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The procurement organization, unleashed

An international big box retailer was facing stiff competition from all sides – other stores, online retailers, mass merchants, too. Senior management needed to act and invest heavily in new initiatives.

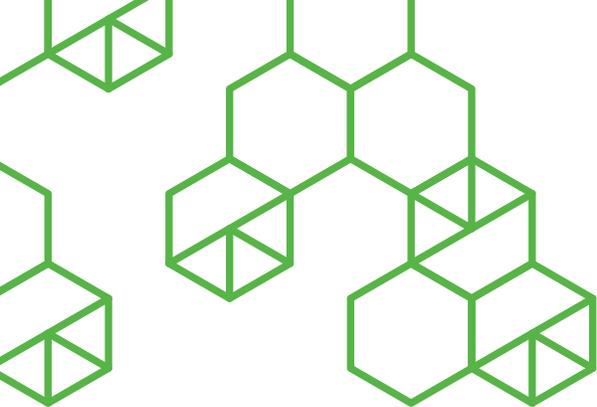
The retailer had made a series of tuck-in acquisitions, but had not yet integrated the operations. The executives wanted to regain the retailer's status as a best-in-class company and set a stretch goal of cutting its annual third-party vendor spending by \$100 million and reinvesting those monies into new merchandising programs.

The procurement organization wanted to help. But, as is the case with many companies, the retailer's procurement organization was hampered by its historically tactical approach to sourcing that limited its strategic potential. Although the team had good

relationships with spend owners including IT and marketing, business unit heads typically negotiated their own deals and only asked procurement to execute the purchase.

Approximately \$2 billion in annual spend, including Cost of Goods Sold (COGS), IT and marketing, fell outside the purview of procurement. The team was rarely given the opportunity to demonstrate its full strategic potential including spec changes, total cost reduction and other state-of-the-art procurement techniques.

Although the Chief Procurement Officer (CPO) had offered to expand the group's mandate in the past to no avail, the dramatic changes in the competitive landscape convinced senior executives to take a gamble. They gave the procurement team a shot and it expanded its focus from tactical purchasing to strategic sourcing. In approximately eight months, it had gained respect across the enterprise and found more than \$100 million to boost the company's bottom line every year. How did they do it?



By upping skill levels beyond tactical purchasing, a strategic procurement function can help achieve corporate goals and gain influence.

UPPING THE GAME—STRATEGIC SOURCING

Most procurement organizations are focused primarily on tactical sourcing, often limiting their work to negotiating, contracting, and buying. They don't usually analyze markets, work directly with business owners on specifications, or conduct rigorous supplier performance management.

Becoming a strategic sourcing function with an active CPO changes all that. Procurement develops and leverages new expertise and turns sourcing into a strategic asset that helps achieve business outcomes. Playing that role increases the function's value and influence throughout the enterprise.

There are three basic elements that anchor a strategic procurement function:

1 Optimizing sourcing

A strategic procurement department actively monitors market conditions and movements to identify potential price increases and swings in time to take action. For example, procurement professionals in a beverage company that uses aluminum cans would closely monitor the aluminum futures market as a proxy of future prices. With this detailed and sophisticated market knowledge in hand, procurement can include commodity price indices in vendor contracts to reduce exposure to pricing volatility.

Strategic procurement organizations also keep close tabs on global geo-political issues to spot potential supply chain interruptions far enough in advance to create back-up sourcing plans. They also keep their eyes out for labor violations and human maltreatment on the part of their suppliers and outsourcing partners.

Optimizing the vendor portfolio is also critical. Many procurement departments use a plethora of suppliers often for the same or similar products. However, the fewest number of vendors possible is the ideal. For example, using only two suppliers for a given product and not spreading the buy evenly between them can make one hungry for more business and the other prepared to stay competitive.

2 Aligning policies

Procurement should establish policies together with business stakeholders. For instance, the function should establish optimal re-order points for materials that assure supply never runs out while minimizing the costs of holding inventory.

Moreover, procurement should be responsible for selecting vendors. If the business simply tells procurement what to buy and from whom, the function has no opportunity to reduce costs or improve the quality of purchased materials. Procurement departments with the greatest enterprise impact first find out what the business needs, then investigate the vendor market to present the best options. Additionally, procurement can leverage techniques such as reverse or blind auctions to help assure the best price for the best brands.

Significant cost savings can also be garnered by more effective policies governing internal costs. For example, instead of allowing employees to use a car service to go all the way home after a certain hour, the company could require that the car take them to the nearest transit point where the employee can secure safe transportation home.

3 Supporting corporate aims

Perhaps most important, strategically oriented procurement organizations can become trusted partners with business stakeholders and the Chief Financial Officer (CFO) by increasing working capital that can be invested to achieve corporate goals. For example, the store operations for a major grocery retailer was buying grocery bags at a very low cost. Investigating their use, procurement professionals discovered the bags were flimsy, and many stores were double bagging, which essentially doubled the costs. By using a stronger bag that cost a little more, procurement raised customer satisfaction and found a hefty amount of cash that was used to improve marketing efforts.

SHOW US THE MONEY

Strategic procurement has a much greater impact on the bottom line over time than a tactical approach. Good tactical sourcing can save from 5 to 8% on a single transaction through rate reduction. But a strategic procurement function can trim costs by as much as 12 to 21% (figure 1).

To deliver ongoing value, the procurement organization must engage the entire sourcing value chain. As figure 2 details, most tactical procurement teams focus their efforts on steps five and six. They prepare RFPs and follow up with the tactical tasks required to finish the deal. They rarely engage in more strategic activities toward the beginning and end of the value chain.

Moreover, a fully strategic sourcing operation—including supplier base management, demand management, cost management, and techniques such as Total Cost Reduction—can deliver significantly more value and sustain it over time (figure 3).

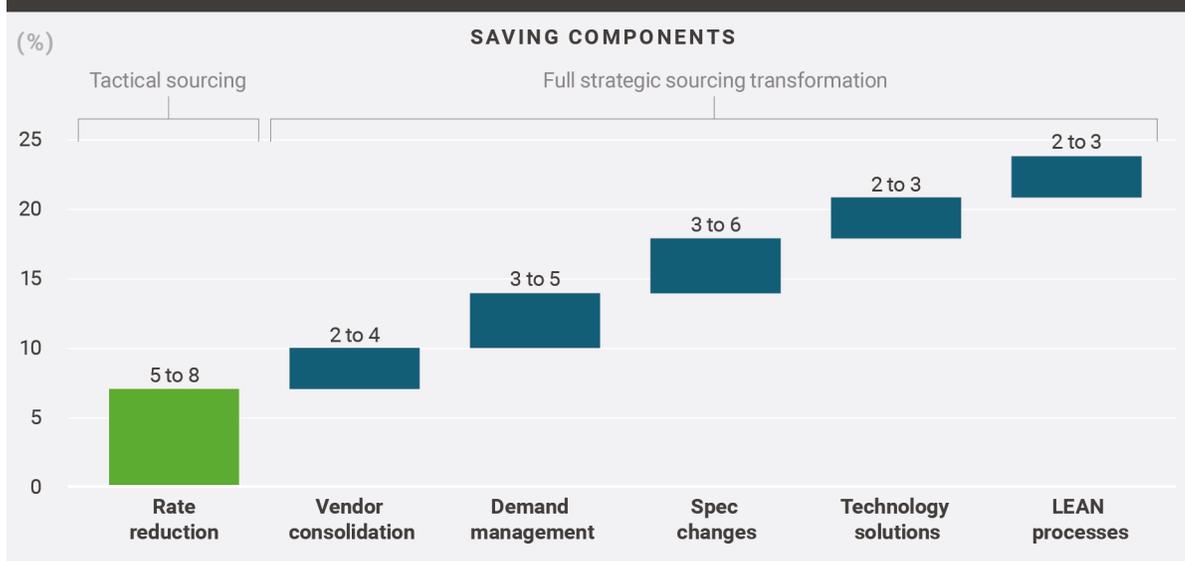
BECOMING A TRUSTED THOUGHT PARTNER

In any major change effort on the part of a corporate unit, the team must develop the trust and confidence of the businesses and functions it works with. For procurement, the most important champion is the CFO. He or she often has the closest relationship with the CEO and welcomes effective approaches to reduce costs and supply working capital for the organization.

The procurement function must also develop close and effective relationships with business and finance functions. Procurement should secure business leaders as sponsors of cost-saving initiatives and clearly articulate the benefits and how long it will take to achieve them. To build even greater confidence, procurement should work closely with business stakeholders on negotiation strategy and other key procurement processes.

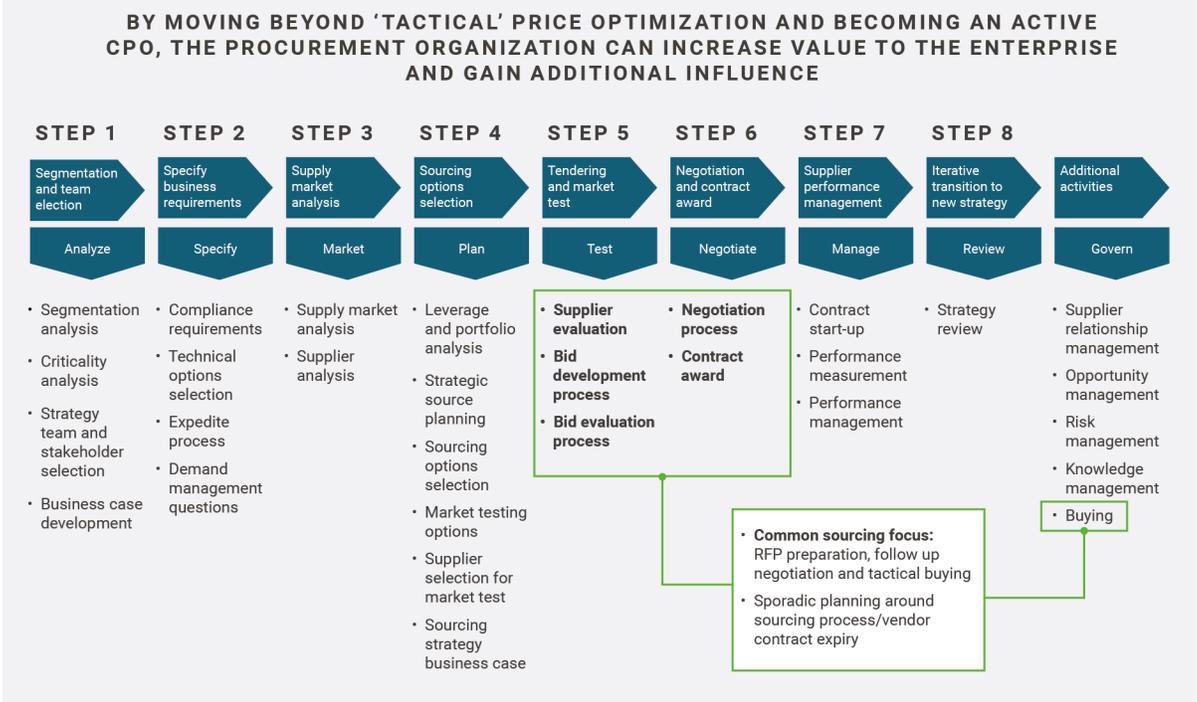
Finally, procurement needs to work closely with finance to validate its savings assumptions and develop KPI reports on a regular basis to keep the function top-of-mind among important stakeholders, including the CFO.

FIGURE 1: PURCHASING TRANSFORMATION



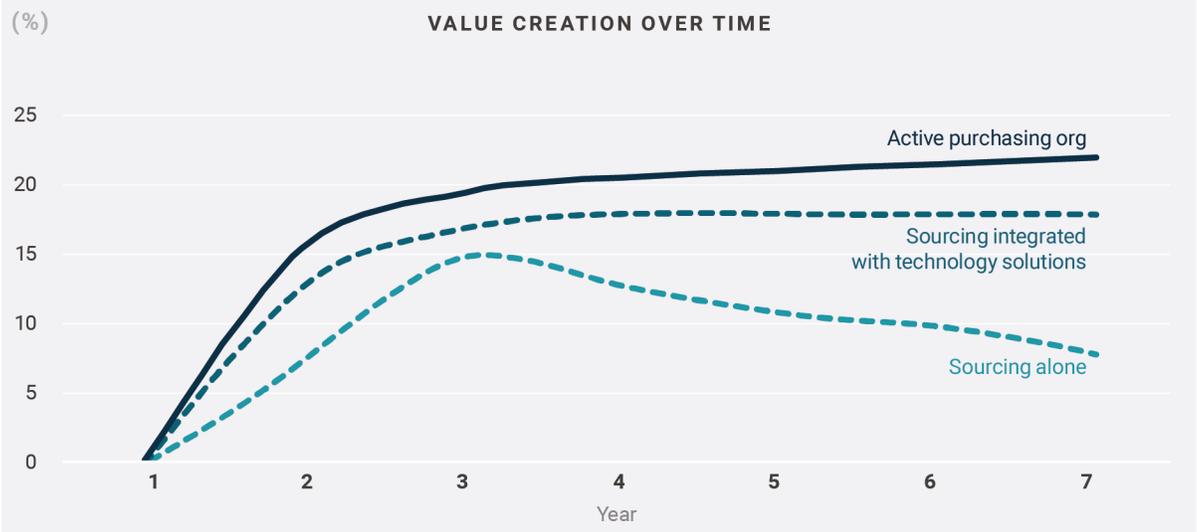
Source: AlixPartners results and experience

FIGURE 2: ALIXPARTNERS SOURCING MODEL



Source: AlixPartners results and experience

FIGURE 3: VALUE SUSTAINABILITY



Source: AlixPartners results and experience

To drive the procurement organization transformation, the CPO needs to address three critical tasks:

Establish a cost-management culture

Set budgets in sync with business sourcing activities. The CPO should also incorporate savings targets and budget compliance into annual management performance goals.

Implement policies to drive cost management

To instill the value of cost management deeply into the culture, the CPO should develop and review purchasing and requisitioning procedures to ensure sourcing is involved in all major spend decisions. CPOs should also assess ancillary purchase policies including mobile telecom, T&E, and HR strategy to ensure there is no spend leakage.

Track cost-management performance

Everything needs to be measured and reported on. The CPO needs to define organizational KPIs to keep work and budgets on track. He or she should consider creating an active Project Management Office (PMO) to monitor the benefits and coordinate savings opportunities with multiple businesses or functions using similar materials or equipment.

CAPABILITIES FOR LONG-TERM EXCELLENCE

Strategic procurement pays off in the long run—often significantly. But to achieve that payoff, the CPO needs to build an organization that has the capabilities to sustain excellence over the long haul.

To start, procurement organization leaders need to develop their managers' capabilities to effectively create and manage teams. Important skills include conflict resolution and process and project management capabilities. Mastering these skills will assure that procurement is successfully plugged in to all relevant company workflows.

The CPO also needs to master the art and science of change management and build that capability among his or her managers. These skills are critical in driving high-performance teams where everyone understands their role and performs it at peak proficiency. Procurement professionals should also understand what is expected of them and have meaningful career paths supported by effective mentoring.

Finally, the procurement organization should have a framework for competencies that employees are expected to develop and scorecards to measure their progress. Competencies include leadership skills and core business skills such as business judgment and problem solving. Core purchasing skills are also essential and include risk management and cost structure modeling. Procurement also needs technical purchasing skills such as knowledge of products and commodity markets.

PUTTING IT ALL TOGETHER

Like many procurement organizations, the big box retailer mentioned at the beginning had basic procurement skills in place—placing orders, fulfilling purchase orders, and developing contracts or other agreements. To become a strategic procurement function, however, the unit had to restructure itself, add

several new roles and positions, and win an equal seat at the monthly senior leadership meetings. These are the foundational steps they used.

Since change starts from the top and needs senior management's ongoing support, the company established a steering team that included the CPO, CFO, business leaders, marketing, and IT. Procurement restructured its department to add a new strategic sourcing team as its core purchasing function, run by directors accountable for category strategy, supply network, risk mitigation, and stakeholder relationships. Leading this group is the CPO who is responsible for annual spend, year-over-year delivery of value, service quality, and risk. The group's work is supported by business and functional leaders across the organization who supply input on supply management and strategies.

The procurement team also has an operations director who oversees the managers charged with buying services, catalog management, and contracts. The operations director is also responsible for local and business unit buying.

CONCLUSION: GETTING STARTED

Irrespective of where your procurement function stands today, there are several steps it can take immediately to move forward and become a strategic sourcing function:

- 1** The process should start by understanding where things stand. Procurement should conduct an internal skills audit to properly assess the procurement team's strengths and identify who would be best suited for training and redeployed to strategic sourcing. The audit should also determine how many new people need to be hired and which employees can remain in a tactical capacity.
- 2** Start having heart-to-heart discussions with your CFO explaining the opportunities to gain his or her support as champion and obstacle remover.
- 3** While deepening the relationship with the CFO, procurement should also strengthen relationships with key business and spend owners. Find out what they think about procurement in case any past perceptions need to be corrected. Highlight the potential capability and reassure business leaders that procurement can work within the business's constraints making it a true partnership.

- 4 Select pilot programs with a friendly group. Use the project's success to build momentum and expand to other areas.

The time is ripe for procurement to up its game. Business is getting increasingly complicated and in many industries profit margins are thin and getting thinner. Procurement has much to offer by taking on the challenge and responsibility of becoming a strategic sourcing function that adds to the bottom line. **A**

Strategic sourcing and M&As

A strategic sourcing function can be crucial to cost-effective operations after an acquisition or merger. A key function of strategic sourcing is to optimize the vendor portfolio. The newly combined company will likely have significant overlap in its vendors resulting in considerable waste. For example, in a recent post-merger integration between two media companies that we supported, the combined company was able to reduce its vendor costs by 30%. They did this by aggressively rationalizing and consolidating the vendors they continued to work with and instituting other advanced measures such as temporarily requiring CFO approval for any purchase order more than \$5,000 to ensure the adoption of a cost-conscious culture.

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