

Saving Procurement from Itself

by Hugh Baker and Fabrice Saporito

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It's time for chief procurement officers to stop relying solely on functional depth and start increasing functional breadth.

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The emergence in the 1980s of strategic sourcing — a concept in which procurement leaders take a holistic approach to their organization's supply chain and constantly seek to improve purchasing behavior — was a defining moment for procurement, with the potential to transform it from a primarily administrative function to a powerful new force for competitive advantage. Today, however, this reinvention has stalled in many businesses.

Many chief procurement officers (CPOs), chasing short-term stretch goals and facing a lack of interest from other functions, no longer seek to influence the supply chain or strive to tackle the underlying drivers of cost and value. They are increasingly focused inward, implementing sophisticated ways of improving procurement itself but neglecting coordination with the wider organization. Indeed, CPOs have been successful in refining their function. Innovations of the past five years, such as e-procurement, e-auctions, spend analysis, and procurement outsourcing, reflect this attention.

But focusing on cost reduction leaves untouched the significant potential for creating value generated when procurement engages the rest of the business and its suppliers. In today's business environment, many companies are finding top-line growth elusive. To generate revenue and eliminate costs, they are devising complex business models that will require more sophis-

ticated skills from procurement leaders. It's time for those leaders to step up to the challenge: Procurement is uniquely positioned to reach out across the organization and the supply chain, pursuing cost reduction, but also emphasizing collaboration, innovation, flexibility, and resilience.

Broadening the Procurement Agenda

Too often, management invites procurement to participate only after decisions have been made and detailed contracts need to be negotiated and drafted. For procurement to be considered more than a functional tool for other departments, CPOs need to build influence and credibility with their internal management colleagues by showing that what they do adds real value. By engaging with peers — that is, by taking a cross-functional approach — procurement can influence the decisions that impact value all along the chain. There are several key ways for CPOs to accomplish this.

Develop a close working relationship with finance. Chief financial officers (CFOs) want procurement to demonstrate clearly how it contributes to value generation. In fact, translating procurement results to the bottom line will continue to be one of the toughest cross-functional challenges CPOs will face over the next five years. To succeed, they must design a procurement performance system that reflects the CFO's definition of

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profitability, but that requires finance to look at inputs rather than outputs. The CPO and CFO should meet regularly to review how procurement's efforts are affecting budgets. Armed with that up-to-date information, the CFO can make the best use of the value created by procurement, and the CPO gets a little well-deserved recognition.

The Lego Group, the world's fifth-largest toymaker, introduced this collaboration as part of its supply chain transformation. It established a purchasing performance management forum that includes regular meetings between the CPO and CFO (monthly if everything goes according to plan, and weekly or bi-weekly if issues have arisen) to ensure that results hit the bottom line. In the case of one initiative to change packaging, such meetings enabled the team to break down consumption by plant and identify the sources of gaps in performance. Working together, they were able to ensure that in the next month, orders were made at the right quantities and savings leakages were minimized.

However, a recent study by *CPO Agenda* makes clear that CPOs have their work cut out for them: An online survey of more than 200 CFOs, vice presidents, and directors of finance in North America revealed that only one in five believed procurement's ability to provide "timely and accurate spend data" was excellent, whereas one-third believed this ability to be poor.

Manage cross-functional trade-offs. CPOs must also measure the efficiency of the organization as a whole and enforce cross-functional decisions. They must ensure that the interests of the whole enterprise are taken into account when deciding to invest in inventory, and manage the inevitable trade-offs that arise from tensions among the company's key functions.

The Spanish clothing company Inditex is a perfect example of how procurement trade-offs within the value chain have led to success. Its most famous brand, Zara, competes with other mass clothing brands, but rather than inducing customers to buy a lot at once, Zara gets them to buy often. Whereas most fashion brands launch new collections no more than four times a year, Zara rolls out 16 new collections annually. Reducing costs through large-scale purchases would undermine its strategy. Instead, procurement contributes to the brand's success by ensuring supply network flexibility; it is the kind of feverish pace that requires speedy decisions and strong cross-functional teamwork among procurement, design, manufacturing, logistics, and sales. Having a procurement department with the ability to step up and synthesize cross-functional requirements in an aligned operating model is key to Zara's success.

By casting procurement in a major role and ensuring it is highly integrated with all of the other functions, Zara has created a strategic advantage that has proved exceptionally difficult for others to replicate. The traditional model of retail procurement is a back-end service function that merely sources fixed designs at the lowest cost, usually irrespective of the delivery lead time. To copy Zara would require top management to recognize purchasing as a strategic function that supports the company's competitive objectives. Because this operating model is embedded in the company's culture, the best way to copy such a strategy is to start from scratch.

Collaborate on the joint supplier-customer value chain. Through sharing data down the chain and forecasting methodology up the chain, preferred suppliers and retailers for some large categories can create a win-win. Procurement can play an important role in faci-

tating this flexible working partnership.

The procurement function at a major northern European food retailer, realizing that both retailers and suppliers incur costs and lose revenue opportunities in an effort to optimize margins, decided to think outside the box to identify joint improvement opportunities with its supplier. The company understood consumer behavior at the retail level, but it lacked its supplier's in-depth, product-specific knowledge and a true end-to-end understanding of costs. Together, they took steps to find mutually beneficial areas of improvement: establishing a common value chain that clearly detailed all costs and revenues for both players, highlighting joint strategic areas to focus on options for improvement, analyzing opportunities to improve profitability and enhance revenue, and establishing implementation plans and benefits sharing.

Procurement's role in this process was to bring economic insights to the table to help build a picture of the joint value chain and to facilitate the necessary decisions internally. They moved from looking at price, to total internal costs, to value chain costs. Not only did this help the retailer and its supplier to identify areas of revenue enhancement, but it enabled them to eliminate costs.

Gain preferential access to innovation. The supplier network can generate many sources of competitive advantages. Procurement needs to find ways to facilitate, not hinder, such advantages. Translating the company's vision into an end product is the domain of innovation, production, and business development, but procurement can play a critical role in evolving the supply base to deliver that vision and evaluating the trade-offs when considering new ideas or suppliers.

Jeff Hawkins, inventor of the Palm personal digital

assistant (PDA), saw this potential. Most competitors attacked Palm's market leadership in the late 1990s with extra features and memory, but Hawkins, rather than using his in-house innovation team to compete head-to-head on functionality, asked procurement to engage the supplier base on innovation. Procurement adapted its role to become a channel for great ideas coming from suppliers. One of these, IDEO, helped Palm understand that simplicity and aesthetic appeal would win out in the marketplace over improvement in functionality alone. The supplier and the Palm team worked for almost three years to develop the next-generation PDA, launching the Palm V in 1999. Consumers were so enthusiastic that they paid a much higher price for the sleek, lightweight Palm V than for rival gadgets.

Design network resilience. By engaging suppliers, procurement can increase network resilience by ensuring greater flexibility in times of discontinuity. Lower-cost supplier networks and longer supply chains are often less resilient by nature. Resilience needs to be inherent in the design and, with the help of colleagues, can be appropriately weighed against cost. When they get involved at the supply chain design stage, procurement can work with other functions to balance the needs of low cost and resilience in the supply network. This is particularly important now that global sourcing is becoming commonplace and supply chains are lengthening.

Such engagement proved crucial for Toyota when a major fire at a supplier's factory in February 1997 halted the supply of a critical valve. Toyota plants, which build more than 14,000 cars a day, had only four hours' supply of this valve as a result of its just-in-time operation. Not being able to replace the part would have resulted in huge losses and damage to the brand.

Fortunately, Toyota's procurement department had designed its supplier base as a network, so that if one node went down, other pathways were in place to secure the necessary components. Toyota had its production lines up and running in four days when experts had predicted it would take weeks. Procurement worked successfully with other functions to keep costs low without sacrificing resilience.

Procurement is at a crossroads. Its increasingly common inclination to focus on reducing the price it pays for goods and the cost of its own operations has certainly benefited organizations, but the returns on these efforts are diminishing. When procurement has moved beyond its traditional role, fulfilling the promise of its earlier reinvention, companies have prospered. Keeping the attention of colleagues is the CPO's responsibility, and it will not be easy. Procurement leaders must constantly strive for the kind of breakthrough thinking that benefits their colleagues' functional and strategic agendas. They must avoid the temptation to look only inward, and instead broaden their reach and take a seat at the strategy table. +

Resources

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