

# Strategic Sourcing

May 7, 2004, By *Blake Harris*

With state and local jurisdictions everywhere facing continued budget difficulties, strategic sourcing could play a pivotal role in government purchasing practices. State officials already involved in strategic sourcing initiatives talk with excitement about the innovation -- and for good reason.

Pennsylvania expects to save \$100 million in the next year -- not by cutting purchases, but by buying smarter.

"There isn't a Fortune 100 company in business today that hasn't done some kind of strategic sourcing in the last five years," said David Yarkin, deputy secretary for procurement of Pennsylvania's Department of General Services. "It's only recently that governments are looking to strategic sourcing to really leverage their buying power and harness a tool that has been very successful in the private sector. My guess is there are eight or nine states currently engaged in sourcing, as well as a number of branches of the federal government."

For an entity as big as Pennsylvania government, turning to strategic sourcing is a no-brainer. Yarkin said the state spends in the neighborhood of \$3.1 billion annually on goods and services, and about one-quarter to one-third of that is in the IT realm.

"If the state were a private enterprise, that \$3.1 billion annual spend would put us up with Fortune 50 companies," he said.

To implement a comprehensive strategic sourcing initiative, Pennsylvania not only contracted the consulting services of Accenture for 15 months, but also hired two sourcing experts from the private sector to fill permanent staff positions.

"We recognized that government is not a leader in the procurement area," said Yarkin. "Most of the innovation in purchasing has been done in the private sector, so we went out and hired some real professionals from that sector."

Pennsylvania Gov. Edward Rendell wanted to ensure that strategic sourcing was institutionalized within the state administration and the \$100 million savings could be delivered year after year. Special emphasis was placed on knowledge transfer from Accenture to all purchasing officers in the state agencies.

At conferences, Yarkin already advises other states to take the same approach. "Don't just make an investment in a consulting firm," he urges. "That's only going to get you short-term savings. Make an investment in people."

Already this comprehensive strategy is paying off for the state. Last year, Pennsylvania spent \$22.5 million on office supplies for state workers. After a reverse auction, the state expects to save \$9.5 million this year buying the same supplies from the lowest bidders. Thus far, the state has also reduced the price of software purchases by \$3.5 million, 2004 model vehicles by \$1.1 million and personal computers by \$1.3 million. After contracts are finalized, it also expects to have reduced the price of road asphalt by \$2.4 million.

### **Nuts and Bolts**

As the term is now used, strategic sourcing isn't simply one approach to procurement, but rather a label to describe a series of procurement best practices that enable organizations to buy more effectively and efficiently.

When Accenture implements a strategic sourcing initiative with a client, the effort usually begins with an in-depth assessment.

"We look at what the client spends, where they spend it, and their buying patterns," explained Owen Davies, a partner in Accenture's government practice in Pennsylvania. "We look at the quality of the data they captured on their prior spends. We look at what they want to spend in the future. Then we break all that down into different commodities or service categories. For each of these, we come up with a strategy that best matches what they are trying to do [but] won't reduce the quality of the product or service they are buying."

In some cases, this might be a reverse auction as Pennsylvania recently held. Other times, it involves fact-based negotiation to reduce margins. Frequently separate purchasing contracts are aggregated to increase

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leverage in purchasing.

Strategic sourcing in government received criticism for focusing on the lowest price at the expense of quality, minimizing agency decision-making and increasing operational risk for organizations, as well as undermining organizational goals for building partnerships with small businesses and minority- and women-owned business enterprises (MWE).

However, according to Accenture's white paper, *Strategic Sourcing for State Government*, these generally happen as a result of poorly implemented strategic sourcing initiatives. In Pennsylvania's case, for example, these pitfalls are being addressed with considerable care. The state selected 10 areas in which to concentrate their strategic sourcing efforts.

"For each of the 10 commodities, we convened a kickoff meeting where all the agencies were present," Yarkin said. "That was very important -- to make sure we really understood the requirements and needs of all the agencies, and the agencies are represented on the RFP committees. There is no point in setting up a contract that is not usable by the agencies because they will just find other alternatives. You will have maverick off-contract spending, and in the end, you won't accomplish any real savings."

Instead of using invitations for bids or requests for quotes (RFQs), Pennsylvania now more frequently uses RFPs for goods. This allows the state to consider quality and service, as well as price. It also opens the door for further negotiation with prospective vendors to ensure there is an adequate delivery infrastructure in place and significant MWE participation where possible.

## **E-Procurement and Sourcing**

Accenture argues that governments do not need an e-procurement system to start a strategic sourcing initiative. It's certainly beneficial, however, to have one in place.

Yarkin said the administration's predecessors invested in an extensive ERP system, which played a significant part in their early sourcing successes.

"For the first time, we have been able to aggregate our volume and take an enterprisewide view of our spend," he said.

In the more progressive e-procurement systems, such as the one currently being built in Florida by Accenture, strategic sourcing is becoming an integrated component.

"This procurement system, branded MyFloridaMarketPlace, has one of the broadest sets of functionality in terms of an e-procurement system that any of the states have undertaken," said Audrey Harrell, a partner in Accenture's government practice in Florida. "It certainly will be the largest once we get it rolled out to all the agencies."

The system, which covers everything from vendor registration and minority business certification to RFPs, RFQs and contract management, also includes a reverse auction bidding tool.

"Part of what we are trying to do is not just build the system, but also transform how they do procurement," added Harrell. "So we are doing strategic sourcing initiatives for different categories of commodities."

In the first major contract, using the new Web-based purchasing system, the Florida Department of Management Services (DMS) hosted a reverse auction for a state term contract for office supplies. This reportedly will save Florida taxpayers an estimated \$18 million. Based on previous purchases, the original value of the contract was estimated at \$51.5 million over three years, but after 11 suppliers spent more than two hours trying to underbid each other, the price tag dropped more than 32 percent.

"Our primary responsibility is to cut the state's cost of doing business," said DMS Secretary Bill Simon. "So we have grouped and ranked all the categories we think will be beneficial for us to aggressively go after in a strategic sourcing approach. Every dollar we can save on things like office supplies is a another dollar that can go toward education, health care and the environment."

"It was very interesting to watch," Simon added. "Much like an eBay auction in reverse, it started out with cautious bids. Then, in the last two

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or three hours, we just watched the price go down and down. This was our first venture into this kind of thing, and I can tell you we are very happy with it."

The success of the auction was, in part, due to a tremendous amount of preparation. "We actually did quite a few things because we wanted to make sure the vendors were very comfortable with the tool," explained Harrell. "So we did some training online and we did some mock auctions, so they could see how to do it before the actual auction."

All participants were prequalified to ensure they could fulfill the state's needs. Also, as a component of this qualification process, vendors were asked to provide a plan of how they would help support Gov. Jeb Bush's One Florida initiative to encourage business with minority enterprises.

"For the state, MyFloridaMarketPlace updates our technology to significantly drive down administrative costs and increase the competition for state purchasing dollars to lower the price of virtually everything we buy," added the DMS's Simon. "For vendors, it gives them exposure throughout the government purchasing community, and cuts down the red tape normally associated with doing business with the state."

## **Starting Small and Piggybacking**

Strategic sourcing does not need to be implemented wholesale to offer significant savings. Often, according to Accenture, governments can get their feet wet by implementing sourcing in just one department or agency.

Another tactic for an individual agency or a local government that doesn't have the aggregated buying power of a large state is to piggyback on another government entity's sourcing efforts.

Pennsylvania piggybacked on a Massachusetts contract with ASAP software, saving \$4 million annually. "This not only allowed us to save money, but even more important, it allows us to actually manage our licenses for the first time," said Pennsylvania's Yarkin, adding that the state also wants other entities to benefit from their sourcing initiatives.

"State law allows local governments, school districts and higher ed institutions to piggyback on our contracts," said Yarkin. "One of our goals is to make our contracts so competitive that local governments, even big ones like Philadelphia and Pittsburgh, will look at our contracts and say, 'Wow!'"

This contract is better than anything we could set up.' So one thing we do in our contracts is try to knock out any provisions that would make it difficult for local governments to use them as well."

He said local governments might do well to watch what their state governments are doing in the realm of strategic sourcing -- or even efforts in other states -- because they may be able to piggyback, save their taxpayers money and reduce the cost of setting up RFPs and contracts.

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