



An executive whitepaper written by Aptium Global, Inc.

Lean Sourcing: Creating Sustainable Purchasing Savings

I. **Setting the Stage**

In the past decade the concepts of “lean” and “strategic sourcing” both made it onto the corporate main stage, separately capturing the executive and media spotlight. Outsiders viewed lean as an art practiced by operational wizards or “Six Sigma Black Belts,” adept at reducing waste and improving performance and efficiency. Lean achieved its magic by introducing new production and operational processes that improved organizational productivity. In the case of manufacturing, this resulted in reduced inventory, increased throughput and improved customer service levels. Lean also stressed lasting, collaborative relationships with suppliers and business partners.

Above all, as its supporters preached, lean is a journey, implemented through continuous Kaizen improvements. A lean transformation could take several years and typically involves complete process re-engineering. But lean success stories slowly began to emerge that captured the imagination of executives, making the time spent well worth it. Toyota’s lean success illustrated to executives worldwide that lean could transform production and quality standards for an entire industry, changing the basis of competition.

Across the manufacturing sector, many organizations began to understand the improvements that lean could achieve. But the art of lean was still very much a mystery to many on the outside. In contrast, strategic sourcing stormed onto the stage in a take no prisoners, hammer-driven approach to cost reduction that was easy to understand. Strategic sourcing was everything lean was not: a one-time effort, a quick hit without any major internal process changes that was less than fully data driven. If lean was the Eastern medicine that focused on treating the corporate patient holistically over time—requiring active involvement on the patient’s behalf in improving his condition—strategic sourcing was the prescription drug that immediately got its adherents hooked on quick-fix savings.

II. **Popping the Sourcing Pill**

How did strategic sourcing generate results? It treated the corporate patient by introducing a new type of structured tender and bidding process into purchasing (with increased competition and greater price transparency). As with cholesterol reducing drugs, patients saw the impact of strategic sourcing almost immediately (but in a similar vein, the underlying cause of the maladies often went unaddressed).

Strategic sourcing was able to achieve tremendous savings for many of its adopters because 70% of a company’s purchasing costs, on average, are tied up in what is being bought (the balance of the costs cover inventory, inventory carrying costs, procurement personnel and ‘maverick buying’). However, most companies historically had tended to focus on inventory reduction (which Lean and other initiatives addressed). When companies began to tackle purchasing cost reduction through strategic sourcing, the results could impact operating performance in months, not years (and without the serious collaboration of different internal teams). Dozens of research studies confirmed this as well. According to separate research efforts by organizations like CAPS, FreeMarkets, McKinsey, The Watch Group, and A.T. Kearney, every \$1 saved through sourcing efforts was worth an estimated \$5–\$25 in increased sales.

According to experts who lauded its adoption, the miracle of strategic sourcing was here to stay. But many purchasing organizations that implemented strategic sourcing processes

and technology began to realize that they were leaving additional savings on the table and perhaps most important, were not creating long-term sustainable partnerships with their supply base to improve other elements of supplier performance beyond price (e.g. on-time deliveries and quality). To go after these additional opportunities, some of these purchasing organizations began to coordinate their efforts with supply chain and operational executives inside their organizations. Thus, Lean Sourcing was born.

III. Getting Started with Lean Sourcing

Lean Sourcing provides four key benefits to organizations. These are:

- 1. Greater buy-in from key functional areas—operations and purchasing which care about both price and performance**
- 2. Greater likelihood of implementing identified sourcing savings**
- 3. Improved quality and reduced waste**
- 4. On-going additional cost reduction opportunities via collaboration with supply partners**

More advanced organizations that begin to experiment with lean sourcing quickly realize that strategic sourcing does not have to be in conflict with lean. Rather, they observe that strategic sourcing is really a precursor step to identifying long-term supply partners and more tightly coordinating purchasing efforts with operations and manufacturing. They also realize that in an increasingly global supply market, conditions change and leading companies need to regularly go to the market to identify, qualify, benchmark, ensure best global supplier capability and competitiveness.

Today, Lean Sourcing is making its way into the middle market, where smaller organizations are beginning to realize that strategic sourcing provides a means for substantial cost savings and at the same time addresses the concerns of operations personnel. Many are beginning to bridge the gap between procurement and operations by getting started with Lean Sourcing.

At its core, Lean Sourcing is really about reducing Total Enterprise Cost. Figure 1, below, describes the elements of Total Enterprise Cost that go into Lean Sourcing decisions.

Figure 1

Total Enterprise Cost: A Lean Sourcing Approach

A Lean Sourcing Approach requires organizations to understand and award supplier contracts taking into account all factors that influence Total Enterprise Cost.

Sourcing Factors

- Supplier identification
- Supplier qualification
- Supplier score-carding
- Quality
- Terms
- Lead times
- Supplier stratification
- Supplier rationalization
- Supplier collaboration
- Supply risk
- Tooling costs

Trade, Tariffs and Duties

- Developing favorable contract terms and conditions
- Minimizing duties, VAT
- Minimizing customs and brokerage fees
- Complying with US port security requirements
- International traffic tracking; INCO-term certification
- Managing tax incentives
- Managing intellectual property issues

Logistics

- Minimize cost of rush shipments
- Inventory carrying cost analysis
- Trade-off analysis on cycle times
- Minimize customs delays
- Distribution and transportation network optimization; Transport cost analysis
- Manage service levels

II. The Basics

The first step in conducting any type of Lean Sourcing initiative involves understanding where dollars are spent. Companies often track expenditures by supplier, but this approach is

limiting, particularly if there are a large number of parts (e.g., over several thousand). Companies that manage their expenditures by part groupings or categories typically have a better handle on where their dollars go and can analyze pricing trends over time. GlobalAutoIndustry.com in conjunction with Aptium Global is currently running a diagnostic benchmarking survey of automotive suppliers on Lean Sourcing. Fully two-thirds of survey respondents are tracking purchases in a centralized manner.

Furthermore, aggregating purchasing volume and dollars using a Pareto Analysis (or the 80/20 rule by examining the 20% of purchases that comprise 80% of the total costs) begins to show where the largest cost savings opportunities might lie and which initiatives would have the biggest impact on the company. In addition, our experience suggests that companies that regularly cast their nets “wide” to identify alternative suppliers, achieve the most significant cost savings. Furthermore, from a “live-bidding event” standpoint, companies that identify six or more market participants typically generate greater savings than companies who include fewer suppliers.

Survey results are less favorable in these areas as two-thirds of companies do not have a formal process in place to competitively bid out part groupings. Moreover, over 90% of survey respondents do not deploy real-time bidding event strategies (e.g. internet auction, electronic sealed bid or live bidder conferences).

III. **Performance and Partnering**

Performance measurement is often an indicator of the level of purchasing process capability within an organization. These specific metrics begin to help organizations understand the total cost of doing business with a particular supplier. Companies that have developed a means to look beyond piece part pricing often wring out additional cost-savings opportunities. Increased defects at a lower purchase price can often increase total cost of ownership.

Companies that implement and have formal processes in place to develop suppliers typically receive the benefits of cost reduction on an on-going basis. Companies that don't measure their suppliers typically have a challenging time quantifying the cost of quality. More advanced companies who have deployed lean sourcing initiatives often work collaboratively with their supply partners on an ongoing basis. For example, a prominent Tier 1 automotive company deployed a supply management team to help streamline and wring out inefficiencies at their Tier 2 partner. (In the automotive industry, the perception is that when a supply management team is deployed it must mean the supplier is near bankruptcy—not an entirely accurate perception) When deployed proactively, the Tier 2 supplier becomes not only more cost effective for that Tier 1 but more competitive in general and better able to compete for new business.

In addition, joint product innovation can provide new growth opportunities for key suppliers. Even in rather standard hard core industrial products, a little product innovation goes a long way. Developing a stamped product to do what formerly was a casting has real savings potential. New engineered products combining hybrid plastic injection molded parts with metal parts can improve performance, reduce weight, reduce welds, reduce shop floor area and integrate functions. The savings are often enormous often in the area of 50–75%.

V. The Lean Sourcing Journey

Lean Sourcing requires a long-term commitment to combining elements of strategic sourcing with lean principles. It is not a destination, but a journey, that has different stages of maturity along the way. Figure 2, below, highlights the lean sourcing maturity model.

Figure 2
The Lean Sourcing Maturity Model



IV. Packing for the Trip

Lean Sourcing success requires that organizations:

Create a Lean Sourcing process that can be mapped and communicated to all team members Open communication and participation across functional areas provides a couple of significant benefits. First, open communication facilitates fairness and buy-in across the company. Second, greater cross-functional input provides a more comprehensive view of the issues that impact the company. By incorporating multiple views, solutions can be developed which address problem areas.

Develop project milestones, deadlines and target dates to get the job done

This is self-explanatory but accountability drives results. A never ending start or end date results in malaise and weak execution.

Create a team member incentive structure and compensation plan tied to process outcomes

We have seen incentive structures that are actually incompatible with such a process (e.g. a plant manager earns a bonus based on company sales instead of quality or total landed cost). Develop bonus structures and cash compensation that are awarded back to employees that identify and help implement cost reduction initiatives.

Take a global perspective, albeit one that carefully analyzes supply risk

Companies can no longer afford to only look at suppliers within a 50 mile radius of their plants. Look to global markets for certain product categories but be sure to model potential risks (e.g. longshoremen strikes, late deliveries, etc.)

VI.

In Summary

Lean sourcing—if carried out effectively—can yield the single biggest cost reduction benefit for your company. We have seen organizations achieve measurable results and savings inside of six months, without any negative impact to cash flow. As important, it is critical to realize that lean is not in conflict with strategic sourcing, nor is strategic sourcing in conflict with lean. Getting the two parties (manufacturing and purchasing) to come to the table and work together is the most important step—bridge the gap! Remember, process is the key, but technology can be a significant enabler.

As important, companies should not let a lack of internal capabilities slow them down. If an organization is lacking either the know-how or the arms and legs in either Lean Manufacturing or Lean Sourcing it is critical to engage the right outside advisors to make lean sourcing a reality. The results will delight your owners, shareholders, employees and your customers.

Are you curious to discover what savings and quality improvement opportunities your organization is leaving on the table? Discover your opportunity by participating in our Lean Sourcing Diagnostic Survey by dropping us an email at info@aptiumglobal.com. We will be happy to provide you with a password and link to get you started.

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