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# Reinventing Procurement to Drive Growth and Profitability



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## A NEW ERA FOR PROCUREMENT

*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.

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 way we traditionally think of sourcing. In leading companies, sourcing is evolving from a stand-alone function that ensures that materials move through the supply

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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.

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 tackle it.

To learn how some leading companies plan to meet this transformational sourcing challenge, Booz & Company interviewed chief procurement officers at more than 100 global companies with a reputation for procurement excellence. Through these conversations, we discovered that companies will need to make four key organizational adjustments to stay in front of the next wave of change in sourcing:

- More cross-functional integration
- Better supply networks

- More collaborative supplier relationships
- Greater supply chain resilience and risk management

*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

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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 that procurement has a crucial role to play in integrating departments within their organizations. And 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. One CPO told us he wanted his

department to learn to take an "active role in challenging the core value" by questioning engineers on their product specifications. This, the CPO believed, would encourage the procurement team to move from simply 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 dis-

cipline. 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.

*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 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.

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As we interview 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 crucial emerging skill. Another important opportunity, CPOs believe, is joint action with suppliers in the continu-

ous 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 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."

*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 last 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

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were able to design a jointly executed check-in process that was much more cost-effective for each partner—and more convenient for 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.

*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 company-owned facilities 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

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## Linking Functions for Improved Results

The experiences of a global toy company demonstrate the potential inherent in cross-functional process improvements. Over time, this maker of construction kits had evolved from making a relatively limited product line requiring parts in a few primary colors and basic shapes to offering an extended line of kits requiring parts in hundreds of colors and shapes. In the process, a low-cost product based on molded resin blocks had grown into something complex and expensive to produce.

This had occurred because the company's engineers were encouraged to create innovative products without regard to cost of supply. As a result, few engineers thought much about the real price of materials or the additional costs—such as inventory expense and the capital required to maintain it—that their requirements generated, a practice exacerbated by lax procurement compliance rules. Over years of incremental “scope creep,” the company lost its scale advantage as a major resin buyer and added a tremendous amount of waste and inefficiency to the supply chain.

The solution to the problem was found in rewriting the purchasing road map and adding a step that ensured regular communication between the engineers and procurement. This cross-functional link led to a reduction in the number of unique resins and colors needed by manufacturing, lowering the costs of materials and also simplifying production. Interestingly, reducing the number of resins also stimulated innovation, as engineers discovered new ways to make do with fewer material options.

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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.

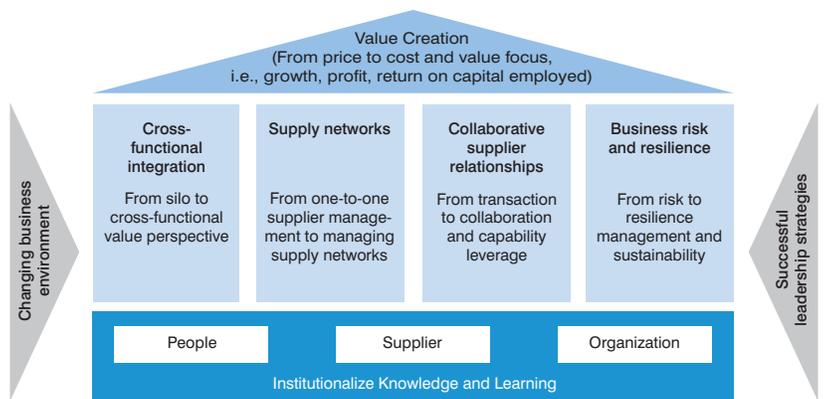
To build resilience and manage risk, one CPO told us, “we need to be broader in our understanding and have people working in different functions across the disciplines.” Consequently, nearly half of respondents—45 percent—say they will be hiring professionals with the strategic knowledge and business 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.

## 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 (*see Exhibit 1*). 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 networks of suppliers who work together to optimize the efficiency of the entire supply chain and

*Exhibit 1*  
“Next Wave Sourcing” Key Themes



Source: Booz & Company

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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.

Better knowledge management will be essential in meeting the next wave challenge. At minimum, purchasing needs to understand the cost drivers of its suppliers. But that's just the beginning. 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 continual dialogue to ensure that the supply network learns and keeps on learning as needs continue to evolve.

Finally, an elevated organizational commitment will be required. For example, to release sourcing's poten-

tial 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 the company 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.

*As one CPO told us, “We need to professionalize the total procurement organization.”*

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But board support—or, for that matter, senior management 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 perfor-

mance 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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