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What Is Your Purchasing Strategy for 2014? - November 2013

By now, planning for 2014 is well underway. For a buyer, this includes determining what to buy, how much to buy, and which suppliers to buy from, along with other factors. To achieve optimal results, the buyer should take time to develop a purchasing strategy that is aligned with company goals. And this just isn't for the major dairy commodity products like milk, cheese, butter, or milk powders. It also includes packaging, warehousing, transportation, ingredients, services... anything that is bought by the company. For most food and dairy companies, the cost of raw materials and indirect materials and services represent the majority of their cost of goods sold. As a result, the effectiveness of the purchasing strategy is critical to deliver strong financial results.

When a structured process is applied to purchasing, the whole company can benefit. Most importantly, significant cost savings can be achieved. In addition, the purchasing function can become more integrated in the business and be seen as a vital part of the supply chain. Developing a strategic purchasing function requires companies to examine the total supply chain management process. A strategic sourcing process involves 5 main steps:

1. Analyzing the category spend
2. Determining business requirements
3. Assessing the supply markets
4. Developing a purchasing strategy
5. Execute, manage, and refine based on business needs

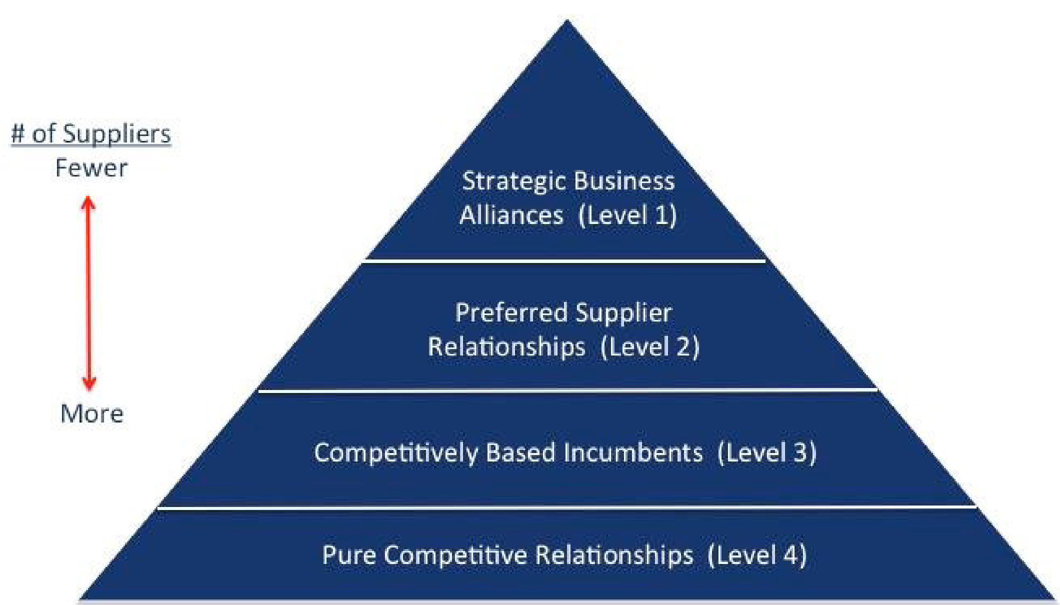
The first step, analyzing the category spend, is about information gathering. Data collected from internal and external sources provides the foundation for the sourcing strategy and also helps to build a knowledge base within the organization. This data should include volumes, pricing, suppliers, supplier performance, and specifications. An important part of this step is to analyze the total cost of ownership or TCO. However, research has found only about 1/3 of companies actually do a TCO analysis in advance of supplier negotiations.

The next step in the strategic sourcing process is to determine the business requirements. This is based on internal company information such as business strategies, cost savings targets, new products, and manufacturing changes, to name just a few. An important part of this step is to develop a category positioning matrix to help differentiate between strategic, commodity, standard, and bottleneck categories, and define the strategies used for each category. The business needs and capabilities need to be understood in order to develop a strategy that delivers the best results. Done correctly, this ensures alignment across other functions and helps prioritize strategies and tactics. It also enables "what if" discussions that can help break down barriers and challenge "sacred cows".

Next, the external environment is analyzed by assessing the supply markets. This step includes conducting analysis on key suppliers, market size, production capacity, growth rates, pricing history, and other factors. Tools such as Porter's 5 Forces are used to determine the competitive intensity and attractiveness of a market. A SCOPE analysis can be used to analyze the supply base, including current and potential vendors, and to understand the company's strategic position in the industry. This analysis measures the strategic fit, operational capability, and economic viability of suppliers.

The output from the first 3 steps is used to develop the purchasing strategy. A good strategy defines the goals of the strategy along with the tactics to execute it. The goals should measureable, time bound, and realistic, yet aspirational. The strategy should also incorporate 1 "big idea" to stretch the imagination of what's possible.

Finally, after the strategy is developed, it is ready to be executed. Different strategies require different tactics for execution and a variety of tools can be used depending on the strategy and tactics. This is where a robust supplier relationship management (SRM) process will help guide the type of approach needed to implement the strategy. The SRM pyramid below is a useful tool when performing a supplier segmentation analysis. When implementing the strategy, a formal project management methodology could be used and metrics should be developed to measure the progress and success of the strategy.



Developing a good purchasing strategy takes time, something that is usually in short supply. But this is where the 80-20 rule comes in handy. Choose the top 3-5 spend areas or products and develop purchasing strategies for them keeping materiality in mind. The annual spend of $10,000 worth of paper towels doesn't need a formal purchasing strategy, but the $10 million spent for warehousing might. And the return on investment can be considerable. If a strategy can deliver 3% savings on a $10 million spend, the $300,000 in savings is far greater than the time spent to develop the strategy. Best-in-class companies use the strategic sourcing process to improve business results and establish the purchasing organization as a vital part of the company.

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