



Picasso's Blue Period begins.

Build “procurement smarts”
into your organization

Supply management: Strategy's hidden accelerator

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BAIN & COMPANY

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Build “procurement smarts” into your organization

In 2004, just days after Greece unexpectedly won the European championship in soccer, Adidas delivered more than 145,000 Greek team jerseys across markets in Europe. Smart marketing, right? Without a doubt. But perhaps even more impressive were its global procurement efforts. The company's supply-management organization identified a dye-house and manufacturer in Southeast Asia that would coordinate to produce the goods fast and deliver them on a global basis. It linked up tightly with in-country sales subsidiaries to generate orders and hit retail markets quickly.

Thanks to that collaboration, Adidas was able to create just-in-time product not only for the championship team but for every *other* winning country as their national teams advanced through the tournament. And its flexible supply strategy delivered those sales without significant preinvestment in materials or finished product.

Such finesse is elevating procurement strategy from the warehouse to the C-suite. It's easy to see why: In an era of faster product cycles, global competition and increased risk of supply-chain disruption, procurement—now often called supply management—is critical to a company's success. So is having the talent required to seize the supply-side advantage. Once, corporate leaders typically rose from marketing, finance or production. Today's leaders, however, need to know where and how to get what their companies need—

which means that procurement-savvy executives can find themselves on the fast track to the corner office.

A survey by the Institute for Supply Management (ISM) supports such a view. Some 34% of Fortune 1000 companies, the ISM reports, have recently placed manufacturing—a key training ground for CEOs—under supply-management execs. For example, Chrysler President Tom Stallkamp used supply-management savvy to transform the car-maker's cost position into an asset that proved irresistible to acquirer Daimler-Benz. Stallkamp, who rose from a Ford buyer to vice chairman of DaimlerChrysler, later went on to become CEO and chairman of MSX International.

Plenty of others are moving from small roles to general management positions as well. Shelley Stewart, Tyco International's chief procurement officer (CPO), expanded his role to senior vice president of operational excellence. As such, he leads Tyco's Six Sigma, lean manufacturing, working capital, real estate and strategic-sourcing initiatives. Steven Armstrong, former purchasing chief of Volvo Car Corp., recently assumed the position of COO in charge of the daily operations of Volvo's R&D, manufacturing, purchasing and quality departments.

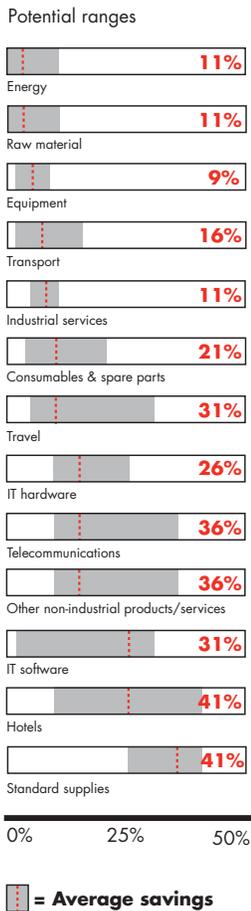
Similarly, when the former CPO at Waste Management Inc., Bradley J. Holcomb, was hired as senior vice president of global materials and supply by Royal Group Technologies Ltd., his mandate became not just to reduce procurement costs, but also to lead key businesses—deciding whether they are a core capability and competitive enough.

In the past, executives typically rose from production, finance or marketing. Today's procurement-savvy leaders—who know where and how to get what their companies need—can find themselves on the fast track to the corner office.

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Figure 1: How much can you save?

The potential savings from improved supply management vary greatly, depending on categories of purchases.



As a result of Holcomb's analysis, Royal has divested several businesses. Holcomb also leads Royal's China strategy, where his experience in outsourcing and global supply is vital.

But greater visibility creates higher expectations. Companies now want supply management to save them money on a very large part of their cost structure—and indeed, our research shows that most companies can average 8% to 12% savings on total procurement costs, and in individual categories—such as hotels and telecommunications—up to 40%. (See Figure 1.) They also want supply management to deliver shorter cycle times, to help with product innovation, to enhance the quality of products or business outcomes and even to play a part in revenue generation. In short, they want the function to play a key role in *executing* and *accelerating* the company's strategy.

Bridging the gap

Are most supply-management organizations up to the role of strategy accelerator? New evidence suggests that many are not. In a recent survey by Bain & Company, purchasing executives acknowledged that they were being charged with new responsibilities. Asked whether their departments hit world-class procurement standards, however, many answered no. Some 65% of respondents, for example, said they do not measure procurement performance based on the creation of shareholder value. Even more troubling, 61% of respondents said that they could not obtain critical, easy-to-analyze spend data from a single source. (See Figure 2.) And close to 50% admitted their organizations were ineffective, harboring overlaps in responsibilities that could tax and confuse suppliers.

World-class procurement organizations understand the race they are in and the obstacles to winning. They know exactly how supply management can accelerate their firm's strategy and what a winning supplier will look like.

The survey, in short, suggests a wide—and growing—divide between what corporate leaders expect of their supply-management teams and what those teams are able to deliver.

We have outlined a distinctive approach to building up procurement's game for the next wave of business competition. It draws both on our own experience with clients and on the handful of companies, such as Adidas, that have transformed supply management into a truly strategic function.

Procurement under pressure

Most companies are already pursuing a variety of initiatives that constitute today's conventional wisdom for improving supply management. They are optimizing costs through expanded (often global) sourcing. They are consolidating suppliers of high-value products and services, and they are linking up tightly with those that remain.

The challenge is to extend and deepen those capabilities to catch the next wave of supply-side competitive advantage. The experience of a handful of world-class supply leaders suggests at least three critical imperatives:

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1. Practice *strategic* supply management

Though many companies are reducing their supplier base by offering higher-volume contracts to a smaller number of suppliers, too many do so without strategic consideration of how the picture may evolve over time. What's more, too many apply the same relationship model to suppliers in different categories, not taking into account variables such as whether the supply base is global or local, the category is direct or indirect, the supplier is strategic or tactical, or the market is competitive or oligopolistic.

World-class procurement organizations take a more systematic approach: They first understand exactly *how* supply management can accelerate their firm's strategy and then determine what a winning supplier will look like. For some, the top criterion may be lower costs. Others may look for speed, flexibility or assured supply. Getting the right picture requires taking into account all the myriad steps in the supply chain.

Your procurement organization needs a clear picture of the race it is in and the obstacles to winning. Only then can it take the five critical steps necessary to placing the right bets:

First, pick the strongest horses by building economic models that predict supplier-industry trends for your most critical parts and materials. Then ask: Which suppliers are financially strong enough to make it through the next downturn? Which are the most innovative? The objective is not necessarily to bet on the supplier with the lowest price but on the supplier that is likely to be the strongest horse in the race.

Second, create competition by searching for new suppliers regionally or globally, developing alternative suppliers, and even considering in-sourcing alternatives. That ensures suppliers will provide their most competitive "total cost." Leaders usually undertake a competitive review of their most important categories every two to three years. In less critical categories, leaders are considering more outsourcing.

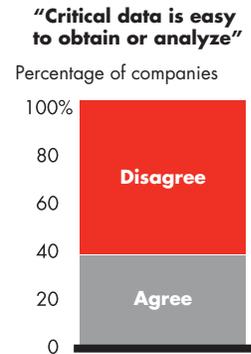
Third, calibrate the odds by performing independent analyses of market information and suppliers' cost structures and returns, then by simulating the impact of greater volume on per-unit costs. That allows the procurement organization to create an analytically robust target price for what it will be buying, thus ensuring both the buyer's competitiveness and the supplier's sustainability.

Fourth, invest differentially by reviewing all of the spending (not just that for direct and indirect materials) and divide suppliers into groups depending on the strategic importance of what they provide. In the largest and most critical categories, you may develop partnerships and integrate with a small number of suppliers, while in less important categories you may rely on electronic bidding from a variety of potential suppliers.

Fifth, gauge and re-gauge your bets by relying on your industry's "experience curve" to project (and demand) continuing cost reduction. Analysis shows that cost per unit in most industries declines between 20% and 25% for every doubling of accumulated experience, which charts as a downward sloping curve.¹ Some of those savings should flow through to the buyer. In the automotive

Figure 2:
The growing divide

Supply-management teams struggle to bridge the gap between what management expects and what teams can deliver.



Source: Bain & Company Procurement Survey data

¹ Mark Gottfredson, Elias Farhat, Paul Rogers and John Smith, "The Ultimate Testing Laboratory: Carmakers Mutate from Heavy Manufacturers to Consumer Goods Companies," *European Business Journal* (January 2001).

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Compliance: How to get there from here

A critical challenge for any company looking to revamp supply management is to ensure compliance. A series of initiatives that promises \$10 million in savings may realize only half that unless the new policies and procedures are actually implemented. Without them, the long-term goal of creating a sustainable supply-management organization with true cross-functional collaboration will recede into the distance.

When it comes to supply management, one financial services firm extended its compliance principles and methods into virtually every nook and cranny of the company. In the past, when business units there hired IT consultants, they were pretty much on their own. Today the company has master contracts with just four IT consulting firms, and everyone who hires a consultant pays a standard negotiated rate. Procurement has narrowed the supplier base to roughly one-tenth of its primary suppliers, saving money and improving quality. The reason: It's easier to track performance of fewer suppliers.

The company levies a "fine" on units that do not go through procurement for their purchases, underscoring the company's commitment to its procurement principles—and to the proposition that supply management matters more than ever.

The following guidelines for compliance reflect the experience of supply-management leaders:

- **Get organizational buy-in from users.** Involve them in the supplier-selection process and communicating extensively. Users are more likely to comply when they are aware of supply agreements and when they feel that they are part of the decision-making team.
- **Ensure active leadership support.** Users are more likely to comply if they see leaders actively participating in the monitoring and communication process.
- **Put an internal auditor in charge of supply-management compliance.** One individual must have responsibility, accountability and adequate levers to ensure results.
- **Agree on a compliance monitoring process.** Compliance is often harder to achieve with users, suppliers or different items purchased (or where each item has a relatively low unit value). Unless the organization has invested heavily in IT, it may not be able to monitor everything in real time. Agree on the sample and frequency of items to be monitored, on sites that will participate, on the templates to be used, and on the data-collection and report-out process. Remember the 80/20 rule.
- **Ensure that compliance results are visible.** Once a compliance report is generated, ensure that it is visible to the entire organization. Post it on the intranet or use other visible communication vehicles to encourage "self-compliance."
- **Create appropriate incentives and penalties.** Assess a "fine" to units that do not go through procurement, or link bonuses to the achievement of objectives spelled out on a time line.
- **Ask for help.** Request that Finance not pay invoices that are not with contracted suppliers. Ask suppliers not to fill orders that don't conform to supply-management requirements.

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industry, for example, suppliers are expected to achieve annual improvement factors between 2% and 3.5% a year.

Consider the example of Bayer Corp. USA, which set up strategic sourcing teams to coordinate its purchases. It moved increasingly toward sole sourcing, with a goal of achieving better-than-market price. Its chief buyers became, as one of them put it, “students of the [relevant] industry.”² Bayer also began regular and careful evaluation of its suppliers, with a goal of obtaining regular improvements in price and performance. Over one two-year period, cost-reduction initiatives for the company’s NAFTA region subsidiary saved more than \$125 million, equal to 8.3% of its total spend on chemicals.

2. Think cross-functionally—and outside your four walls.

As an accelerator of strategy, supply management is not a discrete function; it’s more like a continuous, companywide exercise. And it can optimize spending in many categories—such as marketing, capital expenditures and IT—that lie outside procurement’s traditional scope. Most companies understand that supply management must be led by cross-functional teams, typically including representatives from marketing, R&D, finance and other departments. Thus nearly 75% of our survey respondents agreed with the statement, “Procurement is involved in cross-functional teams to make critical sourcing-strategy decisions,” and 63% agreed that their companies had a “structured approach to establishing and managing” those teams.

But the challenge with cross-functional teaming is to get the execution right. Supply management needs to be proficient at

75% The percentage of companies that involve supply management in critical sourcing-strategy decisions.

engaging with the rest of the organization, as well as at passing the baton where it makes sense. Leaders in supply management develop that proficiency along the following lines:

They clearly define team roles and responsibilities around key decisions. That means first determining who should be the leader—that is, who should make the final decisions—and who should be the supporting cast. Our research indicates that in industries where competition is based primarily on cost, supply management is usually in the leader’s chair. In innovation-dependent industries, it is more likely to play the part of an information resource.

They define team-based metrics and incentives that promote successful cross-functional teaming. In particular, they measure and reward what matters to the business as a whole rather than what might matter to each individual function.

Most critically, they understand that cross-functional teams cannot end at the company gate but must include supplier representatives as well. The notion of an “extended enterprise” is what permits a procurement organization to capitalize on information from suppliers and on the suppliers’ ability to innovate.

Adidas, for example, brought together internal functions and suppliers to pull off its marketing coup in the Union of European Football Associations (UEFA) tournament-

² Doug Smock, “Bayer’s Rx: Innovation,” *Purchasing* (February 6, 2003).

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47% The percentage of companies that say their procurement organization is ineffective and their suppliers are confused.

related soccer apparel. The company moved the soccer supply-management staff in with the Adidas soccer business unit; established a joint incentive based on total sales; included discussion of sourcing in weekly marketing meetings; and gathered regular feedback from the suppliers. In addition, Adidas pushed all of its suppliers to work together—for instance, the materials supplier worked seamlessly with the dye-house and conversion factory to get the right product produced, converted and transported to the right markets at the right time.

3. View supply management as an agent of innovation

As China resets the bar on low-cost manufacturing, innovation has become a do-or-die differentiator for Western multinationals. Open-market innovation—in which companies draw R&D insights from customers, suppliers and even competitors—is the fastest track. Yet only about half of the procurement executives we polled said their companies set targets for supplier-related innovation. Fewer than two-thirds said their procurement organizations regularly brought cost-reduction and efficiency-related innovations to their companies. The numbers were substantially lower when they were asked about other

kinds of innovations. For example, nearly one-quarter said they “never” or “rarely” played a role in generating end-product innovations, while nearly half said they did so only occasionally. (See Figure 3.)

Procurement leaders, by contrast, push the envelope on all sorts of innovation. For example:

They design products to cost. In some industries, as much as 80% of the total cost of a product is determined during the design phase. Bayer actively invites suppliers to propose cost-reduction ideas for some of its chemical recipes. Another manufacturer of healthcare products brought procurement in to review the services, capabilities, pricing, efficiencies and concessions offered by marketing suppliers. It identified \$3.5 million in onetime savings, and \$2 million in savings going forward.

Figure 3: Winning procurement strategies

How frequently does procurement typically bring innovation (on its own or through suppliers) to the company?			
	End-product improvements	Cost-reduction improvements	Service improvements
Often	28%	61%	30%
Sometimes	49%	32%	53%
Rarely	19%	7%	14%
Never	5%	0%	3%

Source: Bain & Company Procurement Survey data

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They tap supplier knowledge for new and improved products. At The Clorox Co., a large percentage of new products are developed in conjunction with supplier partners. When the company wanted to develop a line of surface-protecting cleaning products, it partnered with specialty chemical companies to develop products that could deliver a Teflon-like protective effect.

They expand the supplier universe in search of innovation. Smart procurement organizations are often asked to identify suppliers with new or different capabilities, which in turn can spur initiatives for innovation in a variety of forms. For example, when the division of one health product manufacturer sought a different way to market a new health food, the procurement organization found marketing agencies that expanded the division's thinking on the synergies between tabletop, kitchen and restaurant applications.

Leading the way

Companies too often believe that revamping their supply-management function means replacing staff and starting over. But what really matters isn't so much the individuals involved, it's the principles by which they operate.

In some instances, organizations track not only shareholder-value objectives, such as cost savings, but customer-satisfaction goals and employee-related targets, like retention. In addition, tools such as Six Sigma metrics can improve performance on matters such as turnaround time.

Supply management has changed dramatically. Modern supply management is today both far more complex and critical to a company's success. It includes responsibility for total costs, quality and delivery throughout a company's entire supply chain. Its key metric is no longer simply cost savings but also increased shareholder value. Often supply management means encouraging supplier innovation to improve the company's products.

The leaders of these new supply-management teams can no longer get by on the traditional functional skills like purchasing and inventory management; rather, they need the skills of a general manager. As they develop and use these skills, and as the supply chain becomes ever more critical to a company's success, more and more supply-management leaders will find themselves taking on greater responsibilities—including the job of CEO. 📌

Survey methodology

The survey drew responses from 156 companies. Half had revenues of \$1 billion or more, and half were growing at 10% or more per year. Four out of five respondents worked directly in procurement. A majority said that procurement in their company reported to a vice-president, director or chief executive.

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Measuring up: Are you world class?

In one section of the Bain survey, respondents were asked to agree or disagree with statements about supply management in their own company. Below is a sample. Use them to score your own procurement organization:

- | | | | | |
|--|--|-------------------------------|-------------------------------|---|
| 1. Our company’s supply-management strategy is closely aligned with its overall strategy. | <input type="checkbox"/>
1
Strongly disagree | <input type="checkbox"/>
2 | <input type="checkbox"/>
3 | <input type="checkbox"/>
4
Strongly agree |
| 2. Procurement continually evaluates which value-chain activities are core and outsources the rest. | <input type="checkbox"/>
1
Strongly disagree | <input type="checkbox"/>
2 | <input type="checkbox"/>
3 | <input type="checkbox"/>
4
Strongly agree |
| 3. Although bigger make-or-buy decisions are made by senior management, procurement ensures the execution of all. | <input type="checkbox"/>
1
Strongly disagree | <input type="checkbox"/>
2 | <input type="checkbox"/>
3 | <input type="checkbox"/>
4
Strongly agree |
| 4. Our procurement organization structure is organized around categories with only one face for each supplier. | <input type="checkbox"/>
1
Strongly disagree | <input type="checkbox"/>
2 | <input type="checkbox"/>
3 | <input type="checkbox"/>
4
Strongly agree |
| 5. Procurement is involved in cross-functional teams that make critical sourcing strategy decisions. | <input type="checkbox"/>
1
Strongly disagree | <input type="checkbox"/>
2 | <input type="checkbox"/>
3 | <input type="checkbox"/>
4
Strongly agree |
| 6. When it comes to innovation, procurement is seen as a value-added partner. | <input type="checkbox"/>
1
Strongly disagree | <input type="checkbox"/>
2 | <input type="checkbox"/>
3 | <input type="checkbox"/>
4
Strongly agree |
| 7. Procurement can obtain all critical spend data from a single source, and the data is easy to analyze. | <input type="checkbox"/>
1
Strongly disagree | <input type="checkbox"/>
2 | <input type="checkbox"/>
3 | <input type="checkbox"/>
4
Strongly agree |
| 8. Our IT systems are integrated with suppliers’ systems and provide accurate real-time information from one single source. | <input type="checkbox"/>
1
Strongly disagree | <input type="checkbox"/>
2 | <input type="checkbox"/>
3 | <input type="checkbox"/>
4
Strongly agree |
| 9. A procurement career path is laid out and seen as a qualification for other key roles in the company. | <input type="checkbox"/>
1
Strongly disagree | <input type="checkbox"/>
2 | <input type="checkbox"/>
3 | <input type="checkbox"/>
4
Strongly agree |
| 10. Training for procurement staff includes procurement-specific skills such as supply market analysis, negotiating, contracting and supplier development. | <input type="checkbox"/>
1
Strongly disagree | <input type="checkbox"/>
2 | <input type="checkbox"/>
3 | <input type="checkbox"/>
4
Strongly agree |

Score yourself

Add up the totals and divide by 10. How did you do?

1.0 – 2.0 Behind the times

2.1 – 3.5 Getting there, but in need of improvement

3.5 and up Congratulations! You’re world class

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We help companies find where to make their money, make more of it faster and sustain their growth longer. We help management make the big decisions: on strategy, operations, technology, mergers and acquisitions, and organization. Where appropriate, we work with them to make it happen.

How we do it

We realize that helping an organization change requires more than just a recommendation. So we try to put ourselves in our clients' shoes and focus on practical actions.



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