



Strategic Sourcing: Gaining Advantage, Mitigating Risk

Despite the abundance of focus on supply chain fragility over the past half decade, many supply chains are as vulnerable as ever, and the vulnerability often stems from heavy reliance on a small set of suppliers that results in a supply chain more prone to risks. Additional issues that can impact supply chain viability include talent and/or skill shortages, regulatory compliance, supplier reliability, inventory management, demand fluctuations and a lack of transparency. To address these concerns, executives and board members are pressing procurement departments to improve supply chain resiliency, diversify their supply base, and potentially reshore or nearshore manufacturing and suppliers. While it may be tempting for procurement leaders to rework the current roster of suppliers right away, cultivating a deeper understanding of the nature and extent of risks inherent in the supply chain and taking a more strategic approach to sourcing and supplier selection may deliver greater value.

As new practices in sourcing lead procurement professionals into new territory (geographical or otherwise), hard-won expertise may no longer be enough. Dropped into a new geopolitical context (or into the middle of 2024), they may find fresh information more useful than their own experience. Procurement leaders can't rely solely on historical knowledge to succeed in new contexts. Opening up to new ways of thinking and tapping into current regional and category knowledge circumvents the hazard of relying on past experiences that may no longer apply.

Procurement leaders are better supported when the sourcing strategy not only considers how the

enterprise's suppliers are identified, onboarded and managed, but also maps out fresh approaches to supply chain planning and inventory visibility. A shift in mindset to a strategic sourcing strategy anticipates and mitigates supply chain risk while **improving resilience** and responsiveness, still aiming to reduce total cost of ownership (TCO). By strengthening strategic sourcing capabilities to include stronger supplier identification and regional category intelligence, procurement leaders are equipping themselves to reduce and respond to supply chain risk, whatever challenges the coming months may bring.

Intensifying risks – and the imperative for strategic sourcing

A multitude of risks threatens supply chains, and prognosticators see many of these risks intensifying. In our recent past, the COVID-19 pandemic highlighted the fragility of complex global supply networks. The United Nations' World Economic Situation and Prospects 2024 report describes a "sobering picture of the global economic landscape," with adverse implications for international supply chains.¹

- **Tariffs and trade:** Offshore manufacturing has historically been favored as a way to reduce costs, but new tariffs and other changes can erode those savings, as they introduce an element of uncertainty into supply chains. Strategic sourcing includes monitoring and reevaluating offshore arrangements as conditions change.
- **Cost:** Using suppliers in lower-cost countries incurs hidden costs, including shipping, inventory carrying, and quality-control expenses. When all factors are considered, suppliers closer to home may be the better option — even when labor costs are higher. Domestic sources mean reduced lead times, lower shipping costs and speedier responses to changing needs. Strategic sourcing evaluates supplier scenarios to consider hidden costs or identify additional ways to remove costs from the end-to-end process, not just focus on purchase price.
- **Currency:** For companies engaged in international trade, the volatility of currency exchanges impacts the cost of goods. Strategic sourcing mitigates the risk by identifying approaches to achieve stability in financial transactions. By mitigating currency risk, procurement teams develop more accurate financial plans and budgets and attain greater confidence in their cost structures.
- **Quality and reputation:** Businesses must respond swiftly to negative impressions of product quality. When products are perceived as subpar, brands struggle to recover. As social and environmental awareness has grown, investors, consumers and others have come to consider enterprises' suppliers. Stakeholders note the human rights and sustainability track records of the countries and companies from which goods originate. Strategic sourcing mitigates the related risks of quality and brand reputation and identifies trading partners whose operations and reputation reflect well on an enterprise's brands and products.
- **Labor:** Businesses struggle to find the skills needed to deliver services and build products. For some that have sunk costs into developing workforces in specific markets, these commitments can seem unbreakable. Meanwhile, new markets continue to emerge. Strategic sourcing calls for reviewing and identifying new sources so enterprises can tap into new talent pools. This practice accelerates innovation and ensures a workforce that's aligned with organizational values and goals.
- **Risks of global disruption:** Natural disasters, pandemics and geopolitical events all expose the **fragility of complex, far-flung supply chains**. Strategic sourcing streamlines complex global operations, reduces lead times and facilitates clear, complete and more frequent communication to avoid trouble and ensure speedier resolution when disruptions occur.

A shift in mindset to a strategic sourcing strategy anticipates and mitigates supply chain risk while improving resilience and responsiveness, still aiming to reduce total cost of ownership (TCO).

¹ "World Economic Situation and Prospects 2024," United Nations, January 5, 2024: <https://www.un.org/sustainabledevelopment/blog/2024/01/overview-world-economic-situation-and-prospects-2024/>

Elements of strategic sourcing

To address these risks, procurement leaders should develop a solid roster of suppliers who best meet their requirements, considering each supplier's prices, quality and capacity, as well as business continuity and resilience, location, and other factors. Together, the elements of **strategic sourcing** encompass a set of principles, leading practices and systems. With these elements, procurement leaders put in place the structure and processes to secure a high-performing and resilient supply chain based on a deep understanding of enterprise strategies and values.

Data cleansing and spend analysis

Before evaluating and adjusting supplier relationships, it's important to have a strong understanding of current spend by category, business unit, geographical location and supplier. Many procurement organizations conduct category analysis using historical data that they know to be inaccurate or incomplete. Conducting robust supplier and category enrichment can help to ensure that analysis is reliable and leads to sound business decisions. Additionally, it is important to address the mechanisms by which bad data are being created and not just the existing data itself. Requisition and PO processes and tools are often culprits in propagating inaccurate user-created supplier and spend data.

Category management, sourcing and supplier onboarding

Having accurate, current information about suppliers and supply markets is critical. If an enterprise hasn't cultivated new suppliers in recent years, it will want to strengthen supplier selection and onboarding capabilities, particularly if it is considering resources in new geographical locations.

- **Supplier identification and vetting:** Strategic sourcing considers the drivers that inform supplier selection. Procurement professionals explore internal stakeholders' risk tolerance and study how supplier capabilities, innovation, scale and other factors are valued within the enterprise.

The leading practice for identifying suppliers is to search broadly. There is no escaping the need to gather and analyze data about numerous suppliers — after which many won't meet requirements.

- Larger organizations may divide this work across category managers or even category councils — subject matter experts who specialize in a particular spending classification.
- Trade groups and professional associations help narrow the list of prospective suppliers, especially when those associations administer certifications that suppliers should possess.
- Data providers offer high-level supplier profile information to be rounded out via subsequent requests for information.

Procurement professionals may gravitate toward providers in their procurement software vendor's supplier network. And while this can be a helpful shortcut, inclusion in these networks isn't always a meaningful endorsement, as the software provider might not qualify the vendors it includes. This has quickly become a primary use case for artificial intelligence (AI) in procurement, leveraging AI algorithms to identify potential suppliers based on any number of user-defined criteria.

- **Supplier onboarding:** Strategic sourcing calls for developing repeatable processes that ensure each supplier is well established in its relationship to the enterprise. Engaging suppliers within a structure of clear policies and requirements sets them up for optimal performance.

Procurement leaders can define requirements for suppliers, including requiring them to integrate their systems with the enterprise to facilitate trade or to use a portal to exchange information. Procurement teams can specify purchase order requirements and details to include on each invoice and can work with legal teams to standardize language in contracts and other procurement documents.

Supplier management

An effectively run sourcing process or event must transition to the process of actively managing suppliers. This includes evaluating the importance and scale of each relationship and overseeing it accordingly. Managing suppliers is simpler once they're classified into tiers that dictate levels of communication and performance monitoring. With this method, high-value and high-risk relationships get the attention they warrant. Managing suppliers also should balance the aspects of performance, compliance, risk and relationship management.

Metrics ensure clarity of expectations for the enterprise and its suppliers. These might include:

- Performance targets that apply to all relationships
- Specific targets that apply to particular relationships (for example, metrics for raw material providers would differ from those for office equipment vendors)
- Quantitative targets concerning pricing, discounts, lead times, fill rates, etc.
- Qualitative targets such as service level, responsiveness, spirit of innovation and other vendor attributes

Once captured, metrics become the data by which supplier performance is tracked. Procurement teams use this information most effectively via systems that generate scorecards and dashboards. The information these practices yield not only mitigates risk, but also supports forecasting and enhances the enterprise's bargaining position when renegotiating agreements.

Strengthening strategic sourcing capabilities to include stronger supplier identification and regional category intelligence equips procurement leaders to reduce and respond to supply chain risk, whatever challenges the coming months may bring.

Supply chain planning

Strategic sourcing means understanding what's needed and what's possible while also considering constraints on operations:

- Knowing what's needed means recognizing customer expectations and developing granular demand forecasts. These factor in seasonality, product mix, regional preferences and other components to support accurate inventory allocation and replenishment planning.
- Knowing what's possible means understanding suppliers' capacities and risks to their operations. It means maintaining communication so information about supplier operations and lead times is always current.
- Understanding trading partners' internal constraints (including warehousing, fulfillment, logistics, labor availability, lead times and even process maturity) provides the ability to foresee changing capabilities — not only to execute within a plan, but also to mitigate risks and keep plans on track.

Supply chain inventory visibility

Establishing a complete view of products as they flow from supplier to manufacturer to final consumer is a critical element to gaining an advantage and mitigating supply chain risk. Connecting inventory visibility into supply chain planning and sourcing/procurement teams is a key first step in this process. Using data and analytics, enterprises can monitor and manage supply chains more responsively. By tracking inventory levels, production progress and delivery timelines throughout the supply chain, enterprises make better-informed choices and respond swiftly as market conditions change.

The key to supply chain inventory visibility is data that are current and detailed enough to create accurate, near-real-time views of the flow of goods. This starts with reducing manual processes, since those lead to inaccuracy.

Without integration of inventory data across the supply chain, differences arise between suppliers, plants, distribution centers and retail establishments. Planning, sales, warehousing, shippers and suppliers have their own systems of record. When inventory positions in each group fall out of sync with one another, that lack of alignment diminishes confidence in delivery commitments. Reducing process silos and integrating systems diminishes this risk. Then, automation enables active management of inventory data across all supply chain systems.

Mitigating risk, strengthening resiliency, boosting confidence

Business leaders face a complex global trading environment. Hazards like new tariffs and other unexpected costs, quality issues, reputational risk, labor scarcity and currency fluctuation put

operations at risk. The robust supply chain capabilities that strategic sourcing delivers — identifying and onboarding suitable suppliers, managing relationships effectively, forecasting accurately and attaining supply chain inventory visibility — mitigate risk, strengthen resiliency and boost confidence in operations. By embracing strategic sourcing, procurement leaders can make informed choices that ensure long-term success in an ever-changing global marketplace.

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