

STRATEGIC GOVERNANCE

# Achieving Next- Generation Benefits with Sourcing

Cynthia Hollandsworth Batty, Director, ISG and  
Carol Britton, Managing Director &  
Chief Procurement Officer, BNY Mellon



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Sourcing relationships that are merely tolerated are not fertile ground for innovation and value creation. The ability to create an environment that fosters innovation and process improvement by clearly articulating the roles and responsibilities of all the players is today's strategic imperative and what many CEOs demand of their Chief Procurement Officer.

This focus on added value represents an extraordinary leap in expectations for both the procurement function and the enterprise at large, and it underscores the need for diverse and elevated skills in the people who perform procurement functions.

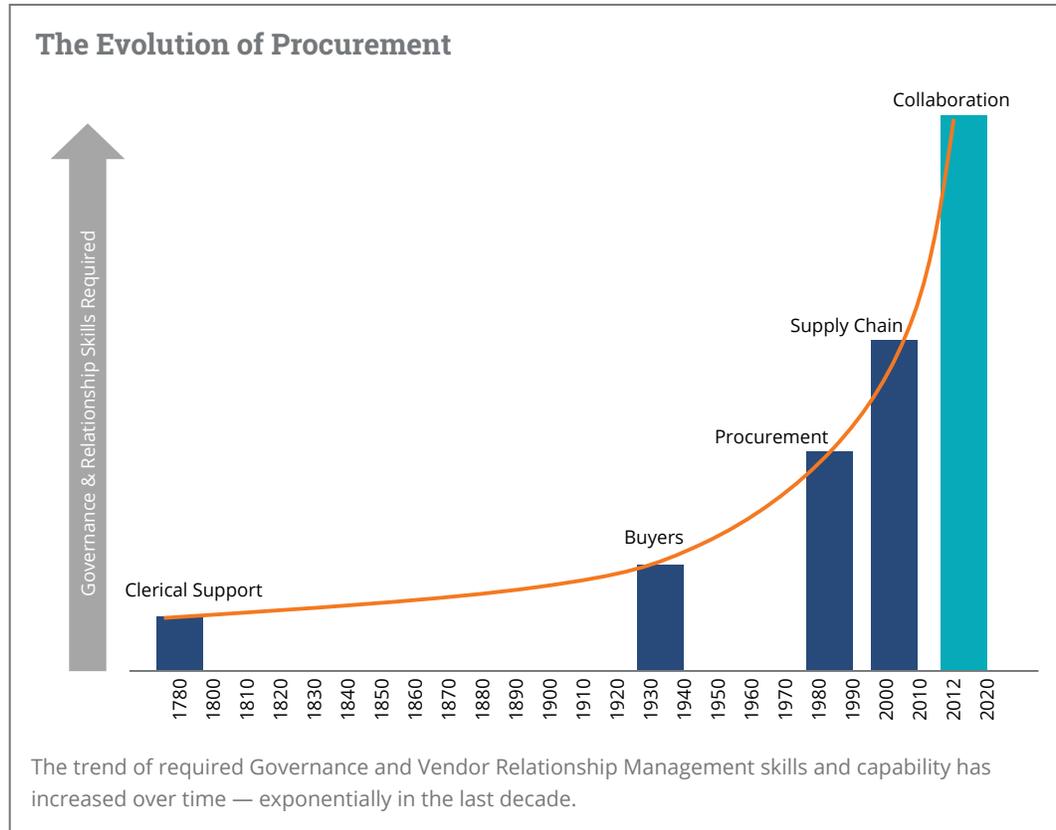
The SIG Global Summit, held in March 2012, focused on innovation and new value drivers. A central theme was that strategic governance practices are inherently linked to innovation and new value. One participant summed it up by saying, "Cost reduction and sourcing is 'old school,' now the bigger discussion is on long-term relationships where both sides want to invest."

In the session we conducted at the summit, the audience was polled to determine the rate of failure of outsourcing relationships. With "failure" defined as a "being in a miserable relationship where services are delivered to contract standards but no one is happy," more than 50% of the audience raised their hands. This points directly to the need for change in the governance approach.

As indicated in the graph on the next page, the evolution of procurement is directly tied to the advancement of purchasing and related functions. Purchasing was first identified as an independent department with a clerical support function in the early 1800s. More than a century later, following the introduction of mass production by Henry Ford and World War II's effect on industrial production, purchasing emerged as an important factor in large-scale manufacturing organizations. The function became "buyers" – a higher skill set than merely clerical support. Purchasing continued to be described as an administrative function through the 1970s.

In the 1980s purchasing again transformed, this time to "procurement." The focus on just-in-time manufacturing practices drove the need for more collaboration with the supply base which, in turn, drove the development of supplier relationship management. A large component of this transformation was the concept of strategic sourcing. From that point until the early 2000s, technology advances, globalization of supply chain networks and process re-engineering elevated the status of purchasing and sourcing functions to that of significant contributors to a company's success.

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Today, the sourcing process is well embedded in most organizations and has been evolving for well over a decade. Today’s sourcing professionals understand and embrace key concepts such as total cost of ownership (TCO) and risk identification and mitigation. They also know that sourcing is not a “three bids and a cloud of dust” process done every three to five years. Sustainable supplier partnerships do not come from low-cost deals. The focus of the supply chain process needs to include the longer-term relationship governance — in the contract, in negotiations, in the business areas that manage the provider, and in the overall enterprise.

The supply chain profession has arrived at the next major transformation point. Just as the introduction of mass production changed the profession from clerical to cooperative, the global integration of the supply chain is the catalyst for transforming purchasing once again. This shift relegates strategic sourcing to a routine function in the supply chain process; so much so that companies are considering it as a candidate for outsourcing. The next “strategic” function for supply chain professionals is governance — and this has implications for the enterprise, as well.

“Strategic governance” refers to the approach all partners in the supply chain use to achieve enhanced and innovative relationships. A carefully-defined governance model provides stakeholders, suppliers and buying organizations a clear understanding of who is ultimately responsible and accountable. According to research conducted by the University of Tennessee, the most successful strategic partnerships are those where all parties have a vested interest

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**The most successful strategic partnerships are those where all parties have a vested interest in each other's success.**

in each other's success. This goes well beyond cost and the transactional components and encompasses process, innovation, relationship quality and continuous improvement programs involving all the enterprise stakeholders.

In order to achieve this level of strategic governance, both business skills and advanced leadership capabilities are needed. These skills include the ability to work collaboratively with both the providers and internal stakeholders with a heightened adaptability for managing changing circumstances and finding joint opportunity for maximizing services, value, and continuous improvement. The ability to build relationships while not forgetting the contractual requirements; facilitating communications, both with outside providers as well as internal stakeholders; and the courage to "do the right thing" are a few of the skills required to transform to the level of strategic governance.

Truly strategic supply chains collaborate with a focus on creating business value across the chain. This transcends the sourcing effort to create strategic relationships that are not focused on margin. Achieving this state requires a sound governance structure that fosters an environment where strategic activities can freely take place so that the benefits are enjoyed by all parties.

So how should enterprises respond? To think that the level of change required to achieve true strategic governance will "just happen" is folly. The capability to conduct business relationships on this level requires substantial planning and change to every organization in the supply chain. Executives must recognize that investment in governance capabilities is needed to adapt to this new world. Strategic governance requires enterprise adherence to new, concrete management processes with measurable outcomes, accurate reporting, correctly placed accountability for service excellence and for financial outcomes, and awareness of relationship impact on value creation and innovation potential.

This means an enhanced focus on skills and capabilities of the employee, in the business as well as in the supply chain function. As such, transformational change must be an objective from the highest level in the organization to ensure success. Organizations that embrace and establish strategic governance practices will reap a multitude of benefits that are not possible when only traditional sourcing practices are applied.

## ABOUT THE AUTHOR

### **STRATEGIC GOVERNANCE**

#### **Achieving Next-Generation Benefits with Sourcing**

Published January 3, 2013



#### **CYNTHIA HOLLANDSWORTH BATTY**

Director, ISG

Cynthia brings 25 years of experience helping clients develop their sourcing governance and service management design. Having worked with more than 50 organizations to improve business management and service management processes in both single-provider and multi-provider environments, Cynthia has become a recognized expert in sourcing governance, vendor and contract management. She currently serves as the architect for ISG's service methodology and global integrator of its products and services. Cynthia works to leverage ISG's accumulated intellectual property resources to help enterprises create effective transformation and governance capability, and maintains a continuing role in the Strategy and Organizational Change Enablement practice.



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