

Sourcing Decisions

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Introduction

- The sourcing decision
- Sourcing strategies
- Supplier evaluation
- Trends in supply management

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Focus

Sourcing decisions and purchasing activities serve to link a company with its supply chain partners

- **Sourcing decisions** – High level, often strategic decisions regarding which products or services will be provided internally and which will be provided by external supply-chain partners
- **Purchasing** – discussed in Chapter 11
The activities associated with identifying needs, locating and selecting suppliers, negotiating terms, and following up to ensure supplier performance

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The Sourcing Decision

Sourcing decisions are high-level, often strategic decisions that address:

- What will use resources within the firm
- What will be provided by supply chain partners

- **Insourcing** –
The use of resources within the firm to provide products or services
- **Outsourcing** –
The use of supply chain partners to provide products or services

} **Make-or-Buy Decision**

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Advantages and Disadvantages of Insourcing

Advantages

- High degree of control
- Ability to oversee the entire program
- Economies of scale and/or scope

Disadvantages

- Required strategic flexibility
- Required high investment
- Loss of access to superior products and services offered by potential suppliers

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Advantages and Disadvantages of Outsourcing

Advantages

- High strategic flexibility
- Low investment risk
- Improved cash flow
- Access to state-of-the-art products and services

Disadvantages

- Possibility of choosing a bad supplier
- Loss of control over the process and core technologies
- Communication and coordination challenges
- "Hollowing out" of the corporation

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Factors Affecting the Decision to Insource or Outsource

Factor	Favors Inourcing	Favors Outsourcing
Environmental uncertainty	low	high
Competition in the supplier market	low	high
Ability to monitor supplier performance	low	high
Relationship of product/service to buying firm's core competencies	high	low

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Total Cost Analysis

A process by which a firm seeks to identify and quantify all of the major costs associated with various sourcing options

- **Direct costs –**
Costs that are tied directly to the level of operations or supply chain activities
- **Indirect costs –**
Costs that are not tied directly to the level of operations or supply chain activity

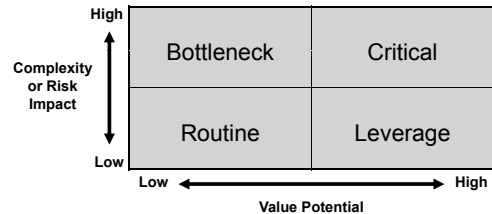
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Inourcing and Outsourcing Costs

	Inourcing	Outsourcing
Direct costs	<ul style="list-style-type: none"> •Direct material •Direct labor •Freight costs •Variable overhead 	<ul style="list-style-type: none"> •Price (from invoice) •Freight costs
Indirect costs	<ul style="list-style-type: none"> •Supervision •Administrative support •Supplies •Maintenance costs •Equipment depreciation •Utilities •Building lease •Fixed overhead 	<ul style="list-style-type: none"> •Purchasing •Receiving •Quality control

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Portfolio Analysis



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Critical Quadrant

- Critical to profitability and operations
- Few qualified sources of supply
- Large expenditures
- Design and quality critical
- Complex and/or rigid specification
- **Strategy**
 - Form partnerships with suppliers
- **Tactics**
 - Increase role of selected suppliers
- **Actions**
 - Heavy negotiation
 - Supplier process management
 - Prepare contingency plans
 - Analyze market/competitions
 - Use functional specifications

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Bottleneck Quadrant

- Complex specifications requiring complex manufacturing or service process
- Few alternate productions/sources of supply
- Big impact on operations/maintenance
- New technology or untested processes
- **Strategy**
 - Ensure supply continuity
- **Tactics**
 - Decrease uniqueness of suppliers
 - Manage supply
- **Actions**
 - Widen specification
 - Increase competition
 - Develop new suppliers
 - Medium-term contracts
 - Attempt competitive bidding

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Leverage Quadrant

- High expenditures, commodity items
- Large marketplace capacity, ample inventories
- Many alternate products and services
- Many qualified sources of supply
- Market/price sensitive
- **Strategy**
 - Maximize commercial advantage
- **Tactics**
 - Concentrate business
 - Maintain competition
- **Actions**
 - Promote competitive bidding
 - Exploit market cycles/trends
 - Procurement coordination
 - Use industry standards
 - Active sourcing

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Routine Quadrant

- Many alternative products and services
- Many sources of supply
- Low value, small individual transactions
- Everyday use, unspecified items
- Anyone could buy it
- **Strategy**
 - Simplify acquisition process
- **Tactics**
 - Increase role of systems
 - Reduce buying effort
- **Actions**
 - Rationalize supplier base
 - Automate requisitioning, e.g., EDI, credit cards
 - Stockless procurement
 - Minimize administration costs
 - Little negotiating

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Sourcing Strategies

- **Single sourcing** –
The buying firm depends on a single company for all or nearly all of an item or service
- **Multiple sourcing** –
The buying firm shares its business across multiple suppliers
- **Cross sourcing** –
Using a single supplier for a certain part or service and another supplier with the same capabilities for a similar part
- **Dual sourcing** –
Using two suppliers for the same purchased product or service

Multicriteria Decision Models in Sourcing and Purchasing



How do we evaluate alternatives when criteria include both quantitative measures (such as costs and on-time delivery performance) and qualitative factors (such as management stability and trustworthiness)?

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Weighted-Point Evaluation System - I

Purpose:

- Evaluating potential suppliers
- Tracking suppliers' performance over time
- Ranking current suppliers

The Process:

- Assign weights to performance dimensions
- Rate the performance of each supplier with regard to each dimension
- Calculate the total score