Organizing for Sourcing Excellence
Insights for impact on profitability and revenue.
The Transformation of Procurement

Strategic decision making opportunities that can have immediate impact on profitability and revenue.

The more critical that a particular activity is to the company’s success, the more important it is to put an organization structure in place to maximize the performance of that activity. Almost every business is dependent on buying goods and services. The quality, cost and delivery of goods and services directly affects the bottom line. As a result, the purchasing function has clearly emerged as an activity that is important to the success of the enterprise. Purchasing importance has been continuously growing over the last four decades. It has moved from an administrative, largely order placing function, to a strategic decision making organization that can have immediate impact on profitability and revenue.

Unfortunately, this transformation has not taken place universally yet. Some companies are further along the purchasing evolution path than others. Recent studies suggest that over half of chief procurement officers report into a C-level executive. One only has to look at the number of articles in non-trade magazines that highlight purchasing activities to realize the growing importance of the function. Often times, the articles highlight the consequences of poor purchasing performance such as when a supplier’s actions have resulted in negative consequences for the business. These types of articles highlight the fact that the sourcing and supplier management activities specifically have become important factors in the success of the enterprise. For these areas, organizational structure can be leveraged to improve results and mitigate risks.

Organizing for Excellence

In an ideal world organization structure would not matter. All employees would understand the overall objectives of the enterprise and would take steps necessary to ensure that they maximize their ability to contribute to the achievement of those objectives. To accomplish this all employees would:

- Have open communication and unlimited access to each other on a worldwide basis;
- Be able to leverage best practices from around the world and accurately assess the implications of their actions on all other groups throughout the organization;
- Take actions within their areas of responsibility that maximized the overall objectives of the enterprise even if it was suboptimal for a given group’s specific objectives;
- Proactively seek out others performing similar functions and exchange information to continuously improve their functional skills;
- Be accurately evaluated on their contributions towards the achievement of the overall objectives of the enterprise.

Of course, this ideal world does not exist. In reality an employee’s daily activities are strongly influenced by the specific objectives of the group to which she belongs, her individual responsibilities, and real world factors such as time constraints and capabilities. And although the groups objectives may be aligned with the overall enterprise objectives, achievement of those objectives requires finding the optimal balance between multiple objectives. For example, consider the situation in which one group needs to bring on temporary resources immediately in order to meet an important deadline for a deliverable. From an enterprise perspective that group’s deliverable is important but other considerations are equally important. These include cost (resources should not be brought on at more than the market rate), delivery (should not require a significant amount of time or resources for the enterprise to expend in finding them and risk (should not create any legal issues with respect to their employment status). The ability to maximize the overall value to the enterprise in this situation (optimal balance between achievement of the group’s deliverable and the other objectives) is highly dependent on the organization structure. Simply put, the organization structure (the way that the enterprise arranges its people and jobs) is a critical factor in enabling the enterprise to achieve its overall objectives.

Great organizations go well beyond transactional and material acquisition functions. They provide advantages to their companies by transforming procurement from a transactional to a strategic focus.

Strategically aligned and consistently mature procurement practices facilitate operational effectiveness. This translates into competitive advantage and bottom line savings across the sourcing value chain.
The factors to consider in organization design are numerous: functional expertise, business unit autonomy, geographical, hard-line reporting, dotted line reporting, centralized, matrix, customer focus, industry focus, decentralized and on and on. Creating a structure that drives the appropriate mix of accountability, empowerment, motivation and performance is not easy. The task becomes even more challenging given acquisitions, divestures, and market, industry and macroeconomic dynamics. Compounding all of these factors is the current economic environment. With the global economy still feeling the effects of the economic crisis that started in 2008 and Europe facing a particularly challenging 2012, companies are going to have to excel at all aspects of their business in order to grow revenue and profits. In the past, deficiencies in the organizational structure may not have been apparent when the enterprise was routinely hitting its revenue and profit growth targets. Now in the era where several iconic corporations have filed for bankruptcy protection, it is clear that the margin for error in company strategy and performance is small. In most cases, multiple factors contribute to declining performance for an enterprise and organization structure is an important component of corporate strategy that companies should seek to optimize.

Based on the fact that two of the most critical purchasing activities are sourcing and supplier management, what steps should be taken to structure the organization so that it can optimize those activities? We start by focusing on the goal of each activity. The goal of sourcing is to enable the enterprise to purchase products and services from those suppliers that provide the maximum value, over all other suppliers, to the enterprise. The goal of supplier management is to ensure that suppliers, once selected, provide maximum value to the enterprise over the life of the relationship between the enterprise and the supplier. There are eight high level factors that can undermine an enterprise’s ability to achieve these sourcing and supplier management goals. These factors are as follows:

- Inadequate sourcing strategy;
- Insufficient industry and market knowledge;
- Incomplete understanding of enterprise wide business requirements;
- Lack of awareness of optimal contract terms;
- Inability to pursue optimal contract terms;
- Insufficient negotiation skills;
- Lack of information that could influence negotiations;
- Lack of a single, unified supplier management strategy and process.

Let’s take a little closer look at each of the areas that can undermine sourcing and supplier management excellence and consider the implications for organizational structure.

**Inadequate Sourcing Strategy**

The Encarta dictionary defines a strategy as a “carefully devised plan of action to achieve a goal”. The development of an effective sourcing strategy is the important starting point in the strategic sourcing process. For example, without a well defined strategy it will be difficult to determine whether all appropriate potential suppliers have been considered. Overlooking key suppliers can lead to suboptimal sourcing performance if those suppliers could have provided more value to the enterprise for the specific product or service to be sourced. The sourcing strategy also needs to take into account all of the enterprise wide requirements for the product or service category as well as the market and industry dynamics. It should be aligned with business unit and corporate strategy, and include benchmarking activities and an assessment of key economic factors. Developing such a strategy requires a significant investment in time. Since the goal is for the sourcing strategy to be leveraged across the enterprise, the resources developing this strategy should be part of an organization that has enterprise wide objectives and targets.
Insufficient Industry and Market Knowledge

An important component of a strategic sourcing process is a deep understanding of the industry and markets associated with the product or service to be sourced. In general, this knowledge needs to be on a worldwide basis given that in some cases offshore sourcing opportunities may provide the most value for the enterprise. Such deep industry knowledge should clearly identify variations by regions if they exist. Developing this understanding and expertise is a non-trivial undertaking and requires commitment by the resource that will be responsible for leading the sourcing activity. From an organizational design perspective, companies will have to consider the best structure to ensure that this deep category specific knowledge and expertise is developed, maintained, and leveraged across the enterprise. An effective way to accomplish this is by having a senior manager within the enterprise that is responsible for determining which resources within the enterprise are going to be accountable for which categories for both production and non-production activities. By having a single manager responsible for this deployment, the enterprise can ensure that all of the categories utilized anywhere by the enterprise are covered in an efficient manner. Similarly, it is important that the organizational structure promote the use of this category specific expertise across the enterprise. The challenge is putting in place a structure that will motivate the resource designated to maintain the expertise to then utilize it in all areas of the enterprise where it is applicable. By placing the resource in a group that has first level objectives that are enterprise wide will achieve this objective.

Incomplete Understanding of Enterprise Wide Business Requirements

Understanding the specific requirements for every entity within the enterprise that will leverage the product or service to be sourced is another important enabler to sourcing excellence. Clearly resources that work closely with or within a certain entity will likely have the best understanding of that particular entity’s requirements. But making sure that they also proactively reach out and fully understand the requirements of other entities within the enterprise is the key. In general, entities are focused on achieving their specific goals and the resources within that entity are going to be strongly focused on meeting that entity’s specific goals. The risk is that goals and requirements of other entities will likely be lower priority. So from an organizational design perspective it is an important that the organization structure provides incentives for the person leading the sourcing activity to proactively determine the business requirements for all of the entities across the enterprise that will be using the product or service. In this way, they can look for opportunities to standardize requirements and reduce variations in requirements across entities thereby reducing the costs and driving more value for the enterprise.

Lack of Awareness of Optimal Terms

Resources that are responsible for leading the sourcing activity should be aware of negotiating toward the optimal terms from the perspective of the enterprise. This means that they should be aware of the business requirements of each entity across the enterprise as discussed earlier, and that they are aware of the corporate wide requirements for items such as pay terms, warranty, Intellectual Property protection, etc. As the requirements and the strategy for these items change, the sourcing resource needs to be able to quickly incorporate them into their contract negotiations going forward. The organization structure should motivate and facilitate the sourcing resource’s ability to stay abreast of the optimal terms. By placing the resource in a group of others that are focused on sourcing across the enterprise, it provides a community of practice that can reinforce each other’s ability to stay abreast of the optimal terms.

Lack of Empowerment to Pursue Optimal Terms

In the course of sourcing a particular product or service, there may be differences of opinion as to what constitutes “optimal terms” from the enterprise perspective and the business unit perspective. The resource leading the sourcing activity needs to be empowered to raise these issues to the appropriate level when there appears to be disagreement. The organization structure should enable such empowerment by ensuring that the person leading the sourcing activity has direct access to a senior manager that has accountability for maximizing the value of the sourcing activity to the enterprise.
Insufficient Negotiation Skills

It is important that the person leading the sourcing and supplier management activities is a strong negotiator. This requires an ongoing investment in sharpening those skills and incorporating best practices from inside and outside of the enterprise. The organizational structure should support the appropriate evaluation and development of these skills on an ongoing basis. A senior manager can definitively assess negotiation performance and identify opportunities for continuous improvement best if the person is within their organization structure. Furthermore, the person should have direct and frequent access to others across the enterprise that are actively engaged in sourcing negotiations so that they can incorporate lessons learned and best practices into their own negotiations.

Lack of Information that Could Influence Negotiations

Access to relevant information such as total enterprise wide spend (current and potential) and supplier performance across the enterprise is critical to developing and executing a successful negotiation strategy. The organization structure should support the development of tools and processes to track this type of information and make it easily accessible to sourcing resources that need to leverage such information in their negotiations.

Lack of a Single, Unified Supplier Management Strategy and Process

The total spend with a supplier should be leveraged in negotiating the supplier performance terms of the contract. The terms should be structured such that optimal value is provided for the enterprise. By making a single resource accountable for ensuring that the supplier performs at a level above or beyond the terms specified in the contract, the enterprise benefits by avoiding situations where the supplier might receive multiple conflicting messages from the enterprise. It also ensures that the entire enterprise has a voice in raising supplier issues and identifying opportunities for improvement. Tracking supplier performance across the enterprise and incorporating it into business reviews and negotiations requires a well defined process and strategy. The organization structure should enable such a singular focus for base is probably best performed in the context of an organization that has enterprise wide responsibilities and accountability.

The common theme throughout the discussion of factors that can undermine sourcing excellence is the need for an organization structure that enables an enterprise wide view. However, some have expressed a concern that enabling an enterprise view is suboptimal for each individual entity. A typical argument for why a business unit should have its own sourcing resources is that it enables faster decision making and execution and provides for sourcing outcomes that are more aligned with the business unit objectives. In some cases, that could be true. However, organizations must ask themselves if the benefits outweigh the risks. Another approach that is often used is to organize sourcing and supplier management resources by geography. The logic is that this will enable more efficient sourcing because the resources will be located in the regions where the product is to be used as well the location where the suppliers are likely to be. However, given the growth of multinational suppliers and global sourcing, such an organization structure could still be suboptimal from an enterprise perspective.

An organization structure for sourcing and supplier management that supports an enterprise wide perspective does not have to be centralized or even centrally located. It is probably worth rereading the previous sentence because it addresses a common misperception. To centralize means to remove power from lower levels and concentrate it in a single place. To optimize sourcing and supplier management requires only that enterprise wide accountability be enabled and supported by the organization structure. In such a structure, lower level resources can still be empowered to make real time decisions. And they can , and in fact should, be located wherever they can provide the most value to the enterprise in the execution of their responsibilities. If there are a high concentration of suppliers for a given product or service category in South East Asia then its sourcing and supplier management resources should be located there also. If there is a high concentration of people that set the business requirements for the product or service in one geographical location, then it is worthwhile to consider locating the relevant sourcing resource there also.
Recall our discussion regarding an ideal world earlier in this paper. In such a world employees would always work with colleagues across the enterprise to maximize the value of their contribution to the enterprise’s overall objectives. In reality, employees have limited time, and multiple objectives and priorities based upon their specific group. It is these specific group objectives and priorities which are most relevant for the day-to-day activities of the employees. So it follows that to ensure that sourcing and supplier management resources take an enterprise perspective into consideration in their activities, the organization should be structured in such a way that they are part of a group that has enterprise wide objectives.

There are basically two high level common models for structuring sourcing and supplier management resources as shown in Table 1. The table also shows the various high level factors, as discussed earlier in this paper, that can undermine sourcing and supplier management excellence. The table provides our assessment on the ability of each organization structure to mitigate the risk on performance associated with each factor. As indicated by the assessment shown in the table, we believe that organizations should strongly consider implementing a center-led approach to optimize their sourcing and supplier management activities.

Table 1: Assessment of Organization Structure on Sourcing and Supplier Management—Performance Risk Factors

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<th>Potential Factor Undermining Ability to Maximize Value to the Enterprise for a Given Product or Service</th>
<th>Sourcing resources report to...</th>
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<td>Manager in a business unit or geographical entity*</td>
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<td>Insufficient Industry and Category Knowledge</td>
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* Sourcing or supplier management resource does not have to be co-located with manager

- **Mitigates risks**
- **May mitigate risk** if strong communication/coordination processes across business units and entities exist, enterprise level sourcing objectives exist and senior level sourcing oversight exists.
- **Mitigates risk only if product or service is used only by that business unit or geographical entity and senior level sourcing oversight exists**
- **Does not mitigate risk**
- **Potential for redundant activities**
A center-led structure for sourcing and supplier management activities is one in which the resources that lead the sourcing and supplier management activities are all part of the same organization, and that organization is led by a very senior manager that is accountable for enterprise wide sourcing optimization. However, the sourcing resources themselves can be located in close proximity to either high concentrations of suppliers or customers of the product or service for which they are responsible for sourcing or managing suppliers. The sourcing resources are supported by a management structure that supports fast decision making with respect to activities for a specific entity or supplier.

If your organization is not structured in a way to minimize any of the eight risk factors discussed in this paper, then it may be worthwhile to consider whether there are opportunities to improve your organizational structure so that your sourcing and supplier management resources can deliver maximum value to the enterprise. It may be worthwhile to consider leveraging a well qualified outsourcing service provider to help assess your current organization structure and the implications for your sourcing activities.

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