Procurement Transformation
Objectives

- Provide an Overview to Procurement Transformation:
  - Strategic Sourcing
  - Total Cost of Ownership
  - Global Sourcing
  - Supplier Assessment & Development
  - Make vs Buy
  - Value Engineering
  - Capability Development
Table of Contents

I  Why is Procurement Important?

II  What is Procurement Transformation?

III  How is Procurement Transformation performed?
Direct materials costs typically represent **50-80% of COGS** and **30%-50% of revenues** in most industries.

Indirect procurement costs (e.g., capital equipment, office supplies, MRO, IT, travel) absorb as much as **15 – 25% of revenues** for most companies.

Every dollar saved in procurement is a **dollar to the bottom line**.

The current competitive climate requires greater efficiency in costs to **maintain and grow margins**.

*Source: Accenture Client Experience; Accenture SVA Analyses; CAPS Benchmark Studies*
Financial Impact of Procurement Transformation

Improvements in procurement have a significant impact on a company’s profitability and associated shareholder value

— $5 Billion Company Illustration —

<table>
<thead>
<tr>
<th>($M)</th>
<th>Baseline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>5000</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>3000</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>2000</td>
</tr>
<tr>
<td>SG&amp;A Expenses</td>
<td>750</td>
</tr>
<tr>
<td>Operating Income</td>
<td>1250</td>
</tr>
<tr>
<td>Addressable Spend</td>
<td>2000</td>
</tr>
<tr>
<td>Increase in Operating Income</td>
<td></td>
</tr>
<tr>
<td>% Increase</td>
<td></td>
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</table>

Spend Reduction Scenario

<table>
<thead>
<tr>
<th></th>
<th>5%</th>
<th>15%</th>
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<tbody>
<tr>
<td>Addressable Spend</td>
<td>-100</td>
<td>-300</td>
</tr>
<tr>
<td>Increase in Operating Income</td>
<td>100</td>
<td>300</td>
</tr>
<tr>
<td>% Increase</td>
<td>8%</td>
<td>24%</td>
</tr>
</tbody>
</table>

Taking this farther...

If we assume that this company makes a 5% improvement on the addressable spend, has a 33% income tax rate, and a PE ratio for its stock of 20:1, the equity equivalent is an increase of $1.3 billion of shareholder value.

\[(\$100M \text{ in savings} - \$33M \text{ in taxes}) \times (\text{PE of 20}) = \$1.3 \text{ billion}\]
Common Procurement Challenges

In working with many large companies on hundreds of supply chain engagements, we have found that a common set of issues and challenges often impacts procurement:

- **Multiple purchasing units** exist across the company where planning and purchasing are performed and managed independently:
  - Each site has duplicate personnel
  - Procurement is locally negotiated and locally executed
  - Several suppliers are common across the various independent purchasing units
  - Inventory information is not tracked at a global level (across sites)

- Companies **do not leverage scale**, exploit volume/preferred customer discounts; **limited control** on managing the number of suppliers

- **Information exchange with suppliers limited** to the necessary operational level, rather than extensive data exchange to improve mutual logistics performance

- Supplier **performance not actively measured** and monitored against comprehensive qualitative and quantitative criteria

- **Little differentiation** in purchasing activities for strategic purchases versus routine purchases

- Rampant, **uncontrolled “shadow spending,”** inability to proactively manage demand

- Lack of a true global purchasing system – **numerous paper based, ad-hoc processes**

**INCREASED PROFESSIONALISM**
To effectively overcome the many challenges facing procurement, companies should not focus on individual projects to drive incremental benefit, but rather embark on a holistic step-change improvement in performance – a Procurement Transformation.

**Procurement Transformation**
- Best Practice Sourcing process +
- Process enabled by eSourcing solutions +
- High Caliber Buyers deployed optimally

**Enabled Strategic Sourcing**
- Best Practice Sourcing process +
- Process enabled by eTools
  - Cycle time reductions
  - Better Information
  - Automated transactions

**Traditional Strategic Sourcing**
- Best Practice Sourcing process
  - Total Cost of Ownership
  - Multi-functional team

Benefits may fade away over time due to difficulty to sustain the Best Practice process.
Table of Contents

I  Why is Procurement Important?

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Procurement Transformation Summary

• Procurement Transformation is an *integrated multi-year program* that provides a truly transformed procurement organization, well on the road to *best-in-class status* with the ability to constantly reinvent itself.

• Generates *immediate savings* through strategic sourcing – typically reaching *5%-15%* of total addressable spend – and allows for a *self-financing* structure where savings generated are *reinvested* in capability building initiatives.

• Leverages *best practice processes* and key enablers to achieve *sustainable procurement capabilities* within the client’s organization.
The Procurement Transformation Program requires the re-engineering of all drivers of procurement value creation.

**Processes**

- Target Setting & Performance Monitoring
- Strategic Sourcing
  - Strategy Development
  - Contracting
  - Supplier Management/Development
  - Requisitioning
    - Ordering
    - Receiving
    - Paying

**Enablers**

- Organization
- People
- Systems

**Setting aggressive targets to drive the need for change**

**Realizing benefits through best practice sourcing and requisitioning**

**Sustaining benefits by developing best-in-class capabilities**

- Deploying buying resources optimally in the organization
- Recruiting, training and developing the best buying resources
- Equipping these resources with accurate and fast information to support superior decision-making
The Strategic Sourcing methodology is deployed to help drive a lower total cost of ownership.
Procurement Transformation focuses on "Total Cost of Ownership" to identify Cost Reduction Opportunities.
Table of Contents

I  Why is Procurement Important?

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Procurement Transformation

Strategic Sourcing
- Strategic Sourcing
- Global Sourcing
- Cost sheets & Costing Norms

Supplier Development
- Supplier Development & Partnership Programme
- Supplier Cost Reduction
- Alternate Source development

Make vs Buy & Value Engineering
Make vs Buy
Value Engineering

Capability Development
Organization
People
Systems
Procurement Transformation Approach

![Diagram showing the steps of a procurement transformation approach]

- **Strategy Development**
  - Internal Analysis
  - External Analysis
  - Develop Strategy
  - Screen Suppliers

- **Contracting**
  - Issue RFPs (Domestic/Global)
  - Shape & Negotiate Value Propositions
  - Implement Agreements

**Capability Development**

- People
- Organization
- Systems
Total Cost of Ownership (TCO) is an assessment of all acquisition and ongoing operating costs associated with the purchase of cables for capital projects as well as ongoing maintenance.

This chart shows the generic components for a Total Cost of Ownership for cables.

There are a number of “pre-purchase” cost elements around design, forecasting and procurement.

<table>
<thead>
<tr>
<th>Pre-Purchase Costs</th>
<th>Capital Projects</th>
<th>Purchase Price</th>
<th>Ongoing Operating Cost</th>
<th>Maintenance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Engineering &amp; Design</td>
<td></td>
<td>Material Cost</td>
<td>Preventative Maintenance</td>
<td></td>
</tr>
<tr>
<td>Forecasting</td>
<td></td>
<td>Labor Cost</td>
<td>Reactive Maintenance</td>
<td></td>
</tr>
<tr>
<td>Procurement Effort</td>
<td></td>
<td>Profit</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Logistics/Transportation</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Installation</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Inventory Carrying Cost</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Cost of Non-Delivery</td>
<td></td>
<td></td>
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</tbody>
</table>
Need to implement a comprehensive approach to China Sourcing

Strategy & Planning

1. Category Assessment
   - Review of total spend profile
   - Country profiling
   - Total Cost of Ownership modeling
   
   Plan of what to source where

2. Risk Assessment
   - Country Risk Assessment
   - Industry Risk Assessment
   - Supplier Risk Assessment
   
   Mitigation Strategy

Sourcing Execution

3. Supplier Prequalification
   - Supply market intelligence
   - Supplier search
   - Qualification/On-site Audits
   
   Short list of Qualified Suppliers

4. Sourcing
   - Differentiated bid strategies
   - Fact-based negotiation
   - Contracting
   
   Selected Suppliers

Long-term Capability Development

5. Supplier Integration
   - Production process qualification
   - Quality & Delivery assured
   - Order-to-Delivery process defined
   
   Supplier integrated in Supply Chain

6. Fulfillment
   - Optimized logistics solution
   - Inventory locations
   - Global Trade Management
   
   Products delivered to own sites

7. Supplier Development
   - Assessment of capability gaps
   - Lean mgt program, “6 Sigma”,
   - Workshops and training
   
   Capable Suppliers

8. Local Procurement Office
   - Organization design & “3P IPO”
   - Staffing, recruiting, training
   - Integration to global organization
   
   Established Procurement Office
Supplier Development

**Supplier Assessment**
- Select pilot category
- Compare the different suppliers in the category
- Select supplier for supplier development effort
- Identify Capability Gaps / issues

**Supplier Development**
- Conduct work-out sessions, identify root causes and develop solution themes
- Prioritise opportunities & develop implementation plan
- Initiate Implementation and Monitor results
Make vs Buy Analysis at an Auto-Electricals Company

**Strategic Importance Parameters**
- Does it impart a competitive edge to the company?
- How critical is it from the point of view of product performance and quality?
- Does the company have opportunity to gain competitive advantage / technology lead?
- Does it involve any risk of sharing proprietary knowledge on technology or design with suppliers?
- How specialised are the manufacturing skills and physical assets related to sub-assembly?

**Company Capability Parameters**
- How are the company’s manufacturing capabilities / technology relative to potential suppliers?
- Do we have any cost advantages / economies of scale as compared to potential suppliers?
- Does the company have superior quality control capabilities / processes as compared to potential suppliers?
- What is the level of capital investment / resource allocation planned as compared to potential suppliers?

**Make Buy Decision Matrix**

<table>
<thead>
<tr>
<th>Strategic Importance</th>
<th>Company Capability</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Low</td>
<td>Low</td>
</tr>
</tbody>
</table>

- **MAKE or BUY**
- **MAKE**
- **BUY**

Grey Zone - Make / Buy decision to be based on detailed Economic Analysis

Case Study: Make vs Buy Analysis at an Auto-Electricals Company
Accenture experience indicates that Product Cost Reduction Initiatives can result in ~ 3-5% savings in addition to strategic sourcing initiatives.

### Initiative Description

<table>
<thead>
<tr>
<th>Initiative</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>Value Engineering</td>
<td>Initiatives to reduce product costs through changes in type of material used, amount of material used, design modifications, manufacturing process changes etc</td>
</tr>
<tr>
<td>Standardisation</td>
<td>Initiatives to reduce component variety thereby increasing component volumes</td>
</tr>
<tr>
<td>Feature-Rationalisation</td>
<td>Rationalisation/conversion of low value adding features to options</td>
</tr>
<tr>
<td>Indigenisation</td>
<td>Developing imported items with local suppliers</td>
</tr>
<tr>
<td>Competitive Cost Analysis</td>
<td>Methodology and supporting tools to perform competitive product cost analyses and feedback results to product development and procurement</td>
</tr>
</tbody>
</table>
Capability Development Approach - People & Organisation

**Procurement Capability Diagnostics**

**Finalise Organisation structure, Job descriptions and KPIs**

**Define Competency Framework & Requirements**

**Conduct Skills Assessment**

**Identify capability gaps & solution themes**

### Deliverables

- **Procurement Capability Survey results**
- **Org structure**
  - Manning levels
  - Job descriptions
  - KPIs
- **Procurement Competency Framework**
- **Skills Assessment**
- **Gap Closure Plan**