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**Work with the Winners**  
*Strategic Procurement  
Management  
Under Crisis*



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**Contact Information**

**Düsseldorf**

**Detlef Schwarting**

Partner

+49-211-3890124

detlef.schwarting@booz.com

**Shanghai**

**Joni Bessler**

Partner

+86-21-2327-9800

joni.bessler@booz.com

**Stephen Li**

Principal

+86-21-2327-9800

stephen.li@booz.com

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## EXECUTIVE SUMMARY

*As the aftershocks of the financial crisis continue to play out in economies across the world, enterprises are facing increasing challenges. In today's new reality, manufacturers must confront not only an unprecedented downturn in global business, but also increasing pressure on margins as the recession forces businesses to cut prices. Although the Chinese consumer market is potentially extremely lucrative—and the country has weathered the global recession remarkably well—the impact of the economic crisis was nonetheless felt in China. As a result, companies are well aware that to profitably access the Chinese market, they must upgrade their capabilities and embrace long-term strategies focusing on product competitiveness and improved procurement practices.*

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Problems encountered by suppliers include issues such as overcapacity, shaky financials and unstable workforces. In addition, manufacturing footprints typically are far from ideal, raw-materials management is commonly poor, and inefficient management practices mean suppliers often face wastage levels of 20% or more.

The days of applying traditional procurement management practices such as squeezing suppliers for price cuts or simply allowing market forces to clean out the supply base are over. Given the extent of the current dislocation, Booz & Company believes enterprises should seek more proactive solutions. In particular, managers should look to following three principles:

- *Segment* your supply base, determine future “winner” and “loser” suppliers.
- *Confirm* “winners and losers” in supplier negotiations.
- *Act* on suppliers—taking supportive and aggressive actions towards the supplier segments.

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## NEW SUPPLY MARKET REALITIES

China has reached its economic success mainly by growing its export trade before the economic crisis which hit home with unprecedented speed in 2008. China surpassed Germany in 2009 to become the largest export economy in the world which deserves a celebration. However, ever since the crisis, the Chinese government has started shifting the focus of economic growth from export trade to domestic consumption, which has been supported by a series of giant stimulus plans and new regulations. As a result of fast economic growth and a slowdown of global demand, overcapacity is indeed an issue. Since then, ensuing uncertainties have helped sustain an unprecedented “buyer’s market”. Compounding these problems, managers must deal with the realities of a new business landscape, as China’s domestic market continues to grow and new competitors and partnerships evolve into major players. Lower demand has impacted sales volumes and driven down profits, leaving increasing numbers of suppliers across the value chain facing severe financial pressure. In addition, high borrowing costs have not only halted

investment, but also intensified financial pressures on suppliers. The buyer’s market, therefore, is likely to last for the foreseeable future.

The story is not all bad, however. The recession has led to the collapse of raw material and commodity prices, thereby lowering input costs, while transportation and energy prices also have seen a rapid downturn, leading to further savings on logistics bills. At the same time, currency fluctuations have significantly changed the procurement landscape. While the RMB has so far remained stable against the USD (though it is likely to continue to appreciate in future), the strong depreciation of the Euro and Eastern European currencies against both the USD and RMB have brought new opportunities for Chinese manufacturers in their procurement practices. In this new supply-market scenario, enterprises can leverage lower raw materials prices and also adapt capacity and resources to meet the new market demand. In particular, managers should be seeking to attract more competitive suppliers and implement greater supply flexibility.

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## THREE STEPS TO RESHAPE SUPPLIER BASE

From a practical point of view, the exercise of streamlining the supplier base can be divided into three distinct stages.

### *1. Segment your suppliers*

Most fundamentally, enterprises need to determine the likely “victims” and “survivors” of the crisis. There are two primary selection criteria, namely financial situation, and long-term partnership potential. It is important not to over-emphasize the importance of financial health as a selection yardstick, suppliers with temporary financial difficulty could still be healthy at the core. For example, many medium size companies, especially those who have a strong R&D competence with potential to be drivers or partners for future technology or innovation and/or who have been cooperative and willing to share business advantages, but do not have the clout to finance a further business expansion at

affordable costs, should not be misjudged upfront.

In evaluating financial health, attention should be paid especially to corporate profit-and-loss statements, balance sheets and cash flow statements, as well as debt-to-equity ratios, ownership structures, existing customer contracts, and the level of idle manufacturing capacity. Other relevant financial indicators include the extent of ongoing losses, reduced sales and order backlogs, lower cash flows, falling share prices or market values, and reduced investment levels (especially in R&D). Finally, insider share sales, changes in accounting practices, the cancellation or deferral of investor meetings and reports, or even officially filing for bankruptcy are all criteria indicators that should be closely watched.

Apart from visible financial benchmarks, enterprises should

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also look closely at various operational indicators to assess supplier performance. Suppliers requesting earlier payments or higher prices, or who unilaterally cancel prior agreements, defer payment to suppliers, announce plans to shutdown facilities, default on payroll obligations or begin to make irregular deliveries, may be in hot water financially. Other indicators are even more serious. Suppliers who sell assets, dissolve JVs and partnerships, withdraw from certain business areas, lose important projects or project bids, refuse to participate in new bids, cut headcount significantly, or lose key people are all showing classic symptoms of financial distress.

Based on the above criteria, managers can opt to deal with suppliers in the following ways:

- Provide help: including financial support and business support.

For these suppliers, however, the temptation to leverage short-term “buyer’s market” advantage should be resisted.

- Keep and grow: collaborate and take joint action (e.g. cost reduction), carefully leverage “buyer’s market”, no financial support.
- Leverage: fully leverage “buyer’s market”, tender new business only by exception.
- Exit: no new business, gradually or immediately exit from current business.

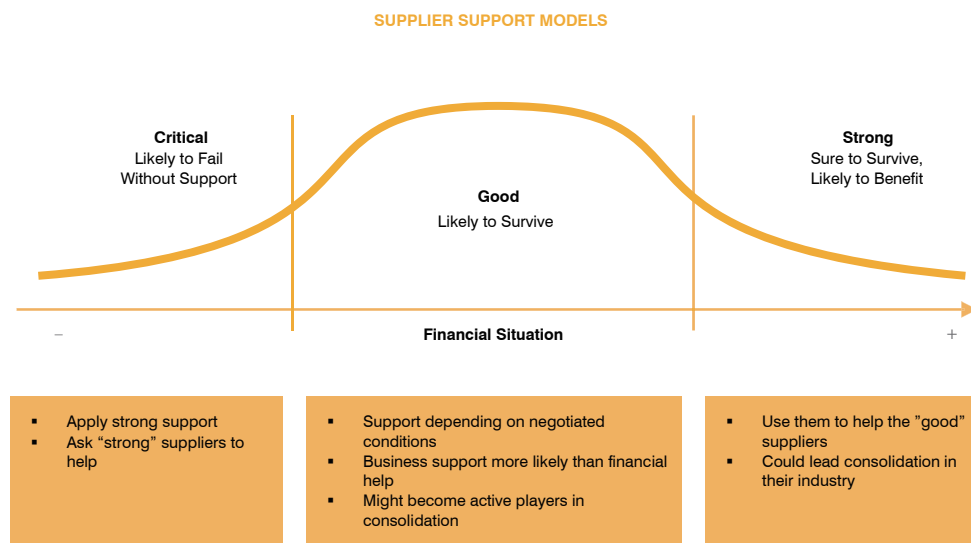
Remember that many of those suppliers you want to survive and keep as business partners will be “likely victims”. Therefore, companies should prepare for active intervention in order to support these suppliers. However, also remember

that such support offers a fair return on investment only if the long term partnership potential (which involves factors such as innovation strength, cost structure/footprint, process technology, business attitude and geographical proximity to buyers’ markets) is not necessarily obvious at the outset and may change as negotiations progress.

## 2. Confirm “winners and losers” in negotiations

As a second step, enterprises need to negotiate with suppliers to confirm the “winners and losers” segmentation. A strong and strategic negotiation will help you to uncover hidden potential of your supplier base. Through this critical step, you will go beyond financial and operational indicators to negotiate future business plans with suppliers to test their commitment and adapt your segmentation based on negotiations results.

**Exhibit 1**  
Determine a Differentiated Supplier Support Model Based on the Criticality of a Supplier’s Situation



Source: Booz & Company analysis

Booz & Company believes supply base restructuring negotiations should include following process:

- Prepare for negotiation: collect detailed facts about supply market and suppliers, select suppliers for negotiation, develop supplier negotiation book, prepare negotiation positions, teams and targets based on relevant levers and develop supplier conference material.
- Negotiate: conduct supplier conferences with executives and coordinate sourcing events at different locations.

- Define and execute action plans: finally, formulate action plans with suppliers, conduct closing meetings, implement agreed changes, and capture lessons learned to prepare for Wave 2.

Of course, two primary principles should be observed during negotiations. First, speed is of the essence—take no more than eight weeks to negotiate. Second, the involvement of suppliers’ top management is key for success.

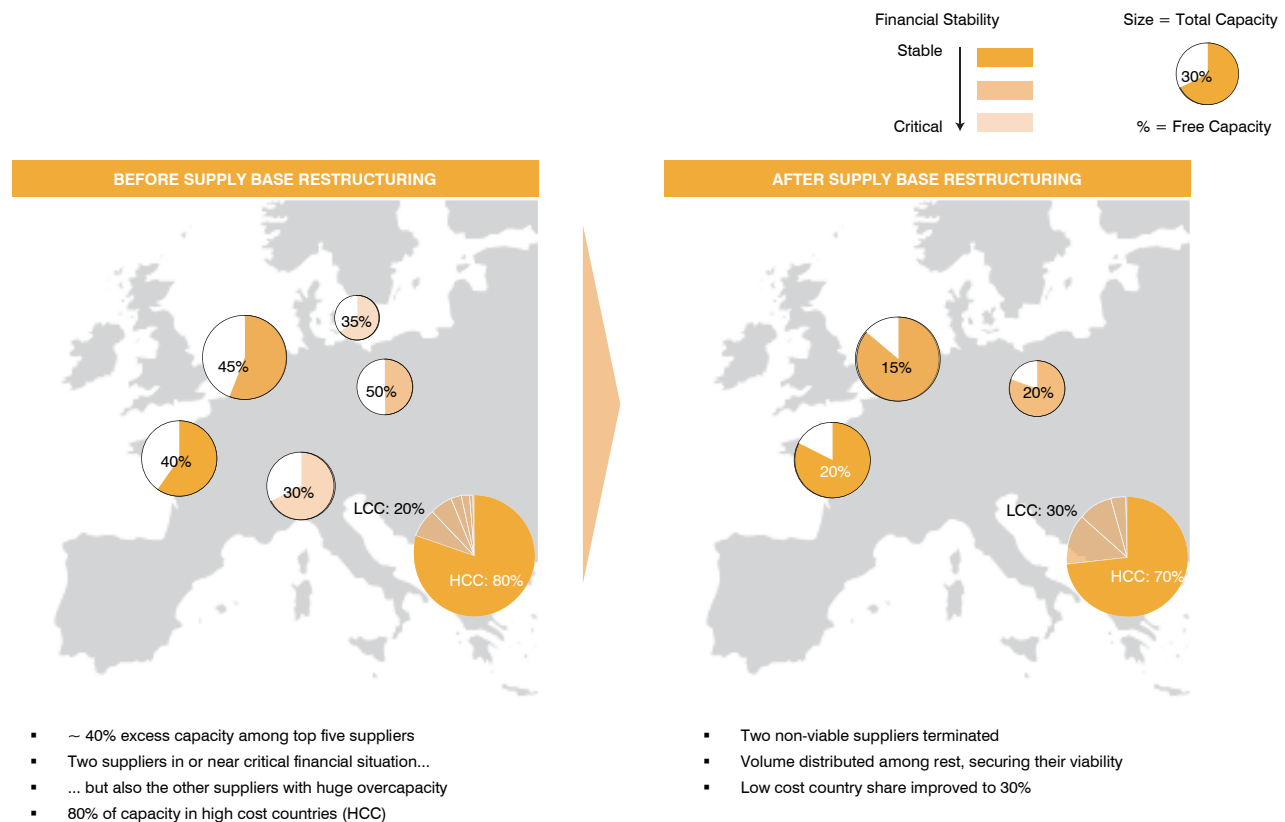
3. Act on suppliers

While action should be taken on identified “losers” to accelerate their

exit, enterprises should determine a differentiated support model for those identified as “winner” suppliers. The speed and likelihood of success can be improved if you evaluate candidates in an integrated manner (see exhibit 1, page 5).

Enterprises can support suppliers by providing financial and/or business support. Financial support may include direct financial engagement, support in finding new shareholders, assistance in getting loans, Supply Chain Financing (SCF), the shortening of payment terms and the provision of financing for assets, tools, and R&D projects. Business

Exhibit 2  
Booz & Company Case Example Structural Components



Source: MOST; Booz & Company analysis

support, meanwhile, might come in the form of new business awards, business guarantees (e.g. a Letter of Intent), tier 2 sourcing (i.e. buyer-furnished material), the granting of identical conditions among shared suppliers (e.g. for the purchase of raw materials), operations support and supplier development, innovation support, and the sharing of know-how.

Once this restructuring exercise is complete, buyers should be left with a stable supply base and an improved cost structure, with benefits for both customers and the remaining suppliers

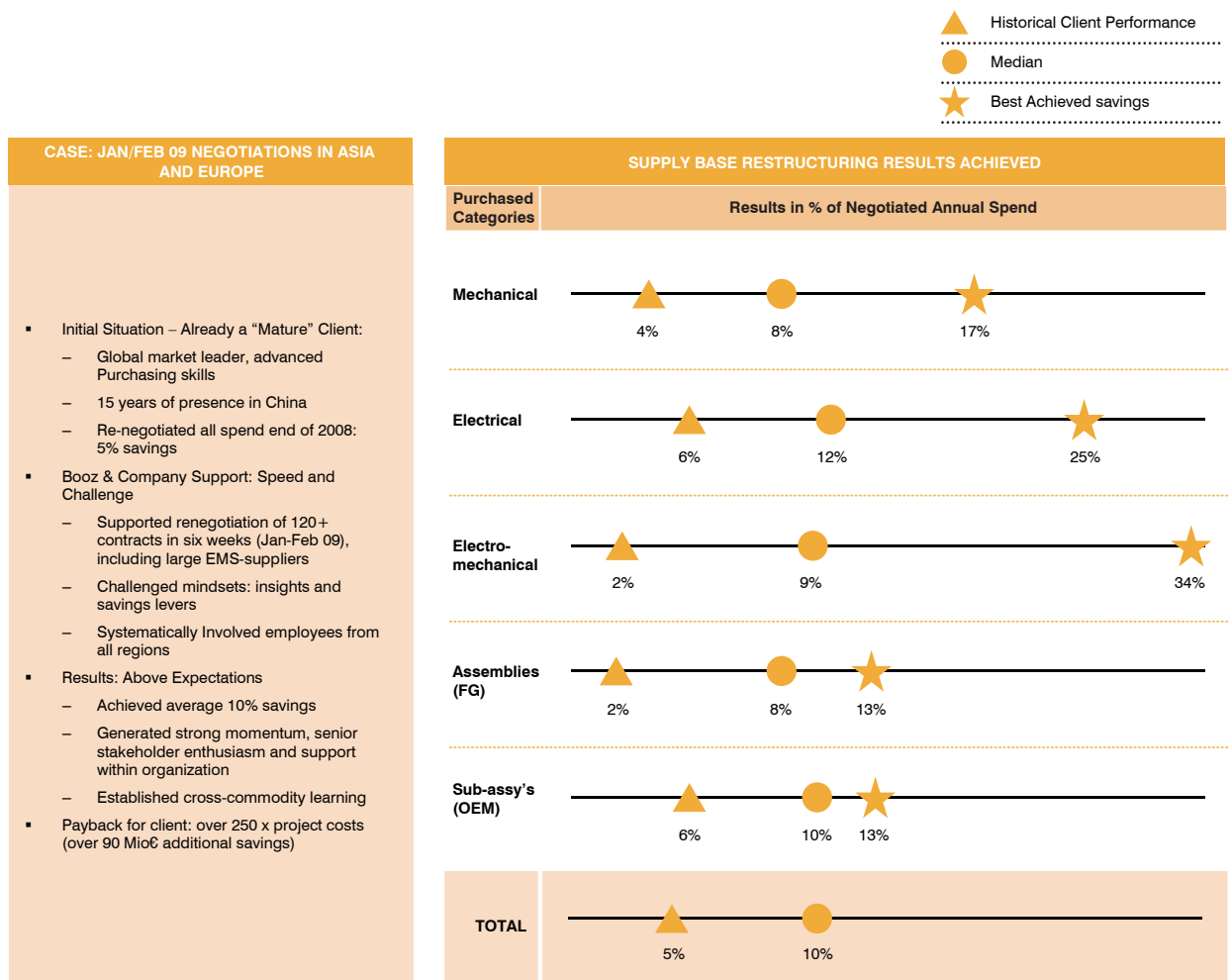
(see exhibit 2, a client example on supply base restructuring).

Booz & Company has found that, in the current buyer's market, suppliers' need for stable business means that this approach will yield results far above historic performance.

In 2009, we applied this supply base restructuring methodology to help a client renegotiate with its suppliers in Europe and Asia (see Exhibit 3). The client, a global market leader with advanced purchasing skills and a 15-years track record in China, had renegotiated all-spend at the

end of 2008, achieving 5% cost savings. After a six-week period of preparation, Booz & Company supported renegotiation of more than 120 contracts, including deals with large electronic manufacturers. By providing saving levers to restructure their supply chain, the client was able to achieve average further cost reductions of 10% or Euro 90 million—far beyond their initial expectations. The result generated strong momentum, senior stakeholder enthusiasm and support within their organization, and a cross-commodity learning mechanism.

Exhibit 3  
Booz & Company Case Example Structural Components



Source: MOST; Booz & Company analysis

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## MOVE EARLY AND QUICKLY TO CAPITALIZE ON OPPORTUNITIES

Industry leaders recognize that the current trend of consolidation in supply bases is inevitable:

- “A supplier shakeout is inevitable, the sooner it begins, the sooner it will be over.”
- “You have to let nature take its course...The supply industry has to be thinned out, and the car companies are trying to do it anyway.”
- “Companies are shifting work from failing companies to healthier suppliers... We’re seeing this consolidation take place.”
- “The most important thing that we do now is help them consolidate because we have this overcapacity.”
- “Suppliers can operate on a level playing field, with the healthiest winning out.”

In light of this development, companies cannot afford to delay. Rewards for activism can be significant, while the costs of inaction may be prohibitive, very possibly culminating in the bankruptcy of key suppliers and the evolution of an environment shaped increasingly by rival suppliers and competitors. In addition, if unhealthy suppliers require financial support to remain solvent this, in turn, will constrain the ability of companies to improve long-term cost and technology positions.

Conversely, companies that respond quickly and appropriately are likely to gain first-mover advantage in securing and developing relationships with critical suppliers and enjoying the most benefits from supply market as they restructure supply bases to adapt to the new environment. Accelerating the process of supply-chain restructuring can produce results within 12 to 18 months, and companies that act simultaneously to

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### **About the Authors**

**Joni Bessler** is a partner with Booz & Company in Shanghai. Ms. Bessler has 27 years of consulting experience specializing in operational improvement for global companies.

**Detlef Schwarting** is a partner of operations with Booz & Company in Düsseldorf. Mr. Schwarting has 16 years of consulting experience specializing in sourcing, cost transformation and supply chain management.

**Stephen Li** is a principal with Booz & Company in Shanghai. Mr. Li has 15 years of both industry and consulting experience specializing in sourcing, supply chain management, and operational improvement for both global and Chinese companies.

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increase the impact of restructuring typically benefit from an additional 5% to 10% decrease in materials costs. Companies can also help their suppliers become more efficient by, for example, helping them lower their proportion of fixed costs to pre-crisis levels.

All of these goals and measures can be realized with the help of consulting firms such as Booz & Company. By bringing in knowledge, introducing best practices, tools, and templates, and managing the overall project, results can be achieved quickly as we support, coach, and challenge your team.

Our work has won enthusiastic praise from our clients and their suppliers. Booz & Company's global presence allows us to provide you with support in all key supply markets. Our dedication towards developing and executing solutions ensures project success.

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