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Next Wave Sourcing  
*Reinventing Procurement  
To Drive Growth and  
Profitability*



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# NEXT WAVE SOURCING

*Reinventing  
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## Executive Summary

Over the past 10 years, company procurement departments have done well, on the whole, in meeting a series of new challenges. Whether it meant working with an increasingly global vendor base or managing partnerships with back-office service providers, procurement generally accomplished the task at hand. With each success, the visibility and importance of the function in the overall organization grew—so much so that procurement now controls half of the annual budget in many industries and up to 80 percent in sectors such as manufacturing and retail.

As confidence in procurement departments soared, companies counted on them to take on even more challenging projects. Now, procurement chiefs are being asked to undertake a host of new responsibilities: decrease supply chain complexity; speed products to market; stimulate supplier innovation; enhance operational security; and even consider the social and environmental impact of the supplier in sourcing decisions. And they are experiencing diminishing returns with yesterday's best procurement strategies, such as optimizing supply structures, e-auctions, and finding suppliers in low-cost countries.

To find out how cutting-edge procurement departments are meeting these challenges, Booz & Company conducted a survey of more than 100 business leaders, including CPOs and C-level executives at leading global companies such as Toyota, Procter & Gamble, Vodafone, and Novartis.

We learned that addressing issues like these requires a higher level of talent and commercial acumen than anything procurement departments have tackled before. Indeed, these aims demand a reach beyond that of the organizational supply nexus: They require a transformation in the traditional way we think of sourcing. In leading companies,

sourcing is evolving from a stand-alone function that ensures that materials move through the supply chain at the lowest possible cost to a nerve center that monitors, anticipates, and responds to a variety of needs throughout the company—and even those of its suppliers. These companies take a holistic, highly strategic approach in which they look at every supplier relationship from a variety of perspectives; it is designed to ensure that procurement decisions maximize the long-term value of the company, in terms of both cost and top-line growth. This 360-degree approach optimizes sourcing processes inside the company as well as those of the company's suppliers, and extends even to the network of suppliers' suppliers. Basically, it encompasses any supplier in a position to create or destroy value for the company.

Many companies covet the potential rewards of this kind of holistic, integrated approach to sourcing, but few are prepared to implement the organizational changes such an approach demands. Often, the sheer scope of the challenge can overwhelm management's ability to visualize the steps necessary to accomplish it.

To understand how to bring about such a transformation, we will examine the forces pushing CPOs toward their new future; the four key organizational changes necessary to stay in front of the next wave of change in sourcing; and the capabilities that procurement organizations will have to build.

### The Case for Change

Companies today are searching for new ways to leverage value from their suppliers into growth and profitability. They want to take advantage of global competition to find better sources of supply

and, at the same time, decrease their supply chain complexity, meet shorter response times, and build resilience. These opposing forces are rapidly leading to a crisis at many companies—and, for a few leaders, an opportunity to create a new kind of competitive advantage.

Most of the executives we interviewed agree that their procurement department has the potential to play a catalytic role in creating new value for their companies: Eighty-seven percent told us that they expect procurement to take a more active role in defining and fulfilling the business strategy in the coming decade. "We need to be setting the strategic agenda through growth and innovation," one CPO told us. "Procurement can act as the glue to make it happen."

Whether procurement is up to the job is another question. Despite the widely held belief among many CPOs that the potential exists for procurement to play a more central part in the corporation, most procurement departments have not made the changes required to do so. In fact, our research suggests that many departments are still working hard to implement the classic sourcing levers that constitute yesterday's best practices.

Today's challenges are enough to fill up many CPOs' agendas: To what degree should we manage our third-party suppliers? Do we need to find a backup parts supplier for Asia? Have we done enough hedging on our energy buy? But among leading CPOs, we find a growing awareness that such day-to-day problems can only be patched using the traditional approach. They are concluding that only a new program based on a holistic vision of sourcing will enable them to find deeper answers to both their short-term and long-term concerns.

### Overhauling the Organization

Our survey indicates that there are four key organizational changes necessary to initiating a transformation in procurement:

1. More cross-functional integration
2. Better supply networks
3. More collaborative supplier relationships
4. Greater supply chain resilience and risk management.

**1. More cross-functional integration:** At present, the silos and borders that separate functions often limit opportunities for cost savings and value achievement. For example, the walls that separate R&D, marketing, and suppliers inhibit jointly executed and coordinated projects aimed at such goals as developing new products and services or driving down sourcing and life-cycle costs. Breaking down these barriers can have a substantial impact.

Two-thirds of the survey's respondents told us they believe procurement has a crucial role to play in integrating departments within their organizations. Even more, 73 percent, saw a need for similar procurement-led, cross-functional integration with external suppliers and partners.

The procurement function is well positioned to serve as the catalyst for bringing internal departments and external suppliers closer to each other: After all, the function often serves as the communication link between them. Many procurement leaders point to better management of specifications as a key catalytic mechanism in this effort. In fact, 44 percent of CPOs see demand and specification management as a top priority for procurement over the next five to 10 years, while another 44 percent believe they will be doing more demand

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and specification work. One CPO told us he wanted his department to take an “active role in challenging the core value” by questioning engineers on their product specifications. This, the CPO believed, would encourage the engineers to go beyond identifying unnecessary design elements to better defining the product’s absolute needs.

The advantages of this kind of dialogue are not limited to the CPO’s organization. Large global retailers, such as Wal-Mart and Gap, have discovered that closer contact with their suppliers allows the suppliers themselves to integrate logistics and returns-management solutions, as well as to adopt new supply chain technologies such as RFID more rapidly.

Greater integration, and the looser boundaries that may come with it, should not be confused with less discipline. On the contrary, many CPOs complain that buying procedures must become both more rigorous and more widely applied. “There is still too much maverick buying,” declared one CPO. A vast majority of respondents—86 percent—believe that creating global purchasing processes and systems will be increasingly important over the next five to 10 years.

- 2. Better supply networks:** Today, most supplier interaction happens within a point-to-point relationship—procurement to supplier. This relationship has evolved in some industries, such as the automotive sector, where it is now standard practice for companies to manage deeper into their supply chains, down to Tier Two and Tier Three suppliers. But soon, even this extended management will not be enough.

In our interviews with leading executives, increasing numbers are telling us that the ability to orchestrate a vast network of supply relationships will become more important. Such networks will look at the supplier not just as a source of a material or a component, but as a partner that will help improve delivery systems and design products

These executives anticipate using a variety of strategies to improve their ability to manage supply networks. Fully three-quarters of respondents believe supplier cost modeling will become more important over the next five to 10 years, as buyers seek a greater understanding of their suppliers’ underlying expenses. And 81 percent of respondents see low-cost country source modeling as a key emerging skill. Another important opportunity, CPOs believe, is joint action with suppliers in the continuous reduction of waste: 47 percent see the challenge to reduce waste as a top priority, and an additional 30 percent say they will be focusing more intently on waste reduction in the future.

All of these tools speak to the growing need of companies to gain a deeper, more differentiated understanding of their supply networks. “How to manage strategic partnerships will become key,” one CPO told us. Another agreed, but warned that at present, “there is a lack of clear approach and tools to manage this.”

- 3. More collaborative supplier relationships:** Many unrealized opportunities for value arise within a company’s supplier network in areas that neither the buyer nor individual suppliers can identify on their own. Collaboration is needed to

optimize cost, to drive top-line growth, and, sometimes, to develop breakthrough concepts.

CPOs still see a tremendous untapped potential in collaboration. Although 86 percent of the procurement leaders we surveyed said they have worked hard to develop collaborative partnerships over the past three to five years, most believe their work is nowhere near complete. In fact, 44 percent still see the development of these partnerships as a top priority over the next five to 10 years, and even those who don’t see such partnerships as a top priority say they intend to pursue a greater level of collaboration (38 percent).

Typically, collaboration with suppliers occurs in the areas of new product development, order delivery and fulfillment, and manufacturing. In a recent example, a northern European airline uncovered valuable synergies while working with a private airport to improve its luggage handling and check-in facilities. By ignoring organizational boundaries, the two were able to design a jointly executed check-in process that was much more cost-effective for each partner—and more convenient for their passengers

In this new collaborative world, competitiveness will be based on a detailed understanding of the suppliers’ costs, not the back-and-forth of negotiations. Companies will gain an advantage over their competitors not by squeezing an extra nickel out of their suppliers’ margins, but by working with suppliers to boost the level of efficiency in the supply network or to develop new cutting-edge products.

The benefits of supplier collaboration are becoming well recognized. One study by the Toyota Motor Corporation found that whereas negotiations can reduce costs by about 5 percent, collaborative practices can yield as much as a 38 percent cost reduction. Toyota analysts estimate that the benefits of collaboration stack up this way: 5 to 10 percent in cost reduction from engineering improvements; 5 to 8 percent in lower inventory levels through just-in-time shipping; and, most productive of all, 15 to 20 percent in sourcing raw materials and finding low-cost sourcing strategies for the supplier.

- 4. Greater supply chain resilience and risk management:** Many CPOs believe they will need to focus more on risk and resilience than they have in the past, because they fear that today's extended supply chains have made their companies vulnerable to new kinds of dangers. A total of 68 percent of respondents believe their greatest risk is the interruption of deliveries from key suppliers. (By comparison, less than half as many, 31 percent, fear physical damage to a company-owned facility or breakdowns in information security.)

"Risk management becomes more important as a larger part of production and development is done by partners," said one CPO. In fact, this heightened dependence on external partners has exposed companies to new problems that are falling under the purview of procurement. Issues such as a contractor's level

of social responsibility in its labor practices are fast becoming an important part of due diligence.

One new kind of resilience many CPOs say they must develop is the ability to work with their suppliers to create products that are manufactured and distributed with less carbon. And as environmental sustainability or "green" business practices become more and more popular with customers and even become a regulatory necessity in some markets, such an ability will become a greater priority.<sup>1</sup>

To build resilience and manage risk, one CPO told us, "we need to be broader in our understanding and have people working in different functions across the disciplines." Consequently, nearly half of respondents—45 percent—say they will be hiring professionals who have the types of strategic knowledge and business sense that would enable them to tackle as-yet-unidentified social, regulatory, and environmental roadblocks. Risk management is a much-needed capability as well, according to 18 percent of the CPOs.<sup>2</sup>

### Meeting the Next Wave Challenge

The last wave in sourcing's evolution was based on disaggregation—that is, evaluating the potential value of each supplier and then making sourcing choices based on that more granular understanding. The next wave of sourcing will build on that foundation and extend it in a holistic sense, propelling companies still further beyond the old zero-sum approach to purchasing.

First, the purchasing department will encourage cross-functional integration to develop greater insight into the needs of the business. Next, it will work more closely with suppliers to help them address these insights in ways that go beyond simple price cutting. To do this, procurement will build supplier networks that work together to optimize the efficiency of the entire supply chain, and they will create collaborative relationships with their network partners to engineer innovative new ways to create value. Finally, purchasing will apply these new capabilities to find ways to better manage the business risks their companies face and to boost resilience (see Exhibit 1).

Better knowledge management will be essential in meeting the next wave challenge. Before, the procurement function needed to understand the cost drivers of its suppliers. In the future, a much deeper understanding will be necessary in all directions—among suppliers, between suppliers and procurement, and between procurement and other departments within the company. This requires a complex and systematic web of cross-reporting and regular consultation to ensure that the supply network learns and keeps on learning as needs continue to evolve.

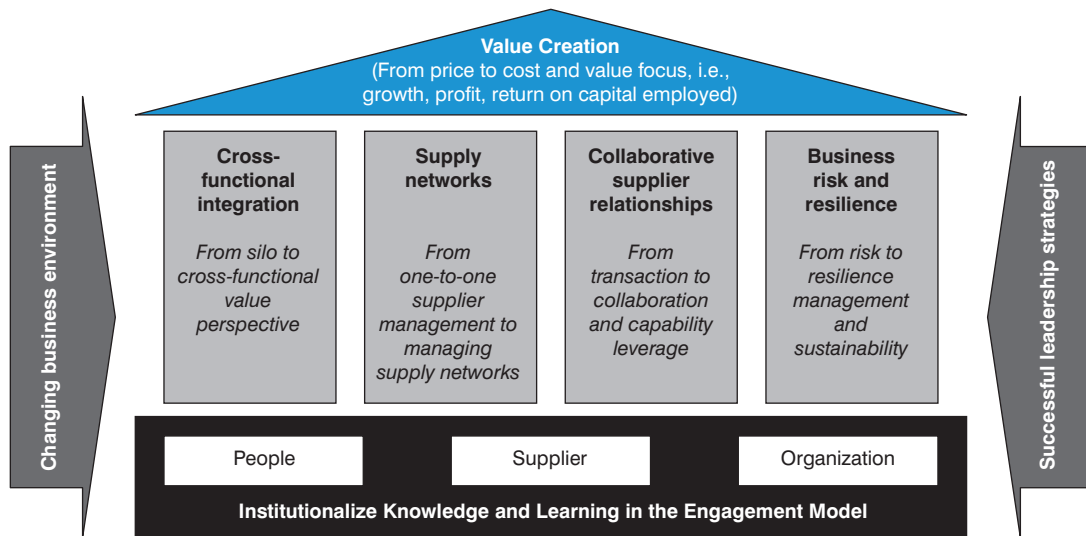
The transformation will also call for a new breed of procurement professional. When asked which two capabilities will be most important for sourcing professionals in the future, CPOs say most often a professional with strategic understanding and overall business sense (46 percent). The second-most popular trait is risk management expertise (18 percent), followed

<sup>1</sup> For more information on green sourcing, see Martha Turner and Pat Houston, "Start with Sourcing," *strategy+business*, Summer 2008: [www.strategy-business.com/press/article/08206](http://www.strategy-business.com/press/article/08206).

<sup>2</sup> For more information on supply chain resilience and risk management, see Dermot Shorten, Jean Lewis, Joseph Martha, and Salman Syed, "Prepare to Bounce Back," Booz & Company, 2008: [www.booz.com/global/home/what\\_we\\_think/reports\\_and\\_white\\_papers/ic-display/41289877](http://www.booz.com/global/home/what_we_think/reports_and_white_papers/ic-display/41289877).

**Exhibit 1**

*“Next Wave Sourcing:” Key Themes*



Source: Booz & Company

by more cross-functional supply and value chain understanding (15 percent). The response suggests that CPOs see a need for sourcing professionals who combine deep technical insights with broad leadership skills, particularly an ability to manage cross-functional teams and skill in managing outsourced relationships. “Our capabilities need to cover technical, commercial, and strategic issues. We need to be broader in our understanding and have people working in different functions across the disciplines,” said one CPO. Fortunately, developing first-rate sourcing professionals may be easier now that sourcing is a more strategic element in business, and one that is increasingly seen as a stepping-stone toward the executive suite.

Finally, an elevated organizational commitment will be required. For example, to release sourcing’s potential to drive growth and profitability, the procurement department will need a strong board-level presence: This will ensure that the company’s purchasing strategy incorporates and is aligned with its long-term goals. More critically, it will help realize important changes, such as arranging the sourcing footprint in a way that reflects the expected growth of the market or anticipates future requirements for limiting carbon output.

But board support should not be a blank check. It must be given only if procurement’s values, processes, and key performance indicators are aligned with corporate projections

and tactical plans. To accomplish this, CPOs will need to develop a culture of continuous learning within their departments, ensuring that the procurement team is able to adapt to changing business conditions. At the same time, they will need to build an infrastructure to continually raise the level of performance management and controls. As one CPO told us, “We need to professionalize the total procurement organization.”

Sourcing is at an important juncture. Many companies are ready for a procurement transformation; others are not. But simple awareness is a first step: Companies that recognize the importance of holistic sourcing practices are on their way toward implementing the next wave of procurement strategies and opportunities.

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