

# The New Procurement Mandate:

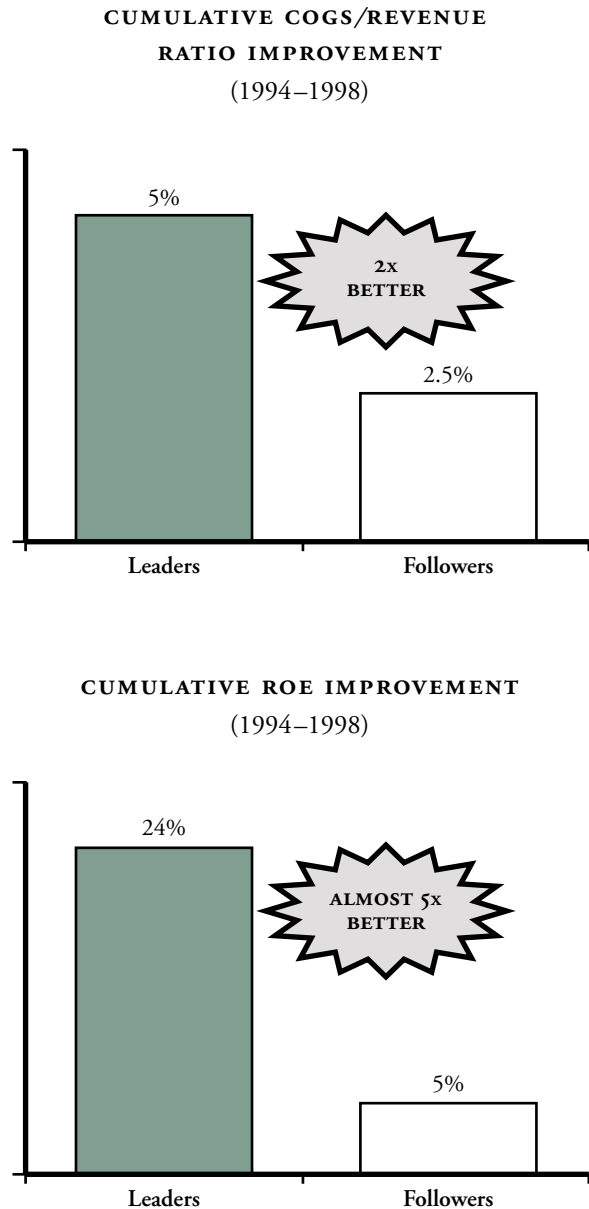
## *Growing Within Tomorrow's Supply Webs*

Forget for a moment today's progressive thinking and ground-breaking technology. These external changes—from the Internet to the euro, from deregulation to consolidation, from the demise of state-owned industrial sectors to the fall of physical, business and political borders—will pale in comparison to the severity of the internal changes that companies must initiate in order to survive.

A.T. Kearney's latest study, *Assessment on Excellence in Procurement*, reveals that procurement already serves as an ideal platform to change a company's value proposition, influence its choice of core competencies, and nurture its ability to innovate. Achieving these objectives requires a fundamentally new mindset, new skills, and a clean break with past procurement models. By making these shifts—and by making their web of supplier relationships broader, more responsive and more flexible—leading companies have already begun to harness new sources of growth that will help them construct the profitable new business models. For these leaders, the payoff is already measurable and substantial. They consistently reduce their costs at twice the rate their followers do, and achieve returns on equity five times as large (see figure 1).

The study helped us gather and share insights on which procurement imperatives will be essential to new business models, what tomorrow's procurement organizations will look like, and where these developments will lead. It represents the most comprehensive study of excellence in procurement ever undertaken, covering 162 manufacturing and service companies from 28 countries around the world.

FIGURE 1: Procurement leaders enjoy superior business results



**THE THREE IMPERATIVES: VALUE STRATEGY, VALUE WEBS AND E-BUSINESS**  
Companies that emerged as leaders in the Assessment have begun to reshape their procurement structures by choosing to outsource—thus

buying a majority of their end-product value instead of creating it themselves. They rely increasingly on the combined strength of their own competencies and those of their suppliers as a rich source of innovation and marketing potential. The strategic sourcing of “value packages” and the resulting complexity will become the norm early in the 21st century.

Second, the leaders have realized that the very notion of a “supply chain” does not adequately describe how they produce value. Instead of being a link in a chain, the modern company is more akin to a node in a network, adding value to the goods and information that flow through it. What the business world currently understands as a supply chain will be a subset of this larger, integrated web and will—after considerable compression and the elimination of many links—be much more streamlined than today’s.

Third, and perhaps most important, leading companies know that e-business creates untold opportunities to transform their businesses, but also holds untold risks. Instantaneous and virtually cost-free communications lets companies source their products from any place around the globe with the click of a mouse, leveraging the comparative advantages of other countries and regions more effectively than ever before. But just as these companies now have access to a world of supply options, so too do their customers. E-business raises the performance expectations for *every* supplier.

#### HOW LEADING COMPANIES USE PROCUREMENT TO BUILD AND MANAGE VALUE

The average company already relies on suppliers for about 50 percent of its value creation talent and resources, and this percentage is growing. Add to this mergers and acquisitions and nascent e-business technologies that are independently

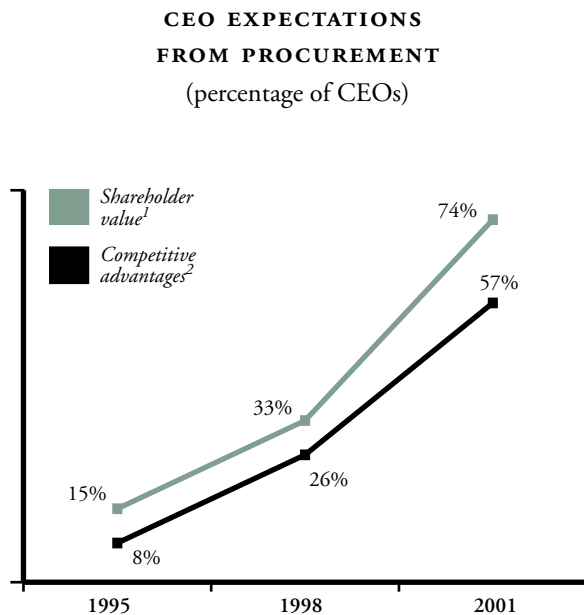
breaking down and reshuffling supply relationships. It is rather unrealistic to think that any CEO will delegate this massive management responsibility to the procurement structure as we know it today. The entire focus of procurement will move away from transaction-based models to value-based models, which foster innovation and capture marketing opportunities while still keeping costs under control. Procurement organizations will need the proper skills to manage relationships instead of paperwork.

Companies want to avoid overbearing relationships with suppliers, but they also want to avoid over-reliance. These supplier relationships that emerge will be deeper, yet more flexible (*see figure 2*). What will be the basis for these new relationships?

#### What the Leaders are Doing

- Procurement at a leading telecommunications company used technology road-mapping on a five- to 10-year horizon to help develop suppliers for a new technology. The company is now considered the technology leader and has increased its market share from 10 to 30 percent. With an early-mover advantage in the next emerging technology in its sector, the company seeks to achieve a market share of 80 percent.
- A leading IT company places procurement engineers in its R&D labs to integrate suppliers at any early stage and provide benchmarks across suppliers. This company now purchases 70 percent of value externally, up from 20 percent one decade ago.

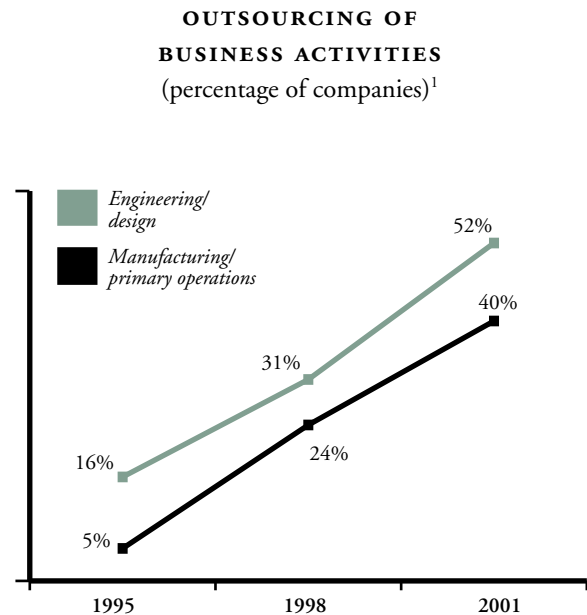
FIGURE 2: CEOs now demand that suppliers contribute more to the creation of shareholder value and competitive advantage



<sup>1</sup>CEOs indicating “high” relevance of procurement to shareholder value

<sup>2</sup>Importance of procurement (relative to other key functions) in developing and sustaining the firm’s competitive advantage

FIGURE 3: Participants will increasingly choose to outsource what used to be considered “core activities”



<sup>1</sup>Companies indicating that they outsource activities to a medium-high or high degree

Value. CEOs understand that value-based procurement strategies can have a direct, measurable impact on business performance. Mergers and acquisitions also underscore the strong link between procurement and value creation, as more than 70 percent of all value creation potential in a merger or acquisition is directly linked to procurement strategy.

This shift in emphasis from cost-focus to value-focus has begun to change strategic thinking in a fundamental way. Certainly, cost aspects cannot be ignored. Not surprisingly, 97 percent of senior managers said that cost management is currently the primary goal of their procurement organizations. But views are changing quickly. More than 20 percent of these senior executives expect marketing and revenue generation to be

procurement’s top priority three years from now, and for another 10 percent, securing innovation from supply markets is at the top of tomorrow’s procurement agenda.

Including marketing and innovation as co-objectives with cost leadership represents a major elevation in the strategic importance of procurement. Senior executives recognize that companies have to compete as an extended enterprise, and must find ways to get additional value from every opportunity—including the supply market. The new procurement question is not “Does it cost less?” but rather “How does it make us better off in the long-term?” The informed “make-or-buy” decision is becoming more essential to answering these questions. Among leading companies, over

two-thirds already use procurement in strategic goal setting, as opposed to less than one-third of “followers.”

By 2001, some 52 percent of participants plan to entrust most, or all, of their engineering and design work to suppliers, while 40 percent plan to outsource manufacturing (*see figure 3, page 3*). Outsourcing non-core activities will also continue to rise as companies look to shed non-competitive operations and focus on what is important to the business. By 2001, two-thirds of participants expect to outsource activities such as logistics, maintenance and repair, and more than half will outsource facilities management, IT services and office services.

The number of companies that outsource day-to-day procurement activities will double by 2001 to 37 percent. And one-third of companies will use strategically-managed consortia by 2001 to leverage their buying power. Even procurement itself is not immune to the outsourcing trend.

#### HOW LEADING COMPANIES EXPLOIT THE POTENTIAL OF VALUE WEBS

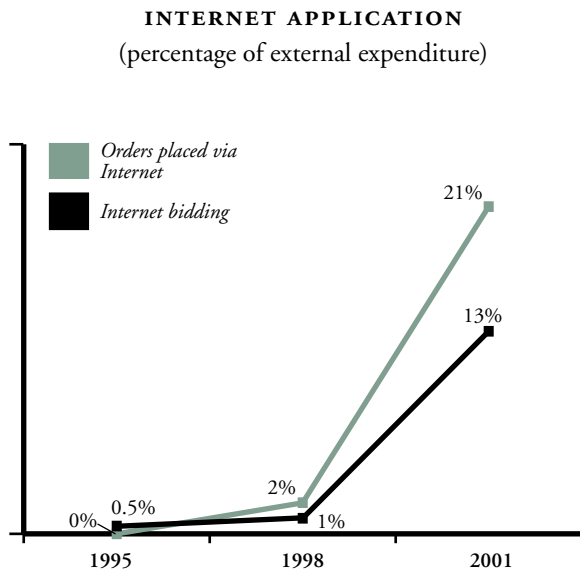
Value webs are replacing supply chains for several reasons. First, customer segments have become more fragmented, meaning that companies must now meet the needs of larger numbers of smaller and more diverse markets, right down to the “market of one” in some cases. Second, an accelerated innovation cycle and a shorter product life requires that rapidly depreciating resources be realigned before the window for profit potential closes. Third, new business models encourage the removal of entire layers from traditional supply chains by bypassing old structures and breaking down old fences. Companies will soon face an identity crisis because there are more markets to reach, and more ways for more companies to reach them more quickly.

These developments give rise to a complex network through which goods, services and information flow, and in which procurement is directly or indirectly involved. Customers suddenly have more transparency, which gives them the ability to make better-informed choices even though there are more options. As competition intensifies, companies must answer the basic question: Where should we position ourselves in

### What the Leaders are Doing

- They view procurement as a crucial link between suppliers and end-customers. One European consumer products company encourages intensive exchange of procurement and marketing personnel, so that both sides have a more rounded view of the value web and can support each other accordingly.
- They develop specialized talent from within. Even as value purchased externally continues to rise, the number of employees in procurement could fall by 25 percent on average and by as much as 90 percent in some industries. The remaining core procurement managers will require a skill set that enables them to comfortably interact with all of the “web interfaces” from both sides: internally, from R&D to marketing, from logistics to e-business; and externally, from the perspective of the suppliers. The insights gained from managing these complex, diverse interactions and interests qualify procurement to influence the company’s strategy at the highest levels.

FIGURE 4: Participants will increase Internet purchasing tenfold by 2001



the network? The leaders have realized that without a deep understanding of supply market capabilities and in-house options, a company risks being bypassed by its own suppliers.

Emerging solutions will also enable cooperation horizontally—outside the organization—with third-party buyers or procurement managers elsewhere in the value web. Buying consortia will emerge more forcefully and wield their power, thereby freeing procurement organizations to focus on strategy.

#### PROCUREMENT MUST STEER THE COMPANY THROUGH THE E-BUSINESS WORLD

Our Assessment revealed that many forms of e-procurement will be firmly in place by 2001. Overall, participants plan to make 21 percent of their purchases via the Internet by 2001, up from just 2 percent in 1998 (*see figure 4*). They also

### What the Leaders are Doing

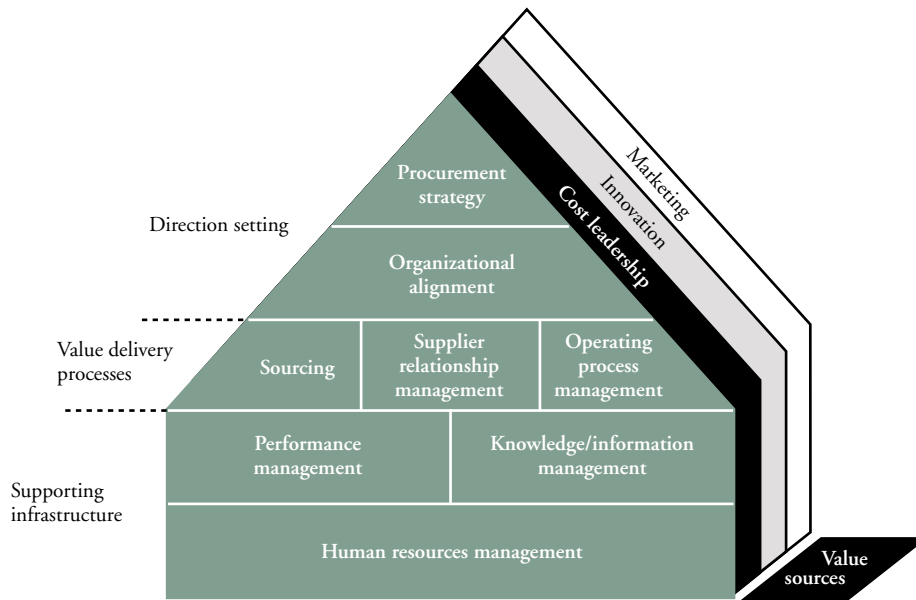
- Online auctions allow suppliers to bid on contracts in an open, transparent, interactive process managed by the buyer. Through such an auction, a U.S.-based telecommunications company successfully contracted out US\$75 million in telemarketing services. In a three-hour process, some 62 potential suppliers from three countries placed over 700 bids before the buyer closed the auction. Incremental savings of around 5 percent from RFP submissions were realized, but that represents only one benefit.

The auction also accelerated the sourcing process and allowed a wide range of suppliers to participate in the process. This allowed the buyer to reduce the sourcing cycle and quickly identify suppliers with the greatest potential.

The use of online auctions represents more than a fine-tuning or a shift of buying methods or channels. It offers a quantum leap in terms of information transparency, speed, and the ability to introduce a maximum level of competition in the marketplace.

estimate that 24 percent of total expenditures will involve automatic payments to suppliers, eliminating the need for invoices, purchase-order matching and payables processing. About 27 percent of expenditures will be covered by electronic order-tracking systems that help customers monitor order status at suppliers.

FIGURE 5: A.T. Kearney's *House of Purchasing and Supply*<sup>SM</sup>



Source: A.T. Kearney Assessment on Excellence in Procurement study

Electronic catalogs will allow direct buying by users and help ensure contract compliance for 29 percent of expenditures. One participant in the transportation sector uses an electronic catalog for 600 standard items instead of 7,000 articles. Employees are also given online access to the latest assortment and prices. This move brought tangible results: article costs fell by 25 percent, process costs were reduced by 60 percent, and replenishment time was cut by 70 percent.

But this marks only the beginning. Anyone can go online and buy something, but going online properly—for the right reasons and with the right resources—presents an entirely different challenge. But few companies currently have the “right resources” readily available in-house. More sophisticated use of IT-based solutions from external suppliers will allow procurement to

improve and deepen its integrative function vertically throughout the value web, through the use of online auctions, for example. To draw a link to an industrial-age institution, these auctions could be thought of as a virtual trade fair. A conventional trade fair involves setting a date one year in advance, then waiting for the representatives of customers, dealers, manufacturers and trade associations—together with truckloads of product—to descend on a convention center in some large, easy-to-reach city. A digital marketplace accomplishes precisely the same effect—at any time, from any place on the globe—for the cost of a phone call.

In other words, this fluid, interactive, integrative form of procurement could also make trade fairs in many industries unnecessary, much as it will reduce the need for other static, discontinuous elements

such as periodic contract renewals, and fixed media such as printed catalogs and price sheets.

Procurement offers a rich source of options for reshaping a business from the inside out and building new forms of competitive advantage based on marketing, innovation and cost leadership. Leading companies have already seized these opportunities to produce visible, quantifiable results. Interestingly, an “e-savvy” procurement organization can also help the company prepare

to implement business-to-business selling on the Web. It is a rich storehouse of knowledge on how companies want to buy via the Internet, and is uniquely able to transfer this knowledge to the sellers.

#### HOW LEADING COMPANIES PULL IT ALL TOGETHER AND MAKE IT WORK

If left unchanged, the procurement department will quickly become the corporate ball-and-chain of the

### About The House of Purchasing and Supply<sup>SM</sup>

The *House of Purchasing and Supply*<sup>SM</sup> was developed by A.T. Kearney in its 1996 Leadership Practices in Procurement research study, and further refined in research for the National Association of Purchasing Management in 1997 and 1998. It was expanded in 1999 to reflect the latest lessons from our Assessment research. For each dimension, our research identified a set of leadership practices (28 in total) that are summarized in these guiding principles:

- *Procurement strategy.* Capitalize on supply market opportunities as an integral part of business strategy to drive value creation through innovation, cost leadership, and marketing and revenue realization.
- *Organizational alignment.* Embed procurement skills and knowledge in the company’s key business processes.
- *Sourcing.* Apply advanced techniques to leverage the full value potential across the entire expenditure base, thus helping the company to understand its own core competencies.

- *Supplier relationship management.* Effectively manage the tension between the value creation potential and the risks of each relationship.
- *Operating process management.* Automate operating processes through aggressive and innovative use of e-business technologies.
- *Performance management.* Link procurement metrics to corporate results and strategic objectives by making procurement’s contribution to results transparent.
- *Knowledge and information management.* Continuously capture and share knowledge across processes, geographies, business units and external relationships.
- *Human resource management.* Create ambassadors of procurement excellence through training, incentives and aggressive rotation of high-potential professionals throughout the organization.

21st century. An anchor to an obsolete way of doing business, it will also hinder the company in its efforts to unlock value.

But what will tomorrow's procurement department look like? Will there be a procurement department at all? Or will the procurement skills simply be embedded into all key processes? Certainly, procurement will bear little resemblance to the old-fashioned purchasing department that carried out volume negotiations, managed inbound orders and conducted ad-hoc market searches to reduce costs. Nor will tomorrow's procurement resemble the "friends-for-life" approach to suppliers, which revolves around long-term, single-sourcing agreements. Instead, tomorrow's procurement department will be more flexible, opportunistic and partner-based because it will understand the "imperatives" which underpin future ways of doing business. This is the new procurement mandate.

The Assessment shows that leaders excel in their efforts to follow this new mandate. They grasp the business case for substantial change, they articulate the urgency, and they aggressively execute detailed implementation plans on all aspects of procurement. A.T. Kearney's *House of Purchasing and Supply*<sup>SM</sup> provides the framework to understand what leaders do, and how they do it. It defines eight dimensions of procurement management (see figure 5, page 6). It further analyzes 106 detailed aspects that identify the implementation keys that differentiate the leaders from the rest.

#### TEN YEARS ON...

E-business is already imposing rapid, radical and continuous change by forcing many companies to reinvent themselves. No one knows with certainty the speed and extent of these effects, but we do know that the best practices revealed in 1999 — the source

### Fast Facts

- When study participants speak, suppliers need to listen — the 162 companies manage a combined expenditure of US\$520 billion per year
- External expenditures are growing as a percent of revenues, from 42 percent in 1995, to 46 percent in 1998, and a projected 48 percent in 2001
- Supplier consolidation continues — on average, respondents expect to eliminate more than 25 percent of suppliers over the next three years.

of the leaders' competitive advantage through procurement — will be temporary, perhaps even fleeting. "Next practices" are already emerging, and forerunners are experimenting with them. Tomorrow's leaders need to:

- *Thrive on vision and creativity to prosper in truly free markets* where "fixed" has become "fluid" and the only kind of time that matters is "real time."
- *Develop leadership and discipline to operate via "trading nets"* in order to manage — directly or indirectly — the entire flow of goods and information throughout the extended enterprise.
- *Acquire the confidence and the capability to extend supply management knowledge throughout the organization* by making it the common background of management. Procurement will thus become a skill base for general management talent, on par with marketing, manufacturing or finance. The worldwide "war for talent" will intensify, as these skill sets remain scarce.

## Research Background

The *Assessment on Excellence in Procurement* is the third procurement research study sponsored and conducted by A.T. Kearney in the past eight years. Its depth of analysis and global scope makes it the most comprehensive research ever conducted on the topic.

Participants included 162 companies representing six diverse industry groups: mass manufacturing, project industries, non-durable consumer products, raw materials processing, asset intensive services and information intensive services. Reflecting today's global economy, participants were based in 28 countries from both industrialized and developing regions.

Data and insights for the study came from three sources:

- The *Assessment on Excellence in Procurement* executive survey provided baseline data on each participant's procurement activities and practices.
- On-site interviews added depth and understanding
- A top-management survey provided boardroom-level perspectives on the role of procurement in today's corporate environment

The study team evaluated participants on 28 best practices in procurement. Companies were rated for each best practice by assessing the degree to which they identified a practice as critical to their success, how well they applied the practice, and the impact of the best practice in delivering clearly measurable benefits, such as reduction in cost and time, and improvement in service and quality. The top quartile of participants on these factors were classified as leaders, and formed the benchmark group against which the other study participants were compared.

The aftershocks will continue for several more years as the wrenching transition to the digital age progresses and takes on a more definite form. Our research also showed that some companies are making changes that will enable them to survive and capitalize on even the most dramatic shifts. But they remain a small minority. The followers must start their transition immediately by taking a much broader perspective beyond cost issues, by accepting and adopting e-business models, and by

identifying and retaining personnel with the skills to manage tomorrow's procurement.

By focusing on *Creating Supply Advantage*<sup>SM</sup>, procurement can achieve its full potential as a boardroom-level weapon. An assessment using insights from A.T. Kearney's *House of Purchasing and Supply*<sup>SM</sup> can accelerate the transition by quickly identifying strengths and opportunities and charting the course for the next decade.

## For Additional Information

<b>ASIA- PACIFIC</b>	John Ashby, Melbourne	+61-3-9648-3704	john.ashby@atkearney.com
<b>EUROPE</b>	Niko Soellner, Düsseldorf	+49-211-1377-610	niko.soellner@atkearney.com
	Carlo Mackrodt, Munich	+49-89-5156-8500	carlo.mackrodt@atkearney.com
<b>NORTH AMERICA</b>	Tom Slaughter, New York	+1-212-350-3130	tom.slaughter@atkearney.com
	John Blascovich, New York	+1-212-350-3287	john.blascovich@atkearney.com
<b>SOUTH AMERICA</b>	Mark Essle, São Paulo	+55-11-3040-6230	mark.essle@atkearney.com
	<b>or contact us at our hotline:</b>	<b>+49-89-5156-8888</b>	<b>aep@atkearney.com</b>

A.T. Kearney is a worldwide management consultancy and executive search firm with headquarters in Chicago. The firm established itself as one of the first management consultancies more than 70 years ago, and we have consulted with many of the world's leading companies in the years since. Our 4,600 employees worldwide serve clients ranging from the largest global companies to domestic companies in every industry sector. A.T. Kearney's offices are located in 58 cities in 34 countries in the Americas, Africa, Asia Pacific and Europe.

<u>AMERICAS</u>		<u>AFRICA</u>	<u>EUROPE</u>	
Atlanta	Miami	Johannesburg	Amsterdam	Milan
Boston	Minneapolis		Barcelona	Moscow
Buenos Aires	New York	<u>ASIA PACIFIC</u>	Berlin	Munich
Caracas	Ottawa	Beijing	Brussels	Oslo
Chicago	San Diego	Hong Kong	Copenhagen	Paris
Cleveland	San Francisco	Jakarta	Düsseldorf	Prague
Dallas	Santa Clara	Kuala Lumpur	Frankfurt	Stockholm
Detroit	São Paulo	Melbourne	Helsinki	Stuttgart
Houston	Stamford	New Delhi	Istanbul	Vienna
Los Angeles	Toronto	Seoul	Lisbon	Warsaw
Mexico City	Washington, D.C.	Shanghai	London	Zurich
		Singapore	Madrid	
		Sydney		
		Tokyo		
		Wellington		

A.T. Kearney World Headquarters

A.T. Kearney  
222 West Adams Street  
Chicago, Illinois 60606, U.S.A.  
1 312 648 0111  
Fax 1 312 223 6200

A.T. Kearney Limited

Lansdowne House  
Berkeley Square  
London, W1X 5DH  
United Kingdom  
44 171 468 8000  
Fax 44 171 468 8001

[www.atkearney.com](http://www.atkearney.com)

For more information or additional copies,  
please contact Marketing & Communications at the above addresses.

A.T. Kearney is the management consulting subsidiary of EDS, a leader in the global information technology services industry for more than 35 years.

Copyright 2000, A.T. Kearney, Inc. All rights reserved. No part of this work may be reproduced in any form without written permission from the copyright holder.  
A.T. Kearney® and the A.T. Kearney® logo are registered service marks of A.T. Kearney, Inc.  
A.T. Kearney, Inc. is an equal opportunity employer.

**ATKEARNEY®**