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Sourcing Transformation



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INTRODUCTION

In today's risky global business environment, supplier networks are the ultimate lifeline for many companies—delivering the far-flung materials, goods, and services that drive worldwide commerce. The sourcing function has thus become an indispensable contributor to the strategic goals and overall competitiveness of companies in every industry.

This is quite a turnabout. Not long ago, procurement was little more than a back-office function, responsible for the downstream process of negotiating price-based contracts and extracting scale benefits from increasingly unyielding groups of suppliers. Year-over-year price improvements and day-to-day supply assurance often represented the extent of purchasing executives' involvement in corporate activities.

Today that antiquated notion of sourcing is scarcely recognizable in leading purchasing departments. Inexorably, these departments and their leaders have extended their sphere of influence within the organization by proving that, given the opportunity, they can generate substantial value.

This value comes in many forms. For instance, procurement departments have taken a leading role in driving cross-functional collaboration at several large companies. They are breaking down the silos that have isolated R&D, marketing, sales, and other corporate departments from suppliers, because such isolation significantly inhibits cost savings and other performance improvements. They are using their newfound muscle to great effect—facilitating integrated sourcing processes, acting as liaisons between internal departments and suppliers, and coordinating projects that are aimed at developing innovative products and minimizing sourcing and life-cycle costs.

Leading purchasing departments have also demonstrated their importance by elevating their activities to new

SOURCING'S CHALLENGE

heights, to a strategic level far above mere cost cutting. Procurement executives can be found at the center of critical aspects of organizational performance, such as maximizing supply chain efficiency, reducing product development and manufacturing cycles from design to delivery, building operational resilience, enhancing marketing effectiveness and efficiency, and collaborating with suppliers to leverage capabilities throughout the supply chain.

Given this wide-ranging set of activities, it is scant surprise that in many industries, purchasing departments now influence half of the annual operational budget. And that figure rises to 80 percent in such sectors as manufacturing and retail.

Despite sourcing's promise and power, many companies have not yet successfully charted a course that positions their purchasing departments to become a catalyst for creating and capturing value, including profitability and growth. Even as chief procurement officers (CPOs) relish the notion that they may finally earn spots on the senior leadership teams of their companies, they must also understand that only superlative performers will retain this privileged position. Indeed, in a recent Booz & Company survey, 46 percent of senior purchasing executives recognized that a high level of leadership ability, a strong business sense, and strategic savvy are the most important traits CPOs need for the future. Conversely—and clearly representing a sign of the times—the more traditional skills of purchasing executives, such as tactical supply management and category experience, did not rank as priorities in the eyes of 95 percent of the respondents.

The opportunity to raise purchasing to the level of other critical corporate functions also means that its leaders must shoulder their share of the responsibility for addressing the increasingly challenging business landscape. When purchasing is managed well, companies can gain a competitive edge because they are able to overcome the obstacles on which their competitors founder, such as:

Globalization. Rich opportunities for profitability and product and service supply lie in the expanding economies and growing markets of India, China, and many other emerging nations; the vast new supply alternatives driven by low-cost labor pools and new factories opening in these countries; and the rising demand for essential commodities. But so do difficult challenges. The companies that most adeptly develop, manage, and optimize their supply networks to serve end markets around the world will have a clear advantage.

Resilience. As supply chains extend ever further into regions that were

nearly untouched just a few decades ago, their exposure to natural disasters, computer network attacks and failures, and political upheaval is increasing. There are many ways that companies can protect their supply chains from disruption, but few companies have actually done so. In fact, a recent Booz & Company survey of leading supply chain executives found that 68 percent believe the greatest risks they face are interruptions in the flow of products and services from key suppliers, but only 46 percent of their companies have developed well-thought-out plans to avoid such calamities.

Complexity/Customization. The proliferation of products and services that has been enabled by digital and other innovations has been a boon to growth for most companies. This is an era of mass customization in which marketing efforts as well as products and services can be tailored to individual customers. However, as any good operations leader knows, this level of variation comes at a

cost—increased complexity. Those companies that can balance the value of variety with the incremental costs of supply will be best positioned for significant profitability. The trick for sourcing is to work collaboratively across the company and with suppliers to provide what customers truly value in a way that minimizes supply costs.

Sustainability. Concerns among all stakeholders—from customers to investors to governments and increasingly to end consumers—about global warming, large carbon footprints, and increased waste are compelling companies to link green initiatives closely to overall strategy. Much like quality, sustainability is evolving into an integral part of the supply equation, and its dictates must be recognized in the way companies produce and design their products and services. Sourcing's role in facing this challenge is especially important because, for most companies, nearly two-thirds of green opportunities reside externally, in the supply chain.

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FOUR RULES FOR APPROACHING SOURCING EXCELLENCE

Simply put, in no other period has sourcing had so much power to make a significant impact in support of a company's strategic direction and overall competitiveness. And those organizations that are striving to achieve sourcing excellence will enjoy the competitive advantages it yields. For example:

Honda Motor Company has developed a no-nonsense way to eliminate the enmity that typically paralyzes purchasing's relationships with suppliers, replacing strident negotiations with open collaboration. Ideas for collaboration are often displayed openly on whiteboards during joint meetings, and then agreed upon by the end of the session. In the process, the automaker has lowered its costs and raised overall performance.

Procter & Gamble Company has begun a comprehensive analysis to determine how its supply chain must be transformed in the next decade. Through this study, the company plans to develop ways to reduce product size, create green packaging, and predict consumer demand so that it can place its factories and distribution points nearer its key sales markets.

Vodafone Group PLC has shifted from purely transactional procurement to a much more strategic approach that includes a comprehensive range of demand-side and supply-side levers and that is focused on creating value and optimizing the total cost of equipment ownership in its global mobile telephony business. This transformation has enabled the company to better utilize supplier capabilities, to develop systematic measurement and insight into supplier performance, and to create extensive cross-functional collaboration internally and with suppliers.

These three examples are leading companies in the sourcing arena, but in our view, no single organization has yet achieved all the benefits of sourcing transformation. And no matter the stage of development at which its sourcing function stands, any company can gain in the short and long term by "reloading" its sourcing function if it closely aligns procurement with the overall business agenda and continuously challenges the function to enhance its capabilities. Further, more companies should do what the best do: improve their sourcing skills in those areas that are organizational priorities—a tactic that begins, of course, with precisely iden-

tifying those areas. From there, the path to purchasing improvement is an incremental activity that ultimately creates a full-fledged and fundamental transformation.

As sourcing leaders undertake this transformational process, they can benefit from these four rules of the road:

1. Pick your spots. Companies should start their sourcing transformation by redesigning procurement procedures in simple, concrete ways that can produce measurable and significant value. These initial successes will build momentum within the organization for greater levels of change.

2. Create total transparency in purchasing costs and trade-offs. Whether it be the costs, savings, and benefits of environmentally friendly product options; the weighing of whether to buy or make a product; or the design

of a more resilient manufacturing footprint, the issues, implications, and ramifications of sourcing changes should be clearly articulated and openly shared throughout the organization.

3. Collaborate fully with internal and external stakeholders. A more robust sourcing process depends on participation throughout the product life cycle, from the concept stage in R&D to the disposal or salvage of spent products by a recycler. This requires the combined efforts of key company departments and suppliers in the quest to deliver innovation, reduced costs, supply chain efficiency, improved product launches, and the reduction of silos.

4. Become an influential corporate leader. Successful CPOs build their confidence and power by leveraging their position in the executive suite. They ensure that purchasing plays a

greater role in developing and defining the company's strategic direction. And they create a road map for sourcing transformation, as well as building the skills and capabilities required to support business partners.

Successful sourcing transformations depend on carefully balancing traditional sourcing approaches with new approaches, earmarking a portion of the gains from new procurement strategies for building fresh capabilities that can drive profit and growth in the future, and building superior purchasing capabilities over time, in much the same way that Toyota, Honda, and Procter & Gamble developed their sourcing functions. To achieve similar levels of success, companies must encourage substantially more proactive and radical behavior in their CPOs and ensure that their organizations leave behind old, unprofitable sourcing routines.

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