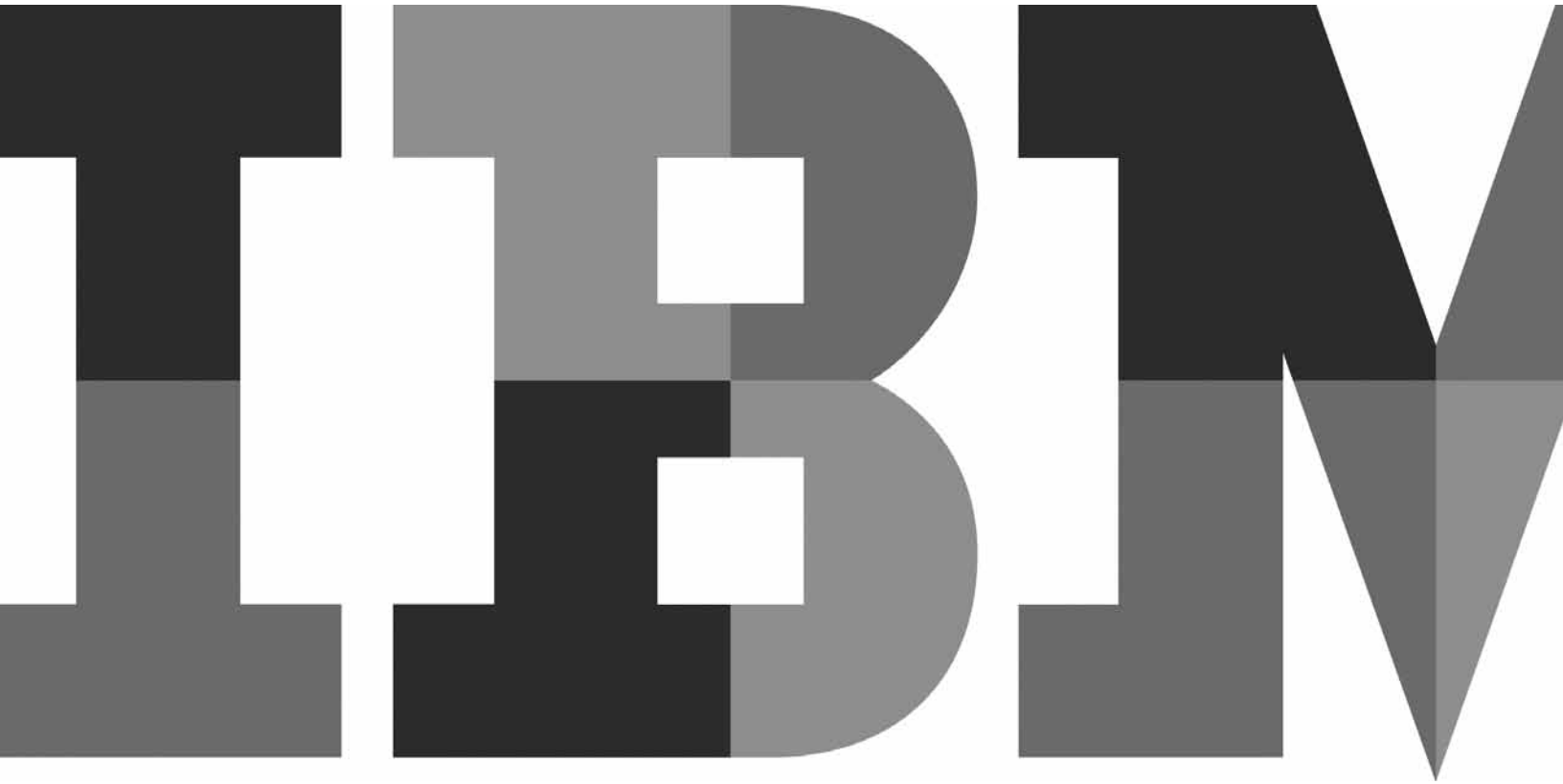


The journey to procurement excellence



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The journey to procurement excellence

Spending on purchased goods and services can represent up to 70 percent of a company's costs, which makes purchasing a critical and strategic priority for improving a company's bottom-line results. Robert A. Rudzki, author of *Straight to the Bottom Line* calculates that by managing this spend better, a typical Fortune 500 manufacturer can boost its return on invested capital to upwards of 20 percent and increase its earnings by upwards of \$100M.

Traditionally the role of the purchasing organization has focused on cost containment where suppliers are squeezed for price reductions and policies are implemented to restrain wasteful "maverick" spending. The opportunities for the role of the procurement organization are so much greater.

So why hasn't the purchasing organization grown beyond its transactional origins?

McKinsey, the respected management consulting firm, in a recent report titled *Inventing the 21st Century Purchasing Organization* stated that the challenges in evolving beyond the transactional role occur because purchasers' activities are often misaligned with company strategy. One large European company cited in this research was more than two years behind

in its efforts to incorporate a product innovation that had been widely adopted by rivals. The problem was that the company's purchasers had a single-minded focus on price, which created tensions with the supplier responsible for the innovation, making collaboration impossible.

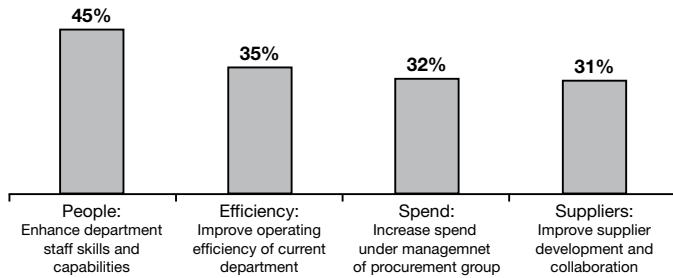
In another instance, a global company with an absence of English-language skills among purchasers organized its purchasing activities according to the nationality of its suppliers rather than by category experts focused on the type of goods being purchased. This structure prevented the company from optimizing its supply base to reduce costs and also made it impossible for purchasers to gain category-specific expertise and credibility with internal customers.

There is a significant difference in the performance and alignment with broader corporate objectives of best-in-class procurement organizations than those that simply deliver at the transactional level.

Best performing purchasing organizations have moved beyond their transactional role and are now significantly contributing to their companies' positive business performance.

Recent studies have concluded that Chief Procurement Officers at best-in-class procurement organizations focus on a broader range of objectives. As a result, their organizations show significantly better cost savings (Figure 1, next page).

Top 3 CPO priorities



Definition of Maturity Class	Mean Class Performance
Best-in-Class: Top 20 percent of aggressive performance scorers	<ul style="list-style-type: none"> • 88 percent of spend under management • 8.5 percent cost savings as a percentage of total spend
Industry Average: Middle 50 percent of aggressive performance scorer	<ul style="list-style-type: none"> • 64 percent of spend under management • 5.2 percent cost savings as a percentage of total spend
Laggard: Bottom 30 percent of aggressive performance scorer	<ul style="list-style-type: none"> • 23 percent of spend under management • 3.7 percent cost savings as a percentage of total spend

Source Aberdeen Group

Figure 1: Focus and performance metrics of best-in-class procurement organizations

How the best-in-class reduce costs

Best-in-class procurement organizations pursue a broader organizational agenda and leverage their organization to do some things significantly better than those in the middle of the industry average. A recent study found that best-in-class companies can have an average of 88 percent of their spend under management and deliver over 8.5 percent cost savings as a percentage of overall spend, whereas the industry average is about 65 percent of spend under management and just over 5 percent in cost savings. Best-in-class organizations also:

- Continually Evaluate Cost Reduction Opportunities:** Best performing purchasing organizations continuously evaluate their environment to identify opportunities to reduce costs. A key way they do so is to take advantage of spend analysis to identify price variance across operating units and plants – and to identify and prioritize areas for strategic sourcing. They also more actively employ contract compliance, so they can extract the savings intended at the time of sourcing. Similarly, they expand the scope of spend under management into new and inefficient categories such as services procurement. Services procurement can account for 30 percent to 60 percent of a Fortune 1000 company’s expenditures, representing over a billion dollars in spending, and the cost savings in this category are between 10 percent to 20 percent of spend.
- Maximize Working Capital:** Best performing organizations increase free cash flow from the business – a critical asset in these economic times. They achieve this through initiatives like reducing inventory through sourcing vendors that implement replenishment models such as Vendor Managed Inventory (VMI); and by reducing accounts payable liability by negotiating better payment terms and early discounts etc. (Figure 2, next page) .

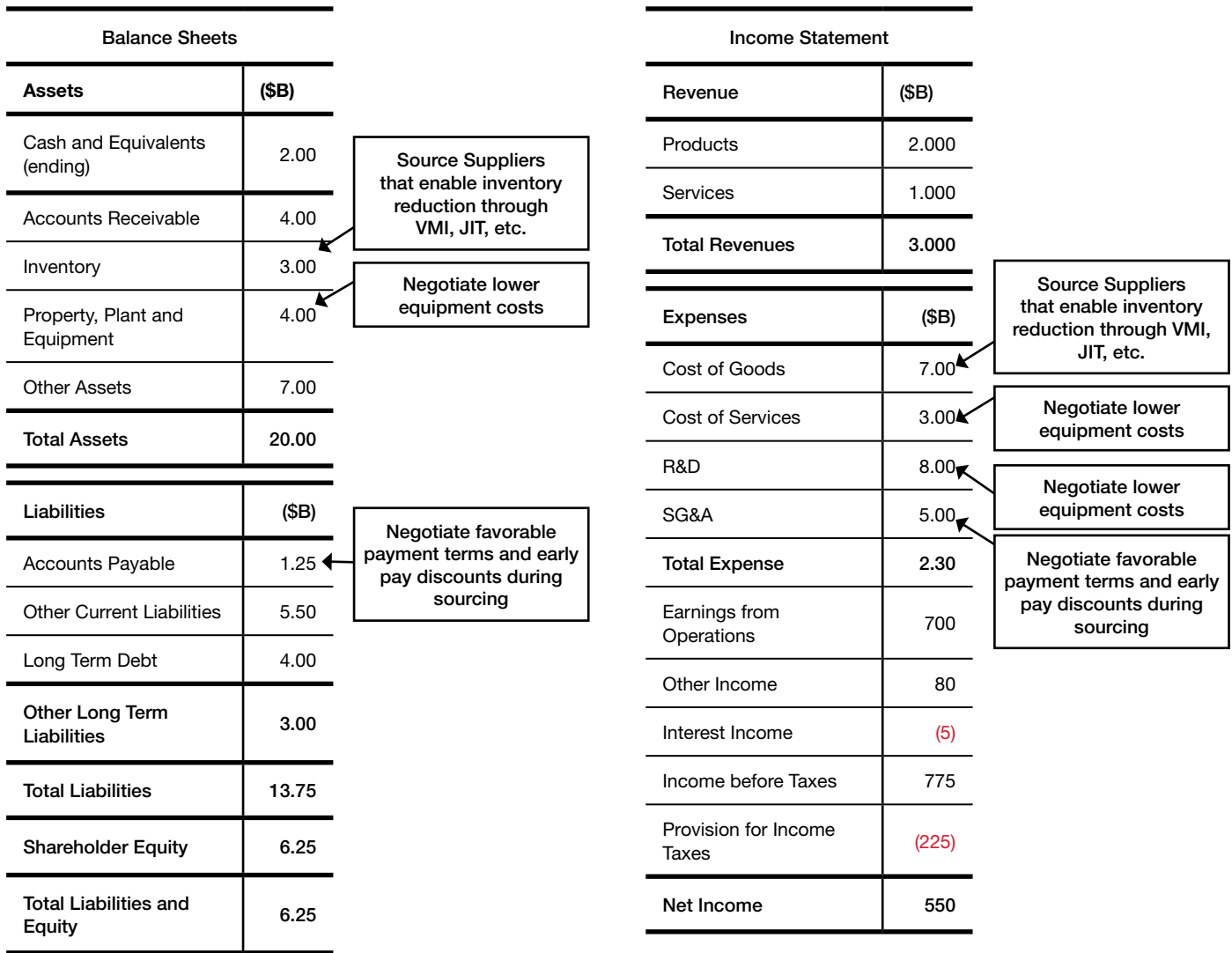


Figure 2: How Procurement Excellence can improve balance sheet and income statement

- **Manage Market Volatility:** The purchasing organization serves as a fundamental link between a company’s supply base and the rest of its value chain. Forward-looking purchasing organizations work closely with suppliers to drive product and process innovations that save money and even offer strategic advantages. This allows organizations to more effectively respond to market changes. In addition, best-in-class purchasing organizations leverage technology to identify issues more quickly than peers and then renegotiate and optimize faster, enabling them to respond to market changes faster. For example, Apple harnessed its supply base for development of the iPod’s hardware and software. They then went on to sell well over 50 million of those supplier-innovated iPods in 2009 generating more than \$3 billion in sales.
- **Manage and Mitigate Risk:** With increasing globalization, shareholder activism and regulatory intensity, risk management remains a key focus for all organizations. Best-in-class procurement organizations actively help their companies identify, manage and mitigate risks. For example, as companies outsource manufacturing and logistics to drive lower costs, reduce capital assets, and beat their competitors to market, they take on additional supply base and currency risk. Similarly, wide fluctuation in commodity prices also creates significant price risk for certain industry segments. Best-in-class procurement organizations that utilize strategic sourcing to create a broad pool of suppliers for key components and then hold those suppliers accountable to excellent performance standards to better manage and mitigate risk.

This paper will examine how best-in-class purchasing organizations are impacting their organizations in two specific areas - reducing costs and lowering risk.

How the best-in-class mitigate risks

Most organizations can enjoy savings of about 2 percent to 6 percent of their total spend by identifying ‘low hanging fruit’ opportunities determined through spend analysis and executed through improved sourcing, better contract compliance, continuous supplier performance management and streamlined services procurement. These savings drop directly to the bottom line.

For a typical manufacturer to show such an earnings increase would require about a 15 percent increase in revenue.

Improvement Area	Performance Impact
Material/ Service Costs	Reduce costs 2 percent to 12 percent through informed strategic sourcing strategies.
Contract Compliance	Improve compliance up to 55 percent and save up to 7 percent through compliance with contract terms.
Inventory Management	Cut excess costs by over 50 percent. Lower inventory costs 5 percent to 50 percent. Reduce expediting costs.
Product Management	Cut unnecessary product introductions by 20 percent. Increase part reuse. Facilitate early supplier integration.

Source Aberdeen Group

Organizations that are procurement leaders typically leverage one or more of the following strategies to achieve greater cost savings:

- **Opportunity Identification:** Identify supply base rationalization opportunities through spend analysis and, prioritize and implement through refinement of sourcing strategies
 - **KPIs:** Define and evaluate key performance indicators and use these as the basis for continuous process improvement
 - **Replenishment Model:** Identify cost savings by streamlining the RFI/RFP process and sourcing suppliers who have proven capabilities in replenishment models that reduce inventory
 - **Automation:** Automate the procurement of complex services and save 10 percent to 20 percent on services spending
- An example of one such best-in-class organization is Heinz. Heinz is a global consumer packaged goods company, with an annual spend of more than \$2 billion across various categories including packaging, ingredients, external manufacturing and indirect products and services. Heinz leverages Emptoris Supplier Performance Management and Emptoris Sourcing solutions for opportunity identification and KPI measurement

as well as to benchmark suppliers and create a consistent system whereby their scale of leverage significantly reduces their procurement costs.

One analysis of procurement operations at global companies found that most (70 percent) of those companies rated as procurement leaders had structured supplier risk and supplier performance management programs in place; as compared to just 5 percent of the companies who were rated as “laggards” in procurement operations. The same study found that a majority of procurement executives expect supplier risks to increase significantly over the next three years.

Best-in-class procurement organizations typically use a comprehensive, technology-enabled framework to effectively manage and reduce their risks. Such a program usually incorporates the following components:

- **Risk Identification:** Best-in-class procurement organizations use technology and information services as a starting point to identify sources of risk. Examples include:
 - Identifying components sourced from either suppliers that are at financial risk or are concentrated in a specific geographic region more vulnerable to political conflicts or currency fluctuations.
 - Identifying components of production that are either sole sourced or come from very specialized suppliers, thus increasing the company’s dependence on them.
- **Risk Prioritization:** Best-in-class procurement organizations perform “what-if” analysis and quantify the impact of supply risk for specific components and commodities. Armed with such analysis, they prioritize actions on those components and commodities that have the greatest potential impact on the business.
- **Risk Mitigation:** Best-in-class procurement organizations also go beyond mere risk identification, to actively manage and mitigate supply base risks. When risks are clearly identified and prioritized, best-in-class companies take action on the higher priority sources of risk. The following chart shows examples of various options based on the impact of a specific risk and the probability of it occurring.

Risk likelihood	(High)	Low Impact, High Likelihood Strategy: Mitigate the Risk. Example: Work with supplier to improve delivery predictability, so buffer inventory can be reduced.	High Impact, High Likelihood Strategy: Eliminate Risk. Example: Dual sourcing if sole-source supplier is financially weak.
	(Low)	Low Impact, Low Likelihood Strategy: Live with the Risk.	High Impact, Low Likelihood Strategy: Share the Risk. Example: Purchase insurance for supply disruption.
		(Low)	(High)

Best-in-class procurement organizations see risk management differently. They understand that risk management is not just part of doing business, but that actively managing and mitigating risks produces operational improvements and boosts the bottom line.

IBM: The role and impact of technology in best-in-class procurement organizations

A unified suite of Strategic Supply Management and Enterprise Contract Management software turns procurement and contracting into a source of sustainable cost savings, improves working capital, and offers powerful capabilities to mitigate risks and improve compliance.

The Emptoris Strategic Supply Management and Enterprise Contract Management solution suite integrates six powerful solutions that may be deployed flexibly and modularly to meet the unique demands of a global business.

The following chart shows the key components of the IBM Emptoris solution:

IBM Solutions
IBM Emptoris Program Management ties the Emptoris suite together with integrated dashboards and portals that provide tailored category-, supplier-, spend-, buyer-, and executive-centric views into your information.
IBM Emptoris Spend Analysis empowers you to identify savings opportunities quickly and monitor the effectiveness of current initiatives across every category of spend leveraging automated spend classification that delivers the most accurate and granular spend visibility available.
IBM Emptoris Sourcing automates all your sourcing events from reverse auctions to complex multi-stage negotiations and empowers you to realize the best value, not just the best price, from your supply base by factoring cost, risk, and performance drivers into decision-making.
IBM Emptoris Services Procurement delivers transparency into an organization's services spend and automates the purchasing workflow associated with each unique complex services category. It allows you to make strategic decisions about and gain control over services demand, pricing, supplier performance and compliance risks.
IBM Emptoris Contract Management delivers greater control and more profitable sales and procurement contracts by automating and optimizing the management of contracts from creation and execution through performance monitoring, analysis, and re-negotiation.
IBM Emptoris Supplier Lifecycle Management manages supply base performance across the entire supplier lifecycle. From on-boarding and registration to efficient tracking and evaluation of supplier performance - this is a complete risk mitigation solution.
IBM Emptoris' Rivermine Telecommunications Expense Management solutions help global enterprises gain visibility into and control over telecommunications spend.

Best-in-class procurement organizations across the globe have embarked on a successful journey to procurement excellence by leveraging the Emptoris solution suite. Syngenta, a global agribusiness company, utilizes Emptoris for spend analysis, strategic sourcing and enterprise contract management, for both its direct and indirect materials, across its global operations in 90 countries. Emptoris enables Syngenta to develop a global contract framework for suppliers; gain single data point for all sourcing activities and provide visibility into spend on a global basis.

The HM Revenue and Customs department of the British Government is similarly using Emptoris spend analysis, strategic sourcing and enterprise contract management capabilities to source and manage more than £2 billion of their annual spend. Leveraging Emptoris, they were able to implement reverse auctions, assess and ensure security credentials of key suppliers, and review sustainability/recycling capabilities and performance data for their supply base, among other benefits. The organization implemented the entire Emptoris solution suite and drove broad adoption within their organization in just six months time.

Similarly Motorola, which uses Emptoris Sourcing for both direct and indirect spend, has publicly stated a savings of more than \$600 million over three years from its procurement operations. Savings were realized not only in pricing, but also in reduced travel, improved cycle time and significantly higher operating efficiency.

Further examples of the impact of best-in-class procurement and detailed case studies are available at www.emptoris.com/knowledge-center and www.emptoris.com/knowledge-center/success-stories.

Summary

The journey to procurement excellence requires driving knowledge and information across the organization; creating global processes; and deploying the right technology and using it in innovative ways to create new insights and continuously measure and improve performance. Best-in-class procurement organizations choose Emptoris, an IBM company, for their journey and as a result, enjoy lower procurement costs, improved working capital performance, better risk management, and superior management of market volatility.

Recommended reading:

We recommend the following whitepapers as part of the Journey to Procurement Excellence series:

Surviving and thriving with world class supply management

Written from the perspective of the executive office, this white paper explains how world class supply management can directly drive improvements in a company's return on invested capital (ROIC) and earnings per share (EPS).

An executive guide for managing risk in global sourcing

Of all of the procurement and supply chain trends to reach the executive boardroom over the past decade, global sourcing has elevated itself to a choice place. It is dominating the focus of a great many conversations because of its massive impact on cost reduction. Read this executive guide to learn how to better manage risk in global sourcing.

Achieving spend visibility: benefits, barriers, and best practices

Learn about the many benefits and substantial bottom line savings companies today are realizing with more complete and accurate views into their enterprise-wide spending, and gain perspective on the best practices they employ to overcome many of the common barriers to achieving better spend visibility.



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