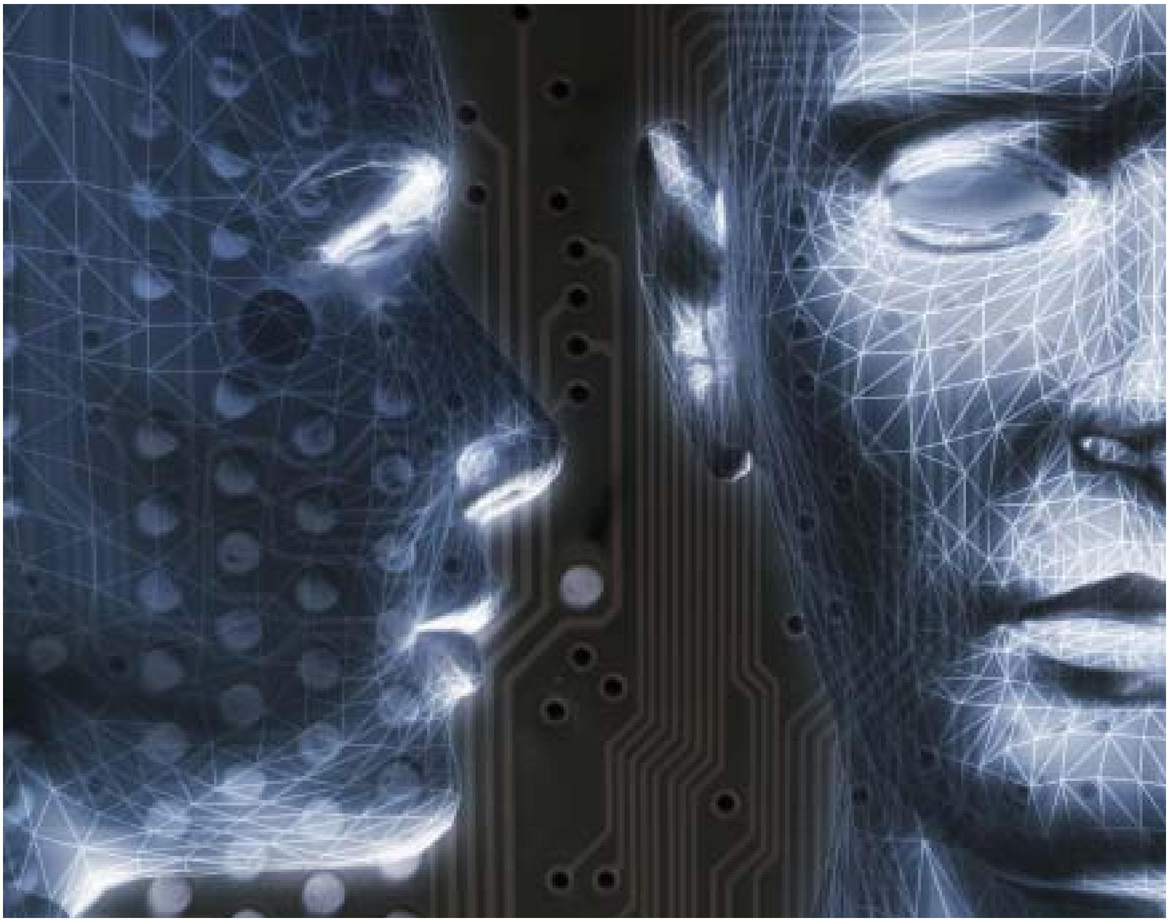
Economist Intelligence Unit

The Economist

The new face of purchasing



An Economist Intelligence Unit white paper
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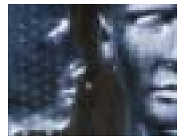


Preface

The new face of purchasing is an Economist Intelligence Unit white paper, sponsored by SAP. The Economist Intelligence Unit bears sole responsibility for this report. The Economist Intelligence Unit 's editorial team executed the survey, conducted the interviews and wrote the report. The findings and views expressed in this report do not necessarily reflect the views of the sponsor. David Jacoby was the author of the report.

Our research drew on two main initiatives. We conducted a global online survey in March 2005 of over 350 senior executives. To supplement the survey results, we also conducted in-depth interviews with senior procurement executives at a number of companies worldwide.

Our thanks are due to all survey respondents and interviewees for their time and insights.

April 2005

Executive summary

The coming decade promises to be a transformative one for the purchasing function. According to a major new survey of over 350 global executives, after years of being perceived as a clerical, back-office function, purchasing is set to gain remarkable prominence in the corporate pecking order. Although only 34% of respondents said procurement and supplier management executives currently play an important or vital role in establishing their companies' overall strategic objectives, 65% of respondents outside the purchasing function—and an overwhelming 91% within it—predicted they will have to do so by the year 2015 in order to maintain competitive advantage.

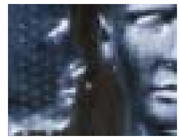
Three external and inter-related forces are driving the elevation of purchasing: globalisation, cost pressure, and innovation. This white paper, sponsored by SAP, identifies four ways in which the procurement function will respond and adapt between now and 2015:

- **The scope of supply management will grow.** In the old days, purchasing simply fulfilled purchasing orders. Today, purchasing aims to harness the enormous leverage of the entire supply chain by increasing the amount of spend controlled, linking purchasing with order management, getting involved early in new product development and taking lean initiatives to suppliers. As companies begin to emphasise performance over price, proactive monitoring of the critical development path of new products will be the next big thing.

- **Supplier relationships will deepen.** Companies are shifting from a smattering of individual suppliers to deeply interwoven supply networks, evocative of Japanese "keiretsu" or South Korean "chaebol". Purchasing executives will apply new rules of engagement in order to deepen their relationships with master suppliers, including non-binding, long-term agreements and cost standards.

- **The CPO will become a strategic partner to the board.** Over 60% of executives say that by the year 2015, their companies will have a chief procurement officer (CPO) who will report to the CEO and set a strategic course for purchasing company-wide. In the process, the CPO will gain the respect occasionally lacking in today's firm: a mere 22% outside the purchasing function think purchasing is respected by internal stakeholders (compared with 39% of those inside the function) and only 40% think procurement's influence is growing (compared with 78% inside the function). To strengthen purchasing's new agenda, the CPO will work to transform the function's skills base by promoting creativity, cross-functional experience, and financial and risk management skills.

- **Technology will be central to change.** Armed with an ever-widening arsenal of technologies, fully integrated networks of suppliers and a voice in the boardroom, the 2015 CPO will be charged with establishing the company's supply chain as a competitive differentiator that is visible to its customers and its customers' customers. To achieve this, CPOs need to work with their technology partners to define a purchasing platform for the 21st century.



The Chief Procurement Officer of 2015

Nearly two-thirds of survey respondents predict that their companies will have a CPO in 2015, compared with one-half of companies that have a CPO today. Among the skills and attributes that will define the successful CPO as a new purchasing environment emerges are the following:

- Clout to redirect price concerns to performance demands. A spotlight on performance, including total cost and delivery, has replaced the traditional focus on price. The new CPO will link supply management to demand patterns in order to craft and maintain extended supply chains.

- Strategic vision as well as operational acumen. Over 60% of executives say that by the year 2015, their companies will have a CPO who will report to the CEO and set a strategic course for purchasing across the company and the extended supply chain.

- Ability to tap the full resources of the supplier. The CPO of 2015 must oversee the fundamental shift from individual supplier relationships to interwoven supply networks that share a common information infrastructure. CPOs must fully exploit opportunities to establish innovative methods of supplier collaboration at every stage of the supply chain.

- Willingness to get involved in the design stage. CPOs must be able to exercise control over products from their conception. The new CPO evaluates efficiency from the beginning, rather than stripping waste out downstream.

- Ability to address a looming shortage of skilled people. A full 58% of executives surveyed see this as one of the greatest challenges to achieving maximum purchasing efficiency. The new CPO will lure staff with hard finance and IT skills to support cost-based negotiations and long-term investment analysis.

- Technological savvy to craft information systems across the enterprise and with a multi-tiered supplier network. The CPO will have ultimate responsibility for assuring the timeliness and accuracy of planning and transactional data.

- Financial and risk management expertise. As the terms of supply relationships lengthen, the company-wide financial implications of supply management decisions will continue to grow. The CPO will bear ultimate responsibility for the management and mitigation of these risks.

The purchasing identity crisis

Up until and throughout most of the 1990s, purchasing was a second-class citizen in most organisations. It played a marginal role in business planning, was ineffective at creating change, and, as a result, was not respected by internal stakeholders. To exacerbate matters, purchasing's price-focused adversarial stance often frittered away goodwill among suppliers.

The purchasing function still suffers from a shaky reputation among its peers. Over one-half of survey respondents outside the purchasing function believe purchasing is still not considered a strategic function at their company. Only 18% of those in the strategy and business development function think purchasing executives currently play an important role in establishing their companies' strategic objectives.

Even under the new moniker of procurement, purchasing still rarely plays a central role in corporate strategy. "The CFO and the CIO control the purchasing processes," says one survey respondent. Indeed, procurement does not have ultimate responsibility for the supplier relationship in many organisations: 29% of respondents say that "ultimate responsibility" is shared by a combination of functions, which some would argue means there is no ultimate responsibility for managing it at all, and 10% say business units have control.

"Spend visibility to indirect is hideous."

Indirect Procurement Manager

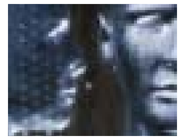
Procurement is still infrequently a ticket to the executive suite. Only 3% of those surveyed strongly agree that procurement is a "fast track" to senior management in their companies. A survey respondent captured this sentiment: "At present, the purchasing role is not a significant role and the people that we have selected lack the skills set and experience." One CEO describes purchasing's traditional career path as a "back-room position for the executive that did not make it".

The forest for the trees?

Part of purchasing's poor image is that it has traditionally been seen as better at pursuing an incremental, short-term and reactive approach to supply management, rather than focusing on longer-term, more strategic benefits. Only 18% of respondents strongly believe that purchasing is regarded as a strategic activity at their companies, and 67% of those outside the purchasing function do not think purchasing is focused on long-term results.

Tactical, short-term thinking is usually associated with a focus on price, rather than cost. "The price variance thing drives the wrong behaviour," explains Paul Novak, CEO of the Institute for Supply Management, referring to decisions based on price rather than cost, flexibility or longer-term objectives such as security of supply. Purchasing is also criticised for trying to generate savings opportunities too late in the day, after the bulk of the cost has been baked into a product through the design, prototyping, and test-marketing stages.

"Purchasing reacts to complaints from the businesses and changes the supplier if there is a problem," agrees Alex Hartley, procurement manager at Sea Containers, a UK-based transportation conglomerate. These are examples of what Christie Breves, CPO of Alcoa, calls "the cost of slow path versus fast path". By the slow path, she refers to the long-term effect of narrow-minded and tactical purchasing, which contrasts with the dramatic results that can be obtained through strategic sourcing and other more modern supply chain approaches.



Under-appreciated

As a result, purchasing is in the unenviable position of trying to regain respect from senior management and suppliers alike. A full 34% of survey respondents say low prioritisation by senior management is one of the greatest challenges to achieving maximum purchasing efficiency. “Senior management…always focused on sales and finance in the past,” said one survey participant. “The fact that purchasing is not linked to the other departments is a potential time bomb waiting to explode,” said another.

One contributing factor to purchasing’s traditionally low status is that, as it has evolved into a facet of the broader supply chain, the mission has struggled to keep up. As one survey participant explains: “We have conflicts between purchasing and product divisions over priorities.”

Purchasing’s ability to respond to these criticisms has been limited by a dearth of staff and information. Fully 31% of respondents say getting accurate and timely spend data is a top challenge to achieving overall success in purchasing strategies and initiatives. An inability to measure company-wide expenses accurately means “indirect [spend] for BAT until very recently has been ostensibly a virgin area, significantly larger than direct spend, and is spread across disparate profit centres, without good spend visibility or strategic sourcing,” says Andrew Brock of BAT in South Korea.

In addition, poor data acquisition and an inability to exploit existing data effectively means that purchasing cannot always ensure suppliers’ compliance with negotiated terms. Nearly 40% of those surveyed say their purchasing organisation is not very effective at monitoring supplier compliance with negotiated terms.

About our survey

In March 2005, the Economist Intelligence Unit queried 358 executives on the challenges facing their companies’ purchasing functions. Approximately 56% replied from western and eastern Europe, 26% from the Americas and 18% from the Asia and Australasia region. Respondents represented a wide range of industries and functions. At 78% of the total sample, executives from companies with over $1bn in annual revenues were the most heavily represented group.

The new face of purchasing

Procurement is poised for a striking transformation. Survey respondents believe that purchasing's strategic role is growing dramatically. A full 85% say purchasing strategies will be very important or vital to extending their companies' competitive advantage in the next ten years.

Three external and inter-related trends are behind this emergent shift:

● **Globalisation**. Fully 50% of respondents said globalisation will be one of the top two factors affecting their companies' supplier management strategies. Worldwide reach is no longer a competitive differentiator but a necessity for survival in a global business environment.

Multinational procurement can be complex of course and companies are now building supply chains to bridge multiple supply and demand points responsively as a prerequisite to effective competition. The recent surge in the price of raw materials, especially oil and metal, has accentuated the need to have a global strategy and contingency plans. More broadly, the world may be entering an era in which superpower economies can control the relative scarcity of materials through fiscal, monetary and exchange-rate policies. Two survey respondents criticised state "giants" that "try to swallow the whole supply market and control the price".

> "We need a different type of manager now—not a purchaser but an Executive Supply Manager who understands outsourced management"
>
> Chief Procurement Officer

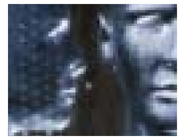
● **Cost pressure**. Forty-one percent of survey respondents said cost leadership will be one of the top two factors driving their business over the next ten years. Aggressive companies do not match lower-cost targets, they set them. In a bold move, General Motors (GM) conceived, developed and launched a car in Brazil called the Celta, which, based on current exchange rates, sells at approximately US$5,000 (pre-tax). GM encouraged its own team of designers to collaborate with a panel of outside suppliers. The company now sells 125,000 Celtas per year in Brazil and plans to extend its market reach.

● **Innovation**. The procurement function increasingly understands that in order to achieve more than incremental cost savings, suppliers must be involved in product development as well. As in the old quip, "which is more expensive—the cost of education or the cost of being uneducated", participative design may seem expensive and time-consuming. However, the majority of a product's cost is determined at the concept stage, well before development, prototype and production. The most effective suppliers can make a significant difference if they are brought in early: 35% of survey respondents inside the procurement function claim their suppliers significantly improve time-to-market and 37% say they deliver better quality and design.

These forces of change present purchasing with both challenges and opportunities. Leading companies are redefining the role of procurement in the enterprise and supply chain in four broad ways:

❍ *Enlarging the scope of supply management* by increasing the amount of spend managed or influenced, linking purchasing with order management and customer relationship management, involving purchasing in new product development, and taking expanding cost and efficiency measures to suppliers.

❍ *Deepening supplier relationships* by forming networks and setting new rules of engagement with suppliers, including long-term agreements, cost standards, and "covenants" or non-binding



agreements.

- *Elevating the function* by centralising procurement, creating the chief procurement officer position and ensuring presence in the boardroom, and transforming the skills base by promoting creativity, cross-functional experience, and financial and risk management skills.
- *Leveraging a range of technology and connectivity tools* to integrate with and even between suppliers, and by envisioning a future where technology can unite companies, suppliers and industries.

Such initiatives naturally reflect traditional procurement concerns: aggressive control of cost, cycle time, and other operational variables. But they also highlight a passion for drawing value from supplier relationships in order to sharpen competitive advantage, boost revenue and reduce costs. As Betsy Harrington, vice-president of Global Supply at Australia-based BHP Billiton, notes: “Our supply strategy is much more about being global than about initiatives for outsourcing or off-shoring…it’s about supporting the growth of our top line while delivering value to the bottom line.”

Enlarging the scope of supply management

Procurement professionals and service providers are aggressively enlarging the scope of supply management. In the old days, purchasing simply fulfilled purchasing orders. From this rudimentary role, "procurement" evolved to cover all externally purchased goods and services, excluding items and services that were "mission-critical" or unique to business units. Now they are aggressively expanding the function's scope to include all external spend, whether managed or influenced, outsourced and outsourceable.

"The definition of procurement is now everything you spend outside the company," explains CEO Avner Schneur of Emptoris, an e-procurement software firm. "When you add that up, the spend and opportunity to control it is enormous...it's all fair game. It's shocking the lawyers, but they're participating."

As purchasing actively seeks new outsourcing opportunities, serviceable spend will increase. This transforms purchasing's job from transacting orders to "running virtual factories", in the words of Barbara Kux, CPO of Netherlands-based Royal Philips Electronics. Of Philips' $20bn annual spend, custom manufacturing (OEM or original equipment manufacturing) accounts for $4bn and is growing.

As globalisation evolves, offshoring will increase and businesses can concentrate on where they truly add value. The risks of outsourcing should not be underplayed, however. According to Ms Harrington, BHP Billiton has insourced some activities as a result of cost or performance failures. The logical next step is to outsource procurement itself. This may seem extreme to some executives but it's not too far-fetched, according to a few CPOs. US-based BNSF Railway, for example, is considering outsourcing indirect sourcing to another company.

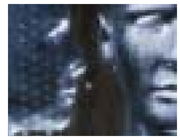
> "There used to be a hand-off. The customer would hand us a design, functional specs, and a list of approved vendors, and we would try to execute. Now we're doing more product development based on objective requirements, not specifications."
>
> Senior vice-president of Global Supply Chain

From price to performance

A spotlight on performance has replaced the traditional focus on price. Today's procurement professionals undoubtedly have a "broadened involvement in the whole supply chain...[to include] total cost and delivery. They're evolving now," says Ken Kempker, Chief Procurement Officer of BNSF Railway. The survey shows this trend is taking hold: 37% of respondents say their suppliers now effectively deliver better design and quality to their customers.

Some companies are carrying supply chain management to the next level by making their supply chain a competitive differentiator that is visible to its customers and its customers' customers. The idea is to "provide our company with a competitive advantage that can be identified by our customers", explains Arturo Díaz Marcos, corporate procurement and logistics director at German engineering giant Siemens in Spain. Rich Weissman, director of The Centre for Leadership and assistant professor of Supply Chain at Michigan's Endicott College, also notes the trend linking customer relationship management (CRM) and supplier relationship management (SRM), and that he is seeing CRM-related staff beginning to report to supply chain in some organisations.

Linking suppliers to customers seems to be working. A full 43% of survey respondents within procurement say their suppliers now significantly improve customer satisfaction. Convincing non-



Linking supplier relationship management (SRM) to customer relationship management (CRM)

Today, smart companies recognise that customer satisfaction can be traced all the way back to the birth of a supplier relationship. For example, Delphi Automotive sets up its sourcing only after considering the entire supply chain from a supplier's supplier to a customer's customer because it targets the lowest possible delivered cost for each product and customer segment. This often means "setting up production operations close to customers and the supply base close to where we manufacture", says Dave Nelson, vice-president of Global Supply Management.

IBM, in the meantime, has been perfecting what it calls the "on-demand supply chain". It designs business processes that link suppliers to customers, ultimately making the supplier's customer IBM's end-customer. "This completely changes how you put the supply chain together, as well as the reward system," says Ian Crawford, Vice President of Global Procurement Sourcing for IBM. Mr Crawford offers an example of how IBM was able to avert a hardware shortage by foreseeing it in demand planning. It built an anticipation stock to meet customer demand, while its competitors slipped six weeks behind because they could not obtain enough supply.

In another striking example of customer-supplier intimacy, Exxon-Mobil's payables department, with billions of dollars of payables, is working with SAP's call-centre CRM capabilities to help answer suppliers' inquiries about the end-customer order status of their products.

procurement executives of this is another matter: over 60% of those in non-procurement functions say suppliers do not currently contribute effectively to overall customer satisfaction.

Getting involved in the design stage

More and more companies are discovering the value of early supplier involvement. As product lifecycles shorten, more products and services will sit in the early adopter and growth stages than ever before. "For high-tech companies, the cost is mostly determined in the design stage," observes Manfred Heil, senior vice-president of Supplier Relationship Management at SAP. Mr Heil points to one company that is no longer interested in "one-off" event-based sourcing after a new product introduction, but instead wants proactively to optimise and monitor the critical path of a portfolio of new products. Early involvement is so important at Herman Miller that it grades suppliers and classifies them as new product development partners or preferred suppliers. If they do not fall into either of these categories, they get downgraded to transactional suppliers and have to earn their way back.

At companies like Alcoa, for which organic growth is a strategic objective, new products are the key to the future success of the company. So Ms Breves "taps innovation from the suppliers to help bring growth". She adds: "It's about value, not just cost. You've got to use the full resources of the supplier." General Motors in Brazil offers an example of how to harvest supplier innovation during the design and development process. It organised first (master) and second-tier suppliers at the concept stage for the low-cost Celta car. Together, they engineered the low-cost modular vehicle with packages of accessories and a small number of options.

Efficiency beyond boundaries

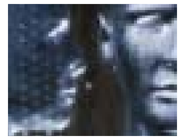
Leading companies that have experienced the success of "lean" operations in their own enterprise are aggressively extending the concept to their suppliers and even to customers in order to cut cost and waste.

At Delphi Automotive, Dave Nelson gathered directors from around the world who answer directly to

him, and they defined a strategic plan based on total cost. He dedicated 60 of his best people to lean supplier development engineering. This measures a wide variety of classic lean metrics, and claims remarkable success with each. For example, supplier productivity (measured in parts per person per hour) improved by 25% after a 90-day supplier development team effort. A similar initiative reduced floor space requirements (measured in square feet) by 25%, increased quality levels (measured in defects per million parts) by 60%, reduced lead-time (measured in supplier "takt time", or the time in which a product is finished) by 40%, and increased supplier inventory turns by 50%.

Building trust is key, as Mr Nelson explains: "Trust is built on showing suppliers results in their own operations. You go into their operations and improve their productivity. Over time, a third of their workforce goes away. You show them results and they develop trust. Also, you split the profits depending on each other's needs and benefits. This also improves trust." Delphi's lean success has spilled over into other initiatives. The suppliers benefiting from the lean programmes are now working closely with Delphi on new product development.

Herman Miller, for example, focused on cost at the highest level—cost of goods sold by measuring flow-days. A single metal fabricated part took over 60 days from the time the coil was made at the steel mill to the time the final part arrived at Herman Miller. The part was handled 80 times in order to perform a total of five hours of work on it. Very little value was added with each touch. "The customer is not willing to pay for that," says Drew Schramm, Herman Miller's senior vice-president of Supply Management, "we need to bring the cycle from 60 to 30 days." By measuring the value-added time and comparing it to the total days needed to get material through the process, Mr Schramm's organisation identifies wasted time, and hence wasted money.



Restructuring the supplier relationship

Many leading companies are forming "supply networks" in order to lock in the benefits of early supplier involvement, joint lean initiatives and on-demand supply chains based on CRM-SRM linkages. Ms Kux predicts this key trend will change the nature of purchasing dramatically. "Ten years from now [it will be all about] networks internally and externally," she says, "and competition from network to network, not company to company." She points to the automotive industry, which is heavily involved in buyer-supplier teaming and clusters.

If these supply networks sound familiar, it is probably because of their resemblance to Japanese "keiretsu" or South Korean "chaebol". In the evolving Western supply network model, there is no cross-shareholding, and there are no family ties as in the Japanese "zaibatsu". But the new vision of supply networks does include a loosely structured mutual support network of the kind that exists between financial institutions and conglomerates in the Japanese keiretsu.

Another similarity is a growing intimacy among companies, including a shared information infrastructure and, like the Japanese model, shared directorships, joint travel and entertainment. This intimacy serves as a foundation for rapid information flow across companies in the network, which ultimately accelerates multiple business processes from product design to problem resolution.

Leaders are radically restructuring the nature of their relationship with suppliers to support more nimble and collaborative supply chains. "Three bids" are out, strategic negotiation is in. Details are out, principles are in. Contracts are out, while covenants are in. Key players in the purchasing profession, as well as the suppliers themselves, are moving towards a consensus on mutual objectives and a co-investment in a long-term relationship. This relationship will be defined by increased supplier consolidation, non-binding agreements and guiding principles, and an emphasis on cost over price:

- **Supplier consolidation**. When viewed from the perspective of purchasing as it existed only a decade ago, the current degree of supplier consolidation is already extraordinary. The survey shows that a full 45% of companies decreased their supply base over

The master supplier: Building General Motor's innovative supplier network

General Motors (GM) fashioned its supplier network by carefully selecting master suppliers, and then worked with them to shape long-term, highly collaborative relationships. The model is described as more Japanese than Western. The purpose is to form a harmonious community of suppliers rather than to promote conflict, confrontation and competition.

GM selected master suppliers based on quality, price, technology and service. Through two rounds of technical and cost discussions, GM worked shoulder to shoulder with the suppliers. It shared sketches with suppliers, asked them for comments on concepts and modules, and gave them a statement of work and cost targets. GM shared concept work with the suppliers and gauged their capability throughout the process so the suppliers shared risk throughout the programme's conceptual development.

The chosen partners then co-ordinated with second-tier suppliers. The master suppliers were responsible for choosing the second-tier suppliers and promoting the concept and their plans and products to them. The extended team worked together to plan a co-ordinated supply chain, involving co-location and short delivery distances for the "just-in-time" delivery that ensures low inventory and fast turnaround.

the last ten years and 59% plan to reduce their total number of suppliers over the next ten years.

● **Guiding principles and long-term agreements**. Contracts are too limiting a medium in which to achieve the paradigm-changing benefits industry leaders are seeking. Instead, procurement executives are focusing on non-binding covenants and "guiding principles", and leaving the details to the working teams. "The network is so close that you don't need to fix every detail," notes Ms Kux.

> "Purchasing isn't even a profession anymore. It is moving from negotiation to problem-solving, team-leading, project management, and financial analysis."
>
> Senior vice-president of Supply Management

The image of a team of corporate lawyers in the negotiating room is receding in favour of the new approach. "Negotiation went away and is back, but in a different sense," says Mr Weissman. "It used to be about 'three bids', now it's about negotiating processes and where suppliers fit in the company's supply chain. (It's about) working together to...eliminate waste."

Several innovations were instituted by GM and its on-site suppliers, such as "supplier park", where all expenses are shared, including cafeteria, ambulatory and other services. Consistent with the "two-way street" type of relationship, China Light & Power's Supplier Assessment System is based not only on an assessment of the supplier's performance (which is jointly determined by China Light & Power and the supplier), but also the supplier's critique of China Light & Power as a customer, according to Bob Dandie, CPO at China Light & Power.

Given the emphasis on strategic partnerships, and the investment of time, manpower and sometimes capital required to stay competitive, it is increasingly difficult for buyers and suppliers to switch horses in mid-stream. In contrast to the old-fashioned margin reduction approach, long-term agreements send a signal to core suppliers that the buyer cares about their long-term financial health.

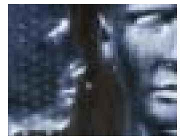
● **Cost over price**. Cost, not price, is the basis for negotiation when crafting a master supplier relationship, according to Mr Nelson. Delphi knows its costs and its suppliers' costs, and tells suppliers what cost is acceptable based on world-class production standards. It has established supplier cost standards for 82% of current production parts and 25% of new parts. Delphi is aggressively expanding this approach: by the end of 2005, Mr Nelson expects 70% of new parts to have a supplier cost standard. Once suppliers agree to the cost standard, Delphi guarantees they will get all of the volume, so long as there is volume to be had.

Cost-based negotiation does not, of course, eliminate requests for quotations, or RFQs. However, they are becoming more a market check than a buying mechanism. And if an RFQ results in a lower bid than the cost standard, the supplier needs to explain his production method, which brings the discussion right back to cost.

Increasing the efficiency of quoting is irrelevant now if companies have chosen the right suppliers, are already consolidated and employ lean manufacturing. "Honda and Toyota don't RFQ [important purchases]... they wouldn't think of running a reverse auction on an important supplier," says Paul Novak of ISM, "they know what things should cost."

As for auctions, their use is more limited than might have been thought several years ago. Mr Crawford views them as emblematic of the old adversarial supply chain relationships of the 1990s. "IBM almost doesn't use auctions at all, except to sell refurbished PCs. We don't believe they support the needs of on-demand supply chain."

Ms Harrington takes a more moderate stance on the subject: "There will be a place for [auctions] for a long time to come. E-marketplaces will stabilise and strengthen. Companies simply need to determine which commodities and categories are best supported by which tools."



Revolutionising the function

Companies are overhauling the procurement organisation to position it for its new, more muscular role as purchasing is increasingly considered a strategic function by executives company-wide: 65% of respondents outside the purchasing function say purchasing executives will play a very important role in establishing strategy in ten years' time. To prepare for purchasing's new responsibilities, companies are centralising procurement to gain control and efficiency, all the way to the executive suite. A full 74% of all respondents say procurement strategies will be vital or very important to successful execution of their companies' competitive advantage by 2015.

With centralisation has come a remarkably expanded authority for purchasing in some leading companies. At Herman Miller, Supply Management has final decision-making authority on direct materials, and the organisation gives them "a wide berth" to make decisions because they are held accountable for quality, service and cost, according to Mr Schramm.

In a sure indication of centralisation, the number of CPOs has risen sharply since the position first appeared ten years ago. In addition, C-level procurement attention increasingly results in procurement professionals sitting on board seats. The function's increased visibility at the board level is not confined to North America; both Alex Hartley of Sea Containers in the UK and Andrew Brock of BAT in South Korea have noted the phenomenon, and two prominent Japanese carmakers have promoted those with strong purchasing experience to the CEO slot, according to Mr Nelson at Delphi (Honda's recently retired CEO, Hiroyuki Yoshino, and Toyota's incoming CEO, Katsuaki Watanabe).

Upgrading skills sets

Leaders are promoting a different type of person through the procurement function than in the past. To support sweeping changes, such as restructuring of supplier relationships and establishment of on-demand supply chains, they are breaking the traditional, clerical, "green eyeshade" purchasing culture by hiring people who are more creative, cross-functional and aggressive. The difference in skill sets required for "the old purchasing" and "the new purchasing" is so large that "the purchasing profession will have to change dramatically" says Drew Schramm of Herman Miller. The survey also underscores this concern: 63% percent of respondents from purchasing said a shortage of skilled people and training is one of the function's top challenges.

Moreover, a large number of top procurement slots in large companies are going to people who have little or no procurement experience but have significant corporate experience and clout. This phenomenon demonstrates the importance that companies now place on the procurement area. For example, the CPOs at Bayer, GlaxoSmithKline and Vodafone hail from Finance, Operations and R&D, respectively.

This new breed of CPO is after a new breed of staffer. Above all, CPOs look for proactive and creative problem-solving capabilities. Mr Schramm says successful procurement executives "must become value stream architects". Mr Schramm's human resource approach reflects his vision that his company's new products "should come to market with a pre-designed supply chain that gets the product through its entire transformation using the least costly approach, rather than [launching a product] and taking the waste out later. There is three times the return in doing this than there is in traditional purchasing." Going forward, Mr Schramm would rather hire a Black Belt (a group leader responsible for implementing process improvement projects) for their problem-solving, team-leading, and financial analysis

"We have centralised to the extent that we have six buyers buying all direct materials for the whole group globally; that's $150 million of spend per employee." Procurement Manager

skills than a classical purchasing person.

CPOs are also unanimous about the need for purchasing executives to look beyond traditional functional boundaries. Staff members often gain cross-functional experience by being "seconded" by procurement to other areas. For example, Delphi added 500 engineers to its procurement department to work on standardisation projects. While working for procurement, their salaries are paid by purchasing. Purchasing departments also need to learn the business units' processes and decision-making timetable. To this end, Hewlett Packard has procurement design engineers physically located in the business units.

Promoting creativity and encouraging cross-functional teams will mean nothing without a push for increased aggressiveness among purchasing staff. It takes an aggressive posture to switch from traditional agreements to results-based contracts and pay-for-performance agreements. But it is not just about old-fashioned adversarial negotiation. Motorola would not have targeted US$3bn in savings in one year by relying on margin reduction alone. It takes an appreciation for the strategic and competitive value of procurement, a culture of ambition and a passion for leveraging the value of the extended supply chain. Mr Schramm expects his staff to save 4.7 to 5 times their salaries per year.

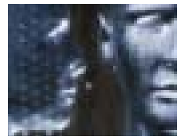
Finally, "strong financial skills sets are a prerequisite" to effective supply management, believes Ms Breves, who includes data mining skills in that category. A shrinking number of major supplier relationships, an emphasis on cost-based negotiations and the increasingly global nature of procurement all drive the need for financial skills in procurement professionals. Financial knowledge should extend far beyond accounting skills in the "bean counting" sense, which is often price-focused and counter-productive, to more sophisticated financial acumen that encompasses, for example, an understanding of hedging, risk management, and alternative cost accounting methods. "The impact of Sarbanes-Oxley has also increased the emphasis on financial acumen in procurement and inspired significant change in the role of procurement at Intercontinental Hotels," says Joe Yacura, Intercontinental's former CPO, now co-founder and chief strategist of Supply Chain Management, LLC.

Getting results and accolades

Largely thanks to these organisational and cultural changes, the perception of purchasing is improving, according to Mr Weissman. "After a brief period in the early 2000s that included the dot-com bust, lots of people moving and changing jobs, and ultimately resistance to change and new technologies, it has gotten better," he says.

And, of course, bottom-line results always help. Much of the improved perception of the procurement function over the past five to ten years is attributable to the positive impact it has had on the bottom line, according to several CPOs. Mr Brock of BAT agrees: "They love us to pieces. We create value-add." In perhaps the most tangible sign of the function's ascent in the corporate pecking order, salaries have risen considerably, according to Paul Novak, CEO of ISM.

However, although their reputation may be generally on the rise, purchasing executives must improve how their function is perceived elsewhere in the company. Even though only 12% of respondents within the purchasing function characterise their companies' purchasing strategies (documented missions, policies, etc) as unclear or undefined, a full 28% of respondents outside the purchasing function say this is true.



Setting the new technology agenda

Nearly every company has experienced the profound effects of technology on the way they buy, sell, manufacture and deliver products. Executives are overwhelmingly positive about the role software tools play in ensuring the overall success of their companies' purchasing strategies and initiatives. Approximately half of the survey sample reported that such tools were very important or vital to success in spend analysis, contract management, e-procurement, supplier connectivity and collaboration, and performance management.

But thorny problems remain. Today, most companies have cobbled together their own solutions by assembling software from different vendors, using proprietary interfaces to link them together, cajoling their preferred suppliers to connect and transact online, and operating without clear standards for business-to-business connectivity. Systems integration, when it occurs, is often accomplished through expensive consulting engagements that are focused on one-off projects such as spend analysis, contract management or strategic sourcing.

As a result, even today's leaders in procurement struggle to envision the architecture that will eventually unify today's disparate systems. Integration within an individual company is difficult enough; far greater process and system orchestration will be required to enable information to flow across supply networks comprised of multiple companies and industries. While e-marketplaces were intended to fill this gap, those that survived the dot-com bust have morphed their business plans to tackle tasks on a smaller scale, such as supplier connectivity.

Leaders in the purchasing community need to work with technology vendors to define a purchasing platform for the 21st century. Some believe the evolution of an SRM platform or platforms will codify tactical purchasing and strategic procurement processes, and in turn accelerate a convergence around a common language and standardised set of tools for supply management professionals. SRM may follow a similar evolution to CRM and facilitate many of the same breakthroughs on the supplier side that CRM brought to the customer side.

Others see the future of purchasing in enterprise resource planning, or ERP. Because of their ability to house data in a central reservoir and their deep installed base, ERP providers can set standards and embed them in the OEM solution even before they are generally accepted.

If the ERP systems end up being the masters of SRM, Connie Spiess of Hewlett Packard will be happy. As vice-president of Supply Chain Integrated Solutions, she has primary responsibility for consolidating the capabilities and business processes of the old HP and Compaq. From her perspective, procurement needs a single integrated dashboard to make intelligent decisions, which should include supplier performance information, market conditions, contract information and inventory visibility.

"Moving from fire-fighting to proactive processes is like reaching over a tidal wave; you've got a lot of paddling to do to get over the wave."
Vice-president of Supply Management

Technology's role as a powerful lever for change in procurement organisations will undoubtedly continue, and in the process create ongoing opportunities for purchasing to reinvent and reorganise itself in a changing business environment. Defining and building the tools that will eventually integrate today's disparate purchasing players, companies and systems will be one of the function's great challenges in the coming decade.

Conclusion

Purchasing has experienced a sea change in recent years and is poised to undergo further transformation in the coming decade. Once the executive's dead end, the purchasing function is coming into its own as a company-wide strategy-maker that executives inside and outside the function predict will play a pivotal role in extending competitive advantage over the next ten years.

Key to capitalising on this transformation is purchasing's ability to aggressively enlarge the scope of supply management to include all spend, whether managed or influenced, outsourced or outsourceable. Sparking the purchasing revolution, however, will require much more than control over the supply chain. Purchasing executives are now reinventing the core aspect of their function: the supplier relationship. Many leading companies are turning away from disparate suppliers, instead forming "supply networks" to lock in the benefits of early supplier involvement.

The CPO's ability to implement the following strategies will determine the pace at which procurement harvests the full value of the changes currently transforming the function:

- **Address risk early.** Given the trend towards single supplier relationships, increasingly global supply chains and volatile raw materials prices, timely risk management methods will be essential to ensuring perfect fulfilment at a reasonable cost. Head-in-the-sand strategies will leave procurement exposed to unique risks associated with integrated, multi-level supply chains that focus on non-binding agreements, shared goals and joint development policies.

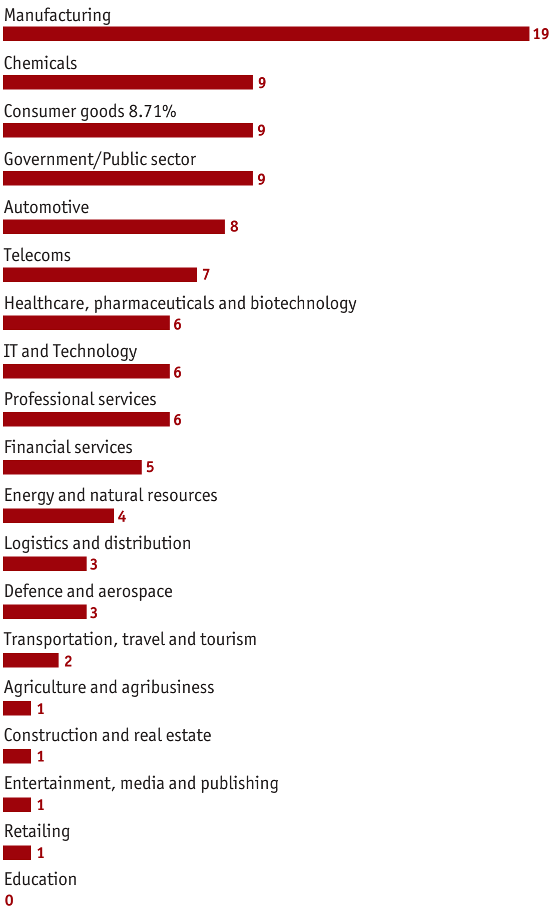
- **Get the right people and tools in the right place.** Procurement professionals will need rapidly to assimilate a diverse range of processes, technologies and strategies in order to unleash the benefits of a changing function. Acquiring the right people with the right financial and creative skills for the task will also be critical. Once the function is staffed with the right people, forward-thinking CPOs will embed their staff in operations—and vice versa—to ensure genuine, company-wide integration of purchasing expertise and priorities.

- **Encourage bonding.** Solutions providers will need to help bond supply networks together. But the design and delivery of the technical solution is only part of the answer. Procurement must develop systematic programmes to share business practices across supplier networks. This integration should extend beyond harmonising processes and quality standards towards the blending of cultures and governance values.

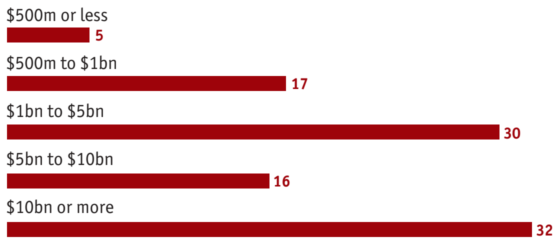
- **Maintain visibility and flexibility.** Despite radical changes within their function, CPOs can sustain their current leadership role by communicating the value of procurement, and staking procurement's territory within the larger supply chain. CPOs must clearly define procurement's responsibilities and defend its political clout within the organisation or risk the fate of the defunct chief logistics officer. Flexibility of the function to adapt to new terminology, including the CPO title itself, is imperative as supply networks, supplier relationship management, and other crossfunctional resource management initiatives are generated by purchasing's sweeping transformation.

358 responses

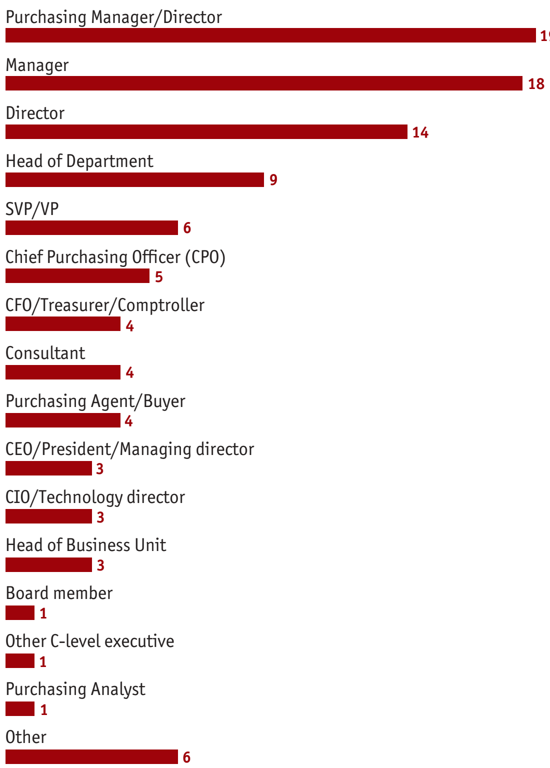
What is your primary industry?
(% respondents)



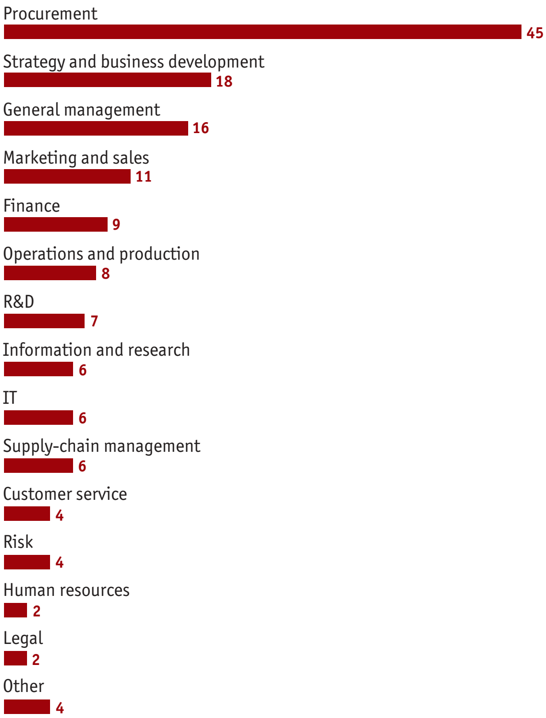
What are your organisation's global annual revenues in US dollars?
(% respondents)



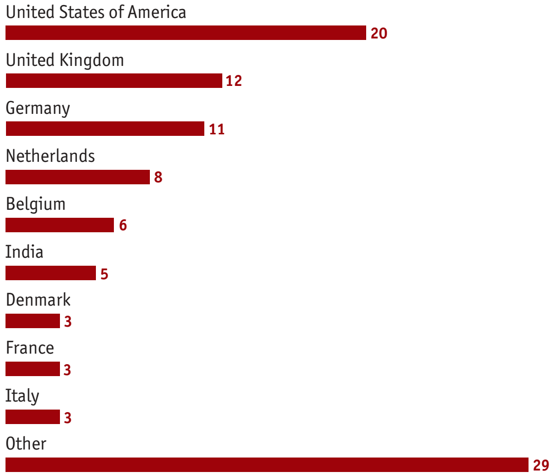
Which of the following best describes your title?
(% respondents)



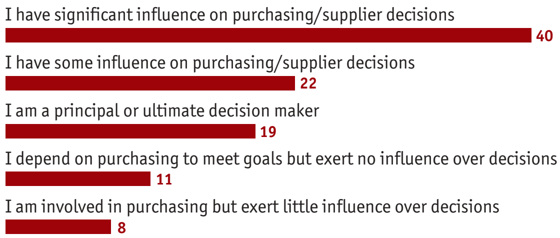
What are your main functional roles? Please choose no more than 3 functions
(% respondents)



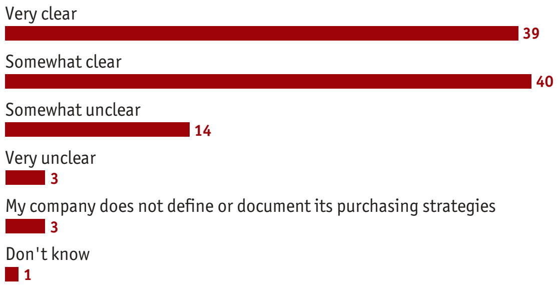
In which country are you located?
(% respondents)



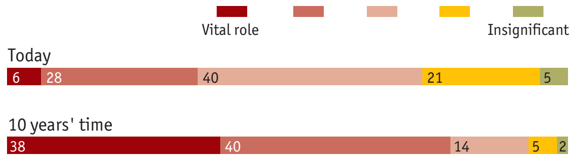
Which statement best describes your level of involvement in your company's purchasing and supplier management strategies?
(% respondents)



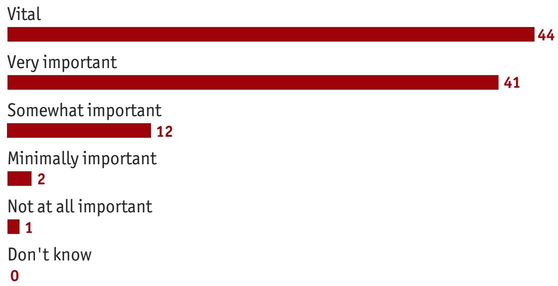
How clearly defined and documented are your company's purchasing and supplier management strategies and practices (eg, documented missions, policies, etc.)?
(% respondents)



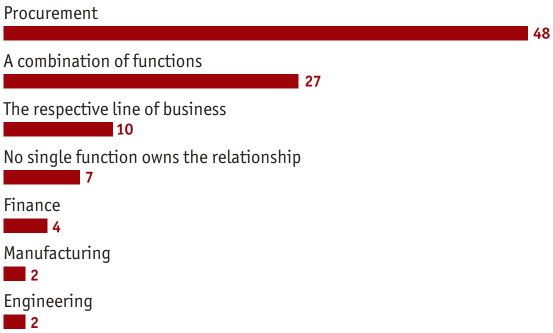
How important a role do procurement and supplier management executives currently play in establishing your company's overall strategic objectives? How important a role should they play in 10 years' time, in order for your company to maintain or extend its competitive advantage?
(% respondents)



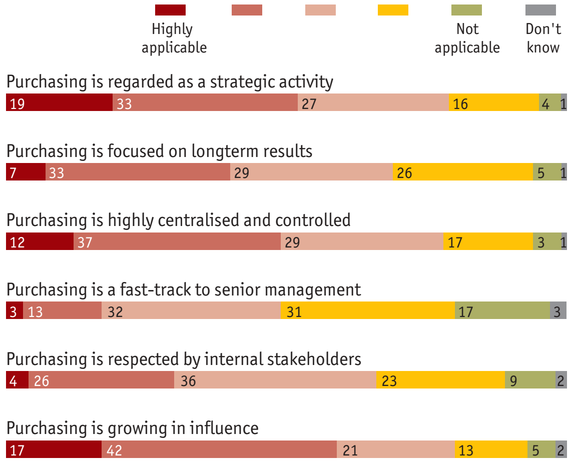
How important do you believe clear and effective purchasing and supplier management strategies will be to maintaining or extending your company's competitive advantage in 10 years' time?
(% respondents)



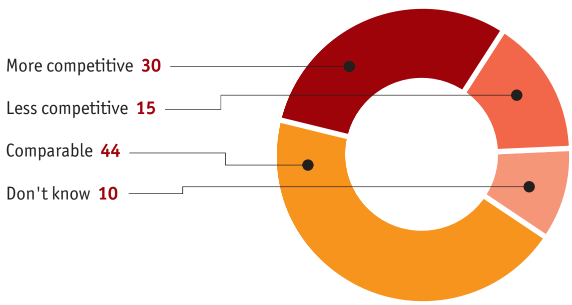
Which business function in your company has ultimate responsibility for managing supplier relationships?
(% respondents)



How accurately do the following statements describe the current state of your company's purchasing function?
(% respondents)

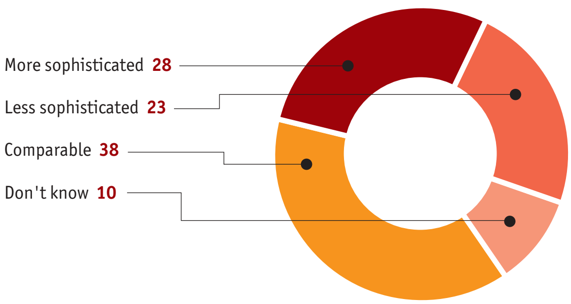


How competitive are your company's purchasing contracts and supply agreements in comparison to those of other companies in your peer group?
(% respondents)

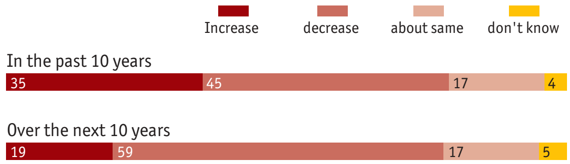


How effective are your suppliers at helping deliver value to your customers in the following areas?
(% respondents)

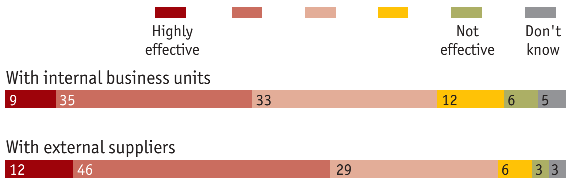
How sophisticated are purchasing operations at your company in comparison to those of other companies in your peer group?
(% respondents)



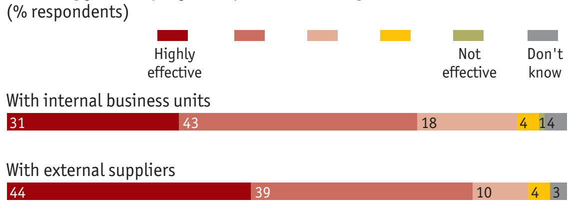
Over the past 10 years, has your company's total number of suppliers increased, decreased or remained about the same? What change do you expect by 2015?
(% respondents)



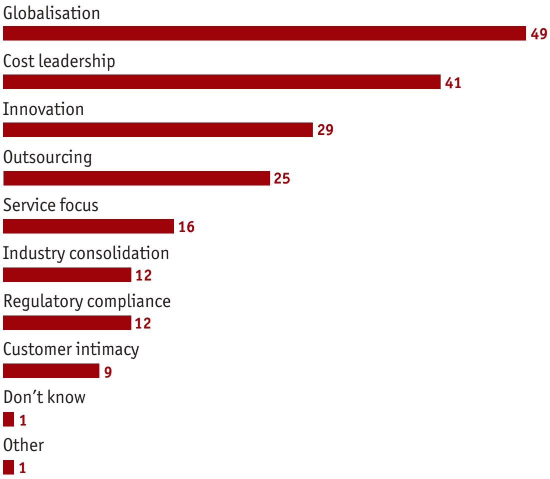
How effective are your company's purchasing and supplier management practices at ensuring compliance with negotiated terms (eg, cost, quality)?
(% respondents)



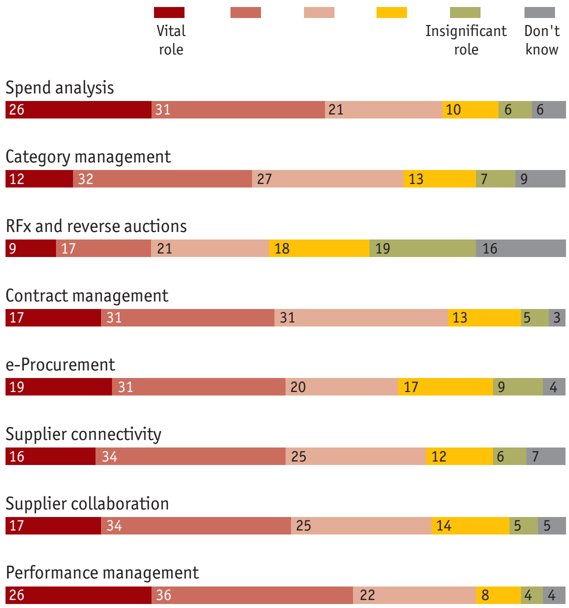
How important will optimising supplier compliance be to maintaining or extending your company's competitive advantage in 2015?
(% respondents)



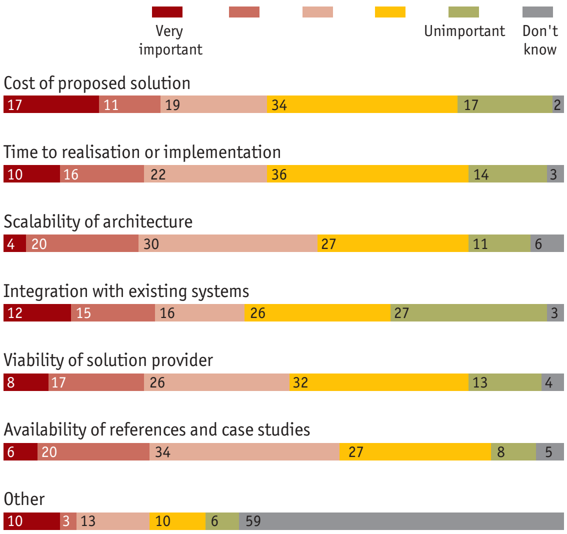
Which business drivers are likely to have the most influence on your company's purchasing and supplier management strategies in the next ten years?
(% respondents)



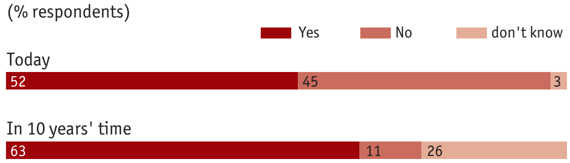
What role do software tools in the following areas play in ensuring the overall success of your purchasing strategies and initiatives?
(% respondents)



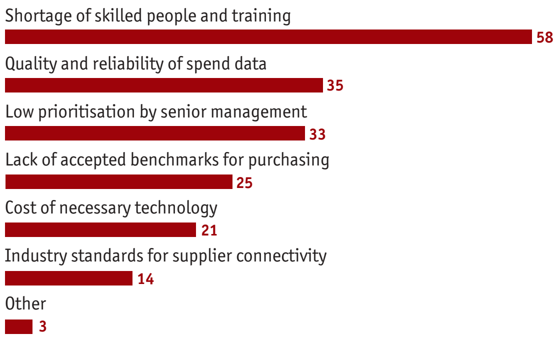
What are your company's most important considerations when evaluating a purchasing or supplier management technology?
(% respondents)



A chief purchasing officer (CPO) reports to the CEO or senior management team and sets the strategic course for purchasing and supply management company-wide. Do you have a person who performs the role of CPO today? Will you have a person who performs the role of CPO in 2015?
(% respondents)



What are the greatest challenges to achieving maximum efficiency within your company's purchasing and supplier management practices?
(% respondents)



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