

strategy&

*Procurement's
new operating
model*



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Introduction

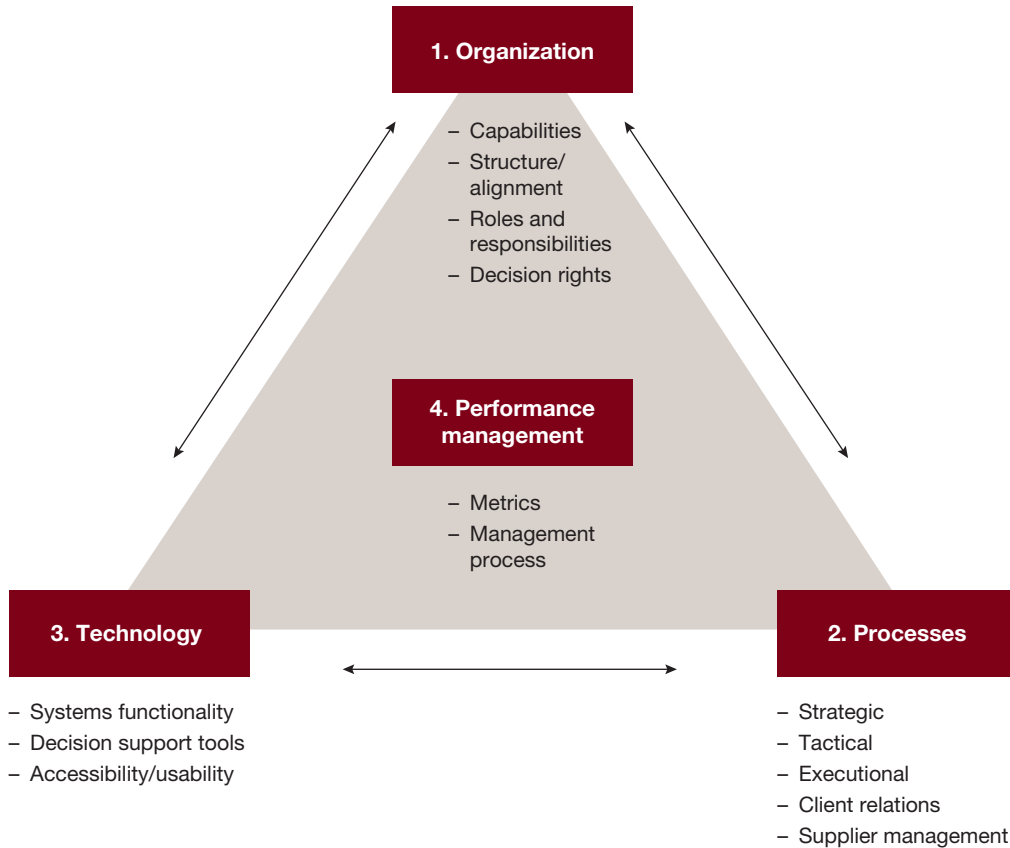
By now, most companies have ridden one or more strategic sourcing waves that have collectively saved their organizations billions of dollars. Yet even after having benefited from these initiatives, the average company still leaves on the table unrealized savings equaling 5 to 10 percent of its total spending. These savings are not lost because of ill-conceived strategies or organizational incompetence; rather, their loss is inherent in flawed or incomplete procurement operating models.

There are many reasons that the operating models constructed to procure and pay for goods and services prove inadequate. They may not include the processes, tools, or resources needed to fully execute the sourcing strategy. They may not be properly connected to organizational decision making or sufficiently integrated into key corporate planning processes. Decision making authority and accountability may not be clearly defined. Or the IT systems that enable them may be fragmented, impeding efficiency and clouding the visibility necessary to ensure compliance with overall purchasing policies and objectives.

In order to mitigate these problems and deliver on purchasing's cost, quality, and service commitments, companies must evaluate and design their procurement operating models along four fundamental dimensions: organization, processes, technology, and performance management (*see Exhibit 1, next page*). Together, these four elements determine an operating model's effectiveness at executing a company's sourcing strategies. And because any model is only as strong as its weakest link, each element must be developed fully and aligned properly. A company may develop a series of nearly perfect procurement processes, but without clearly defined mechanisms for managing and measuring performance, procurement will struggle to ensure compliance and achieve its overall strategic goals. Similarly, procurement technology may provide all the information needed for executives to make well-informed purchasing decisions, but that capability is largely meaningless if the procurement organization has not also clarified the decision rights that identify who will make those decisions and be accountable for their outcomes.

Exhibit 1

Today's procurement operating model



Most procurement organizations excel along one, two, or even three of the operating model dimensions, but very few have fully developed and aligned all four of them. Some companies need to travel only a short distance to properly integrate the four dimensions; others face a more arduous journey. But no matter how long or difficult the road ahead, the best way to begin is to view the purchasing function as a broad, cross-enterprise activity incorporating all elements of the procurement process, from sourcing through contract negotiation, demand management, procure-to-pay, supplier relationship management, and measurement and tracking. Such a view enables companies to better see the gaps in their operating models and address each of the four dimensions.

Organization

The top priority in putting together a powerful operating model is not the issue of overall centralization or decentralization; it is determining how best to structure procurement's various roles in corporate, business unit, and functional-level purchasing. Should the procurement function own, control, and manage the entire process for every corporate stakeholder? Should it participate actively in the purchasing decisions and processes of the individual business units, functions, and geographic regions in which the company operates? Or should it merely carry out those purchasing decisions?

Deciding where to land on this spectrum of options, from managing to facilitating to supporting, involves sorting out a complex mix of issues: How will the decision affect a company's ability to get the most bang for its buck? How will it affect the choice of suppliers, their degree of engagement in the procurement process, and the nature of the company's relationships with them? Would complete ownership of the function allow for greater process efficiency, or would the potential resulting inflexibility make the process less efficient? Would purchasing's alignment with overall strategic goals suffer if procurement were to take on the role of passive supporter?

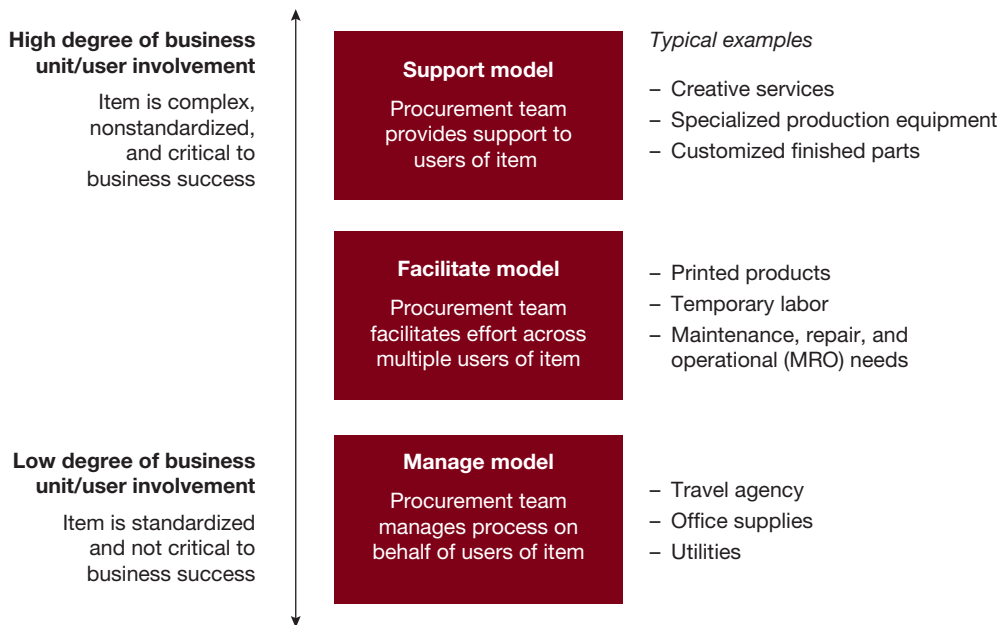
In our view, the ideal procurement organization must balance the desire to leverage purchasing power through complete ownership with the need to maintain the flexibility of the individual business units, functions, and regions. That balance is struck not only in the way procurement — and its accompanying processes and technologies — is structured, but in how the various roles, responsibilities, and decision rights are allocated between the corporate procurement organization and the various procurement functions attached to the business unit, functional, and regional stakeholders.

The amount of influence exercised by corporate procurement should vary depending on what is being purchased and by whom (*see Exhibit 2, next page*). When specific business units or functions must purchase complex, business-critical, nonstandardized items such as specialized production equipment and materials or customized finished parts, the business units and functions should conduct most of the sourcing and procurement activity because the effective purchase of such goods and services

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Exhibit 2

Procurement organization



Source: Strategy&

depends on the knowledge of the user. Central procurement could play a “support” role, performing cost modeling or providing industry and market research, but the business unit or function would make the actual supply decisions and structure its own implementation strategies.

For products or services that are less business specific but still must be somewhat tailored — such as temporary labor or maintenance, repair, and operational needs — procurement might play a facilitating role on behalf of a wider variety of business units or functions. It might establish, for example, the guidelines for evaluating and scoring requests for proposals, while the business unit determines the exact specifications for the products or services it needs.

Finally, for purely standardized purchases that are not critical to business success, such as travel, office supplies, and utilities, procurement should completely manage the process from start to finish.

Every purchasing department must identify where and how to exert its influence and leverage its knowledge of process and technology, managing where necessary, facilitating where desirable, and supporting where most helpful. Doing so will allow it to determine the structure best suited to its various roles and the processes, tools, and capabilities needed to ensure that it has the maximum impact on overall spending.

Processes

Every purchasing organization that stands out from the pack maintains carefully defined and disciplined processes at every level, from strategic to transactional, across the entire procurement life cycle. Just as important, end-users across enterprises that manage the procurement process successfully understand those processes and willingly adhere to them — even when purchasing does not “own” the procurement decision. Well-structured, widely understood processes enhance transparency and ensure compliance with procurement guidelines, thus enabling companies to capture even more savings.

Purchasing processes break down into three categories: sourcing strategy, execution, and ongoing supplier and customer management. Sourcing strategy processes typically harbor a great deal of value, because they determine spending patterns, define requirements for products and services to be purchased, structure relationships with suppliers, and develop supporting contractual arrangements and internal policies. The challenge in optimizing sourcing processes lies in clearly defining and implementing them in such a way that they consistently drive fact-based, cross-functional decision making. Ultimately, these processes must generate the insights into economic and market conditions and internal demand needed to select the right supply structure and supplier pool for the company as a whole.

Procurement execution processes encompass activities such as requisitioning, purchase orders, goods receipt, and invoicing. Here, procurement should seek to establish clearly structured, easily understood, and easily used systems and tools to streamline execution and manage compliance on the part of end-users.

Often overlooked, procure-to-pay processes generally deserve close attention, as the benefits of consolidating and streamlining them can reduce a company’s total spending by 1 to 5 percent. Still, many companies have yet to holistically review the processes (many of which are fragmented legacy structures) that support procure-to-

pay activities. This inattention can undermine compliance, weaken adherence to favorable pricing terms, and encourage maverick buying among end-users.

Finally, the processes for ongoing supplier and customer management are vital to the success of any procurement operation. The new paradigm in dealing with suppliers is collaborative relationships, which allow companies to work closely with vendors to best meet both parties' needs. However, the cooperative nature of such relationships demands far greater participation on the part of procurement professionals in order to capture the hoped-for gains in cost savings, service, quality, and innovation.

At the same time, procurement must design clear processes for actively managing its relationships with business unit and functional end-users, as well as internal demand. This will, in turn, allow procurement to play a greater role in the improvement of end-users' decision making. To do this, procurement needs to be integrated both at the front end — aiding end-users in developing their sourcing strategies and processes — and at the back end, assessing whether end-users are complying with procurement policies and contract terms.

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Technology

Ultimately, procurement processes are only as good as the systems and tools that support them. There are multiple approaches to procurement IT, but the objective is invariably twofold: to enable the wide variety of purchasing transactions on which every company depends, and to arm decision makers at every level with meaningful and actionable information in a predictable, easily accessible manner.

Minimally, procurement IT systems must ensure that all transactions — both internal and external — are carried out consistently, and that decision makers have a clear view of all elements of the company's purchasing. Surprisingly, many highly sophisticated procurement systems cannot boast either of these attributes, typically because they were built for financial reporting and budgeting purposes and are not set up to furnish sufficient data about procurement performance or to facilitate procurement transactions.

Fortunately, the solution to the technology challenge in procurement is not as sweeping or cost prohibitive as many procurement executives might fear. Companies do not need a state-of-the-art, end-to-end ERP system to effectively support their procurement objectives. Instead, they can use the company's existing IT infrastructure in combination with various bolt-on systems.

The advent of powerful, best-of-breed Web-based applications allows for easy integration of any number of functions into the procurement system: supplier portals that let end-users source products and services on their own; end-user interfaces that manage the actual procurement process through purchase order and payment; even performance management systems that provide increased transparency throughout the entire process. Through a combination of policy and systems adjustments, supplements to existing IT architecture, and improved data management techniques, these renovated systems can boost transaction accuracy and compliance while generating more accurate and timely spending analyses to support both supply and demand management decisions.

Performance measurement

The final dimension of a successful procurement operating model is measurement and assessment of performance. Although specific procurement metrics vary, top companies typically adopt a common management process and framework to assess not only the cost savings generated through procurement programs but also how much value procurement is generating on an ongoing basis.

Aided by the technology infrastructure described above, a common framework is typically designed to illuminate a company's procurement performance against specific objectives. To be effective, however, performance management systems must provide stakeholders with the transparency needed to see and interpret the results, conveying sufficient information to generate confidence and buy-in among decision makers. The systems must enable these key constituencies to provide feedback regarding methods and results. The goal is to stimulate a dialogue with business units and functions concerning realistic goal setting, joint accountability, and continuous improvement.

A combination of procurement dashboards, budget data, and continuing assessment against global benchmarks can help in measuring, setting, and refining overall performance goals. The secret to success in performance management, however, can be captured in three words: Less is more. Metrics should be focused, practical, and actionable. They should furnish insight into both procurement efficiency (such as spending per full-time employee and procurement organizational costs as a percentage of spending) and effectiveness (including savings and cost avoidance, cost index performance, percentage of spend under purchase orders, and percentage of spend with procurement influence). Dashboards dedicated to individual spending categories should highlight not only absolute spending and savings but, more important, the state of and trends in cost and performance drivers for that category.

Tracking performance is an integral component of procurement's new operating model if for no other reason than that it helps procurement establish credibility with its business unit and functional clients.

Procuring competitive advantage

The benefits of adopting the right procurement model for your organization are substantial, not only in terms of cost reduction but also in the ability to better focus resources, enhance value from supplier collaboration and innovation, and more fully capture contractual promises.

However, despite having launched successful procurement initiatives, too many companies, in too many industries, find that they have yet to complete the journey. They may have made many of the right moves in implementing the latest capabilities across the procurement life cycle, yet they rightly suspect there is still significant value to be realized. That value, we believe, will come not through a better or brighter strategy, but through more consistent execution of existing strategies.

Companies that successfully execute a “procurement agenda” can deliver a great deal of value, but only if they have the right operating model, one that integrates organization structure with best-practice processes supported by appropriate information technology and performance measurement systems. Of course, the “right” operating model will vary from company to company. It depends on the organization’s existing structure and culture, as well as the role that procurement plays in managing the purchase of goods and services across categories, business units, functions, and geographies. How much a new operating model will affect overall spending varies by business strategy and the broader corporate agenda, but the impact is invariably positive and significant.

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