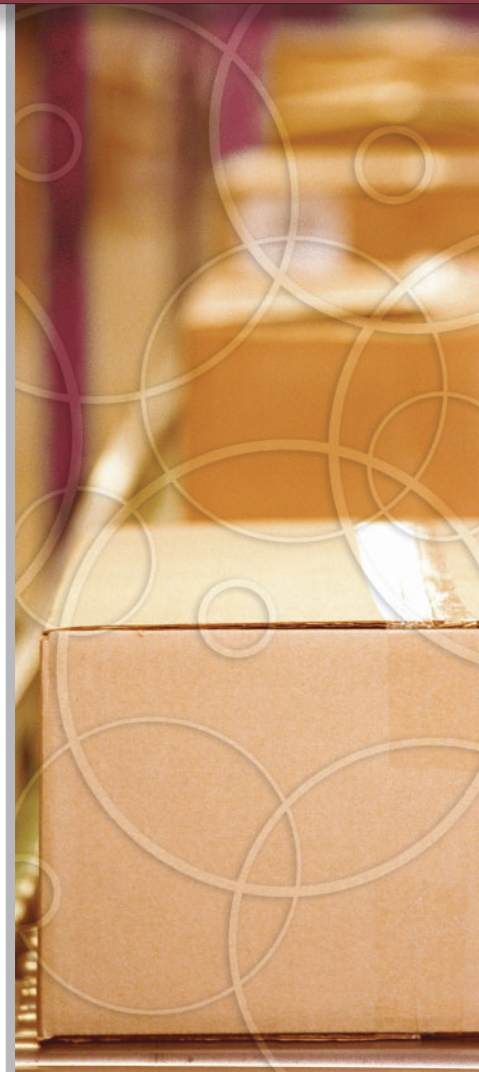


Creating Value through Strategic Supply Management

2004 Assessment of Excellence in Procurement



When are cutting costs and improving quality not enough? CEOs from around the world say that the time has come to do more. According to A.T. Kearney's 2004 Assessment of Excellence in Procurement, senior executives expect procurement to go well beyond its traditional role. Rather than focusing solely on cost reduction, they see procurement's greatest challenge as capturing value from the supply market. This view represents a huge advance in understanding procurement's potential: In 1999, 28 percent of supply management organizations had goals in the area of value creation, but by 2004 that figure increased to 66 percent.

Supply management's move into prominence is a phenomenon that crosses national boundaries and industry lines, as the range of study participants attests: North America accounts for 28 percent of the study's 307 participants; Europe, 45 percent; Asia Pacific, 16 percent; and Latin America, 11 percent. The respondents represent the process, service and manufacturing sectors. Despite the study's breadth, the emphasis on value creation does not differ significantly across these groups.

Top supply management practitioners are indeed delivering measurable value. The study leaders outperformed the pack in generating savings and driving them to the bottom line (*see*

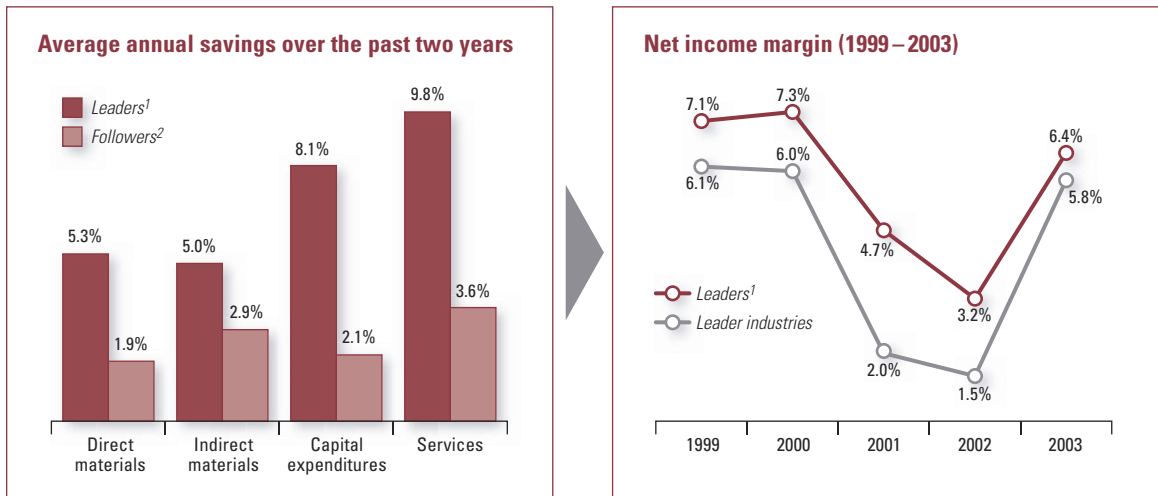
figure 1 on page 2). In three of four procurement categories—direct materials, capital expenditures and services—leaders' savings percentages were more than twice those of followers. Only in the indirect-materials category was the gap narrower. In addition, the net income margins of leading companies have consistently exceeded their industry margins since 1999.

It was not easy to achieve leadership ranking in the 2004 survey (*see sidebar: About the Study*). Nearly all leaders and most followers recognize that the key to their business strategy is value creation, which goes beyond the traditional elements of supply management (*see figure 2 on page 2*). If mastering the elements of the familiar House of

Editor's Note: As this paper went to press, 307 companies have participated in the survey with others still entering their data into the online questionnaire. The initial 238 companies that completed the questionnaire form the benchmarking group that is discussed throughout this publication.

As procurement's role changes and expectations for value creation grow, the industry is frequently replacing the term "procurement" with the broader term "supply management." In line with this shift, we will use both terms interchangeably.

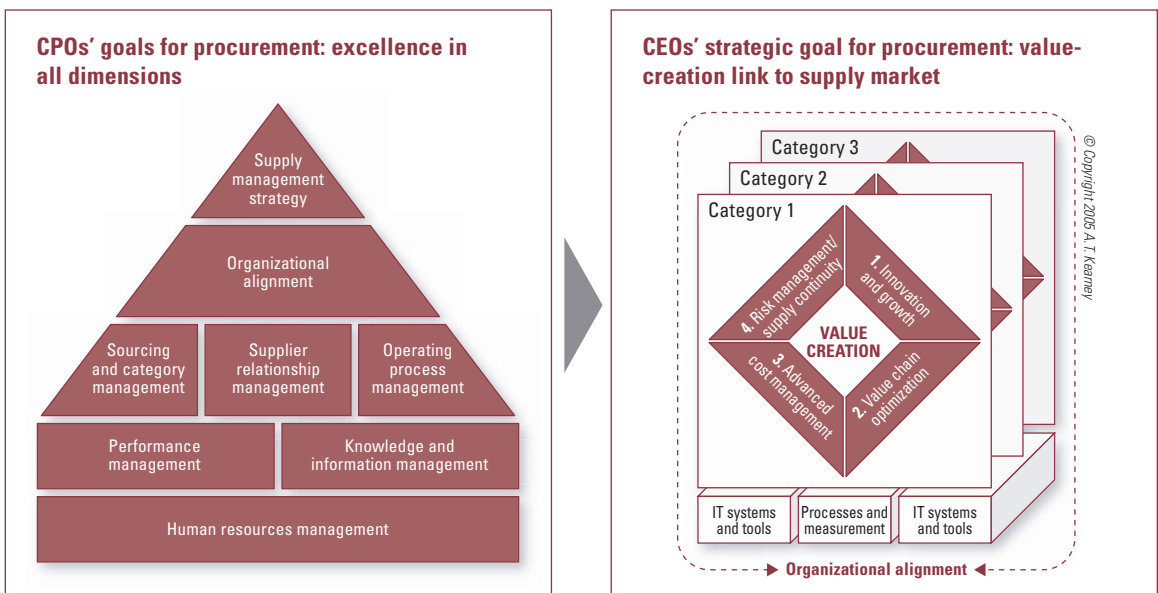
Figure 1
Procurement leaders' savings and net income contribution



¹ "Leaders" includes top-scoring companies that demonstrate strong performance in at least three dimensions
² "Followers" includes the remaining companies

Source: A.T. Kearney

Figure 2
From procurement skills to value creation



Source: A.T. Kearney

Purchasing and Supply® framework is like perfecting basic sports skills, then creating value through procurement is like crafting a unique game plan for each opponent. Procurement leaders and coaches alike size up their own situation, analyze the strengths and weaknesses of the opposition and call the plays accordingly. Then they must execute perfectly in order to capture a winning position.

Leaders in the 2004 study are creating value and gaining competitive advantage from supply markets by focusing on four areas, as shown in figure 2:

- Innovation and growth
- Value chain optimization

- Advanced cost-management
- Risk management and supply continuity

Customer demands for a constant stream of new products and features as well as increased competition have put innovation at the top of the must-do list. Optimizing the value chain is essential for companies that are investing in core competencies and need to find other best-in-class capabilities from external partners. Firms that have embedded basic sourcing approaches are moving to more advanced cost management concepts to capture every possible opportunity to add value. As their supply chains extend into unfamiliar or distant markets, companies are recognizing and managing supply-continuity risks.

About the Study

The 2004 Assessment of Excellence in Procurement is the fifth research study in a series that began in 1992. Developed by a global team, the study elicited responses from procurement and supply chain executives from leading companies around the world. The initial 238 companies, with average revenues of nearly US\$10 billion in 2003, formed the benchmarking study group. To date, 307 organizations have completed the survey, contributed to the database, and benchmarked their performance.

Process industries account for 119 participants, with 65 companies in chemicals; oil and gas; pulp and paper; metals and glass processing; and mining.

The remaining 54 participants produce non-durable consumer goods such as food and nutrition, pharmaceuticals and household and cosmetics products.

The services sector accounts for 103 participants, with 49 firms representing telecom, transportation and utilities; and 54 firms in media and entertainment, finance, professional services and retail.

Manufacturing firms round out the sample with 85 participants; 54 are mass manufacturers (automotive, high-tech and components and systems) and 31 are project-oriented firms (engineering, heavy machinery, construction and aerospace).

Participants completed a

detailed online survey (more than 600 elements), which the study team aggregated into 25 leadership practices and then into eight dimensions of procurement excellence. Company scores are based on performance. The 18 leaders are from the initial benchmark sample of 238 companies; they rank among the top 10 percent in overall scores *and* attained world-class performance in at least three of the eight dimensions.

In addition to the online survey, 63 CEOs and senior executives completed a shorter survey; these were used to compare the perceptions of procurement and supply chain executives with senior management's expectations and perspectives.

While all of these value-creation approaches are powerful, not all are suitable for every spend category. For example, some service categories might not incur supply risks, yet shortfalls in key materials and components can pose significant financial and operational risks. Companies with a large spend on indirect materials would look to advanced cost-management techniques. If highly engineered subassemblies are critical, procurement professionals would explore innovation, advanced cost-management and risk-management solutions.

Like all teams, supply management teams need an organizational structure that allows them to perform at their peak. To select the most appropriate model, supply management organizations must balance the benefits of central coordination against the need for local responsiveness. This study confirms the recent trend toward center-led models, in which most strategic decisions are coordinated centrally while transactional activities tend to be decentralized and executed by users or suppliers.

Finally, underlying these approaches and the organization's ability to act, are the required IT systems and tools, processes, measurement techniques and human resources. Many of the more advanced value-creation techniques require equally advanced information and knowledge-management tools to succeed. In addition, implementing more sophisticated approaches requires clear and formal processes, well-defined metrics and ongoing monitoring and evaluation. And nothing is more crucial to delivering on the supply market's potential to create value than the right set of skilled and motivated employees to identify and act on the opportunities.

Enlisting Suppliers in the Race to Innovate

How would a chief procurement officer (CPO) describe utopia? It would probably include creative

suppliers enthusiastically bringing innovations to their attention. At BMW, as a real example of our CPO's dream, a top supplier proposed adding optic-fiber-enabled light rings to the headlights as a distinguishing feature. Drivers on the German autobahn or elsewhere would see the distinctive lights of a high-performance BMW approaching from behind and know to move aside and let it pass. BMW and the supplier jointly developed the idea—and the contract ensures exclusive rights for the automaker. As a result of this collaboration, BMW gained access to new technologies, increased its brand awareness and reduced its time to market.

Opportunities like this do not appear on corporate doorsteps by accident. Leaders in the study foster innovation by involving suppliers early in the new product or service development process (*see figure 3*). Yet even the most forward-thinking respondents may be missing innovation opportunities. Only one-quarter of study leaders bring their suppliers into the initial concept stage, with just 6 percent of followers doing the same. Even at the launch stage—the culmination of new product development—only 34 percent of followers, versus 78 percent of leaders, report full participation by key suppliers, leaving great room for improvement.

Leaders *expect* their suppliers to innovate. Indeed, at consumer products giant Procter & Gamble (P&G), 50 percent of development in its global baby care business unit is expected to come from suppliers. Leaders frequently use “potential to innovate” as a key criterion for selecting suppliers, and track and evaluate contributions to innovation as part of the supplier development process. Along with assisting in new product development, suppliers can also help to improve processes, quality and responsiveness. For their part, suppliers gain new business, addi-

tional growth opportunities and an enhanced image as an innovator.

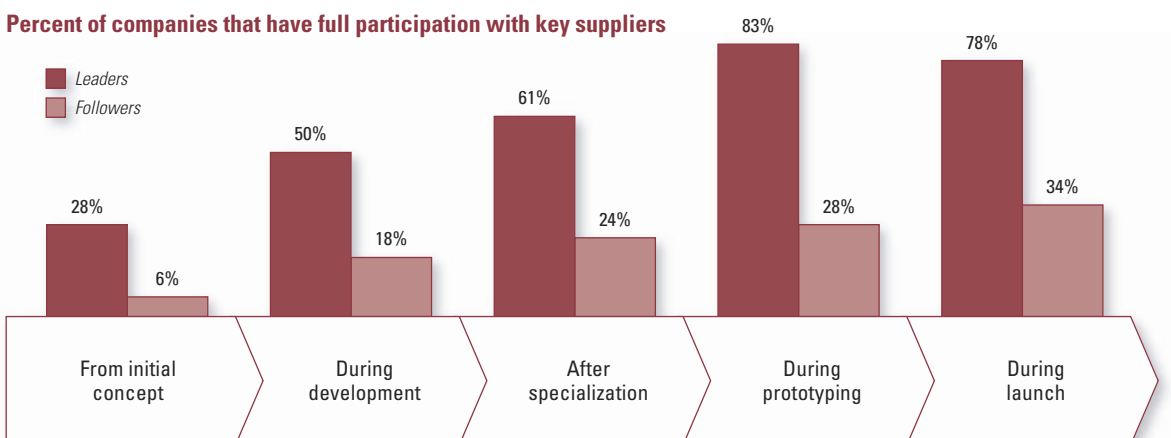
Some supplier-led innovations connect dramatically with the needs of both customers and end consumers, raising the question: “Why didn’t we do this before?” One such smash hit was the two-by-six can Fridge Vendor®, developed by Alcoa and Riverwood (now Graphic Packaging International). The idea grew from Alcoa research into how people cool canned beverages at home, and emerged from brainstorming sessions that included Riverwood package designers and engineers. The team then presented mock-ups to beverage makers. Coca-Cola followed through, renamed the carton the Fridge Pack, and took it to the market, where it has been credited with increasing canned-soda sales by 10 percent. Consumers ask for the Fridge Pack by name, prompting additional applications. Coca-Cola tweaked the carton design for use with Dasani bottled water, and Miller Brewing has now adopted the concept for beer.

The Fridge Pack created a ripple of other innovations as well. The new shape was difficult to palletize using existing equipment, so bottling plant engineers worked with equipment vendors to alter the palletizer and conveying mechanisms. The Fridge Pack’s success also motivated manufacturers of the ubiquitous plastic ring carrier to produce variations with handles and easy-open features.

From their experience in using the supply base as a source of innovation, leaders share some important recommendations and caveats. They suggest creating a picture of likely supply needs in two, five and 10 years, and then mapping the capabilities that suppliers need today in order to deliver in the future. Using this map, companies can deliberately select suppliers that offer the potential for innovation in key areas.

At the same time, however, companies must realize that involving suppliers early in the game can put intellectual property at risk. True innovators set the stage for success in both personal and legal terms: They build strong, trust-based

Figure 3
Key supplier involvement in the product and service development process



Source: A.T. Kearney

relationships backed up by ironclad agreements. Furthermore, knowing that innovation is a living process, they challenge and refresh their supplier capabilities map every six to 12 months to keep it current and reflect strategic changes.

Doing Only What We Do Best: Leveraging Value Chain Partners

Strategic differentiators. Core competencies. Non-core activities. Some might classify these terms as mere buzzwords, but tremendous benefits can hinge on how a company defines these expressions. The benefits come from value chain optimization, which involves determining what processes and activities are truly essential to the company's strategy and then using partners to provide the rest.

At Southwest Airlines, which owns nearly three-quarters of its fleet, high maintenance costs raised the question of who should perform these activities. But cost was not the only consideration in reaching a decision about outsourcing. Airline maintenance falls into two categories: Line maintenance is key to turning around flights quickly, whereas heavy maintenance is critical to maximizing the life span of owned assets. For Southwest, control of flight turnaround time was unquestionably a core necessity. Its solution was to perform all line maintenance in house, which improved turnaround time by 20 percent. Outsourcing heavy maintenance led to savings of more than 30 percent on engine maintenance, more than 18 percent on component repairs and 15 percent on repairs for "rotable" components (those that are fixed and restocked, rather than consumed).

Even as companies become expert strategic outsourcers, most of them have still not captured the full potential of outsourcing. A companion study shows that 89 percent of companies out-

source to reduce operating costs, 81 percent to enable a focus on the core business and 60 percent to access a supplier's technology.¹ In contrast, far fewer companies focus on growth through outsourcing. Only 46 percent outsource to accelerate time to market, 38 percent to grow revenue and 22 percent to gain access to new markets.

Leaders invest time and effort not only to leverage their partners for the right reasons, but also to make the partnerships work. Study leaders pull significantly ahead in managing supplier and partner relationships. They are more than twice as likely as followers to set and track project goals and milestones, use cross-functional teams from both companies, and establish formal supplier-development roles.

Leaders segment their suppliers across all organizational units and geographic regions and use this segmentation when crafting their strategies. Suppliers are commonly segmented into four groups. With strategic suppliers, leaders build long-term relationships that aim to increase the competitiveness of both parties. Collaborative supplier relationships are mid to long term, and focus on continuous improvement of joint processes. With the remaining two categories, there is less emphasis on relationships. These categories are transactional (shorter term, focused primarily on achieving supplier performance against basic requirements) and opportunistic (ad hoc, with no expectation of future business by either party).

By explicitly segmenting their suppliers, leaders can easily see which suppliers offer the greatest potential value, and allocate management attention and resources accordingly. Leaders seek improvement ideas from top suppliers—both on the cost-reduction side and the innovation side. They regularly review, discuss and reset goals for

¹ "Outsourcing Strategically for Sustainable Competitive Advantage," joint study by CAPS Research and A.T. Kearney, 2005.

key suppliers' performance. Many companies also hold supplier events such as recognition dinners to build important relationships, but only in addition to, not instead of, systematic reviews.

Several years ago, a major Latin American consumer goods company implemented a new supplier relationship management program aimed at improving service levels and time to market for new products. After performing a supplier categorization initiative, the company now has more than 100 key suppliers of packaging and ingredients working on multifunctional teams that collaborate on R&D, procurement and supply chain processes. The company improved its service levels by roughly 20 percent across the region while cutting time to market by nearly one-third.

What do leaders advise when working to optimize the value chain? A reexamination of which activities are truly core to the business and its customers. It is easy to overestimate what is core, particularly when tradition or faulty assumptions discount the capabilities available from today's supply markets. Leaders also point out the risks of outsourcing: building a longer supply chain, losing control of intellectual property and creating a competitor. Before making a major decision, evaluate the technological and operational capabilities of current and potential value chain partners, then build a business case that assesses and mitigates risks and recommends what, how much and how fast to outsource.

Advanced Cost-Management Techniques Attack Total Cost of Ownership

You pursue global sourcing like a pit bull. You consolidate volume. You evaluate best prices and quality for thousands of items and services. What's left? The answer is a whole menu of advanced cost-management techniques that tap into cost issues beyond purchase price. These techniques increase

the value of external purchases by better matching purchases to needs and reducing the total cost of ownership.

For example, a lighting-products manufacturer's business model led it to generate as many as 160 new stock keeping units (SKUs) per day—60,000 new product codes and 26,000 parts per year. Managing this complexity was draining scarce engineering, documentation and testing resources. To find a solution, a procurement-led team focused on both above-the-skin elements such as selecting product features and functions and below-the-skin components that didn't influence customer's buying decisions. After putting a product complexity-reduction model in place, the company reduced product codes by 25 percent, parts by 41 percent and overall costs by 10 percent, for an annual saving of US\$16 million.

Solutions like these are more complex and require greater collaboration for success than traditional sourcing (*see figure 4 on page 8*). Internal collaboration was essential to solving this manufacturer's problem, and procurement played a major role in spearheading the effort. Procurement alone could not mandate design changes, but it could lead the way.

In addition to complexity reduction, other advanced cost-management techniques include:

- **Tiered sourcing:** combining company and tier-one supplier volumes so that the supplier negotiates more favorable contracts with its own suppliers
- **Mega-supplier strategies:** offsetting a supplier's advantage in a non-negotiable category by bundling other categories in the negotiation
- **Supplier tiering:** restructuring the value chain by bundling or unbundling activities at various value-added stages (for example, transferring management responsibility for second- and third-tier suppliers to the first-tier supplier)

- **Value-based sourcing:** using supplier capabilities to generate other kinds of value such as shorter time to market or innovation
- **Design to cost:** revising specifications to avoid costs, for example, by eliminating over-specifications or optimizing subsystem designs
- **Collaborative cost reduction:** generating and implementing cost-reduction ideas (and sharing the risks and benefits) with suppliers
- **Best shoring:** finding competitive suppliers in cost-advantaged countries along each step of the value chain
- **Demand management:** rationalizing requirements, controlling approvals and reducing or eliminating non-essential purchases in certain (primarily indirect and select direct) categories

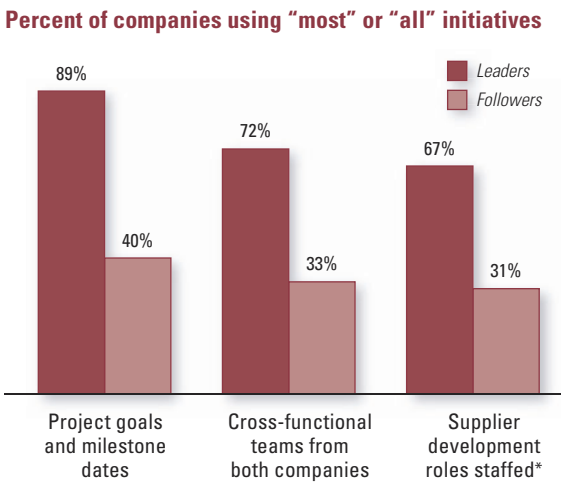
The survey revealed a sizeable gap between leaders' and followers' use of advanced tech-

niques. More than three-quarters of the leaders systematically rationalize specifications, while more than one-third of followers do so. The same proportions of respondents work collaboratively to reduce costs. More than half of the leaders undertake tiered sourcing, which demands an understanding of their suppliers' suppliers, but only about a quarter of the followers do so. These gaps may hinge on being "systematic." Leaders are far more rigorous in applying these techniques to all categories where they make sense, while followers tend to use them in a more off-the-cuff manner.

When using advanced techniques, it is particularly important to ensure that savings are realized, not just identified. All of the leaders have IT systems that track and report results achieved versus benefits identified, as opposed to 60 percent of followers. And 94 percent of leaders (65 percent of followers) make the profit effect transparent and auditable. These tracking processes must cut across numerous internal borders, so cross-functional coordination and cooperation are essential at this stage as well.

Advanced techniques can affect a surprising range of functions at both the buying and supplying firms, as a large European telecom-equipment company found. It had outsourced a significant amount of manufacturing to one of its largest suppliers, and then found that the new relationship overwhelmed its existing interfaces. Customer service issues surfaced, orders were late, and fluctuating demand created problems. When the companies invested in joint-process improvements, on-time performance rose from 70 percent to 97 percent, lead times were reduced by 60 percent and orders were confirmed in hours rather than days. Achieving these results, however, demanded cooperation across departments in both firms to e-enable the process, jointly

Figure 4
Approaches used to manage key supplier initiatives



Source: A.T. Kearney

* This refers to formal supplier development responsibilities within the company

identify and implement improvements and link factory operations to product strategy.

These examples highlight the need for sustained commitment and involvement to make change happen. Advanced techniques that make use of skills and resources normally dedicated to other functions may threaten organizational fiefdoms, so senior-level sponsorship is essential to avoid turf wars. Proponents of change may have to challenge long-held assumptions of product requirements or specifications, the value gained from purchases, or procurement's mandate in the overall company. Internal policies outside procurement's traditional scope may need to be questioned and revised.

Companies that have relationships built on trust will have an advantage. Indeed, P&G promotes face-to-face relationships with key suppliers and recognizes the importance of personal chemistry in creating trust. The company defines trust in the context of supplier relationship management as "the belief that those on whom we depend will consistently meet our expectations." P&G is certainly not alone in defining its expectations of suppliers rigorously and thoroughly, but its emphasis on the personal element is relatively rare.

How Much Risk Is Too Much?

Disruptions to "business as usual" happen all the time. A major supplier goes out of business. Dockworkers strike. An earthquake destroys an overseas call center. A supplier's employee steals a trade secret. Most companies in the study recognize risk management as a strategic issue, but leaders are more likely to have—and to have tested—contingency plans to provide protection from supply disruptions. When lightning struck a Philips microchip plant supplying two mobile

phone manufacturers, Ericsson lost US\$400 million in sales because of its single-source policy.

Even unanticipated market shifts can disrupt business. In the past two years, a spike in steel demand from China, coupled with supplier consolidation and production capacity constraints, caused a doubling in steel prices and shortages that forced some automakers to cut back production.

A recent study found a shift in the numbers and types of risks that have come to the forefront.² Traditional risks stemming from regulation and legal decisions, country financial changes, currency and interest rate volatility and political or social disturbances remain important but less so than in previous years. Emerging risks of governance issues, intellectual-property theft, terror and other security threats have moved from secondary status to the top of business leaders' agendas.

The American Express Bank learned the value of thinking strategically about business continuity on the morning of September 11, 2001. Teams from Amex Bank, its IT operations and its technical-support partner, Electronic Data Systems (EDS), all located at 7 World Trade Center, had just minutes to evacuate their building after the hijacked planes struck the towers next door. Leaving behind 100 servers that handled front-end customer processing, the teams relocated across the Hudson. They headed to a backup operations site in New Jersey, first created as insurance against Y2K glitches. Drawing on a well-designed recovery plan, business recovery specialists helped Amex Bank load backup data tapes and resume operations within hours. By the end of the day, Amex had processed 19,000 transactions totaling US\$14.3 billion, roughly 70 percent of the transactions its customers entered

² "Foreign Direct Investment Confidence Index, 2004," available at www.atkearney.com.

that day. Since then, business continuity has captured executive attention throughout the world.

Procurement must take the lead to place supply continuity at the heart of the corporate risk-management strategy. It should first define the strategic commodities or functions that merit well-developed risk management plans. The next step is to prioritize supply locations, routes and suppliers along a number of dimensions, ensuring that there are multiple suppliers or a single supplier with multiple locations. Procurement should also demand that key suppliers create contingency plans of their own to stabilize the entire supply chain. With this information, the company can conduct scenario-based analysis and develop supply risk-management strategies, ideally as part of a larger enterprise risk-management effort. To keep on top of risks, companies need to identify and monitor supply-related key risk indicators, such as the percentage of purchases in key categories that have a single source, originate in potentially unstable countries, or pass through vulnerable transportation bottlenecks.

Supply Management Organizations Gain More Visibility, Responsibility

The supply management function is rapidly evolving. Just two years ago, leading procurement organizations spent half their time on strategic activities and the other half on tactical activities such as transactions, supplier payment support and general contract administration. In 2004, however, leaders reported spending two-thirds of their time at the strategic level. This strategic focus places leaders roughly two years ahead of the followers and, not surprisingly, the new focus has helped to elevate the stature and influence of supply management within the leaders' organizations.

Indeed, 89 percent of leaders agree that their supply management organization has comparable

standing to finance, marketing and sales, against 61 percent of followers. Likewise, 89 percent of leaders, compared to 58 percent of followers, are involved in setting company strategy rather than simply executing it. And 100 percent of leaders, versus 63 percent of followers, say that senior procurement people are on the executive management team of the company.

Supply management organizations are driving company-wide adoption of common policies, approaches and practices. Both leaders and followers are increasingly doing so from a center-led organizational model, which may take several different forms:

- Central organization that handles all purchases with a single upward reporting structure
- Mixture of a centralized and decentralized organization with responsibilities split by function or category
- Decentralized organization, with a centralized coordinating function (for example, a network of "lead buyers" that report organizationally to different geographic regions or business units, yet manage their categories on behalf of the company as a whole)

Despite their differences, all of these models set policy centrally and execute it locally. For example, all leaders and 80 percent of followers have company-wide category management. Particularly for direct materials, leaders are setting sourcing strategies, establishing supplier-management processes and sharing best practices at the corporate level. Center-led procurement of indirect materials is less common, but growing. Decentralizing and automating transactional activities allows the central organization to focus on strategic issues, policy coordination and goal-setting initiatives. Our study participants from Latin America, half of which represent large multinationals that are headquartered

elsewhere, bear out the dominance of the centered procurement model.

With a wide range of organizational models for supply management, the choice of a model typically depends on how the company as a whole is organized. Although there is no single best-practice model to emulate, the organization structure should embed these principles:

- Emphasize strategic activities rather than transactional executions
- Manage key categories through cross-enterprise coordination
- Exchange learning and best practices among procurement professionals
- Speak to the supplier community with a single voice

The study confirms that supply management organizations have elevated their stature and are recognized as strategic contributors. Many are adopting the appropriate model and are poised to carry out the right activities at the right levels. But to deliver on the full value-creation promise, supply management organizations also need the right capabilities, which stem from IT systems and tools, formal and consistent processes and measurement, and a broad set of human resources skills.

IT Advances Turn Vision into Reality

It goes without saying that advanced value-creation techniques require advanced tools for managing information. Yet many things can go wrong between IT vision and IT reality. Companies may make large IT investments without confirming that new tools and systems can integrate smoothly with existing ones. If cross-functional workflows are to become a reality, procurement systems for direct materials must integrate, for example, with those in product life-cycle management. Companies may also under-

invest in training employees to use the tools. Or they may fail to ensure data standardization and quality, leading to analyses of questionable value.

Leaders are taking a holistic view, applying tools broadly across their spend base to provide better visibility and control in line with their approaches to value creation (*see figure 5 on page 12*). They are empowering electronic collaboration communities, yet building a single repository for all product information within the extended enterprise. To this end, leaders demand easy-to-use tools that will integrate with other company systems. Often, the choice of technology provider is the deciding factor between success and failure. Choosing suppliers that deliver solid user training and support, understand both the business issues and the analytics involved, and make user-friendliness a high priority is nearly as important as the technology itself.

For leading companies, key IT systems support the approaches to value creation from beginning to end. The first step is to standardize spend hierarchies globally across all divisions and consolidate data from all systems—including accounts payable (AP), general ledger and electronic data interchange systems—into a single format. The data then can be analyzed and manipulated to support procurement goals.

Beyond this, leaders are broadening the reach of IT systems to support product life-cycle management, integrated requisition-to-pay, electronic sourcing and closed-loop spend management approaches. These advanced IT systems embed best practices for cross-functional teams, build and manage a repository of knowledge and integrate with workflows from other teams to deliver more value to the company.

GlaxoSmithKline (GSK), for example, combines best-of-breed systems, enterprisewide tools and custom applications to create a powerful

engine for savings. Its modules track contracts and compliance, monitor supplier performance, develop rigorous spend analytics, and field an e-enabled negotiation suite. Through this global program, GSK manages 90 percent of its addressable spend through a combination of requests for information (RFIs), bids and auctions—all carried out using e-tools. These tools have provided a big payoff—the company found that traditional sourcing yields 8 percent savings but when supported by e-sealed-bid and e-auction technologies they realize 18 percent to 26 percent. GSK makes such widespread use of these tools that it has a “command center” auction room for hosting auction and bidding events, which also provides a dramatic venue to demonstrate procurement technology to senior executives.

Another example highlights the behind-the-scenes work that is essential to success. A U.S. telecommunications giant was not happy with its high rate of maverick buying, low compliance with spend procedures, limited spend

transparency and an inconsistent procure-to-pay process. Accordingly, it developed a consistent, streamlined and digitized requisition-to-pay process, which was centralized and integrated with accounts payable. The company strictly enforced new purchasing policies and went through the painstaking effort of standardizing item and supplier codes across the enterprise. After implementation, compliance rose to 98 percent. The system captures 96 percent of spend and provides unparalleled transparency. The technology allowed the telecom company to centralize and integrate AP, reducing headcount by 65 percent. Most important, the system provided the necessary base for moving toward advanced techniques that require detailed analyses and easy access to accurate data.

To obtain such dramatic improvements, companies must invest in the enabling technologies and take care of the details. While the sums are far from trivial, one participant reports that investments in procurement systems are the best investments his company makes.

Figure 5
Applicability of procurement IT tools for value-creation approaches

	Product development tools	Strategic sourcing tools	Supply market collaboration tools	Performance management tools
Innovation and growth	●	◐	◐	◐
Value chain optimization	◐	◐	●	◐
Advanced cost management	◐	●	◐	●
Risk management and supply continuity	●	◐	◐	●

Source: A.T. Kearney

Not applicable ○ → ● Highly applicable

Processes and Measurement: If It's Not Measured, Did It Even Happen?

Like the proverbial tree falling in the forest that no one hears, an initiative may deliver results but if no one measures them, they may essentially disappear. The benefits actually delivered by a value-creation approach depend on three things: executing the approach thoroughly, choosing appropriate metrics, and accurately measuring and tracking performance on those metrics.

Follower companies tend to encounter common pitfalls. They apply inconsistent or informal processes and policies across their geographic regions, organizational units, categories or suppliers. And, they are measured too narrowly—usually against metrics dealing only with annual cost savings. Such metrics do not reduce the total cost of ownership or encourage innovation from supply markets.

Leaders, on the other hand, formalize supply management processes and apply them systematically across the enterprise. For example, leaders take well-defined steps to develop outsourcing strategies, from monitoring supply market changes and identifying candidates for outsourcing, through to negotiating with chosen suppliers and tracking performance. Less than half of the followers take consistent steps early in the process.

Leaders also use broader and more appropriate performance metrics for the procurement organization and its employees. For example, there is a large leader-follower gap in the use of innovation as a performance metric, with 83 percent of leaders and only 31 percent of followers measuring suppliers' contributions to innovation goals. In addition, leaders build bridges to other functional areas by aligning and agreeing on shared metrics where it makes sense.

How can a company improve its processes and metrics? It is important not to formalize

existing processes without first evaluating them against internal and external best practices. Some category management processes may need significant reengineering to capture value beyond sourcing. Once defined, best practices can be formalized, embedded into enabling IT tools and linked to appropriate metrics for tracking. The overall set of procurement metrics should focus on more than just annual percentage cost savings, and instead cover all sources of value from procurement. These metrics should also tie directly to individual goals and incentives. To begin evaluating where your company stands, see the sidebar, "Measuring Up and Moving Ahead."

Supply Management as a Stepping-Stone: Attracting and Retaining the Right People

Is supply management leadership a precursor to company leadership? It was at specialty chemicals producer Hercules, following a successful turnaround. Craig Rogerson served as corporate vice president of global procurement (and president of two business units) before being named acting president and COO in October 2003, and president and CEO in December 2003. Procurement also led to the top at Chrysler in the late 1990s. Thomas Stallkamp joined Chrysler in 1980 as a general purchasing agent, rose to head worldwide purchasing operations in 1996, became president of Chrysler in 1997 and vice chairman of DaimlerChrysler in 1999. Before he left in 2000, his collaborative approach to supply management had made Chrysler the world's most profitable automaker.

Stories like these will become more common. All of the studies' leaders encourage key employees to be involved in procurement as part of their career development; 64 percent of followers do the same.

One consumer products company is exceptionally committed to developing supply management

talent. It has established a purchasing university to build skills in stewardship, strategy development, relationship management and execution. After mastering 13 separate disciplines, employees must demonstrate their proficiency by delivering results. The company offers ample opportunities to do so, since supply management gets involved at the early

stages of product development and shares supplier decision-making with R&D. Procurement increasingly uses advanced sourcing techniques and technologies. Not surprisingly, supply management has elevated its standing within the organization and earned the right to continue working on the company's most strategic issues.

Measuring Up and Moving Ahead

By this time, most readers have been mentally comparing their organizations' practices to those of the leaders. To make the evaluation easier, this leadership value-creation checklist provides a quick self-assessment and key to interpreting your score.

Leadership value-creation characteristics	Not yet on radar	On the "to do" list	Now underway	Getting results
Our supply management organization is involved in setting, not just executing, company strategy.				
Our key suppliers provide innovation throughout the new product or service development process that helps fuel our growth.				
Procurement is involved in identifying and managing alliance and outsourcing opportunities (not just in negotiating and contracting).				
Our company systematically applies advanced cost management strategies across our spend base.				
We understand our supply risks and have mitigation strategies in place for all major spend categories.				
Our supply management organization fosters cross-functional teaming throughout the company.				
Our procurement processes reflect best practices and are applied company-wide.				
Our procurement tools (such as e-sourcing, requisition-to-pay and contract management) function together as a system to allow for efficient execution of procurement processes.				
Our organization is actively developing and strengthening the employee skills required to successfully apply advanced techniques.				
We have a comprehensive management plan to attract and retain the best talent for supply management.				
TOTAL				
Scoring (sum of your "now underway" and "getting results" check marks) 9-10 = Well prepared —must continue to evolve in a rapidly changing environment 5-8 = Approaching readiness —must fill critical gaps to reach leadership level 0-4 = Falling behind —must build foundation capabilities and launch remedial actions to avoid a competitive disadvantage				

Even without setting up a specialized university, leaders encourage skill development. They rotate staff through supply management and provide training across a broad range of topics. In our study, 89 percent of leaders offered skills training in both project management and finance and accounting for procurement staff, versus 64 percent and 52 percent, respectively, among followers. The largest gap between leaders and followers is in training for operational improvement techniques such as Six Sigma: 94 percent against 38 percent. Among the leaders, training in supply management topics is also offered.

Leaders also report that supply management veterans often move to head other units, seeding the organization with procurement allies. Some respondents suggest regular rotation of supply management staff and even CPOs, proposing a three- to five-year maximum for procurement tours as people rotate through the organization. One company reported that its last four CPOs are now running business units within the corporation. Furthermore, supply management executives who lead outsourcing initiatives gain valuable experience and enhance their ability to assume other C-level positions.

If supply management requires capable people with diverse backgrounds, where do companies find this talent? To begin, recruiting appears to be degree independent. For example, Rogerson of Hercules holds a degree in chemical engineering, while former Chrysler leader Stallkamp has degrees in industrial management and economics. HR cannot recruit fully formed procurement whizzes from business schools, even though professors will network with business to nudge the best students in their direction. Instead, recruiters look for people from various disciplines with

a track record of success in areas such as problem resolution. Or they will look for veterans of other firms' procurement and supply chain programs.

Study participants report that retaining their best people is a growing challenge. One participant says he aims to keep the function fresh and leading edge, so people want to stay. Another approach is to tailor recruitment and training strategies for people at different points in their careers—one program for undergraduates and a separate program for those with five to seven years' experience.

Delivering on the Promise

The supply management function has matured and broadened far beyond what we imagined when we first studied procurement excellence in 1992. Yet one theme has remained constant: the need to transcend the functional silo. In 1992, the study found that coordination and integration with other functions was becoming increasingly important to better understand business needs. By 1996, leading organizations were shifting to team-based approaches that included sourcing councils and cross-functional supplier development teams. In our latest study, we have concluded that procurement must be a catalyst in leading multi-functional (and multi-company) teams to meet executives' expectations.

When discussing the future, study participants agree that supply management must continue bridging internal boundaries to increase its influence. Similarly, supply management must continue bridging boundaries between companies to work jointly with suppliers and other alliance partners. By combining its increasingly sophisticated procurement skills with greater outreach to other functions and partners, the supply management organization can deliver on its truly vast potential.

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