



THE BOSTON CONSULTING GROUP

PUSHING THE VALUE ENVELOPE IN PROCUREMENT

A CALL TO ACTION IN 2018

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CHIEF PROCUREMENT OFFICERS MUST balance two equally important imperatives: they need to adopt digital procurement technologies even as they sustain traditional procurement methods. Both digital and traditional procurement will be sources of significant value. These were the principal issues discussed at the 11th European Procurement Roundtable, which we hosted in Amsterdam in October 2017. More than 80 CPOs and senior procurement executives attended, representing companies whose annual spending totals €770 billion. Our theme, “Pushing the Value Envelope,” captures the challenge faced by those who must keep a foot in the world of traditional value drivers while pushing forward into the new digital world.

Among our guest speakers were Gordon von Bretten, managing director at KKR Capstone, proclaiming: “Strategic sourcing, including technical and demand levers, is alive and kicking but requires a strong executive mandate to drive out cost.” Guest speaker Vivienne Bracken, CPO at National Grid, joined us too and stated: “The pro-

curement function is growing in its reputation as a commercial function that can add real-time value to National Grid’s businesses by developing deep category knowledge.”

Following are summaries of just some of our in-depth discussions.

The Digital Future Is Now

Digital is no longer only a buzzword in procurement. It is now a call to action. Of 30 companies listed on the German DAX, 29 mention digital as a focus in their annual report and 17 particularly cite digital innovation of the procurement core as a field for the future. Of course, some digital applications are already underway in procurement. In operational procurement, for example, robots and automated solutions such as touchless purchase order approvals are changing the landscape, with an expected 30% workforce reduction in the medium term.

In strategic procurement, CPOs are focused on how to generate meaningful data from systems inside and outside their depart-

ments and how, based on these data sets, to generate insights that go beyond what is possible today and that will guide their strategic choices. This includes gathering tail spend data to prepare for focused tail tenders as well as monitoring strategic suppliers' internal cost curves to keep their margins in check.

The CPOs concluded that the first thing to do when making choices concerning digital tools is to consider their own strategic priorities, be they savings, innovation, speed, or risk avoidance. They should focus on tools that directly support these priorities, rather than choosing solutions simply because they are in fashion.

Plan now for the digital supply chains of the future. These supply chains need to be understood from the perspective of the end customers' demand. Becoming best in class with respect to demand forecasting will have a massive impact on all upstream activities, including procurement.

We demonstrated and discussed important technologies in the advanced planning space, such as artificial-intelligence-based forecasting procedures. It's important for CPOs to get familiar with these technologies: according to a recent study, about 60% of companies are not yet using AI to harness the analytics power it can potentially deliver. However, 90% of the CPOs in attendance indicated that their companies are planning dramatic changes in their supply chain management.

Overall, the participants felt, it is mandatory to take prompt action in the field of supply chain management because digital will be the new standard in a few years. Companies must adapt to new digital ways of working. We know that leading companies today are already doing so.

Take heed of Industry 4.0. It's crucial, CPOs say, to look at developments in procurement and supply chain management not narrowly but widely, with an understanding of how digital changes in other functions have implications on their work. Industry 4.0, the latest phase of the indus-

trial revolution, was identified as a critical area because it describes the changes occurring among functions that are core business partners for procurement.

The technologies that make up Industry 4.0 will influence procurement in two ways:

- **What Items Are Procured.** The shift to 3D printing, for example, will have an impact on spare parts spending, reduce the complexity of tail spending, and render supplier markets for printing solutions more complex. In the future, 80% of spare parts and 50% of MRO items will come from 3D printing and thus will not have to be sourced.
- **How Items Are Procured.** Smarter machines and their underlying sensors and smart algorithms will anticipate when parts need to be replaced, reducing the urgency of the procurement process.

Traditional Procurement Methods Remain Vital

We discussed a number of well-established procurement levers, including zero-based budgeting (ZBB), commodity sourcing, and "should costing," which are still driving large shares of value.

ZBB will allow companies to remain lean in the long term. ZBB is a cost philosophy that introduces a new way of working based on a rigorous bottom-up budgeting process and clear cost accountability. The objective: to rigorously reset the cost basis of an organization and ensure that it is kept lean on a long-term basis. Typically, it results in reductions of SG&A costs of up to 30%, and its sustainability is embedded through a set of new roles, responsibilities, and processes. ZBB goes beyond planning a zero-based budget. It introduces clear, zero-based accountabilities.

Take a look at commodity sourcing.

Commoditization continues to increase. Once products and goods have reached a certain level of commoditization, the trend is unlikely to reverse naturally. More and

more companies are buying commodities and are thus subject to commodity-related challenges such as price risk, scarcity, and the need for transparency.

Additionally, supply markets have become increasingly competitive. Merchants and distributors, given their size and integration along the value chain, have built strong market positions. But emerging commodity platforms and expanding exchanges offer additional sourcing opportunities and routes to market. Most players will need to adapt their commodity strategy and supporting operational platform. While they do not need to transform into classical traders, they should embed critical trading, optimization, and risk management capabilities to build a competitive edge and master the challenges ahead.

“Should cost” modeling is a game changer.

In times of new technologies, shorter product life cycles, and continued cost pressure, the case for product cost optimization is stronger than ever. Experienced practitioners and beginners both need to realize next-level product cost savings. Should-cost modeling works best when built on a strong fact base, which allows for eye-opening insights and strong arguments for more cost-efficient solutions. In fact, should-cost modeling can also be a powerful tool to wield during negotiations.

Two main conclusions were reached in this discussion: companies should not be complacent—premium brands and higher-margin manufacturers can be cost leaders too. And should-cost modeling capabilities are a game-changer and prerequisite for continuous product cost optimization.

There are ways to set up BPO deals for success. In negotiating big business-process-outsourcing (BPO) deals, five factors help to ensure success:

- Bring all of your procurement talent to the table, to handle the significant complexity of packaged deals and advanced compensation models.
- Given supplier stickiness, make sure

you understand your suppliers’ service costs in detail and understand, from the outset, the desired end state of the deal.

- Digitization and technology are shifting BPO providers’ cost structures drastically. Be open to new needs and possibilities.
- Harvest the savings that technology drives but push suppliers to adopt more.
- Set the right incentives for procurement—move away from cost savings to value creation based on business cases.

Of course, trust and transparency remain the key prerequisites for a successful long-term BPO partnership.

Take a fresh look at how to manage indirect spending. CPOs from across industries strive to add value but struggle to gain the support of business and functional stakeholders for those efforts. In many organizations, delivering value through indirect spending management is met with resistance.

CPOs need to step outside the traditional procurement view and look at issues from the perspective of stakeholders, including the CEO. Procurement needs to move beyond just cost-cutting and take a more differentiated business view in order to really belong to the core of the company. Procurement functions should adapt to fill very different roles, those of strategic partner, strategic enabler, risk owner, or efficiency driver, depending on the risk and impact involved. CPOs who seek to step up and deliver strategic competitive advantage, beyond cost savings, should ensure that the procurement function includes skills in business development, risk insight, and stakeholder management.

REVISITING THE ENGAGING and inspiring discussions from our October 2017 roundtable is a good way to launch into the new year. We look forward to more conversations—and a chance to convene with you again at the 2018 roundtable.

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