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When All Eyes Turn to Purchasing *A Memo to the Chief Procurement Officer*

Chief procurement officers face both major challenges and valuable opportunities in today's increasingly volatile and recessionary environment. If they take five actions now, they can quickly reduce costs and secure supply in the short term, while enhancing sourcing capabilities and sustainable advantage in the long term.

WHEN ALL EYES TURN TO PURCHASING

The severity of this recession and the disruption it has caused across industries and geographies have fundamentally altered purchasing conditions and imperatives. Companies are striving to achieve substantial cost reductions as quickly as possible. The supply base is morphing, as weak vendors struggle to survive and stronger vendors consolidate and restructure. And commodity prices remain unpredictable and a thorn in the side of many buyers who had hedged against record-high prices, only to see them drop by 50 percent and more.

Chief procurement officers face substantive short-term challenges in this environment. As companies respond to recession-driven cost pressure, they are asking procurement to save more, faster. A Booz & Company recession survey of Fortune 500 senior executives in January 2009 revealed that the purchasing function was considered the leading source of savings; the average reduction target was 8.6 percent, with initial savings targets likely to expand as the recession drags on. In addition to delivering these savings, CPOs also must ensure the short-term security of supply in increasingly dynamic marketplaces that are being shaken by consolidation, capacity reduction, and price volatility.

The most successful CPOs, however, will do more than manage the short-term challenges of taking out costs and securing supply; they will also recognize and capture the unique opportunities to successfully restructure supply and procurement capabilities for long-term competitive advantage that are hidden within this recession. To deliver on the urgent short-term challenges and capture opportunities that offer long-term benefits, CPOs should consider five actions:

1. Aggressively negotiate lower pricing and improved terms in nonstrategic spend categories. Discretionary indirect spending represents low-hanging fruit in cost reduction initiatives. In many companies, these spend categories, such as travel, have already been cut through top-down budget reductions. But with a little effort, CPOs can stretch the remaining dollars even further. Many of the vendors of these goods and services are desperate for business and, in return for sourcing commitments, may be willing to offer discounts and more advantageous payment terms. The market-based, noncritical nature of these products and services allows for aggressive renegotiations with existing vendors and the tendering of contracts to new, more cost-effective vendors.

2. Leverage the current demand for cost reduction to capture savings across the company. As leaders in business and functional units strive to cut costs, they are increasingly viewing procurement as an enabler of savings and are willing partners in driving both sourcing strategies and spend management activities. This provides an opportunity for CPOs to create a model for attracting support as well as expanding and deepening the influence of the procurement function across traditionally off-limits spend areas, such as marketing, legal, and professional services. At the same time, the demand for short-term savings creates a valuable opportunity to review legacy decisions, current approaches to spend management, and the associated processes, policies, and tools for managing compliance.

3. Restructure the vendor base to reduce costs and better manage risk. The recession has affected, and some-

times fundamentally altered, the structure and capacity in supply markets. CPOs must consider how to optimize their supplier mix (both in their portfolios of preferred vendors and in how they distribute their spending among them) and move their volume to capture savings in a way that protects and strengthens their supply chains. In some cases, this may mean establishing collaborative relationships with clear winners to obtain price savings and protect supply continuity. In others, it may mean supporting weaker players (and a more competitive marketplace) in return for advantaged terms. The best approach will vary depending on the spend category, the inherent market dynamics, and a company's appetite for risk.

4. Leverage core strategic supply relationships to drive out costs and develop strategies to weather the storm. For companies that have established and encouraged strategic collaborative relationships with core suppliers, now is the time to reap the benefits. CPOs should be working jointly with these partners to find new opportunities for waste elimination and to develop mutually

beneficial solutions that can protect and strengthen each other's financial positions. For companies that haven't yet developed collaborative relationships, this is an excellent opportunity for taking a new approach with key suppliers. Their CPOs should be working with their most important suppliers to build a bridge for long-term success and identify key trade-offs for mutual near- and long-term benefit.

5. Proactively reengineer commodity sourcing strategies linked to business and risk management objectives.

Falling prices for commodities—oil, metals, and food among them—have provided substantial cost relief for some companies. But for others, hedges put in place at price peaks that locked in higher prices are now contributing to continued losses. Whether falling prices have caused relief or pain, CPOs should use this break in the long-term rise in commodity prices to pause, reflect on the often-reactive strategies of the past, and establish a considered, long-term approach linked to strategic, financial, and risk management objectives. Some will seek security

and stability of supply and price; others will seek to track, or even beat, the market. But regardless of strategy, all CPOs can be building the analytical capabilities and skills needed to produce the economic and market insights that will lead to better, more proactive buying decisions and strategic choices.

If they haven't already, CPOs should complete the first two actions immediately. They are tactical in nature and necessary to quickly reduce costs, release cash in the near term, and enable competitive pricing for their companies' products and services. The final three actions are more strategic and designed to strengthen purchasing moving forward (while taking advantage of select short-term opportunities for collaboration and cost management). The most successful CPOs will execute against all five actions to meet this recession's challenges and fully exploit the opportunities it has created to enhance sourcing capabilities and sustainable advantage.

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For additional insight into the challenges of the current recession and practical advice for leading your function and company through it, please visit www.booz.com/recession.

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