Strategic Sourcing

Optimizing the process to gain a competitive advantage
Optimizing the process to gain a competitive advantage

Quebec Manufacturers & Exporters (QME) is an association whose mission it is to improve the business environment and to help manufacturers and exporters be more competitive on domestic and international markets by bringing to bear its leadership, expertise, connections and the strengths of its membership. Its activities rest on five pillars: advocacy, intelligence, business opportunities, best practices and networking.

QME is a division of Canadian Manufacturers & Exporters (CME), Canada’s largest trade and industry association, founded in 1871.

For further information on QME or to become a member of the association, please visit our website at [www.meq.ca](http://www.meq.ca) or contact us at:

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This guide has been developed by QME’s Strategic Sourcing Expert Network and produced in partnership with Export Development Canada (EDC), whose mandate is to help Canadian companies of all sizes sell their goods and services to international markets.

For more information on EDC, visit [www.edc.ca](http://www.edc.ca)

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Through the advocacy we practise, the intelligence we produce, the business opportunities we offer, the best practices network and activities we organize, and the networking we promote, Quebec Manufacturers & Exporters (QME) is unrelenting in its efforts to cultivate an enabling environment of the highest degree for Quebec companies.

To this end, one winning strategy proposed by QME has been to create several expert networks that bring leaders together to share their experiences and success in relation to a variety of topics, including continuous improvement, sustainable development, health and safety, and of course, sourcing.

Productivity and competitiveness are an ongoing battle for manufacturers. Those who manage to stand out are constantly reinventing their ways of operating, including in strategic areas such as sourcing.

These companies are aware that their value chain is only as strong as its weakest link. This is why they deploy considerable efforts to strengthen and develop that value chain at all times. We are convinced that the practices described in this guide, which are employed by manufacturers who are leaders in their field, will serve as a source of inspiration to businesses wishing to elevate their performance levels.

We have the good fortune within QME’s expert networks to be able to count on top-ranking manufacturers who readily open their doors and share their practices for the benefit of the Quebec manufacturing community. We thank them most sincerely for their generosity and salute their inexorable drive to always do better.

Simon Prévost
President,
Quebec Manufacturers & Exporters
A Word from the Strategic Sourcing Steering Committee

We are proud to present to you this guide to good practice strategic sourcing.

It is the fruit of a collaborative endeavour carried out over the past two years. Drafted by strategic sourcing executives working for a variety of Quebec manufacturers, it is intended to provide managers with concrete tools.

More than 25 businesses, member of QME’s Strategic Sourcing Expert Network took part in exchanges on winning practices and on the lessons learned from their application in the field. This guide is meant, therefore, to provide an overview of principles that have already been tried and tested successfully in the field. It is not intended to cover every aspects and details that characterize this constantly evolving area of expertise. We would like to express our deepest gratitude to the companies that met with us and kindly shared their experience.

In a globalized economy, strategic sourcing constitutes a vital key to the future success of Quebec businesses. We hope that this guide will be of benefit to the Quebec manufacturing community.

Stéphane Cloutier
Manager, Indirect Purchasing and Services
Mabe Canada Inc.
President, Strategic Sourcing Expert Network
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Introduction

Strategic sourcing has become in recent years a practice developed by organizations wanting to distinguish themselves from the competition through better coordination of activities between a customer and its suppliers. Inefficiencies and problems often exist in the shared activities of these organizations. Strategic sourcing allows managing these risks by focusing on all aspects of a business relationship in order to draw the utmost value from it.

With this guide, QME members wish to share the experience they have acquired at the different stages of the process. To this end, the practitioners who were consulted pooled the multiple practices, methods and tools that they themselves have developed and used. One of the aims here is to facilitate the implementation of similar processes and systems by other Quebec manufacturers.

This guide is intended primarily for supply chain managers. Among other things, it is meant to support these managers in their attempts to sell their company’s senior management on the utility and benefits of such a process. The structure adopted makes it possible to follow the sequence of the principal stages of the process, from the identification of initial requirements to implementation, and then managing supplier’s performance and the relationship with partners. At the end of each chapter, a list of success factors and pitfalls to avoid summarizes the key aspects to retain. A schematic diagram of the strategic sourcing process is provided on page 10 for ease of comprehension.

The table below indicates what is covered in this guide and what is not.

<table>
<thead>
<tr>
<th>What is covered</th>
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| › The strategic sourcing process for direct and indirect purchasing in the manufacturing industry | › Tactical aspects of sourcing  
› Transactional aspects  
› Developing a structure and managing a resource team  
› Developing a purchasing policy  
› Positioning of the sourcing function within the company  
› Corporate culture regarding sourcing  
› Sourcing performance indicators |
**Strategic Sourcing Process**

1. **Identification of a need (good or service)**
   - Acceptance of plan and roles
   - Acceptance of strategy by customer
   - Acceptance of bid and supplier considered

2. **Definition of need and opportunities**
   - Supply and demand market analysis
   - Total acquisition cost and option risks
   - Determination of approach
   - Establish evaluation criteria
   - Preparation of sourcing strategy

3. **Proposed sourcing plan**
   - Supplier selection plan
   - Analysis of bids received
   - Bid for goods or services
   - Calls for bids
   - Elaboration of bid for goods or services

4. **Preparation of calls for bids**
   - Calls for bids
   - Preparation of negotiation
   - Negotiations
   - Preparation of calls for bids

5. **Preparation of negotiation**
   - Acceptance of plan and roles
   - Contract
   - Implementation communication plan
   - Development of transition plan
   - Result
   - Contract required?
   - BATNA
   - Yes
   - Contract: risk assessment
   - Establish contingency plans
   - Contract: risk assessment

6. **Negotiations**
   - Negotiations
   - Establish performance indicators
   - Setup performance meetings
   - Establish contract review process
   - Establish catalogue review process
   - Partnership?
   - Yes
   - Relationship management
   - No
   - Define operating rules
   - Define channels of communication
   - Define strategy objectives
   - Define and communicate expectations
   - Define and communicate outcomes

7. **Approval**
   - Implementation communication plan
   - Updating the information in the system
   - Develop performance monitoring plan
   - Develop transition plan
   - Acceptance of plan and roles
   - Acceptance of strategy by customer
   - Prepare sourcing strategy
   - Supplier selection plan
   - Calls for bids
   - Elaboration of bid for goods or services
Main benefits

Numerous Quebec businesses are steadfastly engaged in strategic sourcing. Based on their own accounts, these are the benefits and advantages that the practice has afforded them:

› Goods and services purchased at lowest possible price or based on best overall value
› Price stability through reduced cost overruns on contracts in progress
› Assurance of being able to count on solid, reliable suppliers that will not tarnish your business reputation
› Better utilization of specialized internal sourcing resources
› Concentration of business intelligence on supplier markets, both domestic and foreign, leading to better decision making
› Implementation of a more efficient process thanks to standardization according to best practices and to the use of customized information systems
› Development of a three- or five-year strategic sourcing plan integrated in the company’s overall business planning and objectives
› Definition and reinforcement of a competitive advantage by sustaining the innovative process
› Structured planning of business continuity and supplier risk management
› Sourcing stability reducing risk of disruption in flow of materials

Strategic versus tactical aspects

Strategic sourcing is nothing new. Indeed, most companies already carry out sourcing activities that can be qualified as “strategic”. What is more recent, however, is placing a greater importance on the strategic aspects of sourcing, recognizing their singularity and allocating resources and processes specifically to them. But what exactly is strategic sourcing? And how is it different from tactical sourcing? To give you an idea, the following table presents a comparative list of strategic and tactical activities.
### TABLE 1. COMPARISON BETWEEN STRATEGIC AND TACTICAL TASKS

<table>
<thead>
<tr>
<th>Strategic tasks</th>
<th>Tactical tasks</th>
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<tbody>
<tr>
<td>› Define a sourcing strategy including an action plan aimed at achieving long-term goals and objectives</td>
<td>› Analyze company needs</td>
</tr>
<tr>
<td>› Review processes and implement best practices</td>
<td>› Calculate volume of products required</td>
</tr>
<tr>
<td>› Manage supplier contracts</td>
<td>› Order parts, merchandise, products and services required and ensure they are delivered on time and in sufficient quantities</td>
</tr>
<tr>
<td>› Manage business relationships with suppliers and reach long-term partnership agreements</td>
<td>› Manage delivery and flow of merchandise</td>
</tr>
<tr>
<td>› Research and select suppliers</td>
<td>› Oversee reception of products or services by verifying quantities, quality and compliance</td>
</tr>
<tr>
<td>› Draft calls for bids and specifications</td>
<td>› Coordinate handling and distribution of products and services</td>
</tr>
<tr>
<td>› Analyze bids received</td>
<td>› Ensure suppliers comply with negotiated conditions</td>
</tr>
<tr>
<td>› Negotiate all terms and conditions with suppliers and draft contracts</td>
<td>› Manage stocks, inventories and storage of various materials</td>
</tr>
<tr>
<td>› Ensure adherence to specifications</td>
<td>› Verify compliance with standards and quality procedures</td>
</tr>
<tr>
<td>› Conceive and implement cost-reduction programs</td>
<td>› Manage communication and daily follow-up with suppliers and subcontractors</td>
</tr>
<tr>
<td>› Implement policies and procedures regarding sustainable development, product life cycles, etc.</td>
<td>› Plan and manage logistics, transportation and handling of materials and purchases</td>
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<tr>
<td>› Conceive and implement supplier evaluation methods and procedures</td>
<td>› Improve delivery schedules and take steps to reduce inventory</td>
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<tr>
<td>› Conceive contingency plans</td>
<td>› Evaluate supplier performance</td>
</tr>
<tr>
<td>› Ensure business wealth and asset protection through implementation of various measures (non-competition and non-solicitation agreements, patents, etc.)</td>
<td>› Identify possibilities for company</td>
</tr>
<tr>
<td>› Analyze and manage risks facing business and use risk management and insurance tools</td>
<td></td>
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<tr>
<td>› Analyze company’s competitive position and ensure its reinforcement</td>
<td></td>
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<tr>
<td>› Set up a succession plan</td>
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<tr>
<td>› Analyze best practices in all companies and implement winning practices throughout business</td>
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<tr>
<td>› Build a dashboard and perform comparative analyses to ensure company is efficient, competitive and taking advantage of all possibilities</td>
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<tr>
<td>› Conceive and implement performance improvement programs</td>
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<tr>
<td>› Conduct audits and set up dashboard and performance indicator systems</td>
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From an organizational viewpoint, separating the tactical from the strategic allows getting around problems encountered when one and the same person is responsible for both components, particularly regarding the following aspects:

› Priorities management: tasks of a strategic nature important for the medium and long term are often put off for the sake of urgent short-term tasks of a tactical nature.
› Personality types: for tactical tasks, a results-focused personality with a mathematical and logical mind is preferable; for strategic tasks, instead, analytical faculties, systemic thinking and communication skills are the qualities required.

**Success factors:**

› Understand company’s long-term vision and strategic plan
› Ensure that organizational infrastructure and division of strategic and tactical roles are already in place

**Pitfalls to avoid:**

› Have a strategic function disconnected from plants and operations and too little mindful of internal customers
› Approach strategic sourcing merely as a cost-reduction initiative
This chapter will take you through the processes observed in successful businesses in order to:

› Understand the objectives of internal customers and stakeholders
› Describe the activities to be performed in order to define and confirm the strategic sourcing mandate
› Depict the stages of the overall process and of the various roles to be filled
› Characterize the goods/services categories and consider the different potential strategies
The strategic sourcing (SS) process is often undertaken at the express request of the head of a function, such as production, quality control, research and development (R&D), engineering, distribution, marketing, senior management or finance. Throughout this guide, the initiator of this process is designated by the term “internal customer”. The notion of customer is important here, because the ultimate objective of the entire SS process is to meet customer demand while making sure to consult with all other stakeholders potentially affected by the key decisions to come.

Objectives of internal customer management

› Understand the genuine business needs of the customer and not only his desires, in the aim of meeting them as best possible
› Agree on expectations and establish the service level required
› Identify possibilities and evaluate benefits and advantages
› Ensure the customer’s commitment to the SS process
› Agree on customer’s obligations in order for the process to work properly
› Communicate our own constraints to the internal customer
› Establish the bases of a sound relationship between equals in order to forge a bond of trust and manage expectations
› Facilitate the establishment and the respect of future contractual agreements
› Establish the indicators to be used to evaluate supplier performance and agree on an evaluation process suited to the needs of the internal customer
› Provide relationship management mechanisms beforehand to ensure that performance objectives are met

At this point in the process, the stages that the certified supply chain professional (CSCP) must complete are the following:

› Define the customer’s need
› Ensure the customer’s commitment
› Confirm the customer’s need

› Identify possibilities, benefits and risks
› Define the supplier relationship type
› Share the overall plan and roles

1.1 Define the Customer’s Needs

The first meeting with the internal customer aims to set the project in motion and to determine the customer’s principal needs. During this exploratory phase, it is important to ask as many questions as possible in order to be able to specify and formalize needs that are more tacit but sometimes also among the most fundamental. In doing so, the CSCP may note potentially contradictory needs. For example, wanting the best possible delivery lead time and the best possible price can lead to conflicts. In situations of the sort, the CSCP must point out these contradictory requests and advise the customer so as to realign from the outset the expectations and objectives with respect to the strategic sourcing process.

At this stage, the CSCP also wants to bring the customer to specify the line of products, components and services that will be the focus of the sourcing project. This preliminary basket will be defined more precisely over the course of the process. The main objective here is to mark out the scope of the process in order to guide the activities to come.

In the course of in-house meetings with the customer and the other stakeholders, the CSCP’s questions and inquiries are aimed at gaining a better understanding of the following aspects, as the case may be:

› Their formal and informal objectives from the point of view of both the company and the department
› Their business model, strategies and operations
› Their competencies and know-how, as well as what they are lacking and what they require
› The particularities of demand (predictability, fluctuations, diversity, etc.)
› The suppliers’ industry and the performance criteria on which they will be evaluated
› The context, trends and issues currently prevailing in the value chain identified
The SS process must also be congruent with the principal strategic priorities defined by senior management and thus help the company progress towards the achievement of its chief objectives. For example, for a business whose strategic intention it is to win public contracts in the United States, priority should be given to finding strategic U.S. suppliers; if this is the dominant requirement, it can trump other criteria, including price.

The various internal customers and stakeholders concerned all have their own idea of what an ideal supplier should be able to do for them. Their different evaluation criteria usually run along the following lines:

- **R&D:** technological and scientific capacities of the organization, intellectual property (patented or not) and know-how, as well as interest in and openness to collaborating on joint processes.
- **Engineering:** technical features, product performance expected, technological capacities, impact of components on product configuration and performance, as well as processes for managing technical modifications.
- **Marketing:** expected product performance allowing the company to distinguish itself in target markets or to develop a competitive advantage, impact on competitive factors such as sales price, quality, durability, delivery lead times, diversity of product line, esthetics and reputation.
- **Tactical purchases:** impact on purchasing and relationship operationalization processes, flow and efficiency of business exchanges, language barriers, logistical aspects of sourcing (proximity, customs, geographical consolidation with supplier base) and delivery terms and conditions.
- **Operations:** user-friendliness of product/component, lot sizes, quality and stability, support services, packaging and conditioning, flexibility dealing with unforeseen events, deadlines, non-compliance management, spare parts management and joint planning.
- **Senior management:** financial solidity, reputation, geographic localization, cultural accounting, positioning relative to competitors, strategic intent and priorities of both the company and the supplier, desire and capacity to invest in a collaborative relationship, technological and societal trends and issues, existing commercial and non-tariff barriers, the governance management process, and specific considerations regarding risks and business continuity.

To support the CSCP at this stage of the process, some companies utilize an instrument that allows integrating the criteria to be considered for the purpose of evaluation and decision making. This instrument serves as a sort of specs sheet that allows structuring and documenting the sourcing process to come. Some businesses use a contract checklist (see Annex A) to ensure that all the elements that will ultimately figure in the contract are taken into account when drafting the initial specifications. Some companies put together a business evaluation file before resorting to a contract checklist.

### 1.2 Ensure the Customer’s Commitment

In order to foster a successful deployment, the CSCP and the customer must agree on a timetable and target date for implementation beforehand. Based on these, the dates for the different stages of the SS process will be negotiated and determined as a function of anticipated constraints. In order to properly plan and manage the execution of projects, some businesses use a sourcing agreement implementation plan (see Annex B). Once the target dates are set, this plan specifies the principal intermediate stages to be completed and the authorizations to be obtained to complete the project.

The SS agreement implantation plan is a project planning and monitoring tool that renders the following information explicit:

- The project’s internal customer
- The person responsible for SS component of the project
- The owner of the process (for ISO purposes)
- The target date for launching the SS process
- The target date for obtaining the information and features regarding the good/service to be purchased
- The target date for obtaining the model contract
- The target date for signing a non-disclosure and confidentiality agreement
- The target date for conducting and closing negotiations
- The target date for commercial acceptance and the required signatures
The target date for acceptance by the internal customer
The target date for acceptance by the legal department and the required signatures
The target date for the supplier to sign the agreement
The target date for the dissemination of the agreement to users
The target date for updating information in the records and systems

The sequence proposed above can differ from one business to another and depending on the nature and complexity of the project. For example, some companies will establish a memorandum of understanding before even beginning to negotiate a commercial agreement.

One good thing about this planning phase is that it allows determining whether the sequence of stages seems appropriate and whether the succession of planned dates seems realistic in relation to the tasks to be accomplished and the availability of resources. In the light of this information, the feasibility of meeting the target date for deployment could be seriously reconsidered.

Setting dates in conjunction with the stakeholders concerned also allows obtaining their commitment to meeting these dates as far as possible. To be sure, numerous imponderables will arise in the course of the process. However, with a plan in hand, it becomes easier to control its progress and to put certain elements of the plan off to later, if need be.

Ensuring the customer’s commitment serves also to ask him to allocate the resources that will be required in order to fulfil the mandate conferred upon the SS function. Depending on the internal operating structure, particularly as regards budgets and internal accounting methods, a gap can exist unfortunately between the desire to reap the fruits of the CSCP’s work and the will to dedicate the requisite energy and resources to this end.

1.3 Confirm the Customer’s Needs

The initial definition of needs and the proposal of a roadmap serve in a way to align the group’s efforts with time and resource constraints. This will probably help to adjust the scope of the project in terms of the products, components or services that will actually be considered. This is also the moment to reconsider the different needs expressed, especially those that might have conflicted with others in light of the company’s strategic priorities and as a function of the acute problems presently affecting it.

Ideally, the SS mandate should be executed within a context that allows sufficient time to do things correctly. In actual fact, however, rarely do such ideal conditions prevail. Organizations often must take prompt action in response to unforeseen external events (e.g., a supplier ceasing operations, a partner sold to a competitor). In such cases, it is essential to re-assess the three intrinsic dimensions of all projects (time, budget, quality) and to identify where it will be necessary to make certain comprises.

At this stage, the CSCP will need to bring to the fore elements left unsaid that have the potential to sink the strategic sourcing project.

Here are a few examples of these:

The need for a very specific expertise
Major logistical constraints
Constraints in terms of intellectual property, patents or industrial secrets
Certifications or qualifications required by virtue of regulatory provisions
Necessary adaptation by the supplier to shifting specifications
Complementary services not mentioned by offered by the current supplier
Joint management of certain processes and desired sharing of responsibilities
Uncertainties and risks weighing on our organization with potential repercussions on the supplier
Particular expectations regarding the supplier justifying the insertion of certain contractual provisions to limit risk
The CSCP must also advise the internal customer regarding the applicability of certain contractual provisions considered. The experience acquired by the CSCP in handling a variety of matters for the company makes it easier to steer the process quickly towards more realistic and feasible options and towards standards that the company already applies in other sectors.

In sum, confirming the customer’s needs is the stage where the CSCP and the internal customer discuss the nature of the objectives of the SS process as well as the needs that they will meet and those that the process will not initially. This confirmation of the customer’s needs will then constitute the mandate to be conferred upon the strategic sourcing team.

1.4 Identify Possibilities, Benefits and Risks

For the purpose of evaluating possibilities, benefits and risks, the CSCP generally begins by classifying the products that are the subject of the process in one of four categories. The CSCP will pay much more attention to products considered strategic and will identify possibilities tailored to each category.

The CSCP often uses the Kraljic four-quadrant matrix in which the four major product categories are defined (see Table 2):

The annual total value of purchases in this category is measured along the horizontal axis of the matrix. The vertical axis serves, instead, to assess the business’s vulnerability to a supplier’s possible failure to meet demand or even to the supplier’s demise. In other words, the matrix translates risk or criticality with respect to sourcing. The value of purchases scale has the advantage of being measured objectively, whereas the risk scale remains a matter of judgement and subjectivity. Where risk is concerned, the principal types of impact to consider are those likely to affect:

- Business continuity
- Quality of end product
- Adherence to regulatory framework
- Business competitiveness

Planned risk management in the course of the SS process should include the following four stages:

- Identify substitute suppliers
- Prepare back-up solutions in the event of default
- Set up indicators to monitor change in risk
- Strike a balance between purchasing performance and risk management

Finally, using this matrix also allows implementing a sourcing and negotiation strategy better adapted to the perceived risk level.
Next, the CSCP tests different scenarios or a combination of several among those listed below:

- Lease vs. purchase, manufacture vs. purchase, and make vs. have made
- Purchase abroad vs. purchase locally
- Longer-term contract
- Guarantee a volume of sales
- Single supplier vs. multiple suppliers
- Consolidate with the similar needs of another internal customer
- Consolidate with current purchases from an existing supplier
- Change costly, unnecessary specifications
- Guarantee prompt payment and reduce transaction costs by integrating processes
- Reduce logistics costs for the supplier by various means
- Manage demand so as to reduce production costs for the supplier
- Determine ownership of equipment/tooling and inherent responsibilities
- Engage in group purchasing with non-competitor businesses (volume purchasing)
- Supply raw material in order to control purchase price and take advantage of economies of scale
- Integrate some of the supplier’s activities in our own installations
- Confer to others responsibilities in the area of replenishment management (e.g., vendor-managed inventory or VMI)
- Compare means of transportation and their impact on lead times and inventory levels
- Outsource certain less strategic complementary functions

Regarding outsourcing, it is a topic of great complexity and the implementation of this type of relationship exceeds the scope of this guide. However, it is important to mention it as one of the scenarios to consider within the framework of a strategic sourcing process.

The outsourcing of a company’s function is a decision made on the basis of the company’s desire to focus its efforts on its core competencies, that is, those central to its activities and through which it manages to create a competitive advantage on the market.

One rather widespread performance improvement strategy in the area of sourcing consists of reducing the number of suppliers. Aside from obtaining volume discounts, the principal benefits sought include:

- Increase our importance as a customer among the supplier’s priorities
- Reduce the fragmentation of time spent managing different suppliers
- Diminish the number of transactions
- Reduce the interval between deliveries through smaller but more frequent lots comprising a broader diversity of products (concept of mixed load)
- Reduce transportation costs

Each of the applicable strategic scenarios is then evaluated in conjunction with the internal customer to estimate its potential benefits, preliminary feasibility and associated risks. For the purpose, the CSCP takes into account the company’s financial policies, the fit with corporate strategies, and the methods for calculating total acquisition cost described further on in the guide.

1.5 Define the Supplier Relationship Type

At the previous stage, intense brainstorming will allow sketching the outlines of what the relationship with a potential strategic supplier or partner might look like. The diagram below illustrates the continuum of customer-supplier relationships. The SS process should allow determining which type of relationship would be most suitable based on product category.
In practice, businesses observe that the internal customer should consult the CSCP before formally and informally communicating with potential suppliers, especially at the following critical stages:

- Supplier selection strategy
- Contact with the market (suppliers)
- Negotiations
- Contract preparation

Failure to observe these guidelines often causes the process to derail and muddies the waters as the supplier can then, through the backdoor, have access to information of such a nature as to modify the business’s position and even reduce the options available. When the process involves a supplier with whom dealings occur on a daily basis, it may become more complicated to manage the process hermetically and it will become necessary to put in place additional means.

**Success factors:**

- Involve customers and all stakeholders in project
- Properly communicate the stages to be completed and the roles to be played by each
- Appoint a person responsible for the project or the file
- Understand the different issues according to product category
- Validate your understanding of the mandate by reformulating its core elements

**Pitfalls to avoid:**

- Let someone from another department manage the sourcing project
- Engage in the process without a detailed plan agreed on beforehand with the team
- Begin the process with a preconception of what the best strategy will be

---

**1.6 Sharing of the Overall Plan and Roles**

The sourcing function is responsible for directing the process as a whole. The internal customer and the other stakeholders participate in and give their approval at different key stages of the process. The table below summarizes how roles are shared within an organization.

<table>
<thead>
<tr>
<th>Activity</th>
<th>Strategic sourcing</th>
<th>Internal customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Definition of needs</td>
<td>R</td>
<td>P+A</td>
</tr>
<tr>
<td>Roadmap</td>
<td>R</td>
<td>P+A</td>
</tr>
<tr>
<td>Market analyses</td>
<td>R</td>
<td></td>
</tr>
<tr>
<td>Suppliers selection strategy</td>
<td>R</td>
<td>A</td>
</tr>
<tr>
<td>Contact with the market (suppliers)</td>
<td>R</td>
<td></td>
</tr>
<tr>
<td>Negotiations</td>
<td>R</td>
<td>A</td>
</tr>
<tr>
<td>Contracts preparation</td>
<td>R</td>
<td>A</td>
</tr>
<tr>
<td>Implementation of new agreement</td>
<td>R</td>
<td>P</td>
</tr>
<tr>
<td>Supplier relationship management</td>
<td>R</td>
<td>P</td>
</tr>
</tbody>
</table>

Legend: A: Approves; P: Participates; R: Responsible

---

**FIGURE 1. CUSTOMER-SUPPLIER RELATIONSHIP CONTINUUM**

<table>
<thead>
<tr>
<th>Compatibility of interests</th>
<th>Mutual need</th>
<th>Openness</th>
<th>Trust</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Distant relationships</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vendor</td>
<td>Traditional supplier</td>
<td>Certified supplier</td>
<td>Partner relationship</td>
</tr>
<tr>
<td><strong>Low value-added relationships</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High value-added relationships</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: APICS-CPIM
This chapter presents the best practices observed for:

› Analyzing supply and demand markets
› Calculating the total cost of a product
› Analyzing the risks of options
Once the certified supply chain professional (CSCP) has properly identified the needs of the internal customer as well as the main possibilities and their respective advantages, the CSCP must next carry out market and risk analyses. The CSCP must gain a firm grasp of the game rules that characterize the market in question in order to be able to prepare an optimal sourcing strategy.

### 2.1 Supply Market Analysis

To study the supply market (i.e., the suppliers’ industry), sourcing professionals structure their analysis along four vectors. For each of these vectors, they ask the following questions:

1. **Are the suppliers in the industry...**
   - a. concentrated?
   - b. numerous and scattered?
   - c. threatened by vertical integration?
   - d. recognized for their efficiency?

2. **Is competition within the industry...**
   - a. fierce or protected by the territory, customer type, etc.?
   - b. composed of equal or dominant players?
   - c. operating below or above capacity?
   - d. in investment mode, in wait-and-see mode or lagging?
   - e. mature?

### 3. Do outside potential competitors have...

- a. easy access to the industry?
- b. an interest inciting them to enter the industry?
- c. the capital and resources required to enter it?
- d. barriers impeding their entry, such as regulations, patents, certification, etc.?

### 4. Regarding competing products:

- a. do they exist or are they under development?
- b. are they well positioned to meet the same needs?
- c. are they well positioned to destabilize the industry?

### 2.2 Demand Market Analysis

The CSCP will also analyze the customers of the supplier’s industry, with whom the company will compete to purchase the industry’s products. In order to study this demand, the CSCP typically will ask the following questions:

Is demand for these products...

- greater or less than the industry’s capacity?
- growing or shrinking?
- facing turmoil?
- sensitive to economic cycles and fluctuations?
- affected by a particular geopolitical, environmental or societal context?
2.3 Calculating Total Acquisition Cost

Calculating total acquisition cost is a widespread practice among the companies that we visited for the purposes of this guide. This calculation typically takes into consideration the following components:

- Unit price
- Transportation and logistics costs, including emergency transportation
- Customs fees and import duties
- Internal and external introduction costs, such as non-quality, purchases, engineering, production, maintenance, etc.
- Amortization of investments in equipment, tools, templates, containers, etc.
- Inventory costs (storage, insurance, financing, adjustments, etc.)
- Transaction fees, such as letters of credit
- Obsolescence provisions
- Cost of managing a second source as an “insurance policy”, if necessary
- Management costs related to the multiplication of components (number of stock keeping units or SKU)

Carried out in conjunction with the internal customer and the finance, production, distribution and engineering departments, these analyses serve to avoid the classic trap of opting for a product that is offered at an attractive base price but that, after all factors are taken into account, ultimately translates into a higher total cost compared with a rival product that, at first glance, carries a higher base price. Annexes C and D contain examples used by manufacturers to calculate the total acquisition cost of a product and to document its non-quality cost once it is integrated in operations.

Even when the business analysis of the impact on the company seems perfect, surprises arise at times that cause a new overseas relationship to abort. The box below relates the lived experience of a business member of MEQ’s Strategic Sourcing Network, which poorly evaluated the total cost of sourcing a product in Asia.

True story – total cost of sourcing in Asia

A Quebec company approached a Chinese supplier to manufacture a typically voluminous yet light-weight moulded carry case for its flagship product.

After calculating the cost of maritime transportation, customs brokerage, inventory maintenance and non-quality risks, the company determined that potential savings exceeded $100,000 in the first year despite having to keep larger inventories on hand in order to bridge the 45-day delivery lead time.

Consequently, the company decided to go ahead and entered into a business relationship with the Chinese supplier. All was well until the company was awarded a large contract following a call for bids. The problem was that the lead time imposed by the contract was shorter than the normal production and delivery lead times for the cases and, therefore, management had to authorize the emergency delivery costs pre-established in the analyses in order to accelerate production. However, as maritime transportation would not allow meeting this emergency, air transportation had to be considered. Understandably, this caused costs to explode: Shipping the equivalent of one container went from $6000 to $80,000. As a result, the savings initially envisaged were nearly all swept away on account of a single high-volume order.

This is the typical case of a company that transferred part of its production overseas without sufficiently analyzing constraints, scenarios and total costs. The changes proposed in terms of transportation modes, manufacturing processes and raw materials often seem very alluring to improve efficiency in the short term. However, if these elements are not considered as a whole, they can easily turn into unexpected problems and cause economic losses.
2.4 Risk Analysis of Options

CSCPs are also concerned with risk-related aspects. In this regard, checklists are used to cover the most relevant risks. To qualify as “low risk”, suppliers normally must demonstrate a high level of command with respect to the following:

› Their alignment and synergy with the company’s business plans, including its social and cultural environment
› Their capacity to sustain the company’s competitiveness in the long term, including with regard to technology, innovation, patents, etc.
› Their recognition of the company’s importance relative to their other customers
› Their capacity to meet the requirements of the current legal and regulatory environment and any foreseeable changes to it
› The robustness of their production and management processes
› Their capacity to respond to extraordinary events such as:
   • Currency fluctuations
   • Changes in policies and constraints in the source country regarding exports
   • Changes in international policy
   • Transportation cost fluctuations
   • Disruptions in logistics (such as strikes in the transportation industry)
   • Contamination of the supply chain by quality issues
   • Changes in the company’s senior management

Success factors:

› Produce a comprehensive model that allows analyzing total costs and that renders other departments responsible for providing useful and accurate data
› Understand the dynamics prevailing in the supplier’s industry and take advantage of factors likely to be in your favour

Pitfalls to avoid:

› Think idealistically that all will be fine and that everything will go off without a hitch
› Maintain a silo mentality to the detriment of global and systemic aspects
› Neglect performing an analysis that could reveal opportunities or pitfalls
This chapter reviews the aspects necessary to:

› Determine the approach to adopt toward suppliers
› Develop selection criteria
› Prepare a detailed plan for the next stage of making contact with the market
At this stage, the CSCP has a complete picture of the situation. On the one side, he knows what the internal needs are, along with their possibilities, advantages and risks; on the other side, he has an understanding of the current situation of the supply market with respect to the goods/services sought. Finding a fit between the two will allow the CSCP to sketch the outlines of the sourcing strategy.

The aim here is to determine and formalize the strategy to be deployed at the next stage of making contact with the market. This is no easy task as the strategy will be developed based on criteria that at times are at odds with one another and on values that often are contradictory. The process that leads to a selection must necessarily first go through another stage where the following questioned are addressed:

- How will we decide and who will contribute to the process?
- On which criteria should we base our decision?
- What will be valorized in the decision-making process?
- How will the proposals received be evaluated and how will they be scored?

Why have a supplier selection strategy? To ensure maximum value for the organization. After all, the choice of suppliers takes on strategic importance as it can have a critical impact on the overall performance of the company as a whole, on business continuity (contingency plans), and on the capacity to innovate, not to mention on sustainable, economic and social development.

### 3.1 Determining the Approach

#### 3.1.1 New possibilities and categorization

For starters, here is a series of questions used to identify new possibilities or risks:

- Should we seize the opportunity to consolidate some of our current purchases?
- Should we develop a new partnership?

- Does this new need have an impact on our power of negotiation with our suppliers?
- Could we standardize some products?
- Should we outsource a part of our operations or bring home certain products or services?
- Is there a perceived risk (or opportunity) likely to harm the robustness of our supply chain?
- Is there a perceived risk likely to harm the quality, reliability or integrity of the product?
- Do we have any influence on the certifications and approvals obtained from certain regulatory agencies?

The table below, which is similar to the Kraljic matrix, allows the CSCP to classify purchases into four categories based on their business impact and the challenges that they entail. For each category, the principal strategies applicable are indicated in the corresponding quadrant.

**TABLE 3. STRATEGIES TO FAVOUR BY PRODUCT CATEGORY**

<table>
<thead>
<tr>
<th>BUSINESS IMPACT</th>
<th>LOW</th>
<th>HIGH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sourcing Challenges</td>
<td>Non-critical products</td>
<td>Strategic products</td>
</tr>
<tr>
<td></td>
<td>Reduce number of suppliers</td>
<td>Ensure long-term availability of product</td>
</tr>
<tr>
<td></td>
<td>Simplify purchasing process</td>
<td>Aim for integrated process and relationship with suppliers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Develop interactive solutions in conjunction with suppliers</td>
</tr>
<tr>
<td></td>
<td>Bottleneck products</td>
<td>Leverage products</td>
</tr>
<tr>
<td></td>
<td>Reduce risk of price increases through good agreements</td>
<td>Use volume to reach good agreements</td>
</tr>
<tr>
<td></td>
<td>Verify “solidity” of supply sources</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Seek out substitute products</td>
<td></td>
</tr>
</tbody>
</table>
3.1.2 Determining strategic avenues

Based on the importance of the product/service to be purchased relative to the contractor's priorities, here are a few examples of questions that can be used to identify the strategic options to develop at time of making contact with the market. The answer to each of these questions depends on the particular reality of the company and on the core values given priority within the organization.

**Single or multiple suppliers?**

This is a constantly recurring question in SS. The figure below provides an overview of the advantages related to each option. The choice will depend on the product category in question.

The following organizational values must be verified:

- Tolerance to risk relative to the criticality of the item in question
- Sensitivity to purchase price
- Support needs
- Legislative and regulatory constraints
- Logistics needs
- Consistency in terms of quality
- Customization needs
- Start-up investment in terms of hours and equipment
- Needs for flexibility in response to demand fluctuations

<table>
<thead>
<tr>
<th>Reasons to purchase from a single supplier</th>
<th>Reasons to purchase from multiple suppliers</th>
</tr>
</thead>
<tbody>
<tr>
<td>› Establish a long-term contract</td>
<td>› Cultivate competition between suppliers</td>
</tr>
<tr>
<td>› Obtain a product under patent protection</td>
<td>› Diminish risk</td>
</tr>
<tr>
<td>› Forge a tie with a supplier that stands out in terms of excellence</td>
<td>› Secure continuous supply</td>
</tr>
<tr>
<td>› Obtain a product whose purchase volume is too small to justify multiple suppliers</td>
<td>› Enjoy access to broader capacity for innovation</td>
</tr>
<tr>
<td>› Consolidate volumes to benefit from discounts</td>
<td>› Minimize supplier’s dependence on volume required by company</td>
</tr>
<tr>
<td>› Obtain greater cooperation</td>
<td>› Increase flexibility</td>
</tr>
<tr>
<td>› Diminish investment for template or tooling or product requiring a mould</td>
<td>› Maintain back-up solutions</td>
</tr>
<tr>
<td>› Obtain a delivery schedule easily</td>
<td>› Meet requirements of certain laws and regulations</td>
</tr>
<tr>
<td>› Integrate logistics with that of supplier</td>
<td>› Satisfy needs that exceed capacity of a single supplier</td>
</tr>
<tr>
<td>› Reduce complexity of managing multiple suppliers</td>
<td>› Maintain capacity to certify new suppliers</td>
</tr>
<tr>
<td>› Forge a genuine partnership</td>
<td></td>
</tr>
<tr>
<td>› Reduce start-up investment, such as for certification, R&amp;D, and validation</td>
<td></td>
</tr>
</tbody>
</table>
Manufacturer or distributor?
When it comes to purchasing tangible goods, it is necessary to ask first whether it is better to do business directly with the manufacturer or with a distributor. Many reasons allow favouring (or merely make possible) one option or another and the assessment in this regard can even lead the CSCP to reconsider how products made for the occasion are bundled together.

The organizational values to verify are the following:
- Customization needs
- Support needs
- Sensitivity to purchase price
- Importance of business relationship
- Sensitivity to delivery lead time
- Needs for flexibility in response to demand fluctuations

Purchase locally, provincially, nationally or globally?
Here, too, what value does the company attribute to this element?

The organizational values to verify are the following:
- Sensitivity to delivery lead time
- Sensitivity to landed cost
- Support needs
- Legislative and regulatory constraints
- Customization needs
- Openness to cultural and linguistic differences
- Tolerance to risk relative to criticality of product
- Start-up investment in terms of hours and equipment
- Sensitivity to local and environmental benefits
- Impact on image

Large or small company?
The CSCP must take into consideration the size of the company relative that of the supplier in his strategy decision.

The table below highlights the principal characteristics of customer-supplier relationships from the customer’s point of view according to the respective size of the partners.

The organizational values to verify are the following:
- Support needs
- Legislative and regulatory constraints
- Customization needs
- Tolerance to risk relative to criticality of product
- Sensitivity to price
- Start-up investment in terms of hours and equipment
- Need to feel important, to have negotiating leverage, and to be heard

TABLE 4. CUSTOMER’S PRINCIPAL CONCERNS REGARDING THE RESPECTIVE SIZE OF THE COMPANIES IN A CUSTOMER-SUPPLIER RELATIONSHIP
Developing a supplier selection strategy

How much flexibility is required based on demand fluctuations?
Defining flexibility and level of service required is critical to a company’s sourcing performance. Here are a few decisions that can have an impact on flexibility:

› Use vertical integration or subcontract
› Manufacture small lots or favour economies of scale
› Opt for standard or made-to-measure parts
› Maintain inventory at the supplier’s site or in the company
› Identify obsolescence risks

Who owns the intellectual property?
Intellectual property is at the core of company strategies. It is important to assess whether intellectual property constitutes an issue in the relationship to be established. If so, the right questions need to be addressed, namely:

› What company intellectual property constitutes an issue?
› What types of intellectual property must be sought from suppliers?
› What existing patents might limit choices?
› What are the patenting possibilities?
› With what sort of partner does the company want to manage the intellectual property?

Who provides the raw material, tooling and technology?
Depending on the characteristics of the companies participating in the relationship, it will be necessary to determine which is best suited to furnish the raw material, tooling and technology to sustain the relationship’s implementation. The organizational values to verify are the following: degree of control wanted in the relationship, sensitivity to price and price fluctuations, complexity of the transformation process, sensitivity of process to quality of inputs, start-up investment in terms of hours and equipment, and perceived capacity of supplier to stock up properly and at a good price.

What are the risks involved?
The CSCP must examine the principal risks inherent to the product category:

› Risks and causes of disruptions: financial health of supplier, technical capacity, geopolitical area (e.g., seismic area, political instability) and different modes of transportation offered (e.g., dock workers’ strike, fuel prices).
› Risks related to the relationship to be established: new supplier, new product, non-standard product, significant value of transaction, degree of responsibility and collaboration in event of major problems, possibility of vertical integration on part of customer or supplier.
› The very nature of the product in question determines a portion of the risks inherent to it on account of its technical characteristics (e.g., petroleum by-product, farm product), the supply market (e.g., rarity, oligopoly, speculation) or the importance it has in your end goods/services (e.g., active ingredient in a drug).

The presence of risk, whatever its nature, forces the company to deploy additional efforts to prevent them from becoming manifest or to minimize their repercussions. In all cases, this entails additional costs. To assess the magnitude of these costs, the CSCP must verify the company’s values and its tolerance to risk relative to the criticality of the good in question and to its sensitivity to price and quality fluctuations.

What other aspects must be considered?
In making his decisions, the CSCP must also take account of the company’s values regarding social, political, moral, judicial and environmental aspects. The advent of the new Carbon Trade Exchange and regulations pertaining to emission credits, child labour, depletion of natural resources, end-of-life recyclability, and product environmental footprint are all topics likely to have significant repercussions.
3.2 Supplier evaluation criteria

Now that the CSCP has a clearer picture of what is valorized by the company, he must integrate this in decision matrices. These matrices include decision criteria and their relative importance, that is, their weight.

There are two types of evaluation criteria: mandatory qualification criteria, such as legislation that must be respected, and evaluation criteria that allow comparing suppliers. The qualification matrix serves early on to shorten the list of suppliers worthy of consideration.

### EXAMPLE OF A QUALIFICATION MATRIX

<table>
<thead>
<tr>
<th>Pre-selection criteria</th>
<th>Evaluation criteria</th>
<th>Evaluation supplier #1</th>
<th>Result supplier #1</th>
<th>Evaluation supplier #2</th>
<th>Result supplier #2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality certification</td>
<td>–</td>
<td>Accepted</td>
<td>–</td>
<td>Accepted</td>
<td></td>
</tr>
<tr>
<td>ISO 9001:2000</td>
<td>At least one or other</td>
<td>Yes</td>
<td>–</td>
<td>Yes</td>
<td>–</td>
</tr>
<tr>
<td>HACCP certification</td>
<td>No</td>
<td>–</td>
<td>Yes</td>
<td>–</td>
<td></td>
</tr>
<tr>
<td>Country covered by free-trade agreement</td>
<td>–</td>
<td>Accepted</td>
<td>–</td>
<td>Rejected</td>
<td></td>
</tr>
<tr>
<td>NAFTA country</td>
<td>At least one or other</td>
<td>Yes</td>
<td>–</td>
<td>No</td>
<td>–</td>
</tr>
<tr>
<td>APEC country</td>
<td>No</td>
<td>–</td>
<td>No</td>
<td>–</td>
<td></td>
</tr>
<tr>
<td>Business office in Canada</td>
<td>Mandatory</td>
<td>Yes</td>
<td>Accepted</td>
<td>Yes</td>
<td>Accepted</td>
</tr>
<tr>
<td>Manufacturer status</td>
<td>Mandatory</td>
<td>Yes</td>
<td>Accepted</td>
<td>No</td>
<td>Rejected</td>
</tr>
<tr>
<td>Company size</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td></td>
</tr>
<tr>
<td>More than 250 employees</td>
<td>Mandatory</td>
<td>650</td>
<td>Accepted</td>
<td>420</td>
<td>Accepted</td>
</tr>
</tbody>
</table>

### EXAMPLE OF AN EVALUATION MATRIX

<table>
<thead>
<tr>
<th>Evaluation criteria</th>
<th>Weight (in terms of importance from 1 to 10)</th>
<th>Evaluation supplier #1</th>
<th>Result supplier #1</th>
<th>Evaluation supplier #2</th>
<th>Result supplier #2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total unit cost</td>
<td>10</td>
<td>3</td>
<td>30</td>
<td>3</td>
<td>30</td>
</tr>
<tr>
<td>Delivery lead time / small lots</td>
<td>8</td>
<td>3</td>
<td>24</td>
<td>1</td>
<td>8</td>
</tr>
<tr>
<td>Service</td>
<td>8</td>
<td>2</td>
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<td>4</td>
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<tr>
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<td>16</td>
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<td>24</td>
</tr>
<tr>
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<td>2</td>
<td>10</td>
<td>3</td>
<td>15</td>
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<tr>
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<td>5</td>
<td>25</td>
<td>3</td>
<td>15</td>
</tr>
<tr>
<td>Social / cultural environment</td>
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<td>5</td>
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<td>Applicable laws</td>
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<td>4</td>
<td>4</td>
<td>3</td>
<td>3</td>
</tr>
</tbody>
</table>

| Total | 152 | Total | 139 |

The CSCP constructs the evaluation matrix that will steer the decision regarding the choice of supplier. To this end, each supplier is rated on each criterion. Careful how scores are calculated! A good grasp of the method is necessary in order to render consistent evaluations across different evaluators. Tallying the scores obtained gives the total score.
3.3 Preparing a Detailed Plan

3.3.1 Identifying the stages and resources

By this point in the process, the CSCP has acquired a good understanding of the market and has sketched a sourcing strategy. He must now prepare a detailed plan. This means establishing a timetable and identifying the resources that will be necessary to make a final selection.

Here is a list of activities that might be included in the detailed plan:

› Develop specifications and request-for-quotation document
› Request for quotation
› Reception and analysis of quotations
› Business survey
› Quotation review with suppliers
› Request for samples
› Testing and qualification of samples
› Process capacity study, certification by agencies
› Negotiation and contractual agreement

3.3.2 Researching suppliers

The internet offers multiple sources of information that are easily accessible, but these often need to be completed by information provided directly by suppliers themselves or by firms specializing in business and financial data. Annex E contains a brief list of web links that can be helpful for researching suppliers.

The CSCP should not hesitate to commission experts to gather the pertinent information, especially persons trained in library and information science. These experts can access fee-based databases to find market studies and journals specializing in science and technology. The Canada Institute for Scientific and Technical Information (CISTI) offers the services of such experts. The Centre de recherche industrielle du Québec (CRIQ), for its part, offers training in internet research techniques. Moreover, the CSCP should monitor the business of certain suppliers proactively via their websites or specialized news websites in order to build a richer file on certain companies that could be of interest in the short or medium term.

So far, the CSCP has been working “under the radar”, that is, he has collected information without making direct contact with suppliers. He has not yet officially announced his intentions in the market. The CSCP will often choose to make more targeted requests for information (RFIs). This method serves to arrive at a good understanding of the suppliers’ offering in general or to obtain further clarifications on the scope of the suppliers’ expertise or on their capacity in certain specific market segments. RFIs allow learning more about what a market as to offer. It might be necessary to sign a confidentiality and non-disclosure agreement at this stage before exchanging any information.

Success factors:

› Structure the process
› Lead the group throughout the evaluation and decision process
› Understand the organization’s values and translate them into decision criteria
› Understand the different issues according to product and supplier categories

Pitfalls to avoid:

› Act too hastily and make commitments without a plan approved by all stakeholders
› Make contact with the market without first having established a strategy
› Neglect to assess the different types of risk
› Establish too many criteria and use complex rating and evaluation systems
This chapter deals more in depth with the activities of the strategic sourcing process geared to:

› Communicating the company’s intentions in the supply market
› Soliciting proposals from suppliers in an effective manner for all concerned
› Completing the call for bids process
4.1 Calls for Bids

In order to get the call for bids process off to a good start, the company must clearly establish in official written documents the nature of the call for bids, the products/services targeted, the technical specifications, the performance specifications, the evaluation criteria selected, the operational modalities required, and the steps to follow in order to complete the process correctly. Drafting the call-for-bids document can at times be a complex task requiring a great deal of work. Whenever possible, it is preferable to use an existing template and to change only the elements specific to each case.

4.1.1 Non-disclosure

Given that the sourcing process is strategic in nature, it is imperative for the company to ensure that the process is covered by rules of non-disclosure binding upon the suppliers approached, who will demand reciprocity with respect to any confidential information they provide. Hence, signing a non-disclosure agreement (NDA) is an important step that must be completed at the very start of the process.

Be careful what you disclose in the call-for-bids documents and in the course of subsequent discussions as this could affect whether or not you are able to file for a patent later. Any information disclosed that is not protected by a non-disclosure clause is considered to belong to the public domain and, therefore, is non-patentable.

4.1.2 Communication protocol

Laying down rules for communications with suppliers is a way for the contractor to ensure that, in the course of this critical phase, only persons authorized to discuss matters of strategic sourcing are contacted. It is important, therefore, to specify to suppliers a list of persons with whom they can have exchanges on the topic. By doing so, the company’s aim is to ensure that all information shared is adequate and documented. All official communications should be in writing to maintain a paper trail for future reference.

4.1.3 Request for information (RFI)

Requests for information (RFI) require contact with the market in order to obtain further general information on the topic of interest or on the capabilities of the firms being considered. Requests can be conveyed by various means: web portal, company portal, email, telephone, mail, and face to face meeting (see section 3.3.2 for further information).

4.1.4 Request for proposals (RFP) or quotations (RFQ)

The main difference between a request for proposals (RFP) and a request for quotations (RFQ) lies in the degree of precision and detail provided in the documents. In an RFQ, the subject of the call for bids is specified precisely, whereas in an RFP, the supplier approached to solve a problem is free to be creative. In the latter case, in order to avoid disputes and conflicts, it would be wise to clarify how the proposals will be used. It is conceivable, for instance, to compensate a supplier for a proposal in order to gain ownership of the ideas generated. It is thus possible to pay a supplier to prepare an RFQ in order to gain ownership of the documents. The documents thus obtained could then be used again to request quotations from other suppliers.

Requests for quotations must be conveyed formally and addressed to the supplier’s official representative, who must in turn confirm receipt of the documents.

An RFQ shall include at the very least the following elements:

1. Plans and specifications
2. Annual volumes and maximum capacity required
3. Clauses to be respected
4. Elements to include in the response document to the RFQ
5. Key deadlines to be respected by the supplier
In some cases, it may be suitable to include a “target” price in the RFQ. This strategy must be used in situations where the requester is able to set this price precisely enough. Otherwise, this strategy could work against the requester and potential savings could thus be left on the table. The fact of specifying a target price at times incites quotationers to propose a price without first thoroughly “doing their homework” regarding the elements of the cost price. This reality can come back to haunt the contractor once engaged with a supplier who poorly assessed the situation.

The deadline allocated to suppliers for the preparation of their response to an RFQ must be commensurate with the scope of the request and the effort required to gather all of the relevant information.

4.2 Managing the Selection Process

Effective management of the supplier selection process entails implementing a series of tools in order to achieve objectives. The tools in question are described in the following sections.

4.2.1 Establishing an ethics and integrity policy

As part of a call for bids, the CSCP must pay special attention to rules of ethics and demonstrate the utmost integrity throughout the supplier selection process. All participants must be at ease with how the call for bids unfolded from start to finish. A process that comes across as unfair or partial can jeopardize future relations as much with the selected supplier as with a supplier chosen as a possible back-up solution in a contingency plan.

4.2.2 Monitoring calls for bids

A call for bids can comprise several stages during which participants must provide deliverables. It is important that the dates on which the stages begin and end be clearly fixed and that compliance with deadlines be monitored in a timely fashion. All participants must abide by the established timetable so as not to taint the selection process.

4.2.3 Communications with suppliers

In order for the supplier selection process to be effective, it is essential to clearly establish from the outset, in the call-for-bids documents, the lines and modes of communication between representatives of the company and those of the suppliers.

4.2.4 Managing special situations

A number of special situations can arise in the context of the supplier selection process. These can potentially compromise the normal course of a project. The following situations occur frequently and each dictates an appropriate reaction in order to ensure resolution as quickly as possible.

- The most obvious option is suddenly invalidated by new information.
  - It is essential to prepare more than one plan B if you do not want to end up with any option! It is therefore preferable to keep all your options open until the very end.

- A new piece of information changes the situation and could have an impact on the quotationers’ offers.
  - This information must be conveyed to all the participants in the selection process, preferably via a written addendum. In the event that this information is not shared in a timely fashion, such negligence could be construed as a lack of transparency and integrity.

- A supplier solicits further information or a meeting.
  - In this event, it is imperative to ensure that the meeting does not allow the disclosure of information inaccessible to the other participants.

- A supplier obtains information that the others do not hold.
  - In the event that you convey privileged information to a supplier or if you learn that a supplier participating in the selection process obtains, in a legitimate fashion, information that you deem relevant to the quality of the call for bids under way, it is in your obligation to convey this information to all the other participating suppliers.
A supplier requests an extension to submit his proposal.

- When a supplier requests an extension for a motive deemed reasonable and justified, this must be communicated to the other participants and a similar extension should be granted to all. However, it is important to first evaluate the impact of this extension on the general timetable of the project.

### 4.3 Evaluating Calls for Bids

The CSCP follows a two-step process to evaluate the quotations and determine the bids that best meet his needs. Accordingly, suppliers must first be qualified before their quotations are evaluated.

#### 4.3.1 Qualification

As mentioned in Section 3.2, the qualification matrix allows assembling in a single table the mandatory and risk assessment criteria used to validate the quotations that will make it to the next stage of analysis.

Here are a few frequently used tools and qualification criteria:

- Standardized survey of supplier’s business model
- Evaluation of the supplier’s financial performance (business audit, Dun & Bradstreet)
- Evaluation of quality system (via an audit) or ISO 9001:2000 certification requirements
- Assessment of supplier-specific risk level (see Annex G – Example of risk analysis)
- First-piece sample analysis
- Supplier set up in the member country of an applicable free-trade agreement.

#### 4.3.2 Evaluating finalists

Once the quotationers have been qualified, their proposals are analyzed with the help of an evaluation matrix (see example in section 3.2). The evaluation committee responsible for scoring the bids should ideally include representatives of all the functions that will be affected by the final decision.

**The company carries out the following activities:**

1. Rank finalists using the evaluation matrix
2. Begin negotiations with the supplier(s) retained
3. Keep one or more options open until the close of negotiations (contingency plan, if needed)

The supplier who obtains the best result should, in theory, be the winner but the situation can prove different in reality where politics may come and interfere. It is probably best to keep sight of the big picture. If one supplier stands head and shoulders above the field then, that’s great. However, if only a slim margin separates the first three, it might be necessary to run the quotations and notes through another round of analysis.

In some cases, it may be necessary to organize a new round of quotations in order to adjust and refine the specifications. Once the quotation documents are analyzed, the CSCP must give the suppliers fair and objective feedback regarding the offers submitted. At this stage, he need not specify the identity and ranking of the candidates, as it is preferable to keep one or more back-up plans open until the end of negotiations.

Special care must be exercised when archiving quotation documents given that they contain sensitive information and that confidentiality agreements have been signed with the suppliers. This is why the documents must not circulate freely within the company.

Ultimately, the CSCP is responsible for keeping track of the distribution and proper storage of these documents. Nevertheless, these documents constitute a very interesting knowledge-base to be preserved in order to enrich the collective intelligence of the SS department.
Success factors:
- Manage the call for bids and evaluation process hermetically to avoid information leaks and to give all potential suppliers an equal chance at being selected
- Use standardized document templates in order to properly cover all the bases when conducting a call for bids
- Provide for a sufficiently long deadline in the process in order to obtain from potential suppliers all of the information required for comparative purposes

Pitfalls to avoid:
- Launch a poorly structured call for bids process in haste thinking you will save time
- Cancel a call for bids for no apparent reason
- Solicit proposals and then plagiarize the proposed solutions (brain picking)
- Handle confidentiality and non-disclosure aspects lightly
The content of this chapter will guide you through the stages that will guarantee success in negotiations. Here are the topics covered:

› Preparing the negotiation strategy
› Conducting the negotiations
› Concluding the negotiations
By now, the CSCP has an interesting “firm” proposal in hand. The next step will aim to confirm various crucial aspects in order for operations to run smoothly. At times, the CSCP may find it useful to keep and negotiate a plan B at the same time in order to maximize negotiating leverage. This particular aspect is covered in Section 5.1.6.

Successful negotiations hinge on mutual respect and on planning that takes into account the objectives and interests of all parties concerned in order to ensure that the business relationship is satisfactory and durable. This way, even if a suitable agreement is not reached, a proper negotiation process allows maintaining good relations with the suppliers contacted.

5.1 Preparing the Negotiation Strategy

Preparation is crucial. It allows staying abreast of the actual situation, avoiding bad surprises, anticipating the reactions of the other party, sharing information in the right order and at the right time, and maintaining leadership in the negotiations.

Proper planning entails the following:

- Defining the type of relationship
- Defining the most desired outcome (MDO)
- Defining the zone of potential agreement (ZOPA)
- Anticipating the expectations of the other party
- Growing the pie... before sharing it
- Defining the best alternative to a negotiated agreement (BATNA) for each party
- Preparing for different negotiation scenarios

5.1.1 Defining the type of relationship

The table below is useful for defining the type of relationship to develop with a supplier. Here are a few guidelines to help you better understand what is meant by “business impact”. Business impact is to be considered “high” if replacing a supplier is difficult or costly or if the product in question has a major impact on:

- Production (stoppages, assembly delays, etc.)
- The quality of the end product sold by the company
- The company’s ability to respect regulations or meet standards
- Company finances (cash flow and profitability)
- Product development (product launch delays)

TABLE 5. CLIENT-SUPPLIER RELATIONSHIP TYPE BY PRODUCT CATEGORY
**Simple relationship:** Value of purchases and business impact are low, two reasons why the CSCP will spend little time with these suppliers. For this non-critical category, simplicity in the relationship prevails in order to minimize indirect costs in the transactional process.

**Leverage relationship:** Value of purchases is high but business impact is low. Generally, for this supplier category, the CSCP will be extremely demanding in his negotiation given that there is no interest in cultivating a close relationship with a particular supplier and that the value of purchases in this category is high. There are many suppliers in this leverage category and the very high volume places the company in a position of strength that can translate into firmer conditions.

**Prudent relationship:** Value is low but business impact is high. Here, the customer may be dependent on the supplier, generally because the supplier is difficult to substitute. Consequently, the CSCP will be prudent in his negotiation so as not to “lose” his supplier. A relationship predicated on prudence should be established in all cases when dealing with a single supplier as there is no way of compensating for the possible loss of the supplier in question.

**Strategic relationship:** Value of purchases and business impact are high. This is the category on which the CSCP will spend most of his time. He must generate the utmost added value for the company by negotiating a “win-win” relationship with the supplier.

In sum, the type of relationship to develop and the presence or not of alternatives in the event of failure will determine the negotiator’s attitude, that is, whether he is inclined to grant or deny the supplier’s demands during the negotiations.

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**5.1.2 Defining the most desired outcome**

The well-advised CSCP classifies the key elements of the negotiations by order of importance, assigning each a most desired outcome (MDO) and a lowest acceptable agreement (LAA) short of which he shall terminate the negotiations.

Here are few key elements to take into consideration:

- Price and commitment to maintain or reduce it
- Cost-reduction sharing
- Risk sharing
- Intellectual property
- Quality
- Delivery reliability and service level
- Withdrawal clauses
- Conflict-resolution clauses to diminish risk

**5.1.3 Defining the zone of potential agreement**

It is important to clearly define the zone of potential agreement (ZOPA). It stands between the maximum the company is willing to pay (LAA of the buyer) and the minimum price that the supplier is prepared to accept (LAA of the supplier). If the supplier’s lowest price is higher than the company’s highest, there is no ZOPA. In such cases, negotiations reach an impasse and risk being interrupted, as they will evidently not meet the company’s needs. Agreeing to negotiations outside of acceptable limits can place the company at risk.
5.1.4 Anticipating the expectations of the other party

Understanding and estimating the supplier’s demands and objectives allows preparing possible responses to objections, finding potential agreements that are mutually beneficial (win-win) and maintaining a serene climate of negotiation.

Thus, the CSCP must also anticipate what is important for the supplier:

› Is it price or margin?
› Is it margin or volume?
› Is it exclusivity or volume?
› Is he concerned by elements of risk? (See note below.)
› Is he concerned by equipment or development costs?
› Is the duration of the contract important to him?
› What are the issues of concern to the other party?
› What sort of customer do we represent for the other party?

Note regarding elements of risk: These are what often block negotiations. As there is always a risk premium incorporated in a supplier’s price, diminishing risk can be a way of negotiating a lower price. Also, it is common practice that the party for whom an element of risk is perceived to constitute a lower risk is the one to assume it. For example, if a party has protection against exchange rate fluctuations (hedging), it should be the one to assume the risk related to exchange rates.

5.1.5 Growing the pie... before sharing it

“Growing the pie” means innovating and creating value with the means available. How can we obtain more by doing things differently? The following is a case in point involving a manufacturer.

A company grouped orders into lots comprising a right-hand part and a left-hand part. As a result, the supplier reduced his loss of raw material and was able to offer a better price. Though the scheme carried no cost for the supplier, the customer obtained a $9,000 price reduction. Thus, the parties created value, grew the pie, and shared the gains of this mutually beneficial initiative.

In order to stimulate exchanges and constructive discussions, the following approaches should be used to:

› Search for information on how to increase value for partners
› Ask the supplier the key question – “Why?” – and thus generate creative information
› Develop ways to reduce costs “inside the system” together (e.g., transportation)
› Bring to bear the advantages that each party has, such as the capacity to absorb exchange-rate fluctuations
› Make proposals without commitment and invite the other party to do the same. For example, “Would you be interested if I did this? What advantages can I offer to distinguish myself as a customer?”
› Build a climate of trust in order to get people to speak more openly
› Find out constraints, limits and obstacles by varying the style of questions

5.1.6 Defining the best alternative to a negotiated agreement

The notion of best alternative to a negotiated agreement (BATNA) applies to both parties in negotiation. Knowing each party’s best plan B allows recognizing who is in a position of strength (or weakness) in the negotiations.

Here are a few questions to ask:

› Is either of the two parties in a situation of having to meet the obligations of some agreement?
› Who has more to lose from not reaching an agreement?
› What do we represent for the other party?
› What does the supplier represent for our company?
› How can we raise the company’s BATNA and/or lower the other party’s? (according to our perception of the situation)
› Will the answers to these questions change over time?
› Is time on our side or against us?
For example:
› The fact of keeping a backup supplier on the sidelines strengthens our BATNA.
› The imminent entry into force of new constraining regulations could reduce our BATNA.
› A supplier’s financial difficulties could contribute to reduce his BATNA.

5.1.7 Preparing for different negotiation scenarios

In order to prepare properly for negotiations, the CSCP must structure his thoughts and ask the following questions in order to build a negotiation file that will be used during the meetings.

Asking these questions will allow him to gain a solid understanding of the elements of the file, review the needs and expectations of the internal customer, go over the elements to defend the company’s positions, and even to take a look at himself (attitude, ideas preconceptions) in order to conduct the negotiations in an astute manner and to bring them to a positive conclusion.

Core questions:
› Is the issue to be negotiated a minor one or a major one?
› What are the objectives?
› Who should be part of the negotiation team?

Questions regarding scenarios:
› What will each party’s strategy be?
› What will each party’s interests be?
› What concessions is the company prepared to make?
› What incentives can be proposed?
› What tactics should be used to draw the parties closer?
› What pressure tactics should be used?
› What reactions or behaviours can be expected from the other party?
› At what moment would it be judicious or appropriate to set in motion the various possible elements of the scenarios?

5.2 Conducting the Negotiations

5.2.1 Stages of the negotiations

Prior to undertaking negotiations, it is important for the parties to communicate their expectations. Thereafter, a few possible options can be explored (grow the pie) before beginning to negotiate. In short, negotiations follow five stages and certain actions can contribute to the performance and results obtained at each stage.

1. Defining needs
› Base yourself on the needs identified together with the internal customer and the stakeholders
› Make sure more than one potentially adequate source of supply is available beforehand

2. Developing options
› Put together the decision matrix (criteria and weights)
› Choose, classify and prioritize options
› Assign resources to qualify options (timetable, contingency, etc.)
› Clarify the communications protocol
› Explore all possibilities for “growing the pie”
› Proceed progressively so as not to “paint yourself into a corner”
› Create value
› Negotiate based on the interests of both parties (win-win)
› Listen and ask questions
3. Negotiating

› Find out what value our company holds in the eyes of the supplier
› Know the supplier, his reality, his motivations, and his objectives
› Negotiate with an eye on total cost, seek optimum efficiency
› Remain as objective as possible
› Keep the value of the offer up to date, particularly with respect to the BATNA
› Find the fittest person possible to represent the company as negotiations can be extremely demanding!

4. Before concluding

› Explore once again new possibilities to “grow the pie”
› Test a few complementary variations
› Think about possible gains for both parties
› Assess potential risks
› Review and confirm the points of the agreement

5. In view of drafting the contract (see Chapter 6)

› Cultivate a productive collaboration rather than a coercive approach
› Aim for the accountability of the parties
› Use quantitative criteria to mark out the relationship
› Designate a manager, the CSCP, who will be responsible for putting together the final contract

5.2.2 Tricks and tips for conducting negotiations

Experienced CSCPs employ negotiation tactics such as described below:

› **To make or not to make the first offer:** The one who makes the first offer lays down an “anchor” from which the rest of the negotiations will unfold. Though making the first offer entails certain risks, it allows the great advantage of maintaining the leadership role. If the analyses are properly done, the risk of setting the bar too high at the outset will be reduced considerably.

› **Rational arguments:** Use the facts and data available.
› **Emotional arguments:** Use emotion to influence the discussion in a positive manner.
› **Counter-arguments:** Prepare arguments to counter objections in a pre-determined order.
› **Be in sync with your counterpart’s personality:** Try to use the same mode of thinking according to personality type (see figure below) in order to get your arguments across more clearly and effectively.
› **Negotiate in a team of two:** One spokesperson and one observer, both equally prepared for the task. Propose breaks on a regular basis in order to consult one another and to revise the pre-established game plan, if need be.
› **“An elephant gets eaten one small bite at a time”:** The same notion applies here, which consists of separating recurring aspects (e.g., services, materials, packaging) from non-recurring aspects (e.g., tooling, equipment, intellectual property, returnable containers). By separating the elements that make up the unit price of production offered, you can manage the negotiations better and identify possible obstacles more clearly. This allows gaining a better understanding of how the other party covers its price risks.
5.3 Concluding the Negotiations

Once the negotiation is completed, it is important to document, there and then in writing, all aspects discussed in order to minimize subsequent interpretations. It is not a matter here of seeking to cover all possible angles. Instead, the aim is to document the essential elements of discussion and the principal conclusions reached. These minutes will constitute the basis for the contractual agreement that will thereafter be established between the parties.

At this point in time, the CSCP must also:

› Advise the quotationers who were not selected and thank them for their efforts
› Assign a contract manager who will direct all of the implementation and follow-up stages (generally the CSCP himself)
› Inform the internal customer and the supplier regarding the implementation stages necessary for later deployment
› Measure results and provide feedback to the supplier and the internal customer
› Do a post-mortem of the negotiation planning and conduction stages in order to identify possible areas of improvement for the process and prevent the repetition of certain errors
› Plan out the contractual process and the agreement’s entry into force, as well as its implications

The next chapter picks up where the negotiations phase ends. Its primary focus will be on the contractual process.

Success factors:

› Make sure the mandate and the approach are accepted by the internal decision-makers in order to avoid a change in direction once the project gets under way
› Be creative in order to increase the number of possibilities and think long term
› Exchange information in good faith and preserve a sound and respectful climate of negotiation
› Offer sales arguments to the other party to help him defend the agreement reached
› In the face of market uncertainties, risk should be assumed by the party for whom it is considered to be lower

Pitfalls to avoid:

› Adopting counterproductive attitudes, such as remaining entrenched in your position, being afraid of losing out on something, having a narrow view of what is possible
› Let the other party or the customers steer the negotiations
› Not knowing nor considering the other party’s interests
› Beginning negotiation sessions without being properly prepared
This chapter describes the elements and aspects regarding the elaboration of the contract from the emergence of an agreement in principle reached to its ultimate signing. The purpose here is to:

› Discern the factors that argue in favour of using a contract
› Understand the course leading to the inclusion of certain clauses in the contract
› Review the stages of the contract approval and signing cycle
Once the supplier/partner has been selected and the negotiations are well under way, the contractual process already begins to take shape in the background. Upon completing the negotiations, the parties will want to officialize their agreement in principle via a written contract having force of law. The previous chapter emphasized the tactical and relational aspects of the negotiations whereas this one focuses instead on the contractual aspects. This chapter covers:

- Risk-related clauses
- Drafting the contract
- Other typical clauses
- Aspects regarding the approval and signing of the contract

**Contractual agreement or purchase order: which to choose?**

A formal purchase agreement (contract, letter of intent or other) is to be preferred in the presence of the following factors:

- The relationship extends beyond the mere purchase of goods and services
- The supplier requests one
- The financial implications are substantial
- The relationship between the parties will last more than one year
- Protection against the supplier is advisable
- It is necessary to secure supplies
- Equipment to be used by the supplier must be financed
- The supplier needs to be convinced that the buyer is in earnest
- The product or service in question is regulated
- Intellectual property is an issue in the relationship

For the utmost consistency and efficiency, the call for bids should already be structured in such a manner as to present similarities with the structure of the contract that will come later. In addition, when visiting the supplier, the CSCP should take advantage of the occasions to note down points to be added to the contract in addition to those included initially in the call for bids.

For a variety of reasons, it may be necessary at times in the course of business negotiations to backpedal and reconsider prices or lead times, for example. When this occurs, the CSCP must then make sure to involve the internal customer once again in order to obtain his consent for the proposed changes.

### 6.1 Risk-Related Clauses

Now that the parties have reached an agreement on all of the business aspects, they must translate these expectations in legal terms. In large companies, the legal department is generally implicated at this stage. This conversion often generates long discussions because the parties suddenly discover the limits of what was agreed upon.

Clauses relating to risk management are generally the ones that the parties discuss most at length. This section proposes steps to follow regarding the different risks that the parties might want to cover in the contract.

#### 6.1.1 Risk Related to the Supplier’s Financial Health

The strategic sourcing process normally aims to establish a significant relationship with the supplier company. It is therefore essential to ascertain that the supplier will be able to make the required investments, maintain supply and deploy the necessary resources. Certain contractual clauses will be used to protect the company in the event that the supplier should slip into a precarious financial situation.

For a private company, the CSCP can obtain references from customers and suppliers. He must ascertain whether the names of the people in question are well known and whether the supplier is active in the market. Moreover, the CSCP can verify key aspects when visiting the supplier’s installations. For a publicly traded company, information is accessible via the D&B database, which offers reports on the level of risk of doing business with a given supplier.
6.1.2 Risk related to a distant supplier

Risk often depends on where the supplier is located geographically, which is to say on the laws in effect there and the local culture. In China, for example, respect for intellectual property is an issue and, in Russia, border practices are suspicious. Contractual clauses are useful provided that national laws are truly applicable. Consequently, in these cases, benefitting from local support in the form of a subsidiary, for instance, might constitute a prerequisite to consider sourcing there.

6.1.3 Risk related to the supplier’s business structure

Risk for business continuity can derive also from the business structure itself (e.g., succession plan, company size). Past relations, when they exist, constitute a reliable point of departure to assess risk and provide for required protection in the contract.

The CSCP must also seek to determine the risk of being bumped at the request of a more imposing competitor or even to evaluate the possibility of this supplier being acquired by a competitor.

In all these cases, the CSCP must examine the situation to identify the potential threats upon the relationship. The CSCP must obtain further information and establish contractual clauses that guarantee the utmost protection.

6.1.4 Risk related to copyright or intellectual property

The CSCP must also be well aware of copyright and current and future intellectual property involved in the relationship. Depending on particular interests, one party or the other could invest in development and thus keep the utilization rights or share them through a licence. The details relative to possible rights transfers, exclusive agreements, territory covered, duration and royalties must be analyzed and negotiated with care in order to protect the company and not undermine future possibilities.

Finally, the CSCP must also assess whether there is a risk of losing the rights to use the intellectual property or even a risk of disclosure that would benefit a competitor.

When a risk of financial insolvency is perceived in the supplier, the buyer can request the inclusion of a third-party or escrow clause intended to protect the buyer by allowing him to recuperate any intellectual property rights, if needed. Tangibly, escrow means placing relevant documents in a sort of safety deposit box with a trustee. No one has access to these documents unless the clause is enforced. For example, manufacturing processes, parts lists, technical documents, and the rights to use patents can all be deposited in this box.

6.1.5 Risk related to a single supply source

Having a single supplier renders the contractor order placer extremely dependent. Under the circumstances, it is imperative to take precautionary measures to secure supply in the event that the supplier should encounter technical or operational problems (owing, for instance, to material shortages, inventory stock-outs, or a loss of expertise). Exclusivity is often difficult to obtain in such cases as the supplier holds a dominant position on the strength of a patent or trade secret.

6.1.6 Risk related to non-recurring investments

In determining unit price, it is advisable to separate amounts representing non-recurring investments related to tooling, manufacturing or handling equipment (e.g., reusable containers), and R&D. Thus broken down, these investments will then be the focus of individual negotiations. When the contractor pays for this sort of investment, risk is reduced, except with respect to equipment maintenance. When tools and equipment are shared property, it is important to assess whether there is a risk of their being used for the benefit of a competitor. Regarding shared equipment, a cost-sharing scheme should be negotiated for modifications and maintenance. In the case of equipment belonging to the contractor, it is important to protect against the risk of the supplier pledging the equipment as security unlawfully. In the event of such a breach of contract, the termination clause should apply immediately.
6.1.7 Conclusion on risk

In the course of the negotiations, the CSCP must have the supplier validate the feasibility of certain clauses. Otherwise, operational problems can emerge subsequently and create friction in the relationship.

All clauses must be submitted to the legal department, which must evaluate their scope and determine the company’s risk exposure.

6.2 Drafting the Contract

6.2.1 The drafter of the contract

Most companies already have a set of written clauses from previous contracts that they can recycle. The drafter’s job, then, is simply to paste them together to produce a preliminary contract. If special clauses prove necessary, it is preferable to have the legal department draft them. Often, the CSCP can sketch certain clauses in broad strokes, but it is incumbent upon the legal department to refine them. To close the drafting process, it is important to ascertain that the agreement obtained by the CSCP corresponds to the final contract laid down in legal terms.

6.2.2 The model contract to be used

It is always preferable that the buyer uses his own contract template and have the supplier add his own specific details to it. The legal department can always verify them, if need be. Depending on the type of product in question, it may however be better to use the supplier’s model. This is the case, for example, for the purchase of specialized software. The size of the supplier, too, can force the company to opt for the supplier’s model.

6.2.3 Applicable laws

Unless the applicable laws are mentioned explicitly, the place of execution determines the laws in force for the purposes of the contract. When contracts are signed by the parties in different places, it is essential to mention the laws that apply.

6.3 Example of a List of Clauses

The following is a non-exhaustive list of clauses that could be included in a contract for the procurement of parts from a manufacturer:

- The Parties (with whom)
- Definition
- Start Date and Duration
- Product and Options Description
- Packaging Specifications
- Markings Specifications
- Forecasts
- Purchase Order Placing and Lead Time
- Support Services
- Price
- Business Language
- Product Evolution Management
- Invoice and Payment
- Specifications
- Quality Acceptance
- Regulatory Agency Compliance
- Product Support and Improvement
- Intellectual Property
- Insurance
- Confidentiality
- Terms and Conditions
- Termination
- Right on Termination
- Applicable Laws
- Delivery Method
- Production Schedules
This list is reproduced in Annex A with a few extra details. The contract could also include the definition of key words used in it.

**Typical annexes:**
- Products, Prices and Minimum Order Quantities (MOQs)
- Product Specifications
- Certifications
- Support and Training
- Inspection Requirements at Origin
- Packaging and Shipping
- Guidelines for Product Returns
- List of Competitors
- Intellectual Property Rights
- Third-Party Software
- Service Level Agreement
- List of Non-Exclusive Territories

### 6.4 Approvals and Signatures

The approval and signing cycle is a stage in the process where surprises can arise, especially if the CSCP did not communicate frequently with the stakeholders whose approval is required. Any objection raised by a person responsible for granting his approval introduces risks and delays, as any changes considered will need to be renegotiated with the supplier. This can have a domino effect on other clauses of the contract, which will in turn require new approvals. A situation of the sort can discredit both the negotiators concerned and the organization, as it can be perceived as a form of retraction relative to the agreements negotiated verbally. Given that the supplier will conduct an approval process of his own, objections are to be expected now and again.

### 6.4.1 Business approval (from stakeholders)

The contract must be reviewed from a business perspective and each party must approve his portion. This review can call into play various departments, including operations, customer service, finance, purchasing and even senior management if the value of the agreement is significant enough and the impact on the company’s competitiveness is substantial. In some companies, the employee union might be consulted informally, especially if the agreement with the supplier has a major bearing on internal processes (e.g., vendor-managed inventory could have an impact on the duties of warehouse employees). Consulting with the union executive early on and well before the approval stage allows maintaining good labour relations and can facilitate implementation later by reducing possible resistance to the changes to come.

### 6.4.2 Internal customer’s approval

As the strategic sourcing agreement is intended to serve a specific internal customer, it is imperative that the customer in question approve the contractual agreement.

### 6.4.3 Legal approval

Finally, in the interest of the utmost caution, a company lawyer must revise the contractual clauses to ascertain that they are legal, that they translate the agreement accurately, and that they minimize ambiguity.

### 6.4.4 Signature

Once the cycle of approvals completed, the signatory duly authorized by the company can proceed to ratify the agreement. This can be done officially or discretely. In this regard, multiple factors must be considered and the impact on the company’s internal organization must be analyzed closely. Some strategic agreements at times can mean internal job losses. Consequently, the company must remain sensitive to this point and must plan the subsequent implementation stage carefully.
**Success factors:**

› Explain the intention of the different clauses to the other party and to the customers
› Conserve written traces of all conversations
› Standardize the clauses
› Understand the company as a system
› Discern the motivation of each player

**Pitfalls to avoid:**

› Underestimate the importance of risk assessment
› Draft vague clauses open to interpretation
› Fail to consult approvers frequently
› Set a strict timetable for oneself that could diminish the quality of the work
This chapter reviews the activities required to implement the new strategic sourcing agreement in the form it was reached, in order to:

› Communicate the scope of the agreement to stakeholders effectively
› Facilitate its rapid integration in company systems and its successful deployment
› Set up the monitoring infrastructure and provide for contingency measures
The contractual agreement signed, it is now time to move on to the implementation phase of its provisions in order for it to take effect and to be deployed towards the stakeholders concerned.

7.1 Communication Plan

The introduction of a new contractual agreement necessarily provokes changes, both big and small, within an organization. In the event of an agreement with a strategic partner, the effects are likely to have a wider reach. In order to support the management of these changes adequately, a large dose of communication is necessary and the CSCP must be diligent in preparing and transmitting information messages.

As the contractual process draws to a close, the CSCP must inform the stakeholders of the progress made and of the imminent signing of the contract. These stakeholders must then distribute the information received within their respective sectors even if it is fragmentary (particularly regarding terms and conditions, the supplier’s identity, and the scope of the contract). Indeed, in the case where a supplier is being replaced by another, it is best not to disclose any information that could hamper the conclusion of the negotiations and sour the relationship with the current supplier.

When major changes are planned, it is preferable to hold an information session for all of the main stakeholders concerned. This is the occasion for providing them with particulars regarding the expected date of the change, the terms and conditions for terminating the existing agreement, the plan for expending residual inventory, and the operational details of the new agreement. In some cases where lead times are critical, it may be deemed necessary to set the business relationship in motion even if certain contractual details still remain to be ironed out. This, however, demands a high level of trust between the partners.

Who must be informed and when?

All of the stakeholders involved in the approval cycle must be informed and they in turn must inform their own groups. As some clauses can go into effect on the signing date of the contract, it is necessary to convey these immediately. The signing of the contract and the communication session can even be held successively in order to minimize the time interval for the transition. Where confidential files are concerned, it can be useful at times to communicate certain changes for which some preparation is required without giving away too much information on their exact nature. For example, it may be necessary to free up space in the warehouse ahead of time.

How should the news be conveyed?

This can be done in different ways, including email or an internal memo indicating that the contract has been officially signed. The CSCP must never attach a copy of the contract to his messages and releases as this is a confidential document containing sensitive information. Sometimes a business meeting with the persons directly concerned is necessary. The more the clauses and the specifications generally contained in contracts are standardized, the more the phase of informing stakeholders is simplified. In this case, the business meeting can serve to highlight the points of exception in the contract that diverge from standard and that will need to be treated otherwise. These points of exception must be discussed among the participants present in order to avoid “dropping the ball”. The participants must also agree on a plan of action for the days and weeks ahead.

7.2 Updating Data in Systems

Price lists and delivery lead times

Price lists and data regarding terms of payment need to be adjusted in the management system on the very day of the signing. If a chargeback clause is provided for in the contract, the new prices must therefore apply to everything that has already been ordered and tactical purchasing should be informed of this. Changes in delivery lead times must be conveyed to the planning department, which will adjust systems accordingly.
Technical copywriting and catalogue

The technical copywriters must also update all the internal and external technical documents concerned. They must also enter all the new parts numbers and their configuration according to appropriate parameters.

Order procedures

The impact of the new parameters on replenishment management must be communicated to the parts warehouse manager, who must reserve the storage space required. The shipping and receiving department must be advised of changes and new inspection and acceptance procedures. Updates must also be carried out in the ERP systems in order to avoid returning merchandise to the sender by mistake.

Integration of computer systems

In some cases, a direct link between the computer systems of the two companies must be established according to communication protocols that will allow information to be exchanged automatically (e.g., sharing of forecasts and production schedules). It may also be necessary to configure access to supplier information portals. Consequently, it would be wise to implicate the IT managers in the process from the start to ensure the proper deployment of resources.

7.3 Implementation of Monitoring Processes

All strategic sourcing agreements should come with a monitoring plan aimed at measuring the achievement of performance targets and stimulating corrective and improvement actions. The CSCP must set up the monitoring process accompanying the new agreement. The following chapter deals with the details regarding performance management.

7.3.1 Quarterly business reviews

The first quarterly business review conducted after the first three months is often the most critical to verify whether the contract is “well lubricated” or not! It is the occasion to ascertain whether all of the non-standard clauses of the contract have been properly integrated or whether certain problems seem to arise from them.

Representatives from the engineering, operations and sourcing departments should be present at these meetings with the supplier. Alternating the meetings between the supplier’s and the contractor’s facilities at each quarter or less frequently, as needed, allows also to stay in touch more closely with the reality of the sites visited. It can also allow discerning possibilities for making improvements after examining the facts directly in the workplace.

To prepare for the business review, the CSCP must consult with the participants beforehand in order to determine the items on the agenda. The supplier, too, must indicate the topics that he wishes to discuss at the meeting. The CSCP will be in charge of following up on the measures that emerge from these meetings to ensure that they are properly executed. In sum, the CSCP makes sure that the contract is deploying as intended and that any variances are remedied. He also monitors the evolution of the relationship in order to identify possibilities for improvement that he will be able to raise during the next round of contractual negotiations.

7.3.2 Monthly performance reviews

The purpose of monthly performance reviews is to share the results of how the supplier is performing relative to the criteria stipulated in the contract. Accordingly, his performance is compared against the contractual targets and the participants propose improvements in order to achieve these targets consistently and predictably.

To monitor the performance, the CSCP can propose using communication tools available in-house via the web or via a board on the work site. Monthly reviews do not serve to correct structural problems but they can generate ideas and proposals for future quarterly business reviews.
7.3.3 Other Monitoring

With respect to compliance management, returns, and monitoring of corrective action, the CSCP must make sure that the infrastructure is in place at the supplier’s facilities. Periodically, he must have the processes audited in order to ensure that they adequately meet the expectations laid out in the contract.

**Contract renewal procedure**

From the outset of the new contract, it is recommended that reminders be programmed regarding the renewal dates to come in order to plan activities properly. The pressure exerted on the CSCP by the imminent termination of a contract hinders his efficiency, especially if a change of supplier looms on the horizon, which may force him to rush certain actions and negotiate in haste. The CSCP should also bear in mind that a contract can always be improved. Indeed, it is possible to amend it along the way without being obliged to wait for the end of the established duration. In this regard, the well-advised CSCP must be familiar with the fundamentals of continuous improvement.

The termination of a contract is often a necessary transition towards new possibilities and the process can take place in harmony or in conflict. When termination must be imposed, the CSCP preferably should resort to the services of a bailiff or a third party who will see to it that obligations are honoured and applicable laws enforced. It is important, also, to respect the advance notice procedures and deadlines. Before terminating a contract, it is therefore essential to verify with the legal department what the company’s commitments and post-contractual obligations are. A legal opinion allows at times to re-asses intentions, especially those of the internal customer, and to anticipate the means that must be provided for before announcing the termination of the contract.

Some contracts contain clauses for the remittance of license fees or rebates by the supplier. The CSCP must make sure that these are indeed correctly entered on the books in-house according to the scale stipulated in the contract.

7.4 The Contingency Plan

It is incumbent upon the CSCP to make sure that a feasible contingency plan be specified should integration of the new agreement result in failure. The proposed transition plan must describe the mechanism provided for to achieve a successful transition but it must also stipulate the measures to take in the event of the supplier’s default. These elements of mitigation are normally mentioned in the contract. The escrow contract covered in the previous chapter is an example of a contingency measure.

In addition to this plan, the company must determine to what extent it is capable of depending on itself to do the work in full or in part.

› How fast can we pull out and reorganize in order to do the work?
› Do we have the human, material and technological resources to do so?
› What would be lacking?
› What would be the total cost related to these exceptional measures compared with the cost of postponing the project or even cancelling it entirely?

It is incumbent upon the CSCP to draw up a feasible plan that takes account of these serious considerations as they could genuinely compromise the company’s continuity if they are taken lightly.

In the event of the supplier’s default, the contractor should be able to call upon a second source that is already qualified and prepared to step in. However, it must be expected in such cases to obtain less favourable conditions as the contractor would be in a position of weakness relative to the supplier resorted to in a pinch. Worse comes to worst, if the company managed and cultivated its relationships well over the years, it could always turn quickly to its previous supplier. In the negotiation process, it is advisable to keep a second option open as long as possible and to make sure that it is qualified with respect to the core elements required.
Success factors:

› Be pro-active in communicating changes to all stakeholders throughout the process
› Use checklists
› Hold meetings to redress the situation rapidly and according to group consensus
› Be prepared for resistance and panic reactions from internal customers when changes are made
› Minimize lead times for rendering changes effective in management systems

Pitfalls to avoid:

› Implement a new agreement in the CSCP’s absence
› Underestimate the need to carry out changes to management systems carefully and thoroughly
› Assume implementation will go smoothly because negotiations were easy
This chapter covers the principles of supplier relationship management within the context of a strategic sourcing agreement in the aim of:

› Defining supplier performance indicators
› Conducting performance meetings properly
› Describing the contract revision and catalogue update processes
Successful companies have understood the importance of supplier performance management. Increased value in the relationship with the supplier created by reducing costs or obtaining a better product for the same price has a direct impact (dollar for dollar) on the company’s financial results. This impact is even greater than that of generating higher sales, against which costs must be deducted.

From this viewpoint, it is easy to understand that the primary aim of supplier performance management is to increase the value of the relationship for the company and not to disqualify a supplier or to exercise undue control over him. Accordingly, this improved management seeks to clarify expectations and avoid surprises.

Companies have shared below their practices regarding certain key points in managing the performance of traditional suppliers. The next chapter, instead, will deal with managing the performance of suppliers identified as strategic partners.

8.1 Performance Indicators

The CSCPs who were consulted for the purposes of this guide shared a few examples of supplier performance indicators commonly used.

8.1.1 Dashboard

Typically, traditional suppliers are evaluated on the basis of three main criteria, namely, reliability, quality and service. These criteria are published in the form of indicators and are consolidated in a dashboard.

<table>
<thead>
<tr>
<th>Reliability (50%)</th>
<th>Quantity</th>
<th>Score</th>
<th>Weight</th>
<th>Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of order lines received on time</td>
<td>91%</td>
<td>25%</td>
<td>23%</td>
<td></td>
</tr>
<tr>
<td>Average number of days late per order line</td>
<td>70%</td>
<td>5%</td>
<td>4%</td>
<td></td>
</tr>
<tr>
<td>% of order lines received with correct quantity</td>
<td>83%</td>
<td>15%</td>
<td>12%</td>
<td></td>
</tr>
<tr>
<td>% of requests according to deadlines accepted in the agreement</td>
<td>79%</td>
<td>5%</td>
<td>4%</td>
<td></td>
</tr>
</tbody>
</table>

| Quality (35%) |
|------------------|------------------|------------------|------------------|
| % of non-compliant parts | 64% | 20% | 13% |
| Average recovery time for quality problems | 60% | 10% | 6% |
| % of certified parts (no inspection at origin) | 99% | 5% | 5% |

| Service (15%) |
|------------------|------------------|------------------|------------------|
| Average number of cost-cutting opportunities identified per month | 90% | 10% | 9% |
| Average number of product development meetings per month | 50% | 5% | 3% |

The use of such a dashboard allows gaining an overall view of the supplier’s performance. It thus allows comparing different suppliers effectively in terms of their performance on the whole. The use of colour codes allows determining where the value of the indicator falls and thus draws the manager’s attention to areas that need to be improved.
8.1.2 Complete measurement of service

This type of service measurement is used with traditional replenishment models.

**FIGURE 3. EXAMPLE OF THE COMPLETE MEASUREMENT OF SERVICE**

<table>
<thead>
<tr>
<th>Aim</th>
<th>To evaluate the supplier’s delivery performance as a function of:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>› date promised (within tolerance margins)</td>
</tr>
<tr>
<td></td>
<td>› quantity promised (within tolerance margins)</td>
</tr>
<tr>
<td></td>
<td>› quality promised</td>
</tr>
</tbody>
</table>

**Formula for determining performance as a percentage**

\[
\text{Number of complete order lines delivered on time in month} \times 100 \over \text{Number of order lines received in month}
\]

**Criteria tolerance margins**

› Complete = quantity is within plus or minus 5%
› On time = no more than three days ahead of time, no days late

**Notes**

› Products that fail to meet quality standards will be deemed not to have been delivered, thus affecting the final score.
› If the delivery date requested by the customer does not respect the standard lead times agreed on, the supplier shall have to confirm to the buyer whether he accepts the shorter lead time in order to be evaluated against this other date.
› Passing mark = 95%

8.1.3 Measurement of total cost of sourcing

Evaluating the total cost of sourcing must take account of all costs associated with the supplier relationship in question. Companies often make the common mistake of considering only cost of purchase and adding to this transportation costs. The example below involves a product whose total cost is much higher than its purchase price once other costs related to inventory, inspections, production stoppages and emergency deliveries are factored in.

**TABLE 7. EXAMPLE OF THE TOTAL COST OF SOURCING FOR A SUPPLIER**

**Total cost of sourcing – Supplier ABC**

<table>
<thead>
<tr>
<th>Category</th>
<th>Information</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase price</td>
<td></td>
<td>$345,750</td>
</tr>
<tr>
<td>Internal costs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>› Logistics costs</td>
<td></td>
<td>$12,300</td>
</tr>
<tr>
<td>› Average value of inventories</td>
<td></td>
<td>$112,097</td>
</tr>
<tr>
<td>› Annual carrying rate (cost of possession)</td>
<td></td>
<td>30%</td>
</tr>
<tr>
<td>› Inventory carrying cost (cost of possession)</td>
<td></td>
<td>$33,629</td>
</tr>
<tr>
<td>› On-site inspection costs</td>
<td></td>
<td>$4,700</td>
</tr>
<tr>
<td>› Production stoppages due to:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Availability (lack of parts)</td>
<td></td>
<td>$5,200</td>
</tr>
<tr>
<td>• Inadequate quality</td>
<td></td>
<td>$3,000</td>
</tr>
<tr>
<td>› Emergency delivery cost</td>
<td></td>
<td>$6,000</td>
</tr>
<tr>
<td>Total internal costs</td>
<td></td>
<td>$64,829</td>
</tr>
<tr>
<td>Rate of internal costs</td>
<td></td>
<td>19%</td>
</tr>
<tr>
<td>Total cost of sourcing</td>
<td></td>
<td>$410,579</td>
</tr>
</tbody>
</table>
This supplier likely costs more on the whole than another supplier whose purchase price might be higher but who could deliver just in time, which is to say without the buyer having to carry inventory. Monitoring in these cases, however, entails having an efficient data-collection infrastructure in place to document a multitude of elements, including production stoppages due to this supplier and inspection costs.

8.2 Conducting Performance Meetings

8.2.1 Preparing for performance meetings

Performance meetings with suppliers were touched on briefly in the previous chapter. Successful companies hold such meetings on a regular basis. They prepare for them rigorously by amassing statistics for the latest period and relevant information from the following sources:

- logistics planning group
- quality department
- production teams
- periodic supplier self-evaluation
- local purchasing groups (in the case of a structure involving a centralized purchasing group)

These companies use the most appropriate analysis methods depending on their situation and employ a set of diverse tools, including the following:

- Balanced dashboards (see Section 8.1.1)
- Measurement of total cost of sourcing (see Section 8.1.3)
- DMAIC projects for supplier quality excellence
- Value stream mapping (see Section 9.1.1)
- Assessment of general business risk associated with a supplier (see Annex G)
- Pro-active self-evaluation questionnaires (Annex H)
- Periodic audits carried out at the supplier’s facilities

These supplier-focused instruments are used to systematically identify, monitor and prioritize performance problems as a function of frequency, total financial impact and criticality for the company.

In certain more regulated industries, successful companies generally develop other tailored instruments for the purpose of managing supplier performance, including the following:

- Supplier certification procedures
- Disqualification, trial-period and requalification procedures
- Programs for exchanging good practices with suppliers
- Supplier training programs in the company’s fields of expertise

8.2.2 Conducting performance meetings

Ideally, meetings are held in person and their characteristics are adapted to the importance and performance of the supplier. They are held:

- In person at the customer’s or the supplier’s facilities
- Every six months
- With participants who have decision-making authority for each of the parties

With an agenda that includes:

- a performance review
- improvement objectives and plans
- deadlines
- a review of future business possibilities
- all that can add value to the relationship
- a contract revision to identify elements that have become obsolete or out of line on account of how the relationship has evolved
8.3 Contract Revisions

Various companies pointed out the importance of implementing processes for revising contracts on a regular basis. Business evolves rapidly and contracts must be adapted to take account of the new reality and to formalize the processes actually adopted by the resources that interact daily. These companies have even documented processes regarding:

- The drafting of amendments covering new, often informal agreements reached prior to the end of a contract’s term
- Reminders of contract deadlines within a reasonable time delay so as not to weaken the company’s position in negotiations

8.4 Updating the Catalogue

Products, too, change rapidly and, therefore, catalogues must be revised on a regular basis. It is extremely frustrating for users to consult a catalogue and to realize that it is not up to date. Of course, the customer should not have to run after the supplier to obtain the good versions of catalogues. Consequently, it is better to agree on processes that define:

- Catalogue control and revision procedures
- Roles and responsibilities in the management of these procedures

Success factors:
- Document performance indicators and calculation methods
- Give constructive feedback at performance evaluations
- Maintain a professional attitude

Pitfalls to avoid:
- Manage a relationship based on perceptions rather than facts
- Communicate only when problems arise
In this last chapter, we will examine the complex topic of partner relationship management, in order to:

› Review the key elements underlying partnerships
› Describe the main operational processes at the core of partnerships
› Propose conduct guidelines for the partners involved
In the early chapters of this guide, we saw that partnership and strategic alliance constituted the two most integrated forms of the customer-supplier relationship and the ones that afforded the most added-value. On the flipside, these relationships demand a substantial effort and commitment on the part of the partners. Typically, a company will have four or five strategic partners, but they will represent about 50% of all of its external purchases. In these cases, the relationship must be managed as though the supplier were an extension of the company.

This type of relationship works best when its strategic aspect is reciprocal. It is not likely to work as well if the customer is not strategic in the eyes of the supplier.

9.1 Definition and Communication of Partnership Type

In order to draw the utmost value from this strategic relationship, the following elements must be clearly defined and communicated by the parties:

- The expectations of each partner
- The objectives of the partnership
- The structure of the partnership
- The channels of communication to use
- The rules of operation

Neglecting to define and clarify these elements often leads to disappointment and can damage the credibility of the relationship throughout the organization.

9.1.1 Definition and communication of expectations

Before committing all out to a strategic partnership, the senior management of the two companies will first have to clarify their strategic intentions in order to determine the compatibility and convergence of their respective interests over the long term. Such affinity allows developing a common vision and the partnership’s objectives. Uppermost among these is reaching a level of performance that would otherwise be unattainable under the current relationship and that would allow creating a competitive advantage for both partners.

The aim of a partnership should not be to squeeze the supplier’s profit margin. If this were the case, the term “partnership” would be a misnomer. The true objective, instead, is to develop innovative solutions that reduce costs for the supply chain as a whole, increase the value available, and facilitate the development of new products. These solutions generally allow lowering the supplier’s price without narrowing his profit margin, which is essential for his survival over the long term.

In order to develop this common outlook, the partners must redefine their process in an integrated manner, particularly through the use of extended value stream mapping (VSM).

As part of the projects undertaken under MEQ’s Program to Strengthen Manufacturer Networks, the use of this mapping instrument served initially to create an inspirational view of the future for partners starting from their present situation. The following figure illustrates the current value chain map between a contractor and his supplier partner. On it are indicated the areas of potential improvement.
FIGURE 4. EXAMPLE OF AN EXTENDED VALUE STREAM MAP BETWEEN AN ORDER PLACER AND A SUBCONTRACTOR

Confirmation of price for specials from subcontractor

Confirm orders and prices

Date change from subcontractor

Confirmation of price for specials from subcontractor

Order entry from Toronto to Quebec City

Orders

Delivery Dates

1 quotation on 10 becomes an order

Order entry

Customer

Third-party logistics

$ risks in terms of suppliers

Suppliers Contract and price negotiated by O.P.

High inventory level according on minimum specified in agreement and real level

Raw Material Warehouse: Safety Stock = 1 month (Condition by the manufacturing plant)

Supply difficult according to specs

Process dependent on individuals

Claims follow the entire process or parts

Loading variation vs Production labor effectiveness

Lateness in modification of promised dates

Specials trading

Production

Production start

Bill Of Material single level : creating products

Process dependent on individuals

Claims follow the entire process or parts

Loading variation vs Production labor effectiveness

Lateness in modification of promised dates

Evaluation of material requirement

Subcontractor customer service

Source: The Createch Group, Strengthening of Manufacturer Networks Project

Source: The Createch Group, Strengthening of Manufacturer Networks Project

$ risks in terms of suppliers

Supply lead time 6 wks Visibility 3 weeks

High inventory level according on minimum specified in agreement and real level

Raw Material Warehouse: Safety Stock = 1 month (Condition by the manufacturing plant)

Supply difficult according to specs

Process dependent on individuals

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$ risks in terms of suppliers

Supply lead time 6 wks Visibility 3 weeks

High inventory level according on minimum specified in agreement and real level

Raw Material Warehouse: Safety Stock = 1 month (Condition by the manufacturing plant)

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Lateness in modification of promised dates

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Bill Of Material single level : creating products

Process dependent on individuals

Claims follow the entire process or parts

Loading variation vs Production labor effectiveness

Lateness in modification of promised dates

Evaluation of material requirement

Subcontractor customer service

Source: The Createch Group, Strengthening of Manufacturer Networks Project
As progress is made in exploring the possibilities at this phase, expectations on both sides become clearer. It is necessary to communicate them rapidly in order to keep the partner abreast of how they are evolving. These expectations will concern in particular the following aspects:

- **Commitment by senior management on both sides:** early on in the talks, senior management must manifest their level of commitment clearly in order to signify to all stakeholders the importance of the success of the initiative.
- **Openness and trust:** through appropriate gestures and actions, the two organizations manifest their openness to collaborate and trust begins to take root. Trust in one another is a key ingredient as each party agrees to depend on the other. Any breach of trust will cause a pullback that will undermine the partnership.
- **Sharing of strategic information, including costs:** one sign of openness is the reciprocal sharing of strategic and financial information, which demonstrates the acceptance of a certain degree of vulnerability towards the other party.
- **Structured and integrated relationship:** for the two organizations to draw closer together, it will be necessary to re-engineer certain joint processes, which may entail changes to organizational structures. These changes can generate resistance within the organizations, which could slow down or even block their implementation.
- **Long-term relationship:** the parties must rapidly agree on the intended duration of the partnership as this factor will determine the extent of the changes and investments that will be feasible and profitable.
- **Continuous improvement and innovation:** innovation necessitates robust processes that integrate continuous improvement mechanisms from the outset.
- **Emphasis on total value:** the partners expect that the emphasis be placed on the common good rather than on one’s own good.
- **Sharing of risks and rewards:** the partners must agree from the start on which party will assume the different risks and how the ensuing losses or profits will be shared.

### 9.1.2 The Objectives of the Partnership

A partnership is not an end in itself. Rather, it is an innovative way to achieve business objectives and high performance levels. Based on a common vision, the partners must determine intermediate objectives and targets in a precise and quantifiable manner, as these will in turn define the scope of the actions to be taken.

The table below proposes a few examples of objectives.

<table>
<thead>
<tr>
<th>Strategic Objectives</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual reduction of inventory in the system (as a % change from baseline at year 0)</td>
<td>30%</td>
<td>20%</td>
<td>10%</td>
</tr>
<tr>
<td>Annual reduction in delivery lead times (as a % change from baseline at year 0)</td>
<td>50%</td>
<td>25%</td>
<td>10%</td>
</tr>
<tr>
<td>Annual reduction in scrap and waste (as a % change from baseline at year 0)</td>
<td>20%</td>
<td>15%</td>
<td>10%</td>
</tr>
<tr>
<td>Annual reduction in unit costs (as a % change from baseline at year 0)</td>
<td>0%</td>
<td>15%</td>
<td>10%</td>
</tr>
<tr>
<td>Joint R&amp;D investment (in millions of $)</td>
<td>$1.20</td>
<td>$1.50</td>
<td>$1.00</td>
</tr>
<tr>
<td>Annual development of new components</td>
<td>2</td>
<td>5</td>
<td>8</td>
</tr>
<tr>
<td>Reduction in development lead time for new components (as a % change from baseline at year 0)</td>
<td>10%</td>
<td>20%</td>
<td>-20%</td>
</tr>
</tbody>
</table>

The partners must also develop indicators for monitoring results and the impact of actions taken.
9.1.3 The structure of the partnership

There are multiple ways of structuring a partnership. The aim of this section is to emphasize the fact that a conscious effort must be made to define the structure most appropriate for the partnership. It is important then to specify the parties’ roles in this structure and to communicate them clearly to all the stakeholders concerned in both companies and, lastly, to make sure that they have been understood.

As part of the projects undertaken under MEQ’s Program to Strengthen Manufacturer Networks, the structure illustrated in the following figure was the one preferred for a number of partnerships.

The highlights of this structure are the following:

› An executive committee dedicated to the partnership is set up.

The composition of this committee necessitates the presence of senior managers from both organizations.

› Bilateral operational teams focused on processes or specific aspects (e.g., quality, logistics, costs) carry out joint projects.

› Coordinators for each partner are the link between the executive committee and the bilateral teams ensuring communication and alignment.

9.1.4 The channels of communication

The figure on page 62 presents schematically two typical situations regarding channels of communication between the contractor and the supplier. The schematic titled “relationship with centralized communication” illustrates the case where the channels of communication converge towards a single representative in each company and exchanges occur exclusively between the two designated representatives. Within the framework of a partnership, such a communication structure has the advantage of rendering communication between the parties more cohesive.

The schematic titled “relationship with multiple channels of communication” suggests a greater intensity of information exchanges and communication between a number of representatives for each partner responsible for different functions. With a heavier accent placed over time on the value chain and its processes, communication becomes more and more direct between immediate customers and suppliers within joint processes. In order to progress towards this level of integration, also referred to as an interlocking structure, it is necessary to agree jointly on the roles and responsibilities of each person within the processes straddling the boundaries of the two organizations. However, this structure presents challenges to the persons responsible for the relationship in terms of documenting all the communications between the partners.
The more the integration between partners progresses, the greater becomes the need to implement rules of operation in order to mark out activities on both sides. These rules can be multiple given the different forms of partnership possible. For example, if an employee of the supplier partner works full-time on site at the customer’s facilities, one of the rules imposed on the employee might be to behave as though he were the customer’s employee.

The rules of operation must delimit elements such as:

- Joint meetings: frequency, participation, members and their roles, typical agenda, reports, follow-up, decision making, conflict management, and so on.
- Objectives: their definition and their utilization with respect to performance indicators
- Production models, specifications and standards, as well as the elements of information to be shared
- The degree of interaction in areas regarding:
  - Periodic measuring of indicators
  - Access by supplier to customer’s sales plans
  - Reciprocal sharing of production plans and capacity in the medium term
  - Sharing of detailed production plans in the short term
  - Interaction between information systems

9.1.6 Model for evaluating the relationship between a contractor and a partner

Under MEQ’s Program to Strengthen Manufacturer Networks, a comprehensive instrument was developed that allows evaluating the quality of the relationship in terms of seven dimensions as represented in the pyramid in Figure 7. The lower levels contribute to the solidity of those above. For example, it would be difficult to have an interlocking structure if mutual understanding is wanting in the beginning. The colour codes refer to the five performance levels proposed in an evaluation grid.
Here are a few real-life examples illustrating the seven dimensions of the relationship:

1 Mutual understanding
It is often observed that partners have an affinity at the business level or even at the personal level among management but that they are unable to collaborate effectively on account of divergent values or different business strategies. For example, a company that manufactures specialized vehicles in small lots with short lead times entered into a partnership with an organization that operates in a cost-centred market and, therefore, would stand to benefit from large lots produced with long lead times.

2 Interlocking structure
A software development company systematically sends its new partners a matrix of persons to contact for each type of strategic and operational issue. It asks its partner to add to it the contact information of its corresponding resource persons in order to ensure effective and efficient communications and thus reduce delays and frustrations.

3 Control systems
Numerous companies are presently working on improving the mechanics of evaluating their partner relationships: definition of frequency of meetings, standard agenda, presence of operational managers (not just salespersons and purchasers), two-way performance indicators to measure the performance of both organizations, and so on.

4 Compatibility of technical capacities
A company in the furniture industry has its partner benefit from its technical expertise with certain types of digitally controlled equipment. This is done by sending one of its own specialized technicians to work a few days a week on site at the supplier’s facilities, where he has his own office and internal telephone number and where he takes part in the partner’s team meetings.

5 Information sharing
A company operating in the manufacturing sector shares its long-term projections with its partners for planning purposes. Information is all it is, not firm orders. These projections are converted to orders three weeks prior to the desired delivery date. This allows the partner to better anticipate volumes, iron out its production schedule, and reduce costs.

6 Joint improvement activities
A pharmaceutical company offers to participate in its partners’ improvement activities by placing its expertise at their disposal. This serves to boost the chances of success while improving the partner relationship. If this results in substantial savings, the customer benefits as well; however, the supplier maintains his price for other customers intact, thus enhancing his profitability and financial solidity.

7 Kaizen and learning
A company participating in MEQ’s Program to Strengthen Manufacturer Networks set up “collaboration workshops” with its suppliers in support of annual joint performance improvement programs.

FIGURE 7. MODEL FOR EVALUATING THE RELATIONSHIP BETWEEN AN ORIGINAL EQUIPMENT MANUFACTURER AND A PARTNER ON THE BASIS OF SEVEN DIMENSIONS

<table>
<thead>
<tr>
<th>Supplier Relationship Index</th>
<th>Level 3</th>
<th>3.5/5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kaizen and Learning</td>
<td>7</td>
<td>●</td>
</tr>
<tr>
<td>Joint Improvement Activities</td>
<td>6</td>
<td>●</td>
</tr>
<tr>
<td>Information Sharing</td>
<td>5</td>
<td>●</td>
</tr>
<tr>
<td>Compatibility of Technical Capacities</td>
<td>4</td>
<td>●</td>
</tr>
<tr>
<td>Control System</td>
<td>3</td>
<td>●</td>
</tr>
<tr>
<td>Interlocking Structure</td>
<td>2</td>
<td>●</td>
</tr>
<tr>
<td>Mutual Understanding</td>
<td>1</td>
<td>●</td>
</tr>
</tbody>
</table>

Level 1 Level 2 Level 3 Level 4 Level 5

Source: The Createch Group, Project for Strengthening Manufacturer Networks
In order to assess the nature of the relationship according to the seven dimensions, the partners evaluate one another on a scale ranging from level 1 to level 5 on the following 21 criteria:

- Commitment to common prosperity
- Cost structure modelling
- Engineering excellence
- Information collection and dissemination
- Level of management presence “on floor”
- Measurement systems
- Parallel sourcing
- Respect of each party’s capacities
- Supplier development
- Trust and respect
- Work groups
- Common language
- Effective communications
- Feedback
- Interdependent processes
- Maintenance of learning
- Operational excellence
- Problem-solving skills
- Structured partnership
- Target prices
- Value analysis and engineering

### 9.2 Other Conditions for a Successful Partnership

Other conditions for a successful partnership have been identified and warrant mention:

1. Determine the criteria for choosing the persons responsible for the relationship
2. Choose the right contacts
3. Define robust management processes jointly
4. Develop performance criteria

#### 9.2.1 Determine the criteria for choosing the persons responsible for the relationship

The more a supplier is important in the eyes of the customer, the more he will deserve that time and energy be spent on him. In order to select the best person to be in charge of the relationship, it is important to specify certain elements of his mandate very clearly:

- His role within the partnership
- The workload relative to the partnership
- His authority with respect to the mandate
- The sphere of influence required

#### 9.2.2 Choose the right contacts

In order for exchanges with the partner to add value to the relationship, the CSCP must make sure to communicate and interact with the right contacts.

In particular, he must make sure that these persons:

- Have sufficient technical knowledge
- Possess the requisite aptitudes for team work
- Are firmly focused on results

#### 9.2.3 Define robust management processes jointly

The well-advised CSCP will also define robust management processes jointly with the partner.

From an operational standpoint, the following processes must be defined jointly to ensure greater efficiency:

- Planning horizons (see below)
- ABC classification of parts by type (see below)
- Replenishment model (see below)
- Innovation management (see below)
9.2.3.1 Example for planning horizons

The integration of the partners’ activities necessitates agreeing on planning horizons starting with the long-term strategic outlook and then moving towards levels of greater detail and shorter time horizons as the executive phase draws closer. It is important to communicate to the supplier the structure of the different planning levels used, the nature of the information that will be communicated, and what will be expected of the partner once he gains possession of this information.

<table>
<thead>
<tr>
<th>Planning level</th>
<th>Planning Horizon</th>
<th>Planning Time Unit</th>
<th>Level of Product Consolidation</th>
<th>Level in Charge</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic</td>
<td>1 to 3 years</td>
<td>Quarter</td>
<td>Family of products requiring a given technology</td>
<td>Senior management</td>
</tr>
<tr>
<td>Tactical</td>
<td>3 to 18 months</td>
<td>Month</td>
<td>Family of products requiring the same equipment</td>
<td>Director</td>
</tr>
<tr>
<td>Operational</td>
<td>4 to 26 months</td>
<td>Week</td>
<td>Family of products requiring the same tooling</td>
<td>Manager</td>
</tr>
<tr>
<td>Executive</td>
<td>0 to 6 weeks</td>
<td>Day</td>
<td>Stock keeping units (SKU)</td>
<td>Analyst</td>
</tr>
</tbody>
</table>

9.2.3.2 Explanation of ABC classification of parts by type

It is in the partners’ interest to agree on classifying parts into ABC categories based on volume, in order to adopt appropriate management policies. It need be reminded that volume generally has a major impact on:

- Demand stability
- Accuracy of forecasts
- Stability of production plans
- Level of emergency stocks
- Economic production lot size
- Inventory control methods and priorities
- Performance indicators

9.2.3.3 Example of an integrated replenishment model

The integration of partners’ planning systems can lead the contractor to transfer certain activities to the supplier, particularly by affording the necessary visibility on certain information. This allows the contractor to focus on other value-added activities. For the supplier, this enhanced visibility allows him to arrange his own activities better instead of reacting brusquely when orders are received, especially if lead times are short.
9.2.3.4 Examples of good practices in innovation management

In order to obtain optimum results, successful companies involve the supplier as far upstream in the development process as possible. Albeit challenging, this proven practice allows saving time and very often avoids unexpected expenses.

The figure above describes a four-phase simplified joint product development process. At each phase, supplier involvement could include the following activities:

1. Brainstorming:
   › Visit to supplier’s technical centre
   › Marketing presentation on future product evolution
   › Market and regulatory trends

2. Cost, benefit and lead-time studies:
   › Design optimization
   › Options development

3. Development and launch:
   › Manufacturing process optimization
   › Reduction of material losses
   › Development of delayed product differentiation processes

4. Ex-post process and outcome evaluation:
   › Recommendations regarding the design of future products
   › Recommendations regarding the product development process

9.2.4 Performance indicators tailored to partnerships

Indicators allow measuring performance and making adjustments quickly, if need be. It is thanks to these measures that managers can add value on a continuous basis. Below are examples of indicators in different categories, including an analysis of the causes of performance gaps.

Examples of two-way and joint indicators:

Two-way indicators allow measuring the performance of the two partners and determining any variance from objectives. An analysis of the fundamental causes of the variance allows developing required action plans. A common mistake that contractors make is to believe the supplier alone responsible for under-performance whereas the source of the poor showing is often to be found with the contractor himself. This is why it is only fair to measure the contractor’s performance as well.

**Indicators on the contractor’s side:**
- Adherence to predetermined purchase volumes
- Adherence to order lead times agreed to beforehand
- Reliability of projected requirements
- Demand stability
- Number of new products

**Indicators on the subcontractor’s side:**
- Monthly service and quality level
- Surcharges with explanations and analysis

FIGURE 9. EXAMPLE OF A SIMPLIFIED JOINT PRODUCT DEVELOPMENT PROCESS
Quarterly indicators of bilateral teams regarding continuous improvement (joint indicators)

- Variance between objectives and results
- Variance between action plan and activities completed (including validation of action plan and its effectiveness)

Examples of objectives for bilateral teams regarding:

Quality:
- Waste reduction

Service:
- Reduction in delivery delays
- Reduction in marketing delays

Costs:
- Reduction in unit cost
- Reduction in transportation costs
- Reduction in production surcharges associated with start-ups

Inventories:
- Reduction in economic production lot sizes
- Reduction in errors in quantities delivered
- Reduction in the number of parts outside the specified parameters for inventory management
- Reduction in obsolescence costs

Success factors:

- Define the elements of the partnership clearly from the outset: each party’s expectations, objectives, structure, channels of communication, and rules of operation
- Make sure to have the right contacts, to define robust joint processes, and to develop appropriate two-way performance criteria
- Use checklists to evaluate the relationship’s evolution on a regular basis
- Help the supplier help us and work with him to reduce costs
- Share risks and benefits

Pitfalls to avoid:

- Seek to squeeze the supplier’s profit margin
- Believe that the supplier alone is responsible for under-performance
- Neglect to involve the supplier in the development of new products
- Be content with initial objective and not renew them
Conclusion

The importance that an effective strategic sourcing function can have on a company’s profitability is undeniable in today’s competitive reality. Beyond the theories advanced in this field, the success of strategic sourcing hinges on senior management’s commitment and on the SS team’s know-how and leadership.

To accomplish its mission, the strategic sourcing function depends on the quality of the team work and on the integration of the multiple disciplines geared towards value creation. To this end, we hope that this guide will raise awareness among all stakeholders concerned and that it will encourage implementation of the exemplary practices documented in this guide. The overarching aim here, of course, is to generate a positive impact on your organization’s bottom line.

MEQ’s Strategic Sourcing Network continues to carry out its work and to hold meetings thanks to the members involved and keen on improving their skills. We invite you in this regard to contact MEQ in order to be kept informed on the developments of our project to make some of the tools mentioned in this guide available to the members of our association.

We would like to thank everyone who has contributed to the cause so far and we invite you all to join the expert network in order to share and document best practices in strategic sourcing.

Bibliographical references:

- APICS – Certified Supply Chain Professional: www.apics.org/cscp
- Corporation des Approvisionneurs du Québec website: www.caq.qc.ca
- APICS-CPIM (Certified in Production and Inventory Management): www.apics.org/cpim or www.meq.ca/cpim

Annex A – Contract Checklist

Below is part of the contract checklist used by a manufacturing company to support the work of its strategic sourcing staff.

Project: Date:

1. The Parties:
   a. Name, address, telephone number, etc.
   b. Possibility of cost reduction on account of volume
   c. Capable of delivering on time
   d. Capable of manufacturing good-quality, stable product
   e. Flexible and collaborative organization
   f. Technical expertise available and capable of sustaining product
   g. Benchmarking
   h. Non-competing company

2. Definition

3. Start Date and Duration

4. Product and Options Description

5. Packaging

6. Markings

7. Forecast

8. Purchase Order Placing and Lead Time

9. Customer Service and Support

10. Price and Taxes

11. Business Language

12. Product Evolution Management
13. Invoice and Payment  
   a. One invoice per delivery, all costs paid
14. Specifications
15. Quality Acceptation
16. Regulatory Agency Compliance
17. Support, Development and Support of Services
18. Intellectual Property
19. Insurance  
   a. US$2 million in civil liability protection
20. Confidentiality  
   a. Non-disclosure agreement between the two parties  
   b. Not entitled to use our name in press releases or in other contracts
21. Terms and Conditions
22. Termination
23. Applicable Laws
24. Right on Termination
25. Arbitration  
   a. Arbitrator  
   b. Neutral ground
26. Materials Management  
   a. Person assigned to purchasing  
   b. Long-lead-time products  
   c. Qualified manufacturers  
   d. Obsolescence and surplus management  
   e. Last purchases  
   f. Inventory on consignment  
   g. CSA, UL, and CE components  
   h. Common parts management
27. Engineering Change Control
28. Delivery Method
29. Production Schedules

Typical annexes:
  › Products, Prices and Minimum Order Quantities
  › Product Specifications
  › Certifications
  › Support and Training
  › Inspection Requirements at Origin
  › Packaging and Shipping
  › Guidelines for Product Returns
  › List of Competitors
  › Intellectual Property Rights
  › Third Party Software
  › Service Level Agreement
  › List of Non-Exclusive Territories
Annex B – Sourcing Agreement Implementation Plan

Project: 

Description: 

Completed by: 

Definition of the needs of each group concerned
(specifications, system and logistics requirements, control requirements, financial requirements, after-sales service requirements, legal requirements, target price, quantity, forecasts…)

› Contractual agreement process launch date:
› Target date to obtain information:
› Actual date information obtained:
› Requested by:
› Owner:
› Other persons responsible:

Obtaining the standard model contract

› Target date to obtain model contract:
› Actual date obtained:

Negotiations with the supplier
(documentation of variance with standard model and technical requirements)

› Target date of close of negotiations:
› Date completed:

Commercial acceptance
› Approved by and date:

Acceptance by the person making the request and the owner
› Signature of person making request:
› Signature of owner:

Legal acceptance
› Date legal acceptance required:
› Signature of legal representative and date:

Signing the purchase contract
› Date signature required:
› Date completed:

Dissemination of the agreement to users
› Date implementation required:
› Date completed:

Updating the non-disclosure agreement registry/contract registry
› Date completed:
Annex C – Measurement of Total Acquisition Cost

The comparative approach between purchase options based on the measurement of total acquisition cost allows making the best choice to support the company’s profitability from a global point of view.

Total acquisition cost must take account of: materials, labour, equipment depreciation, inspection costs, inventory-carrying costs, poor-quality risks, cost of capital, transportation costs, excise taxes, customs brokerage fees, and more. It must also take account of discount gains or losses, subsidies and taxes.

Business impact should be measured primarily as a function of the following aspects:

<table>
<thead>
<tr>
<th>ELEMENT OF COST</th>
<th>RESPONSIBLE FOR EVALUATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unit cost</td>
<td>Engineering / productivity</td>
</tr>
<tr>
<td>Cost of investment amortization and expenses</td>
<td>Engineering / productivity</td>
</tr>
<tr>
<td>Non-quality costs</td>
<td>Quality</td>
</tr>
<tr>
<td>Logistics costs (including customs tariffs)</td>
<td>Procurement</td>
</tr>
<tr>
<td>Expediting costs</td>
<td>Procurement</td>
</tr>
<tr>
<td>Obsolescence risk</td>
<td>Procurement</td>
</tr>
<tr>
<td>Inventory-related costs</td>
<td>Finance</td>
</tr>
<tr>
<td>Cash flow management (working capital to maintain)</td>
<td>Finance</td>
</tr>
</tbody>
</table>

This analysis leads us to the conclusion that moving this assembly to China would cause the total cost for the company to increase 1.9%. Yet, at first glance, the 25% saving on unit cost alone seemed appealing.

Successful companies have at their disposal the numbers that allow them to calculate the cost of different options in order to compare them with or without the help of historical data to enhance the analysis. Unfortunately, the tendency in our organizations to work in silos would probably have incited, based on the case presented above, the sourcing department to purchase in China, driven by the constant objective of reducing purchasing costs.

**EXAMPLE OF A PROJECT TO MOVE ASSEMBLY X FROM QUEBEC TO CHINA**

<table>
<thead>
<tr>
<th>ELEMENT OF COST</th>
<th>DIFFERENCE (in millions of $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unit cost</td>
<td>-64</td>
</tr>
<tr>
<td>Cost of investment amortization and expenses</td>
<td>20</td>
</tr>
<tr>
<td>Non-quality costs</td>
<td>17</td>
</tr>
<tr>
<td>Logistics costs (including customs tariffs)</td>
<td>7</td>
</tr>
<tr>
<td>Expediting costs</td>
<td>6</td>
</tr>
<tr>
<td>Obsolescence risk</td>
<td>1</td>
</tr>
<tr>
<td>Inventory-related costs (see details below)</td>
<td>17</td>
</tr>
<tr>
<td>Cash flow management (working capital to maintain)</td>
<td>1</td>
</tr>
</tbody>
</table>

Total business impact: 5

Business impact (% of annual purchases) 1.90%

Savings as % of unit price -25%
Annex D – Determining the Non-quality Cost of a Supplier

This annex provides an overview of the costs that a successful company will document in order to obtain a comprehensive portrait of what a supplier can generate in terms of total non-quality cost. Several of these costs are difficult to grasp, but they are real nonetheless, and this raises interesting challenges for manufacturers.

Date:

Raw materials:

Lot(s):

Supplier:

1. Cost of raw materials
2. Production losses
3. Poor performance
4. Additional costs for replacing raw materials
5. Direct labour costs (plus payroll taxes)
6. Production scrap
7. Rework
8. Additional costs when materials received and for sampling
9. Additional inspection and test costs
10. Additional manufacturing and handling costs
11. Machine stoppages caused by non-compliance
12. Other costs (tooling breakdowns, start-up)
13. Additional transportation costs

14. Additional inventory costs
15. Expenses related to recalls and warranties
16. Reimbursements to dissatisfied customers and lost sales
17. All other additional costs
   • Total non-quality cost
   • Total non-quality cost for supplier in period
   • % of non-quality cost recovered from supplier

Annex E – Useful Web Links for Researching Suppliers

The following is a non-exhaustive list of interesting links useful for researching suppliers operating in general or more specialized fields:

- icriq.com
- frasers.com
- dnb.com
- propurchaser.com
- chemsource.com
- environmentalchoice.com
- thomasnet.com
- freemerchant.com
- worldpages.com
- localbusiness.com
- buyerzone.com
- yellwo.com
- overstock.com
- buygreen.com
### Annex F – Example of Supplier Audit

<table>
<thead>
<tr>
<th>Subject / Theme</th>
<th>Major Audit Observations</th>
<th>Other Audit Observations</th>
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</thead>
<tbody>
<tr>
<td>Policies and procedures</td>
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<tr>
<td>Annual product review</td>
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<td>Audits</td>
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<td>Complaints</td>
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<td>Investigations</td>
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<td>Product release, production lot control</td>
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<td>Change control</td>
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<td>Components and raw materials</td>
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<td>Lab operations</td>
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<td>Calibration</td>
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<td>Maintenance</td>
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<tr>
<td>Plant, equipment, critical system</td>
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<td>Validation, qualification</td>
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<td>Environmental monitoring, control of contaminants, sterilization process</td>
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<td>Changes to product mix</td>
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<td>Packaging and labelling</td>
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<td>Quality report to senior management</td>
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<td>Training</td>
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<tr>
<td>Warehousing and distribution</td>
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<td>Returns and re-works</td>
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<td>Computer systems</td>
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<td>Outsourced manufacturing and testing</td>
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<td>Recall</td>
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<td>Stability</td>
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<td>Technology transfer</td>
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### Annex G – Example of Risk Analysis

Inspired by a checklist actually used by a manufacturing company, these risk analysis criteria can be translated into several levels in order to establish a system of gradation within risk types.

**Quality:**
- Results of supplier audits performed on site
  - Evaluated based on the number of non-compliances ranging from minor to major
  - The higher the number, the higher the risk
- Number of major non-compliances in a regulatory agency audit (if applicable)
  - Evaluated based on the number of non-compliances ranging from minor to major
  - The higher the number, the higher the risk
- Quality problems and supply interruptions
  - Evaluated based on the number of occurrences observed in the past year
  - The higher the number, the higher the risk

**Capacity:**
- % of manufacturing capacity utilized
  - Evaluated based on the supplier’s total capacity in order to calculate the proportion of annual demand that the supplier can absorb
  - If less than 100% of our annual volume, then high risk
    The more capacity is above 100%, the lower the risk
CONCLUSION

Finance:
› Dun & Bradstreet financial stress score
   • Evaluated on a scale of 1 (low risk) to 5 (very high risk)
› Financial capacity
   • Evaluated based on profitability and debt level
   • Unprofitable and indebted, terms that indicate a higher risk

Importance:
› Importance of the buyer in the eyes of the supplier
   • Evaluated based on the % of volume purchased from the supplier relative to his total revenue
   • The more our company is important, the lower the risk

Market:
› Market conditions
   • Evaluated based on levels ranging from stable (lower risk) to volatile (very high risk)

Annex H – Supplier Self-evaluation

Some successful companies ask their suppliers periodically to complete a list of questions for the purpose of monitoring various situations that might have undergone change or might have arisen at the suppliers’ facilities and that might have an impact on operations and quality.

These self-evaluation questionnaires can cover a variety of topics, such as:
› Deliveries
› Installations
› Manufacturing processes
› Documentation
› Change management
› Quality and compliance
› Commercial aspects

Here are a few examples of self-evaluation questions that relate to manufacturing processes. The supplier responds “yes” or “no”. If the response is “yes”, the supplier is asked to provide further details on the matter.

› Have there been any major changes in the manufacturing process since the last audit? If so, have the changes been validated?
› Have there been any deviations in the manufacturing process that compromise the quality of the materials?
› Have there been any changes in the labelling of materials or in the precautions taken with materials?
› Will there be any changes regarding the manufacturing plant in the next 12 months?