

## **Management and Sourcing – a Managerial Challenge**

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*Work-in-progress*

# Management and Sourcing – a Managerial Challenge

*Work-in progress*

## Abstract

Concurrently with the importance of enterprises becoming more aware of their role in the supply chain and their contribution to the value creation, the question of enterprises' sourcing strategy and use of suppliers, has come more and more in focus of their decision-making.

**Borttaget:** use

This article describes the key questions that companies must ask themselves in order to be able to act appropriately in relation to their own role, and with others in the supply chain.

**Borttaget:** enterprises

**Borttaget:**

Especially focus will be put on managerial implications of a deliberate sourcing strategy. A number of the legal aspects attached to enterprises' sourcing will also be touched upon.

**Borttaget:** In this connection, focus will e

**Borttaget:** n

**Borttaget:** intended

**Borttaget:** discussed

### Key words:

**Sourcing, management, suppliers, agreements**

## Introduction

The division of labour in society has for more centuries, attracted the interest of economists. Concurrently with the emergence of new technology, new possibilities for increased specialization and, division of labour have emerged.

**Borttaget:** , the distribution of work in society has

**Borttaget:** ies

**Borttaget:**

**Borttaget:** and for how to distribute work have generated

**Borttaget:** To c

Contracting out a task, activity or process to an external source is therefore not a new issue for enterprises. Nevertheless, both academics and practitioners have recently taken greater interest in the subject.

There may be more reasons for this. Firstly, modern information technology has given better possibilities of sharing information, knowledge and tasks, between enterprises. Secondly, information technology itself has defined new tasks. Thirdly, new technologies have provided the possibility for, increased specialization and finally, an increased awareness of the importance of specialization has occurred due to, the emergence of new management concepts (Freytag, 2003).

**Borttaget:**

**Borttaget:** sharing

**Borttaget:** ensured

**Borttaget:** because

**Borttaget:** of

Due to this development, sourcing has become more important than previously for the development and operations of the companies. In other words, enterprises' sourcing tasks must be redefined. In this light the following are central:

**Borttaget:** Therefore, enterprises'

**Borttaget:** ir

**Borttaget:** than previously

**Borttaget:** connection

**Borttaget:** 's tasks

**Borttaget:** Making

**Borttaget:** Realization of

- Definition of tasks of the firm,
- Involvement of the organisation.
- Selection of sources/suppliers.
- Entering sourcing agreements.
- Carrying through operational and development oriented assessments of supplier performance.
- Adjustment or termination of sourcing agreements.

The above six points will be clarified with special importance, attached to the managerial dimension tied hereto.

**Borttaget:** ;

**Borttaget:** special

**Borttaget:** will be

### Defining the tasks of the firm,

**Borttaget:** 's tasks

According to Franceschini et al. (2003) the two most important reasons for outsourcing are cost minimization and business organization:

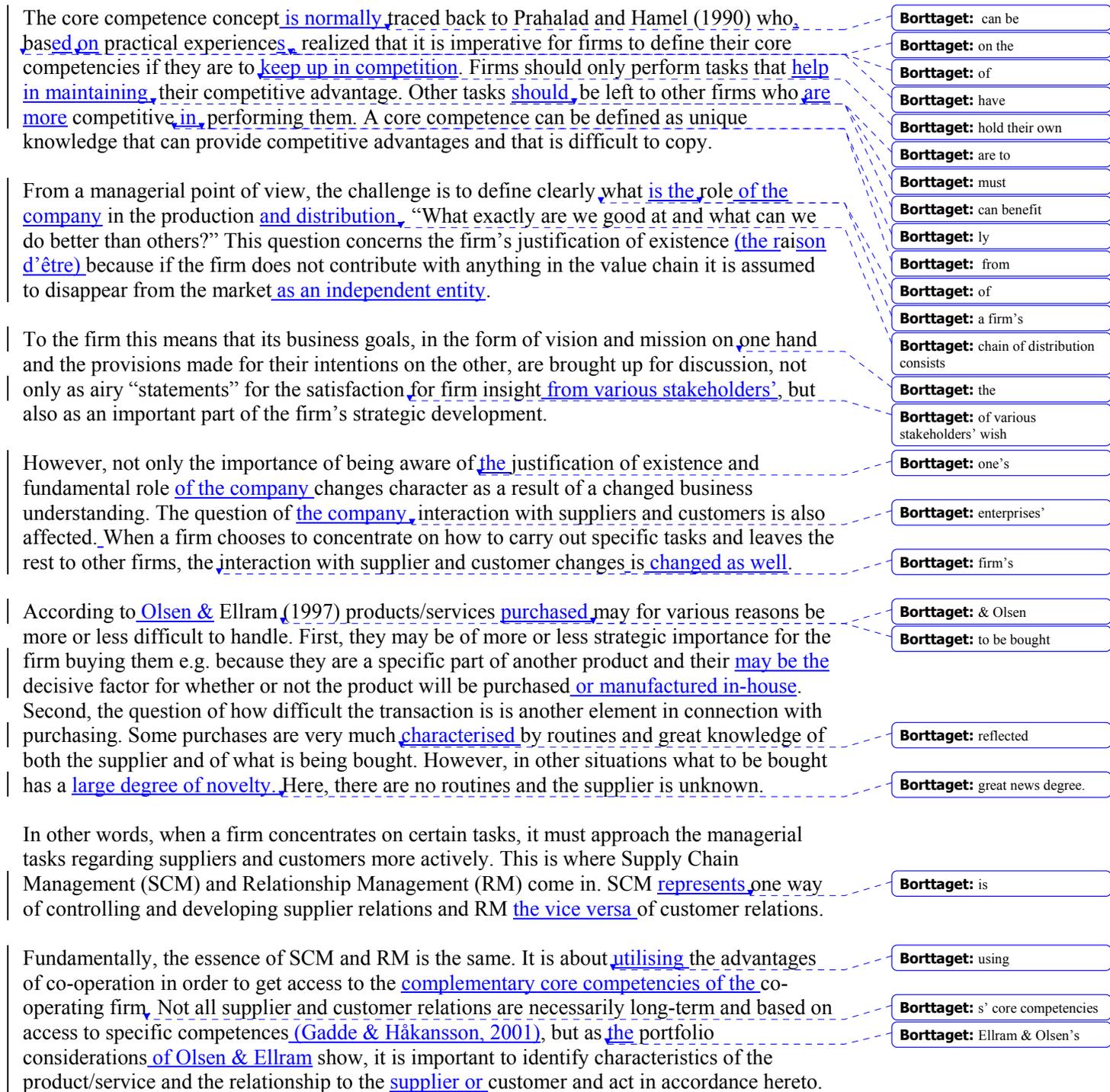
“By outsourcing, companies can focus their efforts on core business, medium/long-term targets and diversification opportunities” (Franceschini et al., 2003 p. 245). In other words, outsourcing is strictly connected to the firm's definition of its own role in a network's value creation (production and distribution chain).

**Borttaget:** of distribution

During the last few decades, a number of new management concepts, that suggest how the firm can reach an appropriate definition of its role in the value creation in a network have emerged. In this context, of this paper, the following three concepts are essential: supply chain management, relationship management and the core competence concept.

**Borttaget:** Recently

**Borttaget:** have emerged



**Figure 1:** Relationship handling in SCM and RM

Strategic important relations and relations difficult to handle should be controlled and developed as follows:

### Suppliers – SCM

- Co-operation rather than competition in the supply chain
- Long-term relations with relative few suppliers
- Sharing risks and profits
- Information sharing, data transparency
- Joint customer service goals and focus
- Internal process organisation

### Customers – RM

- Long-term and stable relations
- Co-operation as a means to efficiency attainment
- The importance of transaction and switching costs
- All parties being active
- The importance of power and knowledge
- The importance of technology, purchasing and logistics

**Borttaget:** well-established

Source: Adapted from Gummesson 1998 and Gammelgaard 2002.

According to Figure 1, the objective, for both concepts, is to gain advantages by acting on a long-term basis and by co-operating closely with other firms. Also, it is about minimizing a number of risks connected with the development of specific competences in order to obtain a competitive advantage. In this connection, both employees and the way companies choose to interact are very important for the success of the co-operation. The employees must be involved if the firm's sourcing efforts are to be successful. It is also important that the agreed rules are unambiguous and coordinated.

**Borttaget:** for both concepts

**Borttaget:** is

A small manufacturer, Aassum manufacturing company, which produces plastic and metal components as sub-supplier, has found it difficult to define its mission and role in the supply chain. The customers are from a wide range of industries and have not always been clear why the company has been selected as supplier. Aassum manufacturing has now in cooperation with some of the company's suppliers started to define its mission and to get a better understanding of what type of value the company is creating for its customers.

*The first managerial challenge is to define the firm's core competence, its role in the network and its desired future strategic development.*

**Borttaget:** wishes regarding the

### Involving the organisation

Outsourcing does not always have positive associations tied to it. Sometimes it is associated with closing down jobs and considerable changes in operations, and in many cases this is true. It is therefore important that management has a well-defined sourcing strategy which is well known in the whole organisation, and that the employees are involved in the process if changes are to be made (Venkatesan, 1992). Often, the employees are an important part of a changed sourcing strategy, which is why it will usually be appropriate to involve them as much as possible. Among other things, employees can contribute with detailed information about:

**Borttaget:** shedding

**Borttaget:** become

- Connections between tasks.
- How to improve products/services.
- Weak points of products/services.
- Relevant benchmarks of products/services.
- Demands from transporters, customers etc. as regards handling.
- Appropriate ways of interaction with possible suppliers.

A successful involvement of employees can also lead to an “ownership” so to speak of the chosen method and solution. This is often a condition for success.

**Borttaget:** ,  
**Borttaget:** which

The second managerial challenge is to define a sourcing strategy as well as to communicate with the employees and involving them in complying to it.

**Borttaget:** to  
**Borttaget:** e  
**Borttaget:** how to respect it.

### Choosing sources/suppliers

**Borttaget:** r

Supplier selection is closely connected to the overall sourcing strategy of buying or producing in-house. It is often proven difficult to separate the question of supplier and product or service supplied. The ability of the supplier to solve problems certainly affects the question of how to evaluate suppliers in general, and the firm’s knowledge about the suppliers also affects how the suppliers are evaluated.

**Borttaget:** question

**Borttaget:** supplier’s

**Figure 2:** Supplier and sourcing needs

		Supplier knowledge	
		High	Low
Problem knowledge	High	Easy to choose supplier	Need of <u>well</u> specified <u>demands</u> on supplier
	Low	Possibility of relying on the supplier’s expertise	Difficult process that can be long-drawn-out and that can lead to reconsideration of the buying out solution

**Borttaget:** to  
**Borttaget:** demands

**Borttaget:** ¶

Source: Own development

In other words, the more insecure the problem solving and supplier choice are, the harder the firm must try to minimize the various elements of risk in the best possible way. Also the demands to the supplier and the wanted product/service are closely connected. The demands usually concern the supplier’s economic stability, management style, and approach to quality and experience with production of the product/service in question or other similar products/services, as well as more strictly related demands to the product/service such as price, quality and delivery performance (Freytag et al, 2000).

Danfoss, a major Danish industrial company, has recently institutionalised the supplier approval process across 8 corporate purchasing teams. The process secures a uniform way of approving the suppliers based on metrics on economics, quality, logistics, environment,

[technology/-innovation, management and Global Compact. A model for the segmentation of the supplier portfolio is also standardised. This enables the company to exchange information and knowledge about the supplier base more efficient by, implementing the supplier over more locations more effectively, and to make sure that the efforts are leading to better and more “fit for purpose” relationships. The Metrics for supplier approval are likewise used for performance evaluation when suppliers are approaching for “preferred supplier status”.](#)

*The third managerial challenge is to relate in general to how different types of supplier relations must be handled and to make sure that the employees understand and respect the intentions behind.*

### Making sourcing agreements

When firms interact on sourcing, it is decisive that their relation is based on [as unambiguous expectations](#) as possible. Usually the firms will choose to make written agreements to ensure that a number of key points are [codified](#) in order to avoid uncertainty [about](#) the character and content of the relations. If agreements are [in writing](#), disputes are usually easier settled. However, a written agreement implies much more than a platform for settling disputes. From a business economic point of view it also implies [interesting](#) information about the objective and the contents of the relation and the parties’ relationship. Two often-used types of agreements are the collaborative agreement and the framework agreement.

**Borttaget:** expectations

**Borttaget:** maintained

**Borttaget:** as to

**Borttaget:** written

**Borttaget:** some

**Borttaget:** piece of

A collaborative agreement is a more overall [type of agreement](#) and indicates the objective and character of the collaboration. More simplistically put, the objective is to describe how the parties want to cooperate. Examples of key points in the agreement are information about the importance of the cooperation, its development, and how the parties’ interact. For example, Siemens Denmark informed one of their suppliers that its objective was to increase cooperation within the field in question, to increase their inter-experience exchange, and to involve the supplier at an early stage in the Siemens product development within the field.

Often, collaborative agreements reflect good intentions more than legally binding agreements.

The framework agreement [is also often used, and](#) typical implies the following (see e.g. Wilke & Freytag 1996):

1. Specification of the [product and/or the service](#).
2. Price.
3. Insurance terms.
4. Delivery terms.
5. Delay terms.
6. Terms for acceptance of delivery/ies.
7. Special terms.
8. Terms of payment.
9. Guarantee.
10. Agreement on possibilities for amendments.
11. Publication.
12. Possibilities for transfer (sale of rights).

**Borttaget:** output

13. Inspection and maintenance.
14. Education.
15. Disputes.
16. Legal venue.

Thus, an agreement usually implies a clear indication of what is to be delivered, customer needs, specific demands to be met, and how the parties should interact (how is the power balance? What means are used?).

From a legal point of view, the specific conditions put a supplier, a customer respectively, in a more or less favourable position. From a sales point of view, terms in a framework agreement also reflect determination of marketing mix, and from a purchasing point of view they reflect determination of delivery parameters. Therefore, framework agreements imply strong commercial elements. In practice, this is partly missed because buyers, legal advisors and sellers do not always cooperate as closely as might be appropriate. Some legal advisors have too little knowledge about the commercial considerations attached to specific contractual points, and buyers and sellers are not always interested in the legal aspects of an agreement. Finally, this may result in a poorer contractual basis than is actually possible and appropriate in a given situation.

The above points representative of a framework agreement show that the agreement also implies many forward-looking elements that relate to the evaluation of the delivered product/service and the parties' relationship in a wider sense. Contractual points on performance measures, mostly can not stand alone, and are often supplemented with a set of overall and more specific benchmarks.

**Borttaget:** The framework agreement's c

**Borttaget:** analyses

**Borttaget:**

**Borttaget:** mostly

As part of an outsourcing project IAT a company mainly transporting dangerous liquids made an outsourcing agreement for the service of the trucks. It was here important to secure that the main competences of IAT was preserved. The agreement for servicing the trucks did no include tank and that it was made clear how IAT employees should work together with the service provider.

*The fourth managerial challenge is to ensure that both juridical and commercial aspects in connection with the firm's sourcing are matched and form a synthesis.*

### Assessing supplier performance

Performance assessments are well known in connection with most sourcing agreements. Traditionally, the customer has made one set of assessments and the supplier another. In some situations, customer and supplier have not at all, or only to a very limited extent, informed each other about their evaluations. However, this is now changing. Today, there is more openness about performance evaluations, and in some cases joint evaluations have been made. Ceteris paribus, it is easier for the supplier to meet the customer demands when he knows about evaluations. On the other hand, involving suppliers in methods of analyses and benchmarks gives others in-depth insight into the firm's management and a new platform for dialogue and negotiation with the supplier is opened. To the customer the degree of openness therefore will often go hand in hand with the benefit and costs (e.g. time spent) of such

**Borttaget:** analyses

**Borttaget:** parts

**Borttaget:** analyses

**Borttaget:** in

**Borttaget:** analyses

**Borttaget:** analyses

**Borttaget:** analyses

**Borttaget:** the analyses

**Borttaget:** to

**Borttaget:** e

**Borttaget:** an

openness. For example, a product/service or a supplier may be of importance so peripheral that it is not worthwhile informing the supplier of more than the demands to him.

**Borttaget:** an

**Borttaget:** there

Being sure to receive the agreed product/service has received increasing attention throughout the 1990ies. A new managerial concept, Total Quality Management (TQM), is very much the result of firms' need for assuring themselves that they get the agreed product/service when outsourcing a task to another firm. For many firms it is very important that they can control their processes and thus the quality. This fact has definitely had an impact on the demands made toward the suppliers. Simply put, one of the basic ideas of TQM is that "what gets measured gets done". Often, suppliers cannot permit themselves to rest on the laurels; they must continuously improve their performance in order to live up to their customers' demands. It is evident that the slack in the "service window" is decreasing.

**Borttaget:** have

**Borttaget:** d

**Borttaget:** agreed upon

**Borttaget:** had

**Borttaget:** importance

**Borttaget:** 90s

**Borttaget:** want

Roblan, an Australian company producing plastics packing and stemmed metal parts according to the customers' specifications, has integrated TQM on all levels in the firm. Not only has it prepared a number of benchmarks within each of the two business areas, the firm also spends a considerable amount of time exchanging experience and benchmarking across the two business areas. This has resulted in measurable advantages for both production and the development of both areas.

*Thus, the fifth managerial challenge is to identify relevant benchmarks and consider to what extent the development/choice of benchmarks must be done in cooperation with the supplier.*

### Adjusting or termination

In principle, needs for certain products/services can remain unchanged for a very long time, and examples of outsourced tasks that have remained so for both 10 and 20 years do exist. However, it is seldom that products/services do not change. It is therefore important that the parties are aware of how changes or terminations of some deliveries are realizable.

Most framework agreements have time limits, which naturally brings about an evaluation of whether or not to hold on to the supplier. Sometimes, the parties have opposite interests. The supplier can be interested in continuing the cooperation and the customer can be interested in not being "engaged" to a specific supplier. A way to minimize the risk of disputes is to be aware of potential conflicts and to inform each other of the various interests. Another way of avoiding disputes is to stress that the basis for decision is continuously changing and that future changed decisions may not necessarily have to do with the supplier, but more with the basis for decision having changed.

**Borttaget:** s

A problem sometimes observed is a special kind of insourcing, at times called back-sourcing. After a period, the firm for different reasons may be interested in solving a specific task itself again, and so its wants to take up production (Gadde & Håkansson, 2001). In this situation, it is important to inform the supplier that the firm's wish for insourcing is not necessarily due to the supplier's performance, but due to that the situation has changed on which the former decision was made.

**Borttaget:** the firm having changed its decision because its situation has changed. ¶

A special problem in connection with considerable changes or termination of a supplier relationship is the relation specific investments made. If a supplier has made investments that go beyond the period agreed upon in the contract, it is important that the customer is also aware of this fact. Often, a supplier cannot make use of a specific investment in other connections and a termination of a specific relation will therefore result in a lost investment. Sometimes, the customer takes advantage of this and tries to press the price. It can be beneficial for the customer, but it can easily rebound in form of loss of image and others being less interested in cooperating with the firm in the future. In any case, termination of customer-supplier relationships can always imply potential conflicts, because of which one part will consider a reduction of costs; the other will consider loss in earnings.

**Borttaget:** the investment to be lost.

**Borttaget:** possible

The former mentioned company, Danfoss, has developed a “code of conduct” on how to handle and inform suppliers, of indirect materials, regarding decisions made concerning the supplier relationship. Among others things it is stated that suppliers who are not selected as preferred suppliers, or suppliers at all, to Danfoss shall receive positive feedback on the background for not being selected. If a current supplier relationship is to be terminated, the supplier shall also be presented with a plan for phasing out. If the business foundation of the supplier will be affected a more considerate plan has to be agreed upon. By doing so Danfoss stresses that the company is a professional and reliable business partner.

*Thus, the sixth managerial challenge is to avoid that change in or the termination of customer-supplier relationships lead to unnecessary disputes that may complicate future cooperation with the current or other suppliers.*

**Borttaget:** or others.

## Conclusion and further reflections

**Borttaget:** ¶

What to be produced inside or outside the boundaries of the firm is not static but changes continuously. What is, or has been, outsourced at a given time may be in-sourced later. In this context it is decisive that the company pays attention to its decisions, and the background for the decisions taken.

In this paper we have tried to outline the important managerial challenges and questions that companies have to deal with when sourcing from and engaging with outside parties. Six managerial challenges have been identified, and reflected upon, from definition of the boundaries of the firm over organisational involvement, supplier selection, entering into agreements, assessment of the relationship and to the adjustment or termination of the relationship.

There is no uniform “one size fits all” way of sourcing from outside the boundaries of the firm. Every company and sourcing situation is unique. However, there is a set of managerial challenges and questions that companies have to deal with if the sourcing strategy of the company is to be turned into activities complying with the intentions of management.

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Borttaget: ¶

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