WHITE PAPER

FIVE WAYS YOUR PROCUREMENT COULD BE LEAVING MONEY ON THE TABLE

SUPPLY CHAIN EXPERT SERIES

EXECUTIVE SUMMARY

Enterprises that provide their strategic procurement teams with proper tools can expect them to deliver year-over-year cost savings, close to 10 times their expenses.

This white paper lists five key pieces of intelligence that enable strategic sourcing professionals be more effective:

#1: Total past spend with a given supplier

#2: Total projected spend with a supplier in the future

#3: Total projected demand for parts by product

#4: Key cost drivers in manufactured products

#5: Life cycle dynamics that influence pricing.

Top-performing procurement teams return almost 10 times their costs to the bottom line.

Having this critical information at their fingertips gives profound leverage on every purchase. For example, this paper describes a real-life negotiation in which this information helped minimize a dramatic price hike attempted by a supplier.

Finally, this white paper presents a recent analyst's report that confirms the value of strategic procurement, and describes several key characteristics of the top-performing teams... especially how they exploit technology to gather this strategic intelligence and avoid leaving money on the table.

THE ROLE OF STRATEGIC PROCUREMENT

Just as sales organizations are expected to deliver year-over-year top-line revenue growth, supply chain VPs who report directly to CEOs—backed up by competent staff who oversee all aspects of sourcing—can be expected to deliver year-over-year cost savings. At the top end, this can be close to 10 times their expenses.

One key driver that has helped raise the profile of strategic sourcing over the last 15 years is the sharp increase in outsourced manufacturing.

As well, companies that have expanded through mergers and acquisitions have come to see the need for better sourcing, as they strive to understand, aggregate, and control activities across numerous business units that, in some ways, still operate as autonomous entities.

These have helped bring increased attention to information systems that can provide the kind of tracking required to achieve high performance with a more distributed business model.

Tactical vs strategic procurement

Any local purchasing agent, focused only on his own factory or region, worries mainly about how to get the best price on enough supply to get through coming months with no outages.

Strategic procurement teams, on the other hand, take a wider view over a longer timeframe, seeking to maximize the return on a much larger total spend and save the enterprise millions of dollars.

In any large organization, there is bound to be ongoing tension between local decision-making and centralized control. This white paper seeks to describe how better information helps both tactical and strategic players get their money's worth in any negotiation.

Smaller companies can often find this intelligence faster than larger enterprises.

Figure 1: Five Types of Intelligence

FIVE KEY TYPES OF INTELLIGENCE

As shown in Figure 1, five key types of intelligence can enable sourcing professionals to be more effective when they sit down to negotiate with a supplier. Any company that provides this intelligence for their procurement teams gains a dramatic edge.

Key intelligence type #1:
Total past spend with a given supplier

The total spend at the supplier level is not difficult to find in a smaller company; any robust accounting system can track how much money was spent with who during the last quarter or the last year.

However, a larger organization may be challenged here. The enterprise may be running numerous instances of the same ERP system in different divisions or regions. Or worse, it may be running incompatible systems. Purchasing may be focused by division or region, with little information-sharing between them. Parts and vendors may be given different code numbers by each division.

In these cases, finding the total spend for each supplier may not be easy. Without this basic number, purchasers lose a valuable negotiating chip.

Without this intelligence, the opportunity for strategic gains is fumbled away.

Key intelligence type #2:
Total projected spend with a supplier in the future

While the past is one thing, the future is another. Additional leverage can obviously come from knowing what a company **plans** to spend in the coming months, quarters, and years.

Any ERP system can provide a preview of future requirements at the component level. This preview will have as much precision and forward visibility as the forecasts in the system.

The challenge, again, is to aggregate this detailed information from the entire enterprise. If several divisions buy the same component for different product lines, it can be a challenge to roll up all those purchases into one global number.

A system that provides this capability can truly leverage the expert knowledge of the entire sourcing community, including Product Management, Engineering, QA, and Operations. Without it, another valuable advantage is lost.

Key intelligence type #3:
Total projected demand by product

While intelligence type #2 looked at the sum of all demand, type #3 breaks down that aggregate number by product. This might be achievable for companies that produce only a small number of end products. But this challenge is amplified greatly for any enterprise with multiple business units; multiple manufacturing sites, some internal, and some owned by third-party contract manufacturers or ODM's; and many different systems containing the necessary data.

Without these numbers, procurement likely occurs at the most tactical, disbursed level... and another opportunity for strategic gains is fumbled away.

Key intelligence type #4: Key cost drivers in manufactured products

Most companies, large and small, know most of their significant cost drivers, because these are easy to spot. Computer companies, for example, understand that processor chips from Intel or AMD are key cost drivers for their products, so they focus significant energy on negotiating for these key components.

But if the product in question is much more complex, has a much larger bill of materials with many more levels, is produced with components and subassemblies made in multiple plants, by hundreds of suppliers around the globe, the challenge is much more significant.

Brute-force data consolidation driven by supply chain pain is not sustainable.

Many companies do some form of manual data consolidation as a brute-force exercise once a year, or whenever they feel the pain of their supply chain most acutely. But this approach is not sustainable, and it increases the likelihood of errors and approximations that erode the value of the data turned up.

Fortunately, there are now systems that can take all the detailed requirements and where-used information, and provide exactly the kind of visibility that's required. An ideal system can perform this data consolidation and reporting on an ad hoc basis, completing it quickly whenever the information is most needed.

Key intelligence type #5: Life cycle dynamics that influence pricing

Most components are more expensive in the early part of their life cycle, when the supplier must recoup an investment in R&D.

At the end of life, or once a part is commoditized or reverse-engineered, the price naturally gets lower. Existing inventories may be cleared out, offering a tempting price on a volume of some component—but will it become obsolete before it's used up?

The same dynamics come into play for the brand-owner's products. New products with no competition can be priced higher; as competitors and alternatives emerge, these prices naturally fall.

A system that can capture and convey the life cycle of purchased components and assembled products is a powerful asset during negotiations. Without these insights, buyers may be leaving money on the table without realizing it.

CASE STUDY: STRATEGIC PROCUREMENT IN PLAY

This strategic intelligence came into play rather decisively during a recent real-world crisis.

It began when a key supplier with a 90%+ worldwide market share for a family of highly engineered niche components announced an intended **price increase of 50%.**

As you can imagine, some impassioned negotiations followed.

Using strategic intelligence, one manufacturer was able to focus on give-and-take at the component level to minimize the impact to products, programs, and customers about which the supplier had little information.

For example, since one of the brand owner's product lines was winding down in the near future, the company accepted a larger increase on components for that line. In exchange, it won a smaller increase on components for a newer line.

Strategic information helped one manufacturer reduce a threatened price hike of 50% to only 20%.

In other words, strategic information enabled this manufacturer to drill down to a more granular level and to bargain component by component, instead of accepting a 50% increase across the board.

In the end, **the actual cost increase to this manufacturer was reduced to about 20%**. This was a direct result of key intelligence linking components from the supplier to manufactured products from the brand owner.

A superior supply chain information system helped this manufacturer push an adversarial negotiation towards a more collaborative process, and find the best possible outcome for each trading partner.

MOVING TO PROCUREMENT MASTERY

A recent study by Accenture confirmed that mastering the procurement function "is a worthy and cost-effective goal for any organization."[1] In fact, this study found that top-functioning procurement teams return almost 10 times their costs to the bottom line. That's a strong case for supporting strategic procurement with appropriate tools and systems.[2]

This study labeled the top 16% high-performing teams as "procurement masters." What are these top teams like?

"Procurement masters are different. They approach the function more strategically and holistically. They engage more fully with suppliers and frequently work to partner, rather than bargain.

"Perhaps most importantly, procurement masters are technology leaders: They use processing power to:

- Increase efficiency
- Make better or faster decisions
- Leverage and focus internal skills, and
- Connect with suppliers and third parties."[3]

1 : "High Performance through Procurement: Accenture research and insights into procurement performance mastery," Accenture, 2007, page 3. Retrieved September 28, 2009 from www.accenture.com/NR/rdonlyres/802B0ECC-B838-42C0-B878-A6B56B0DFCB6/0/HHP_brochure_low10_07_07.pdf

2 : Ibid, page 5.

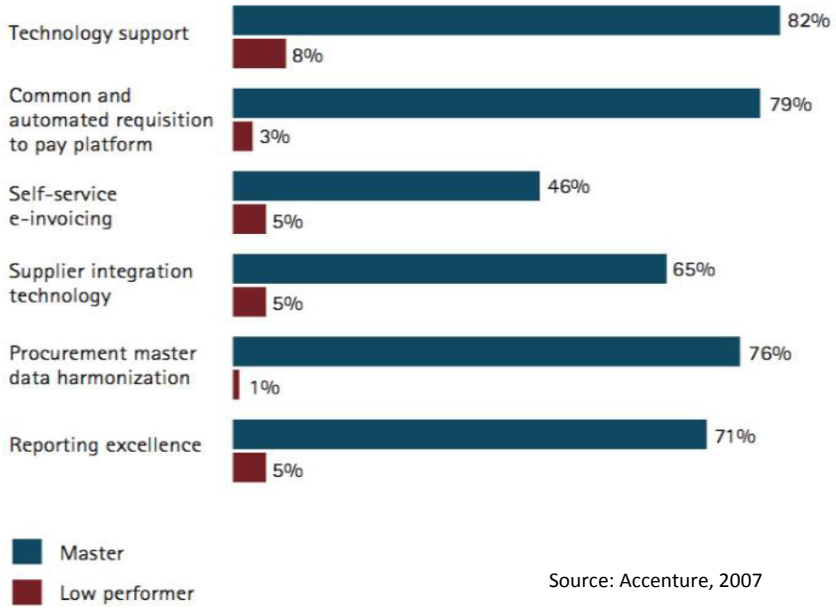
3: Ibid, page 10.

Figure 2 shows some of the ways these top performers exploit technology; the blue bar represents the top-performing masters, while the brown bar shows the low-performing laggards.

As expected, the vast majority (82%) of top-performing procurement teams use technology to support their efforts... fully 10 times as many as the lowest performing teams.

82% of the top-performing teams use technology to support their efforts.

Figure 2: How Procurement Masters Exploit Technology



Source: Accenture, 2007

Technology to promote supplier integration is used by two-thirds of the top-performers (65%) but only 5% of the laggards.

And three out of four (76%) of the top companies use tools for harmonizing master data—creating a central corporate repository to ensure that information about materials, products, customers, suppliers and assets is consistent and accurate.

HARMONIZING DATA AND BETTER REPORTING

Data harmonization is a key process in strategic procurement. This includes building cross-reference tables that tie together piece parts given different part numbers by different divisions.

These relationships are unique to sourcing and supplier management, and generally do not exist inside the typical ERP data repositories; this information exists only in spreadsheets and in the minds of sourcing professionals.

99% of the worst-performing teams do not harmonize data between systems.

With no systems to capture this intelligence and support collaborative decision-making, this information remains an unused resource that is never harnessed for the benefit of the enterprise.

Without this fundamental capability, it is almost impossible to consolidate data from disparate and incompatible ERP systems. This is the sad situation of 99% of the lowest-performing companies in this study.

Data harmonization removes this block, so that data can be effectively merged from various corporate systems and any point solutions used by third parties. This opens the door to generating all the key intelligence listed earlier.

Seven out of 10 procurement masters also enjoy "reporting excellence," while only 5% of the lowest performers do. This can make a critical difference, according to Accenture.

"Developing user-friendly ad-hoc reporting capabilities is... one of the most fundamental ways to increase buy-in, raise entity-wide transparency, and capture the information needed to discover and drive improvement opportunities."[4]

The key to procurement mastery is to systematically gather all the required information, combine it with ERP data, and provide visibility through ad-hoc reporting. Technology that provides these capabilities can deliver all five types of strategic information, and revolutionize corporate relationships with suppliers.

CONCLUSION

As we have seen, a truly effective information system provides a way to leverage the knowledge and skills of the procurement organization to negotiate from a more informed position.

This position will be based on:

- Detailed component volumes, past and future (intelligence types #1, #2 and #3)
- Crucial, specific knowledge of programs and customers (intelligence types #3 and #5)
- Other metadata related to the product, its value chain, and life cycle (intelligence types #4 and #5.)

A system that provides easy access to all this information supports the strategic procurement team with the most important levers to negotiate with suppliers. This enables them to manage supply as part of a coherent strategy for the business, to collaborate effectively with trading partners, and to avoid leaving money on the table.

4 : Ibid, page 26.

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