decide to start a close collaboration or to merge, the IT function is often considered to be an important obstacle. Different systems, different standards and different suppliers pose a mere impossible harmonisation challenge. A Strategic Sourcing strategy can provide the solution.

Aqua is a relatively small player in the utilities market. Aqua consists of several business units that deliver services in a specific geographical area. The IT services are supplied by a central unit. A merger is on the way and the technical and administrative IT function needs to be reconsidered.

¹ The examples are based on real assignments executed by the consultants of Kirkman Company. For more information the consultants of Kirkman Company can be contacted.



In order to determine the way forward, possible sourcing scenarios were prepared for the management. The scenarios were based on a technical, financial and situation analysis of Aqua and its partners.

Conclusion

Strategic Sourcing has become a precondition for organisational success. Business enterprises, but also government organisations need to think strategically about their processes and the different possibilities to source them. Several sourcing models may apply, but only when an integrated strategy is developed, maximum benefits will be achieved in terms of effectiveness and efficiency of services.

The management of the sourcing process and the suppliers delivering their services have become complex, global and competitive. New suppliers are moving in and new service offerings become available. A corporate sourcing strategy needs to provide clear guidance for sourcing decisions and prevent suboptimal solutions. At the same time the strategy needs to provide a reference for the maturity levels of clients and the suppliers in the sourcing process. Mature players are an essential precondition for success.

The development and implementation of a corporate sourcing strategy requires specialists with a good understanding of the market, sourcing possibilities and supplier/contract management. Organisations can set up their own sourcing functions but may also decide to source this specialised service providers.

Further reading

The literature on Strategic Sourcing is growing fast now that more and more experiences become available. Below we present a selection of the available literature that we believe provides a good starting point to deepen the understanding of the possibilities and pitfalls of sourcing.

Books and articles

- Banfield, E., *Harnessing Value in the Supply Chain: Strategic Sourcing in Action*. John Wiley, 1999.
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