Introduction

The term strategic sourcing has been used in state government procurement for several years now. Over the past decade many states have implemented formal or informal strategic sourcing programs as a means to drive cost savings, enhance efficiencies and bring best value to those utilizing their established contracts.

This research paper highlights how strategic sourcing is used within state central procurement offices. It outlines integral components of the practice while identifying key associated benefits to state governments. The paper assesses the use of this approach to procurement and provides a glimpse into the future of strategic sourcing in state government. Information obtained through phone interviews with 15 states (California, Colorado, Delaware, Indiana, Massachusetts, Maine, Michigan, North Carolina, New York, Oklahoma, Pennsylvania, South Dakota, Tennessee, Texas, Virginia) provided the basis of this assessment as well as feedback during and after a session at the 2014 Annual Conference of the National Association of State Procurement Officials (NASPO).

Strategic Sourcing Defined


A few definitions from various sources (quoted below) confirm that there is not one single definition for this sourcing approach.

- “Strategic sourcing is the collaborative and structured process of critically analyzing an organization’s spending and using this information to make business decisions about acquiring commodities and services more effectively and efficiently. This process helps agencies optimize performance, minimize price, increase achievement of socio-economic acquisition goals, evaluate total life cycle management costs, improve vendor access to business opportunities, and otherwise increase the value of each dollar spent.” (OMB, Memorandum for Chief Acquisition Officers, Chief Financial Officers, and Chief Information Officers, Subject: Implementing Strategic Sourcing - Washington, D.C.: May 20, 2005)

- “Strategic sourcing is an institutional procurement process that continuously improves and re-evaluates the purchasing activities of a company.” (Wikipedia)

- “A system and fact-based approach for optimizing an organization’s supply base and improving the overall value proposition.” (University of Michigan)

- “Strategic sourcing is the selection and management of suppliers with a focus on achieving the long term goals of a business.” (ISM Glossary of Key Supply Management Terms, fifth edition, 2009)

- “One of the key aspects of the [strategic sourcing] concept is the collection and analysis of a government’s procurement spending for commodities and services.” (2015 NASPO State and Local Government Procurement: A Practical Guide)
When talking about strategic sourcing or considering implementing a strategic sourcing program, it is important to understand what this approach to sourcing entails. Some jurisdictions use the term liberally to describe early cost savings efforts even when they do not employ a strategic sourcing program in the traditional sense, or even where only titles specifically related to strategic sourcing have been created.

The question is how to decide what strategic sourcing really is. This is especially critical at the beginning of the process so that everyone is on the same page and can avoid potential pitfalls stemming from a misunderstanding of the term and processes entailed. Table 1 below highlights some common misconceptions about strategic sourcing and what the approach is and should be in reality.

### Table 1.
**Common Misconceptions and Reality about Strategic Sourcing**

<table>
<thead>
<tr>
<th>Common Misconceptions about Strategic Sourcing</th>
<th>What Strategic Sourcing Really Is</th>
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<tbody>
<tr>
<td>Strategic Sourcing = Sole Sourcing</td>
<td>Strategic sourcing initiatives often result in multiple awards.</td>
</tr>
<tr>
<td>Strategic sourcing means buying the cheapest product, regardless of quality.</td>
<td>Maintaining or enhancing quality is a key component of most strategic sourcing engagements.</td>
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<tr>
<td>Strategic sourcing is about changing suppliers.</td>
<td>A strategic sourcing initiative will sometimes, if not often, result in using the same supplier.</td>
</tr>
<tr>
<td>Small, local and/or diverse businesses always lose out when contracts are strategically sourced.</td>
<td>Socio-economic policies will often dictate these suppliers be included in strategic sourcing activities.</td>
</tr>
<tr>
<td>Strategic sourcing is a one-size-fits-all approach to procurement.</td>
<td>Strategic sourcing methodology anticipates and provides for unique circumstances and challenges.</td>
</tr>
<tr>
<td>Strategic sourcing is about strong-arming suppliers.</td>
<td>Strategic sourcing is about understanding the marketplace, the category and the supplier community in order to obtain best value.</td>
</tr>
<tr>
<td>Strategic sourcing is a one-time project.</td>
<td>Strategic sourcing involves continuous improvement over the life cycle of many contract iterations.</td>
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In addition to understanding what strategic sourcing is, it is critical to also understand the difference between strategic sourcing and traditional procurement and where strategic sourcing can add value. Key differentiators for strategic sourcing are listed below.

- Advanced research and analysis play critical role
- Data-driven decisions
- Increased emphasis on aggregating demand
- Process leads to optimal number of suppliers
- Includes total cost of ownership
- Includes measurement of quality of goods and services
- May enhance relationships with supplier community
- Different skill set required of buying staff.

Benefits and Challenges of Strategic Sourcing

Due to the opportunities for cost reductions and efficiency gains associated with strategic sourcing, many states have undertaken measures to introduce these practices into their programs. According to the 2014 NASPO Survey of State Procurement Practices, 25 states have implemented some type of strategic sourcing initiative within their central procurement office. Thirteen states contract for strategic sourcing or spend analysis services. While state initiatives vary, many programs focus on creating cost savings and efficiencies through analysis of all state expenditures, leveraging aggregation opportunities and targeting significant spend categories. Thirteen states plan to implement tools to track and record cost savings and cost avoidance metrics from strategic sourcing in the future.

The methodology employed by the strategic sourcing process in evaluating the big picture of both contract consideration and internal business processes introduces the potential for a state to enjoy numerous benefits and advantages that may not be as easily seen under traditional procurement. Advantages can also be seen through careful monitoring of internal processes related to certain expenditure categories. Outside of the spend analysis portion of strategic sourcing, an organization can use this approach to evaluate their operational performance. State procurement professionals can use data to determine how efficient their department’s processes are as they relate to contract management, requisition timing, and overall employee performance. This information can then be used to develop goals and objectives to consolidate processes and improve the way central procurement offices conducts their business, leading to additional cost savings.

From a contract management perspective, this data-driven approach allows for the identification of opportunities to create enterprise contracts across state organizations that leverage buying power. Specifications for commonly purchased goods/services can be measured against contract evaluation to not only develop more focused specifications for future procurements but also to recognize trends in supplier performance related to the delivery of contract needs. By acknowledging opportunities for improvement on both sides of the aisle, a state can actively work to develop and manage relationships with suppliers that can work to foster more efficient and effective procurements and increase the quality of the goods/services obtained by the state.

Implementing strategic sourcing programs is not always an easy task. Outdated systems or systems not designed for
Strategic sourcing is an evolving approach. The number of steps and specifics of the process employed by different jurisdictions may vary. Broad principles that apply to most methods and strategic sourcing steps critical to successfully implementing strategic sourcing are discussed in this section.

Every strategic sourcing effort should begin with an opportunity assessment. Figure 1 below shows recommended steps when conducting an opportunity assessment to identify strategic sourcing opportunities. The five steps include data collection, data cleansing and analysis, a review of statutes, assessment of the political climate to understand all the factors at play and stakeholders involved and how they can be affected by the strategic sourcing, and the wave prioritization.

Additional challenges include:

- Lack of support/buy-in at executive level
- Difficulty in calculating savings
- Overly aggressive timelines
- Lack of trained resources/staff
- Restrictive laws/rules/policies
- Legislative resistance/pushback
- Agency resistance – decentralized environment
- Potential adverse impacts on small minority- and female-owned businesses
- Conflicts and/or litigation with strategic sourcing consultants

Figure 1. Opportunity Assessment

| Collect Data | • Accounts Payable, Appropriations, ERP, eProcurement, p-Card, Vendor Sales Data  
  • Can be a time consuming process |
| Analyze Data | • Data cleansing (duplication removal, standardization, extrapolation)  
  • Mutually exclusive, collectively exhaustive (MECE), Price x Quantity Data (PxQ), Extrapolation  
  • Preliminary Benchmarking |
| Analyze Statutes | • Review statutes, rules, and policies  
  • Distinguish from procedures that are status quo |
| Assess Political Climate | • Vendor Community  
  • State Leadership (Legislators, Agency heads, Governor’s Office)  
  • Affected staff |
| Prioritize Waves | • Based on two or more facets including Competitive Landscape, total category spend, Savings Potential, Complexity, time to source, etc. |
Once the opportunity assessment is complete and major categories of addressable spend are identified, each category can be assessed on three or more of the most important factors in order to prioritize efforts. Wave I should include category items that scored high in terms of anticipated savings opportunities and low in terms of complexity and time required to strategically source. Categories appropriate for Wave I are big impact large spending items with centralized spend, complete data collected, known and competitive supplier base, and easy specifications.

Figure 2 below is an example of a multi-dimensional matrix to use for wave prioritization, including factors such as anticipated savings, competitive landscape, complexity, level of effort required, political climate, time since the category was last sourced and total spend.

Each individual strategic sourcing process should include conducting research and analysis, and engaging with stakeholders, including vendors, before finalizing the sourcing strategy. The stakeholder discussion is then followed by setting up the procurement event which includes all the steps leading to the contract award, which is then followed by the performance management phase. It is important to document lessons learned from the strategic sourcing process for each category for future reference. Figure 3 below shows an example of a simple four-step strategic sourcing process which can be followed for each category of spend identified.
However, most state reported agency-specific carve-outs or delegated authority as follows:

- 67% of states reported carve-outs for the Department of Transportation
- 60% of states reported an independent procurement oversight for IT goods and services.

Question: On a scale from 1-10 (with 10 being the highest) how much emphasis and focus does your state place on formal strategic sourcing activities?

Interview results indicated a ranking average of 6.1 for strategic sourcing initiatives with the highest ranking of 9.5 and the lowest of 3.0. Some states noted their focus was increasing. Others have experienced a decrease in focus in recent years.

Table 2. Measuring Savings

<table>
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<tr>
<th>Baseline Price Options</th>
<th>Advantage</th>
<th>Disadvantage</th>
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<tbody>
<tr>
<td>Retail Price (Comparing your results to the retail price)</td>
<td>Can be time-consuming, but relatively easy to obtain</td>
<td>Produces unrealistically high savings</td>
</tr>
<tr>
<td>Market Price (Comparing your results to those of similar entities)</td>
<td>Accurate ongoing measure of performance against peers</td>
<td>Very time consuming. Also can be difficult to find good comparisons</td>
</tr>
<tr>
<td>Previous Contract Price (Comparing your results to the previous price)</td>
<td>Easiest to obtain</td>
<td>If done right, savings eventually fall to 0</td>
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Note: If Previous Contract Price is adjusted for inflation, savings are sometimes referred to as “Cost Avoidance.” Some states measure savings as the difference between the initial price offered by the winning responder and the final negotiated price.

Interview Highlights

Highlights and statistics from interviews with state central procurement officials and/or strategic sourcing directors are presented below.

Question: Is your procurement function centralized?

Interview respondents reported the following:

- 93% of states have centralized or partially centralized procurement operations
- 100% had negotiated multiple mandatory-use contracts.

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Administrative Support and Travel Services

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Tales from the Trenches: Evolution of Strategic Sourcing
Question: What are some skill sets and attributes needed for strategic sourcing?

Skill sets and attributes deemed essential for strategic sourcing staff are summarized below:

- Detail oriented person - creative/innovative thinker
- Strong communication skills - analytical skills
- Think outside the box - negotiation skills
- Big picture person - good rapport with stakeholders
- Good understanding of total cost of ownership.

Question: Which categories have been the most successful/challenging?

The most successful categories sourced (see chart below) were office supplies, followed by print, IT hardware, and fleet. The most challenging category noted by all participants with just a couple of exceptions was Maintenance, Repair, Operating (MRO).
Question: What level of support have you received from your legislature, administration, and your small and minority-owned community?

Legislature
- 87% of respondents indicate neutral or positive view
- Education/Communication is key

Administration
- 86% had full support of their administration
- Mid-stream administration changes can drastically change level of support

SMWB Community
- 67% reported unsupportive Vendor Communities
- However, a majority (71%) of them reported that this negative view was shifting

Question: How has the growth of cooperative purchasing impacted strategic sourcing?

Consensus among states is that use of cooperative purchasing as an approach will continue to grow and be used as part of the strategic sourcing analysis.

Question: Will strategic sourcing continue to grow, fade, or change in state government?

Most state directors interviewed seem to believe that the trend is growing with the caveat that changes in administration can sometimes change focus on strategic sourcing.

Interviews with states revealed the following key elements common to existing strategic sourcing initiatives among the interviewed states.

- Reduce number of suppliers
- Look at total cost of ownership
- Low price does not equal best value
- Use a defined process
- Consolidate enterprise needs
- Standardize

Comprehensive review of contracts
- Conduct market research
- Evaluate timing of solicitation
- Conduct front end spend analysis
- Systematic and structured approach
- Establish sustainable contracts
- Determine best procurement methodology
- Target specific categories
- Engage others in decision making process

Tales from the Trenches: Evolution of Strategic Sourcing
This paper addressed several critical questions around strategic sourcing starting with state definitions, including whether this is still a major focus for state government. It includes an investigation in terms of what organizational changes are made and/or what skill sets are added by states to effectively implement a strategic sourcing program. Also discussed is an assessment of how strategic sourcing has evolved over the past decade and where it is headed, based upon interview information.

Strategic sourcing still seems to be a critical part of state procurement organizations across the country. The number of states that are developing formal strategic sourcing programs continues to grow whether they use strategic sourcing in the traditional sense or a newer version of it, modified to fit the specific needs of a state. The job title Director of Strategic Sourcing, almost non-existent 10 years ago, can now be found in several state procurement organizational charts. The meaning of the term strategic sourcing also continues to evolve and change. While common themes exist, no two states would define it exactly the same. Policy mandates, differences in statutory authority and administrative philosophies dictate how a state implements a strategic sourcing program. The continuous evolution of strategic sourcing implementations may call for a new widely-accepted terminology, to more accurately reflect how states use this method and approach.

Additionally, while more and more states are pursuing strategic sourcing, challenges continue to exist. Restrictive laws, changes in administration and lack of executive support must be accounted for when implementing or developing a program. Additional challenges are faced in some states stemming from the lack of spend analytics tools and availability of comprehensive spending data to assist with their strategic sourcing efforts.

One example of a challenge states may need to address going forward is the fact that contracting is cyclical. Another challenge is to apply strategic sourcing principles to categories already sourced. An argument could be made that if strategic sourcing is successful, there would be little room for improvement in future generations of a category. In theory, the need for a strategic sourcing organization would diminish. However, in reality, due to the nature of government procurement, there will always be factors to consider: markets changes, economy shifts, change in direction of administrative policies, enhanced data capture helping to drive decisions, expansion of cooperative purchasing providing more options, and skills of staff becoming sharper. States will always have the opportunity to apply improved techniques and learn from the prior contracting cycle. Moreover, new categories and emerging trends in which the principles of strategic sourcing can be applied will continue to occur.

As government funds fluctuate throughout time due to changes in market conditions, states are increasingly looking towards strategic sourcing as one tried-and-true approach to help them become better stewards of taxpayer resources in the procurement process. Strategic sourcing, however defined, will continue to grow, evolve and play an ever expanding role in the future of state procurement.

Conclusion

This paper addressed several critical questions around strategic sourcing starting with state definitions, including whether this is still a major focus for state government. It includes an investigation in terms of what organizational changes are made and/or what skill sets are added by states to effectively implement a strategic sourcing program. Also discussed is an assessment of how strategic sourcing has evolved over the past decade and where it is headed, based upon interview information.

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About NASPO

The National Association of State Procurement Officials (NASPO) represents the directors of the central purchasing offices in all 50 states, the District of Columbia, and the territories of the United States. For more information on NASPO, please visit www.naspo.org.

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