

Supply Chain Management

Tapping the strategic potential of procurement

By Gregory S. Spray

Few business functions play a more critical role across the entire global organization than procurement. And for a select group of leading companies, procurement has become a strategic, proactive organization that contributes to profitability, growth and competitive advantage. Here's how it's done.

If you can imagine the pleasant surprise of an executive who finds that a little-noticed business unit is contributing hundreds of millions to the bottom line, you'll understand the reaction of many of today's CEOs who come to fully understand the potential of their procurement function to generate significant business returns.

That's right, you read correctly: procurement. That often anonymous function—with the traditional mission of obtaining high-quality goods and services for the lowest possible cost—has become a strategic, proactive organization with the potential of contributing as much as, or more than, other business

functions to profitability, growth and competitive advantage.

Procurement began to have a higher profile during the most recent global economic downturn, when senior management started paying attention to how much value and cost savings were hidden in all the material and supplies companies must purchase as part of the cost of doing business. In fact, for the typical company, procurement costs can represent anywhere from 50 percent to 75 percent of annual revenues, so even small reductions in that cost base can have a big impact. One research study by the Aberdeen Group found that it would take a \$5 increase

in sales to equal the impact of a \$1 reduction in procurement costs.¹

So although few executives today would view procurement as they might have 20 or 30 years ago—merely as a cost center with mostly clerical responsibilities—most companies continue to undervalue and underoptimize their procurement functions. However, based on Accenture research and experience, and on the insights of several leading chief procurement officers, we are able to highlight the strategies and approaches of a select group of leading companies that have successfully unlocked the secrets of driving high performance through the procurement and supply chain functions.

At the heart of procurement's potential to generate value is its inherent connectedness to the rest of the business. Ideally designed and enabled, procurement not only has visibility but serves a critical role across an entire global organization: to oversee the basic tools and processes that different areas of the business are putting in place to serve customers, manage suppliers, and develop new products and services, and to point all those resources toward optimal business ends.

Reconceived not merely as a valve controlling the optimal influx of goods and services but also as a distributor of organizational value—as an arbitrator or collaborator connecting parts of the business, creating new synergies—procurement ends up being placed in a powerful position to guide strategic direction and support better business decisions.

Steve Welch, former chief procurement officer of AT&T, believes that

in light of procurement's potential, its mission should be redefined. "The new mission is to create and convert supply chain opportunities into bottom-line opportunities that meet the strategic needs of their clients," says Welch. "That is, the proper domain now for procurement is the sum of supply chain objectives of the corporation's strategic business units, not just the cost-reduction objectives of the procurement function. If you can connect to that entire supply chain, it unleashes business value."

Paul Massih, global head of downstream procurement for energy giant Chevron Corp., puts it this way, with a nod to the long-running advertising campaign for the BASF corporation: "We don't make the business decisions—we help the business make those decisions better."

Lower cost, higher productivity and more effective operations are the hallmarks of procurement mastery, which, in turn, has a demonstrable link to high performance.

A recent Accenture study² about this link shows a clear pattern of distinctive capabilities—one of the building blocks of high performance according to Accenture's ongoing research program—among the high performers. Ten percent of the surveyed organizations warrant "master" status in terms of their procurement achievements. These organizations exceed the survey average across the board—in strategy, technology, sourcing and category management, requisition-to-pay, supplier relationship management, and workforce and organization.

The masters have procurement productivity levels that are 30 percent

¹ "The Procurement Outsourcing Benchmark Report: Accelerating and Sustaining Cost Savings," March 2004, Aberdeen Group

² "High performance through procurement: Accenture research and insights into procurement performance mastery," Accenture, June 2007. Note that many of the insights provided by procurement executives in this article were obtained at a recent Accenture Procurement BPO Services Innovation Forum.

higher than those of lower-performing companies. Yet their procurement organizations typically cost only half as much to run. Based on controlled normalized spend from one year to the next, procurement masters save almost 10 times as much as it costs them to operate their procurement organizations. This is more than four times the savings realized by companies that have not achieved procurement mastery.

Challenges

Yet even companies that excel in procurement face significant challenges in their ongoing efforts to outpace the competition. Visibility, business acumen and reputation constitute one set of challenges. Because traditionally, procurement has been perceived primarily as a support function, it has not enjoyed much status in the corporate hierarchy. “The only experience that lifts you out of that position,” notes

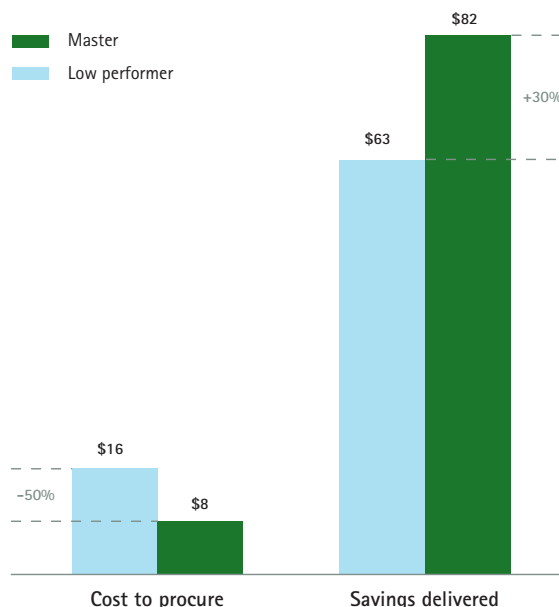
former chief procurement officer Welch, “is to deliver strategic value to the company; if you’re not doing that, you’re just performing.”

Procurement professionals thus need more general business skills as a foundation for delivering greater value. They also need ways to get out and see how “ideal” processes are actually being performed in real life.

One global procurement chief asks a provocative question: “As a procurement professional, are you out with your sales force, for example, and interacting with the customer to see how general policies translate into real behaviors? Are you following along with supply and product deliveries to see how things are really operating?” She notes that historically, procurement people “are not trained and rewarded to stay close to the customer and to

High impact

On \$1 billion of controlled, normalized investment, procurement masters achieve 30 percent higher savings with costs that are 50 percent lower.



The traditional us-versus-them mentality between a company and its suppliers can be a serious impediment to procurement transformation.

the workers actually performing the processes. Yet that up-close-and-personal approach is the only way that we can transform procurement into a value-generating enterprise.”

Getting the basics right is critical. As Chevron’s Massih notes, “Procurement begins with making sure the basic transactional processes are efficient and reliable, supporting the business 24/7/365.” That’s the price of admission, says Massih: “If you can’t get that right, the rest of the value generation goal doesn’t matter.”

Getting those transactional processes right is not easy, given the pressures on supply capacity. “The marketplace continues to be relentless in terms of shop capacities and manufacturing capacities,” Massih continues. “Prices may have flattened out a little bit, but the capacities are just not there. So many companies are looking at 15 to 25 percent schedule overruns just because they cannot secure the necessary supplies. So if a CPO could develop better anticipatory capabilities—having the analytics in place to let the business know, ‘Hey, here’s why your business project is at risk’—that value would be almost immeasurable.”

Massih also feels that the global talent shortage is likely to be felt acutely in the procurement field, especially at the entry to mid-line level. Specific skills are also a concern, from sourcing to supplier management to category management to commercial contracting.

“We currently cannot recruit enough qualified people in the United States,” Massih says. “So we are looking to other places such as India and China. We need to hire multiple thousands of people each year to match our growth needs and the normal loss from attrition, so we have to take a global approach to filling that need.”

Key success factors

The experiences of CPOs working for companies that have mastered procurement point to a list of consistent success factors in creating a procurement organization that helps drive high performance.

1. Collaborating across the business

If the new mission of the procurement function is “helping the business make its decisions better,” procurement must have the processes and skills in place to understand the company’s critical business functions.

Another sourcing and procurement executive who works for a major US entertainment and media company, emphasizes how critical collaboration is. “You have to be collaborative with the business,” he says. “You have to demonstrate that you understand their needs at least as well as they do. And you need to be proactive—you need to go to them with an idea and a business case, and not wait for them to come to you.”

“The CPOs that I admire the most today,” says Chevron’s Massih, “have the ability to speak the business language, to collaborate, to work across functional teams at the highest levels in the organization, and then translate all that into a supply chain strategy. That kind of CPO is able to balance the business needs and the supply market.” Procurement professionals who will succeed in that kind of environment will do so, he adds, “not only because of the hard skills that they bring to the table—category management and supply management and so forth—but also because of their knowledge of the business and their skills in communication and leadership.”

Yet a collaborative mindset is not enough. New programs and tools are needed to translate those mindsets into practical innovations.

One of the capabilities Chevron has introduced is a market intelligence

group that works both with and across the business functions, collaborating with them to find opportunities for greater efficiencies. For example, when the company looked into its steel purchasing, recalls Massih, “we discovered that we had more than 100 people working on steel pricing around the world—amounting to an annual spend exceeding \$750 million—but there was no real collaboration among them. By establishing a market intelligence group, we’ve provided the means for greater visibility and collaboration across the company—driving millions of dollars of value to the company’s bottom line.”

2. Establishing trusted supplier relationships

Because the traditional us-versus-them mentality between a company and its suppliers can be a serious impediment to procurement transformation, collaboration also has a critical external dimension. Procurement masters are able to establish closer and more trusted relationships with their suppliers, based on a deep knowledge of their business and on a mindset that says that the optimal functioning of every part of a value chain is important to the performance of the whole.

Establishing that deeper relationship may take some time, however. Kevin Smith, who is in charge of the global supply management and purchasing function for Delphi Corp., a mobile electronics and transportation systems company, notes that many organizations are now in a difficult situation as they approach suppliers, promoting a collaborative mindset and asking them to work together to create business value. “Now that companies have wrung out all the price concessions they could from their suppliers, they now say they want to collaborate,” notes Smith. “But, with some justification, suppliers don’t trust their buyers.”

Dave Nelson, the former CPO of Deere & Company and Honda Motor Co.’s American manufacturing division,

among other companies, and the author of several books on purchasing and supply chain management, tells the story of a supplier fair panel discussion that featured US and Japanese auto manufacturers. “Someone in the audience asked the panelists to explain the conditions under which they would terminate a supplier,” relates Nelson. “Both the US companies said that they publish monthly reports showing how suppliers stack up against their competitors. If suppliers show up in the underperforming section of that report and remain there too long, they will eventually be released.

“Then the Japanese representative spoke up: ‘We’ve never fired a supplier in our entire history. If a supplier is not meeting our expectations, it means we’ve made a mistake, too; so we go to them and see what they need. Do they need different skill sets? Better processes? If so, we’ll help them develop or improve those skills and processes so we can bring them up to our expectations.’”

Concludes Nelson: “That commitment to the success of the entire extended enterprise, including business partners and suppliers, is not the entire story of why the Japanese, and not the US, now have the world’s leading auto manufacturer. But it’s one big part of the story.”

3. Using outsourcing to extend the value-producing potential of procurement

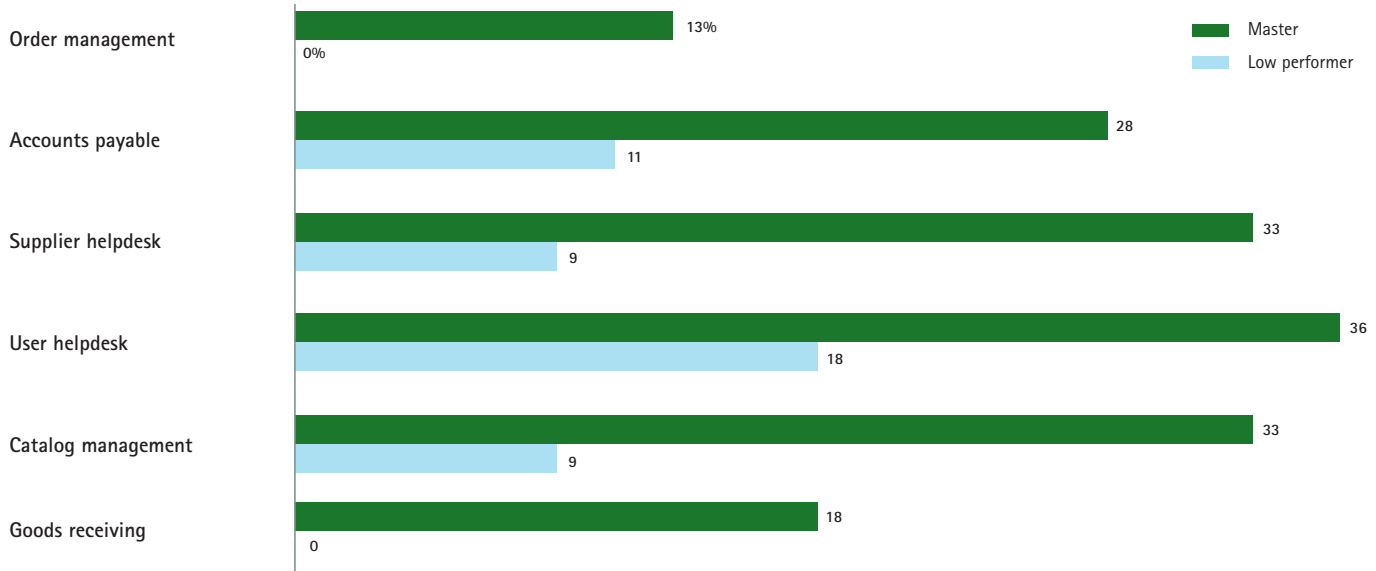
Another increasingly popular form of collaboration used to extend the value-generating ability of procurement organizations is outsourcing. As Nelson says, “For companies that have, say, \$500 million or more in direct spend, the opportunities today to leverage the capabilities of a procurement outsourcing provider are something to be closely considered.”

Outsourcing is an especially important option for companies that may not have a high-level professional

Outsourcing and procurement mastery

Looking at the six key transaction management functions at the heart of procurement, procurement masters are more likely to outsource or contract out such activities than are low performers.

Percent of companies outsourcing or contracting out key transaction management functions



Source: "High performance through procurement: Accenture research and insights into procurement performance mastery," Accenture, June 2007

procurement program in place. Accenture research into procurement mastery found that across the board of procurement activities—from order management to helpdesk to catalog management and goods receiving—procurement masters were far more likely to engage outsourcing service providers.

In Nelson's view, companies looking to transform their procurement function have an important decision to make: "Are they going to go after the management experience and the category-level expertise needed to become world class? Are they going to create a system themselves that is going to handle procurement across different regions and countries, and different kinds of businesses? Those companies need to compare the business case for internal capability development versus an outsourcing option."

Chief procurement officers who have leveraged outsourcing as part of their overall transformation strategy usually recommend a phased approach—demonstrating to the business that outsourcing can meet its needs in one area and then expanding from there.

"If I'm running a large global operation," says Nelson, "it's unlikely I'm going to start out applying outsourcing to all businesses, everywhere around the world. I'm more likely to take one manufacturing plant or one type of commodity and see if outsourcing works for that." This approach offers more control over the risk and the impact. "If it works, proving the business case and getting take-up in other areas would not be much of an effort. Other business leads will be coming to me asking how they can replicate the initial trial success in their business or region."

Process excellence is a key to maximizing the value of procurement.

4. Combining process excellence with technology innovation

Our research points strongly to process excellence as a key to maximizing the value of procurement. As Steve Welch notes, “Up to this point, procurement organizations have achieved a great deal of cost savings simply by manipulating markets, buyers and suppliers. Now we’ve about drained that well. We are moving toward a more process-oriented approach—changing processes and designs, becoming more involved in engineering and product design.” Becoming more involved in downstream processes—growing contractors and suppliers into the procurement space, and helping increase suppliers’ capabilities—is essential.

At the same time, CPOs need to look at new technology solutions to help digitize the entire supply chain. The analytic, insight-generating technology capabilities available today are especially important. Chevron’s Massih points out that procurement must remain agile and flexible. “This will allow procurement to change at a rate equal to or faster than the business. You have to be able to predict through demand management and planning, and by digitizing the supply chain. Those technological capabilities can help procurement professionals distill information that can identify true procurement-related business insights.”

For his part, Steve Welch anticipates new, Web-based desktop tools that will make information available for every procurement manager, enabling them to see the current status of the flow of what he calls “supply chain events,” not just financial figures.

An executive who heads procurement for a major European financial institution concurs, noting that business intelligence technologies offer the promise of propelling procurement toward its value-generating potential. “As the supply chain and

purchasing functions become more intelligent,” says this executive, “with an infrastructure in place attuned to supply chain events, procurement could become a real-time function, with companies optimizing the value chain rapidly, and maybe even paying for things only as they need them.”

5. Making a commitment to talent development

As procurement has evolved, so have the skills needed to run and manage procurement toward optimal business ends. The skills have become less tactical and more business-oriented. Developing the talent needed to continue propelling procurement toward its true potential can no longer be left to chance. Focused programs geared toward nurturing procurement capabilities must be put in place. (For a related article, see “Talent: Leveraging your most important competitive asset,” *Outlook*, September 2007.)

Rotating promising employees through a variety of functional jobs, including procurement, is one practice that has worked for a number of companies. For example, Chevron instituted a program in which the company takes the top 20 percent of its younger managers, segments them, then rotates them through different business functions.

“We attempt to put our best procurement people out into the business on an 18-month cycle,” explains Massih. “In turn, other business functions rotate their top performers into procurement on the same cycle. The learning curve is very steep everywhere these people go, but that’s part of the excitement and the challenge. The broad sweep of experience these younger managers get is invaluable. They know more, they understand more, and our initial analysis suggests they are more likely to stay with Chevron because they are more engaged in our business.”

Fulfilling potential

If procurement is to fulfill its business potential, it must transform itself from a support function to a value-generating function. And the way it does that is by getting as close to the business as it can. Procurement should focus on the business, not on supply relationships. The procurement organization brings the analytic skills, the view across the enterprise, and the supply relationships to provide critical strategic direction.

In the long term, executives looking to drive high performance through their procurement organization should consider the process, technology and workforce development initiatives that create procurement mastery.

The best news for procurement executives today is that there is great untapped potential in any function that has been underutilized from the standpoint of innovation. Mastering procurement drives value and leverage that has not been used strategically by companies. And that means that procurement is particularly ripe for transformation.

About the author

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