

WHITE PAPER

PROCUREMENT STRATEGY

IS IT NOT TIME YOU GO DIRECT?



synertrade | econocom





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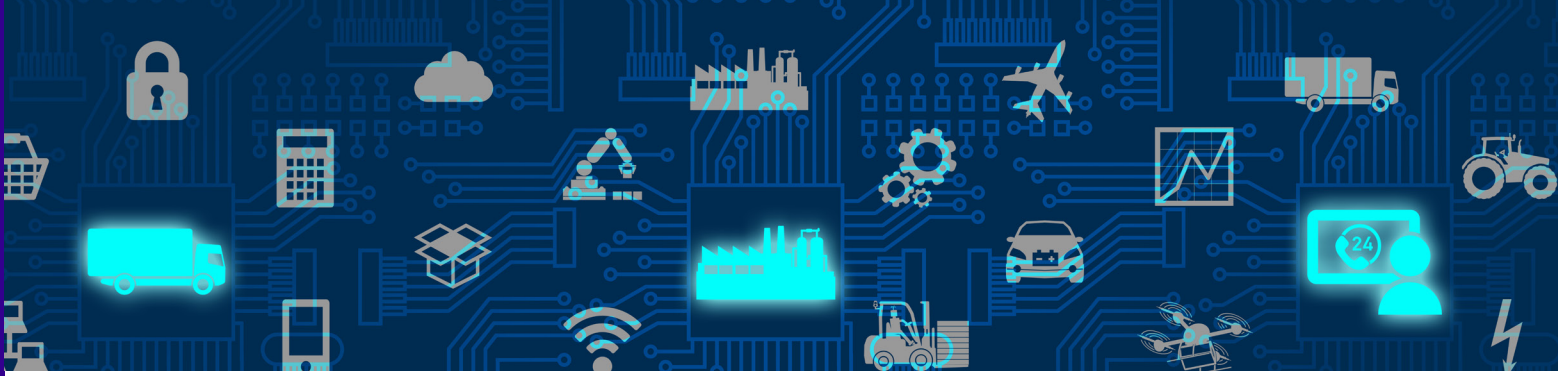
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*“What is direct sourcing?
And how is it different
from regular sourcing? Or
even indirect sourcing?
Especially when some
experienced professionals
would argue there is no
difference at all.”*

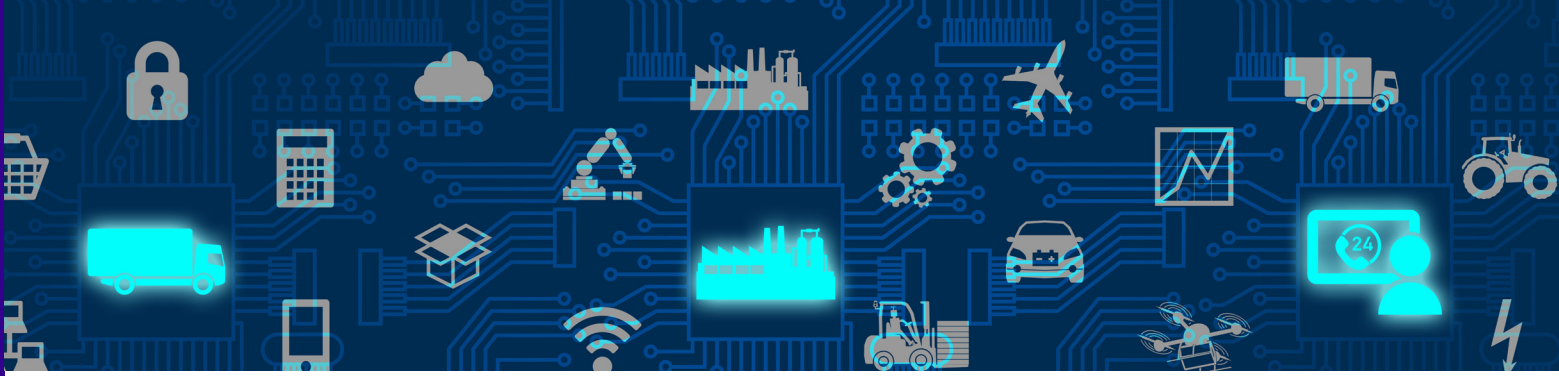


INTRODUCTION

The common definition is that direct sourcing is done by manufacturers and similar industries that source raw materials and components for use in production and indirect sourcing is done by retailers, distributors, and service organizations that are buying finished products for sale and/or consumption. And, as most experienced professionals would point out, there's fundamentally little difference. In one case, the organization is buying raw materials, and in the other case, finished goods, and, in both cases, the organization should, more-or-less, be employing the same best practices. Moreover, even with the technical difference, one organization's direct is another organization's indirect.

And while, theoretically, they are the same, from a technological viewpoint, they are different. Any sourcing platform can support indirect sourcing, but not any sourcing platform can support direct sourcing. Why? To support indirect a platform only needs to support line-items and lots for bundled bids -- which is what the majority of platforms support. To support direct sourcing, platforms need to support complex multi-level bill of materials, which the majority of platforms do not support. And from those that do, most do not support it very well.

For example, there are some platforms out there, ~~built as~~ that can import bill of materials, but they cannot maintain, or even manipulate them. This is problematic for direct sourcing because you don't always source an entire bill of materials. First of all, sometimes you already have some of the components under contract, so you don't need to source those. Other components are low dollar, non-strategic, or better bought on the spot market, so those won't be sourced. And, most importantly, some components will need to be sourced across multiple categories and products,



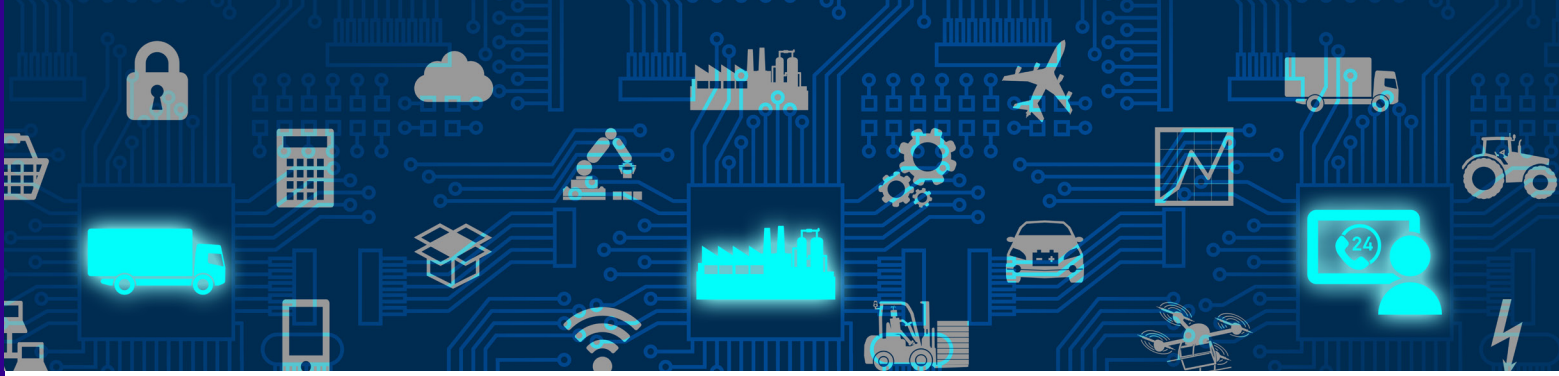
represented by different bill of materials. As a result, if you are sourcing direct, you really need a platform that can slice and dice a bill of materials to cut out common raw materials and components, identify those that have already been sourced, and group those that need to be sourced into one or more sourcing events.

So, while there may be no difference in theory, there is a big difference between indirect and direct platforms in practice.

And, moreover, even if the bulk of your organization's purchases is indirect, the reality is that you still need a direct sourcing platform to figure out the right strategy and make the best overall sourcing decision.

Why?

That's the first very important question we are going to answer in this short white paper. The other very important question is "what constitutes a proper direct sourcing platform?"

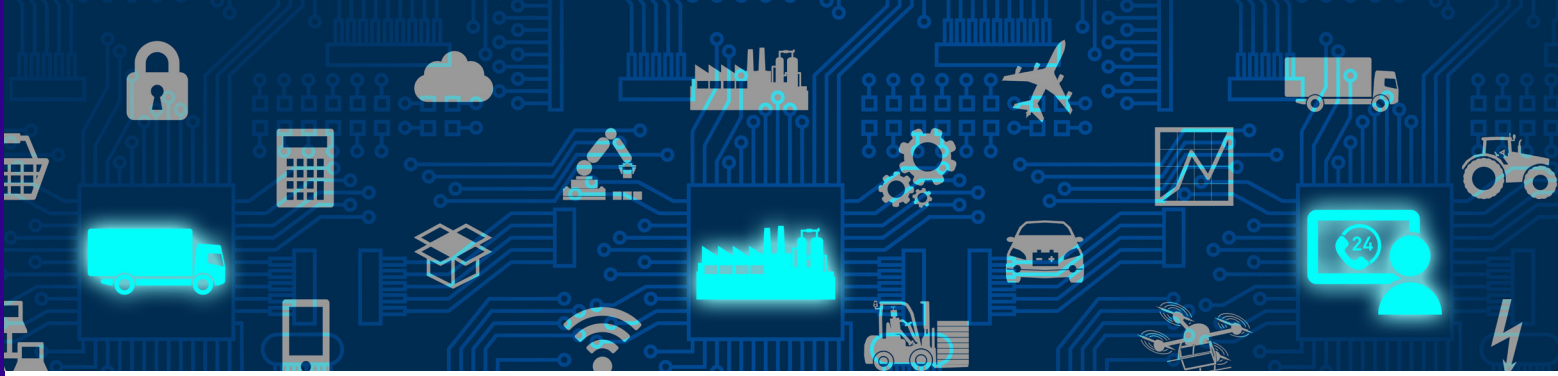


I. WHY DO YOU NEED DIRECT?

If your organization is a manufacturing, pharmaceutical, aerospace, defense, oil & gas, or other industry that does custom manufacturing, then you know why you need a sourcing platform that supports your needs. But if your organization is in retail, CPG distribution, financial services, or a similar industry that primarily buys finished goods, you might not realize why you need a direct sourcing platform. But, hopefully, after you read this paper, you'll understand.

Simply put, there are five major reasons why you need a direct platform:

- Without a direct platform, you don't know what the **cost drivers** are.
- Without a direct platform, you don't know how **market events** impact categories.
- Without a direct platform, you don't know **where** the products are really coming from.
- Without a direct platform, you don't know **who** is putting you at risk.
- Without a direct platform, you don't really know **why** you should, or should not, source from a supplier.



Only Direct Platforms Clarify the Cost Drivers



If all you have is an indirect platform, your market intelligence is generally limited to two sources:

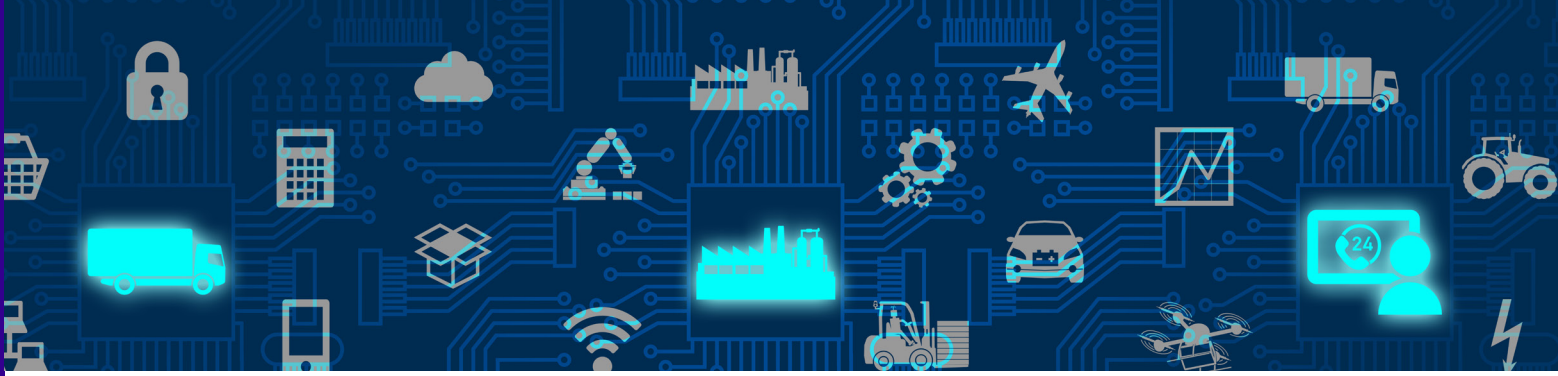
- a) supplier bids
- b) market prices from online sites, GPOs, etc.

This means that you have insight into how much you should be paying today, but no insight into why the prices are what they are. Did the prices go up because raw materials went up? Because labour went up? Because energy costs went up? Because transportation costs went up? Because the tariffs went up as a result of the Trump Trade Wars?

And if you don't know why prices went up, not only do you not know how to combat the price increases, but you don't know if the price increases the supplier is asking are even justified. For example, if the primary product is steel, and steel just went up 30%, that doesn't necessarily mean your supplier's prices should go up 30%. First of all, how much of the product is really steel? Secondly, did the supplier's steel prices really go up 30%? **For example, and their costs might only have went up 10%** ~~if the primary reason~~ They might have had a long-term contract with the raw material provider. And if the real reason for the local steel price increase was tariffs, that doesn't mean they were hit if they were sourcing from, manufacturing in, and primarily shipping to countries without the tariff. Maybe only your US-bound products are affected.

But if you have a direct platform, you can build detailed should-cost models based

Single Line!



on the product bill of materials (using commodity market feeds from the respective countries); a break-down of the overhead into labour cost, energy costs, and remaining overhead costs; the true supply chain export and import tariffs (from source material country to production country to destination country); and a fair margin for your industry. Then you'll know if the supplier is justified in demanding a 3%, 13%, or a 30% price increase when you go (back) to market.

Only Direct Platforms Measure Market Event Impacts

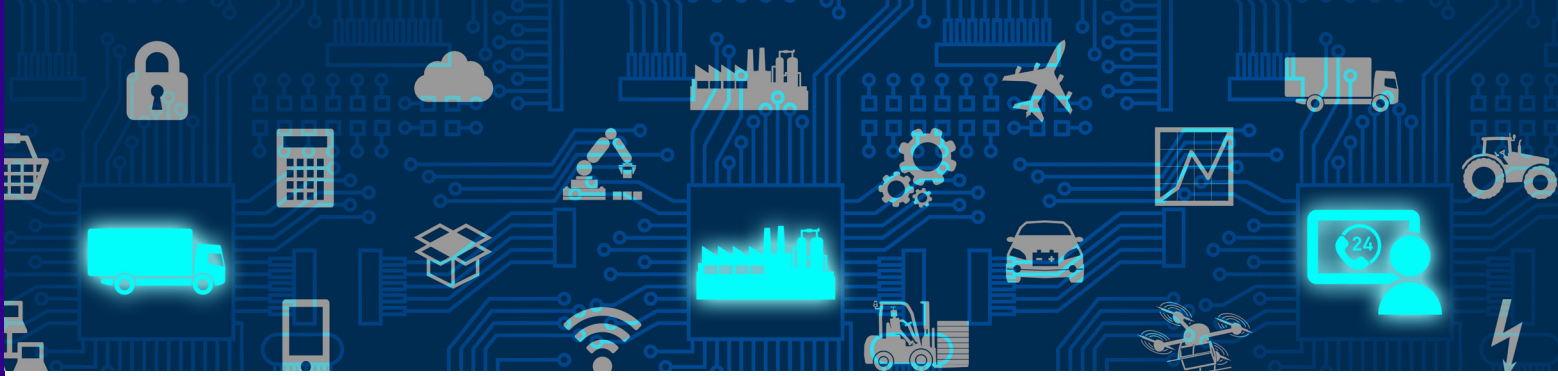


Categories are impacted by more than just cost increases, which we covered in depth in the last section. Categories are also affected by supply shortages, which can prevent production at all, regardless of how much money you have in the emergency coffers. They can also be impacted by transportation strikes or port strikes that prevent delivery of critical raw materials and products. They can be waylaid by natural disasters that bring down mines, refineries, and production facilities.

Without a direct sourcing platform that allows you to model all of your key products as complete bill of materials, you really have no idea how little or how much of a raw material you actually need. For example, just because a natural disaster knocks out 10% of the world's supply of a raw material, that does not mean your organization will be impacted. Maybe you only use 1/10th of 1/10th of the world's supply, and your current supplier has enough raw materials stored to last you a year. Or maybe you use 1% of the world's supply in your high-end electronics, and you will be highly impacted if you don't lock up more supply soon.

Nor do you know much material you would have to stock to withstand a 1 week, 1

Single Line!



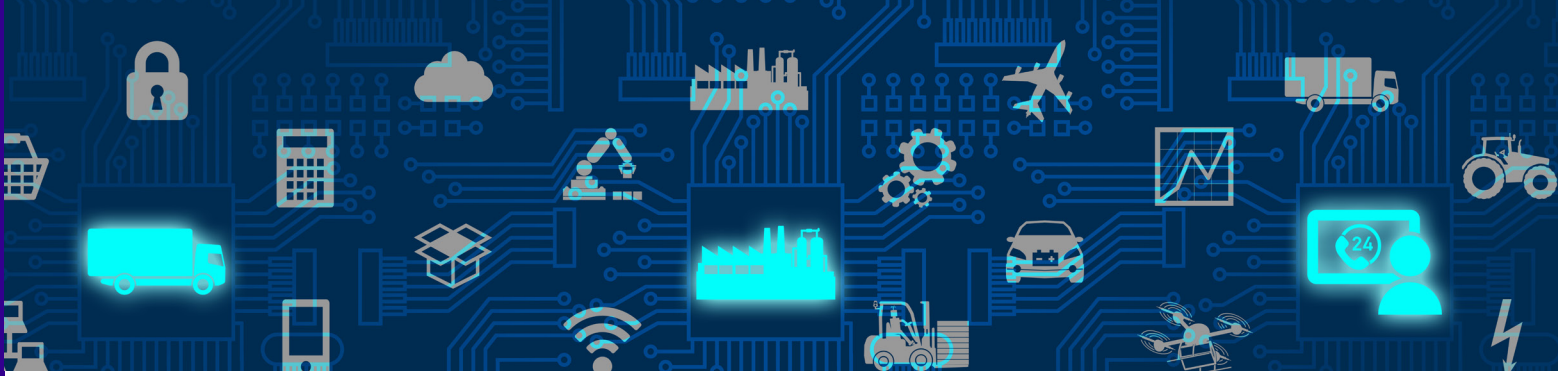
month, or 1 quarter supply disruption. Or how much an anticipated port strike of three weeks will impact you, and, more importantly, **what** categories will be impacted and what percentage of revenue they represent. If the strike will only impact categories that represent a mere 5% of your organizational revenue, the impact will likely be minimal. If the strike will impact categories that represent 35% of your organizational revenue, the impact is likely to be significant and mitigation plans will need to be put in place immediately.

Only Direct Platforms Show the True Origin of Your Raw Materials



This is becoming critically important in France, the UK, Canada, the US (especially California), and other countries and states putting in place laws that not only require complete country of origin information on every product you sell and adherence to denied party lists, but also putting in place anti-slavery and anti-human trafficking laws. You need to not only know who you are buying from, where they are, and whether they have passed necessary audits but who your suppliers buy from, where those suppliers are, and whether they have passed necessary audits.

The last thing you want is for the government to find out that your suppliers are sourcing from denied parties, your customers to find out your supply chain contains slave labour, or your shareholders to find out that you can't trace the source of origin of all of your products and can't immediately identify the source if a product makes a person sick, putting your organization at risk for costly lawsuits.



Only Direct Platforms Provide True Pictures of Your Supply Base

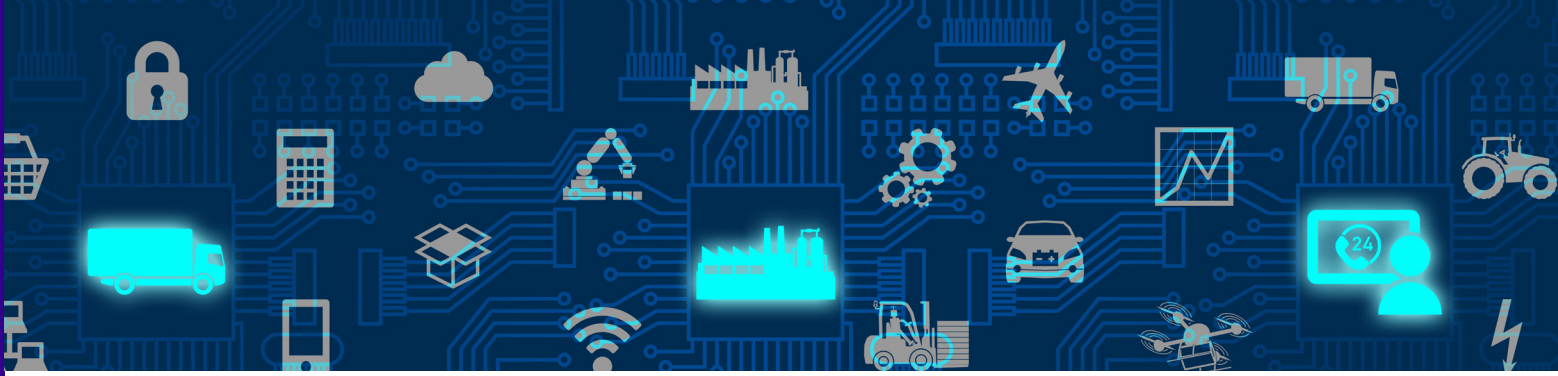


As should be quite clear by now, your entire supply chain puts your organization at risk, not just your tier 1 suppliers. Unless you can build deep bill of material models, understand what you are buying, and collect information from your suppliers as to the source of any regulated raw material, you're at risk. Furthermore, if you don't know how a strike, natural disaster, or trade embargo is going to affect your organization, a month or two down the road your organization could suddenly find that it's stocked out of its highest revenue product line with no chances of replenishment for six weeks. Only a direct platform allows an organization to collect and query the data necessary to make the right inferences on each event and put the right mitigation plans into place when necessary.

Only Direct Platforms Support Sourcing Strategies



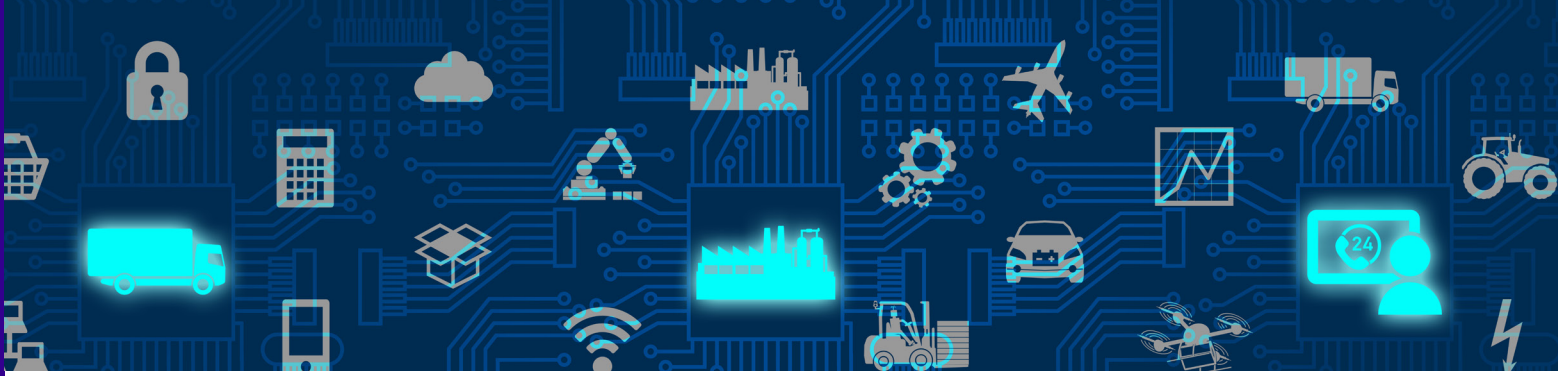
Every new supplier can bring great benefits and great risk to your organization -- risks that are not limited to the supplier itself, but the supply chain it uses. And unless you understand the full picture of the supplier, you don't know if the benefits outweigh the risk. And if you don't know that, you don't know if you are making the right sourcing decision. Period.



II. WHAT MAKES A PLATFORM DIRECT?

Hopefully by now you know that, even if the majority of your purchases are indirect, you still need a direct sourcing platform. But what is a direct sourcing platform? What is necessary for your sourcing success? A number of things make up a great direct sourcing platform, but the following four things are absolutely critical for sourcing success.

Too much white space!



Deep Bill of Materials Support



As made clear in our previous sections, deep bill of materials support is one of the foundations of direct sourcing. The ability to import, manipulate, and analyze bill of materials is key for direct sourcing support, and for understanding the true cost drivers, and inherent risks, of any purchase.

Deep Should Cost Modelling

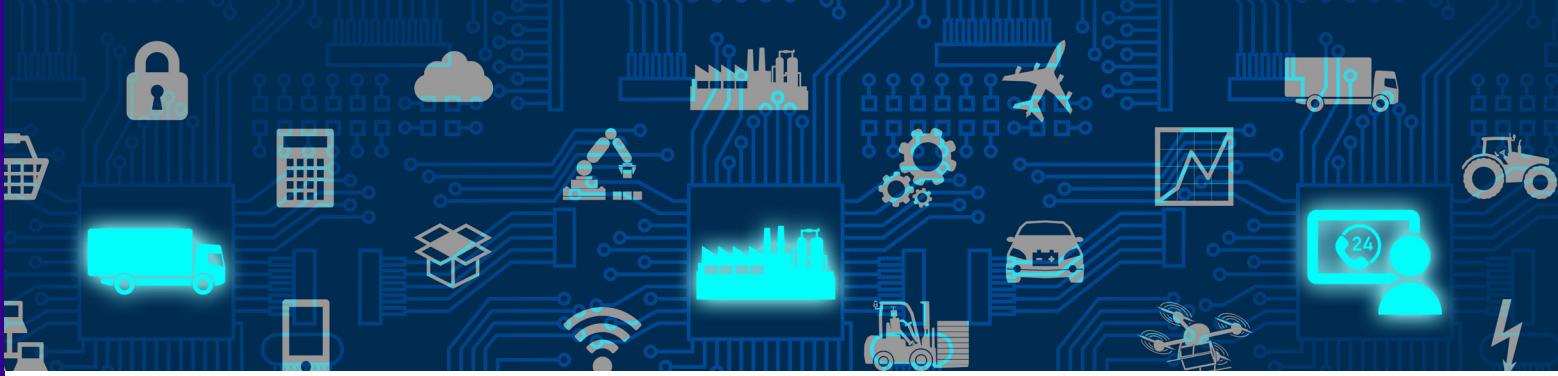


A deep bill of materials can help one understand the cost drivers, but not the current should cost of a product. That requires the ability to break the product cost down into raw materials, overheads, tariffs, and fair margins and then import all current market and supplier costs into the model to understand what the cost should be.

True Strategic Sourcing Decision Optimization



While optimization is important for indirect sourcing, as it's the only way to minimize total cost of ownership, when there are purchase costs, transportation



costs, (intermediate) storage costs, and other ownership costs, it's much more important for direct. Do you source the entire bill of materials, do you source sub-categories, or do you source particular raw materials? And, it's also important for understanding how an organization can optimally split awards across the supply base -- ensuring that strategic suppliers get categories that allow them to optimize raw material buys and minimize risk to your organization.

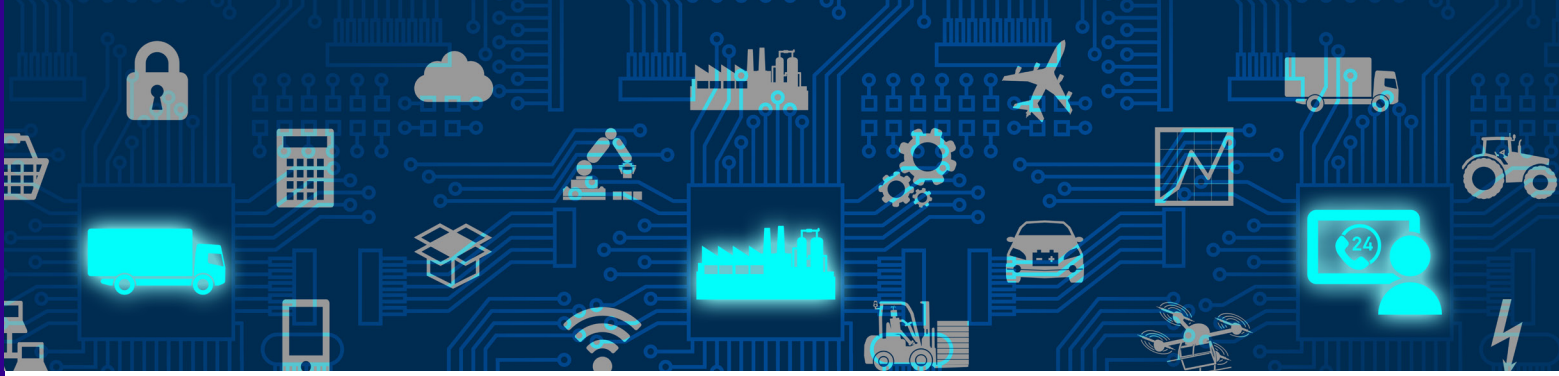
360-degree Supplier Profiles with 3rd Party Data Support



Hopefully it is now abundantly clear as to why deep, integrated, 360-degree supplier data is critically important for sourcing success. This is true for all sourcing -- indirect and direct -- but only direct sourcing platforms are built to support the depth of information necessary to ferret out risks in the supply chain beyond just tier 1 suppliers. It's always the risk the organization doesn't see that has the biggest impact, as mitigations can be put in place to minimize the impacts of known risks.



UNNECESSARY WHITE SPACE!



CONCLUSION

The conclusion is simple, even if your organization is primarily buying finished products, if those products are high revenue, strategic, or high risk, the organization still needs a direct sourcing platform to truly understand what those products should cost, what risks they bring, and which suppliers are the best overall suppliers for the organization.