

Hitting the bulls-eye: Value Sourcing

Transforming Procurement from old school to new age



The traditional procurement model does not help organizations achieve additional and sustainable financial targets. The CFO is asked to use the procurement department as an internal value partner to address and discuss new ways of spending the budget; often called value sourcing. Cost savings of up to 25-30% can be realized in many industries such as automotive, consumer goods, energy & utilities, financial services and engineering & manufacturing. In this viewpoint, Arthur D. Little showcases three project experiences from the telecommunication and travel & transportation industry to explain the goals, mode of operation and the impact of value sourcing.

Rethinking the traditional role of procurement

Today, many industries face constant performance and cost pressure, and search for new and innovative ways to improve their financial situation. Hence, optimization and the strategic alignment of an enterprise are the major challenges for top management.

Typically, CFOs have a limited toolset for cost optimization. The most essential ones are 'controlling' and 'procurement.' Both are difficult to utilize as often 'controlling' only defines budgets and monitors compliance, whilst the function of traditional 'procurement' is seen as "purchasing at the cheapest price" with limited impact on entire cost types.

This traditional procurement approach is often observed in organizations but is only impactful in tenders and negotiations. This is also one of the main reasons why procurement departments are not considered to have a strategic function within an organization (see Figure 1). The constrained levers result in limited savings and an insufficient alignment with other departments.

Arthur D. Little conducted a cross-industry survey among 200 companies regarding the strategic function of procurement within the company. More than two-thirds of the participants assessed the positioning of their procurement department as "not strategic". Only 26% of the companies consider procurement to have a strategic function. Additionally, the cooperation between procurement and other departments

is a field for improvement as only 33% of companies have established "live interfaces" between them.

The **new value sourcing concept** shows how additional business value can be generated through an integrated commitment to procurement between business departments. Value sourcing typically covers the classical procurement levers as well as new strategic levers (Figure 2 overleaf).

When focusing on cost optimization with classical procurement levers alone, advanced cost levels cannot be reached. Due to the maturity and full exploitation of these levers, only marginal savings of around 2% to rarely 7-8% can be achieved. However, applying a combination of 'Classic Procurement' and 'New Strategic' levers allows cost optimization and value creation to be addressed simultaneously.

Figure 1: Strategic positioning of procurement within companies

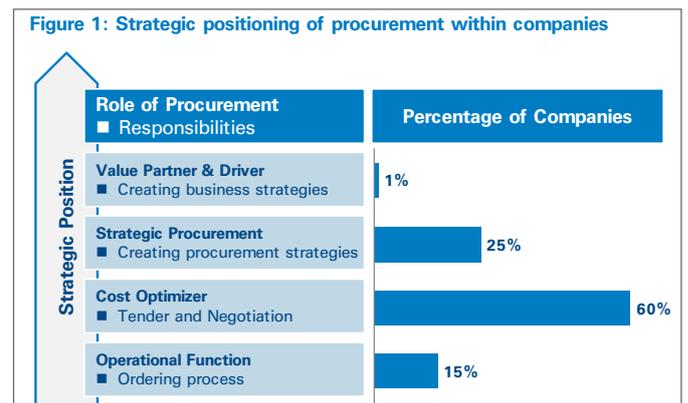
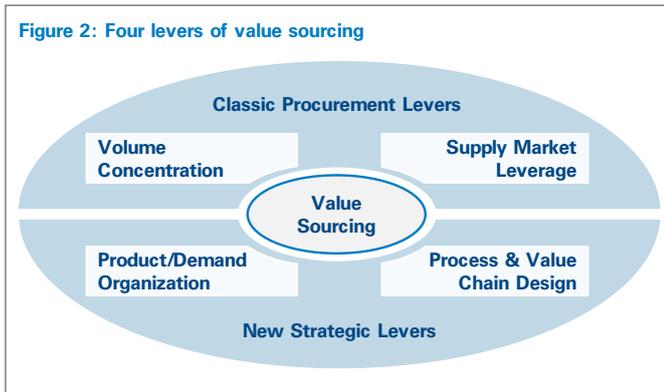


Figure 2: Four levers of value sourcing



Overcoming challenges of value sourcing implementation

Implementing the concept of value sourcing within an organization requires new standards of C-level commitment, qualifications, methods, communication and cooperation with functional departments. Companies with traditional procurement departments will face four major challenges when implementing value sourcing:

- **Aligning targets** between all departments based on company targets is a major challenge because often procurement and corresponding departments have neither the same strategic focus nor aligned KPI-targets.
- **Strategic interaction** of the procurement with each department in regard to hierarchy and processes is not sufficient. Roles and responsibilities are often not defined.
- **Traditional qualification standards** of the existing personnel in procurement are regularly not sufficient to generate new impulses. The lack of technical know-how, soft-, leadership and communication skills prevent an appropriate realization.
- **Missing tools and process definitions** impede a smooth implementation of value sourcing within an organization.

Business and procurement expertise

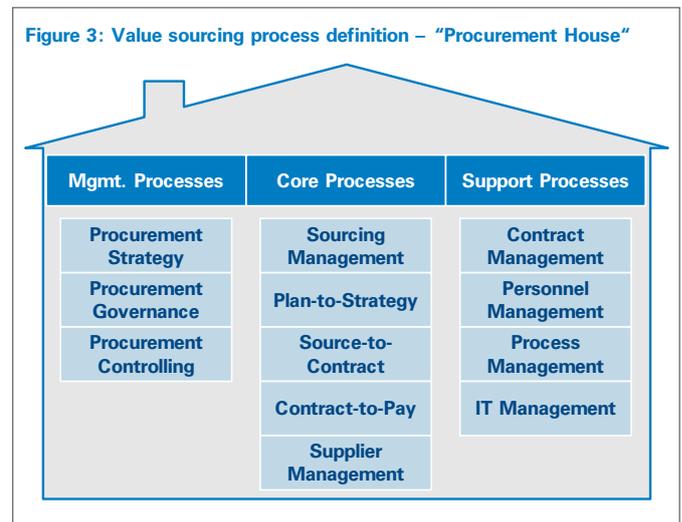
To solve portrayed challenges and to fulfill the high expectations of cost savings, a new understanding of the role of procurement is necessary: the role of a business value driver. This means that procurement initiates and drives strategic discussions with all relevant stakeholders.

The role requires a combination of functional business expertise and procurement know-how. A modern procurement organization incorporates this knowledge to fulfill its mission: optimizing the cost-benefit-ratio of procured goods as well as finding new ways to prevent or reduce costs. Hence, cost types (material and personnel costs) need to be assessed holistically. Therefore procurement has to act as a value partner of the functional departments (IT, marketing, sales, engineering etc.) and not as a service provider.

A balance has to be found between the realization of requests of functional departments and optimizing their demands. This means finding an optimum position within the strategic continuum (cf. Figure 1 overleaf)

In order to ensure a goal-oriented interaction between procurement and other departments, clear processes and responsibilities in procurement have to be defined. For example, best-in-class procurement departments establish so called "Procurement House" (Figure 3) with management, core and support processes. Due to the new strategic relevance of value sourcing, existing process models need to be adapted accordingly. Ideally, a direct interlinkage between the processes "sourcing management" and "plan-to-strategy" should be secured.

Figure 3: Value sourcing process definition – "Procurement House"



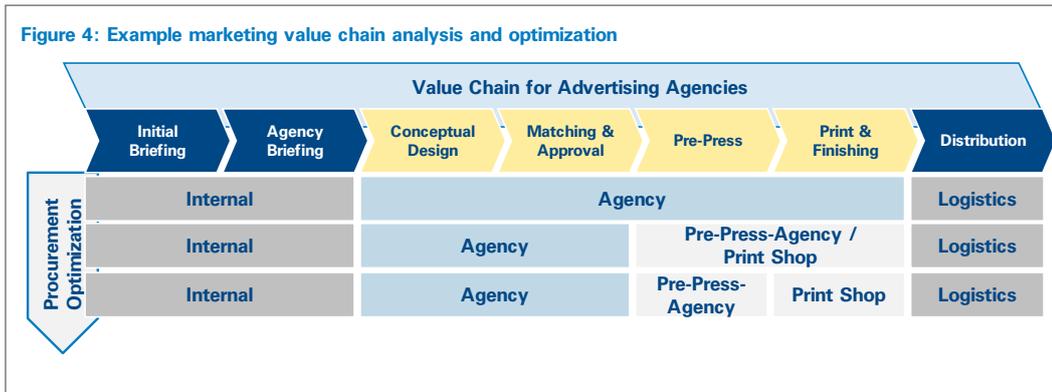
Based on recent case examples, Arthur D. Little will showcase the procedures, methodologies and impact of a modern procurement function in corporations on real-life assignments.

Identify the real value of your marketing service in travel & transportation

Functional departments have a narrow scope when it comes to identifying the value created from the demanded products. It becomes especially true for marketing and creative products. Therefore, consistent application of **value chain analysis** and **re-design** helps to reveal the real value of the services. This analysis provides the possibility to critically evaluate the value of each chain link and determine suitable suppliers with appropriate remuneration models (Figure 4).

To achieve an improvement in the output of your marketing services, companies are advised to design their value chains specifically to the corresponding products (e.g. print, commercials, outdoor, online etc.). It is often beneficial to separate creative and productive services.

Figure 4: Example marketing value chain analysis and optimization



Introducing a new IT demand management process to allow for strong collaboration between line departments, IT and procurement, enables the potential of **reassessing the actual requirements** from scratch. The core of the new process is an extensive interaction of all stakeholders along the entire project. This includes

The exact definition of the single steps in the value chain provides a solid foundation for the **specification of marketing services** and the traceability of an agency's delivery. Additionally, **rate cards and defined skill-levels** provide a basis for price comparisons between advertising agencies (e.g. among career levels) and the client's actual requirement regarding the individual jobs.

To leverage the full potential of procuring marketing services, strategic procurement should effectively re-design marketing processes in collaboration with the department. Main **cost drivers** in marketing are inefficient briefings and unnecessary iterations, which can be avoided by the introduction of effective and efficient **procurement processes** and appropriate quality-gates; for example, the introduction of a target price per campaign and maximal iterations per job respectively. Furthermore, it can be advisable to define **fixed prices** for standard "marketing crafts". The processes have to be part of a "House of Marketing" targeted at improving the input-output ratio in marketing.

With the above mentioned activities, advertising agencies can reduce time spent on jobs by 15% - 25%. **Cost savings of up to 17%** could be achieved.

Additional application of such marketing value chain separation can be introduced in all industries (e.g. automotive, FMCG, electronics etc.) to identify the best level of value creation for each supplier.

Broaden the horizon of IT demand management in telecommunication

In most enterprises, IT divisions only have a service function for delivering specified requirements set by the corresponding departments. Often, the requirements contain a pre-chosen system and supplier. In these cases, procurement departments only serve with negotiations and simple purchasing realization. Hence, the freedom of action for procurement and IT divisions is very limited. Therefore, the purchased solutions tend to be more conservative than innovative and miss optimization potential.

the initial idea, the definition of requirements and analysis of alternatives, up to the implementation of the final solution.

In the case of customer relation management (CRM) systems in telecommunication industries, it was shown that the involvement of all stakeholders and rethinking the demand could create a **cost reduction of 20%**. Broadening the horizon of the demanding departments can lead to the inclusion of innovative solutions. For example, in contrast to "classical" solutions, Cloud service providers could gain better performance and usability without the expense of functionality. Other potential industries for demand reassessment and solution redesign (e.g. cloud service solutions) are automotive and consumer goods.

Reassessing the needs and requirements for customer interaction in travel & transportation

Today customers freely choose and switch channels to interact with companies. The vast majority of interactions with the travel and transportation business are performed by telephone. Online transformation of customer interactions by offering online self-service tools for example can be a demanding task since the trade-off between cost optimization and the increasing value of the service has to be assessed. Dealing with such implementation, procurement as well as customer management business units must be cross-linked to reach an optimum solution.

A major success factor is the **cross functional view** on the total customer interaction volume that creates transparency. The main lever lies in the identification of potential topics for customer inquiries that can be met with a more convenient and cost-efficient channel. Therefore, the precise analysis of historic interaction volumes across the company by reason of contact and interaction channel is key. A recent case example from the travel & transportation industry shows that switching designated interactions to an online channel can **reduce costs by up to 18% -25%**. A leading global telecommunication company was able to reduce its budgets for external call center providers by up to 45% over three years after implementing an online self-service portal!

Large quantities of interactions such as reservations can be transformed to an online self-service, using the appropriate customer-oriented tools. Secondary functionalities like email confirmations or calendar appointments may additionally increase the customer value. Initial set-up costs for online self-service tools can be refinanced quickly due to the reduced personnel expenditures and increased process efficiency. In addition to the reduction of interactions by inbound telephony, fewer complaints were reported with regards to the process of making and changing reservations.

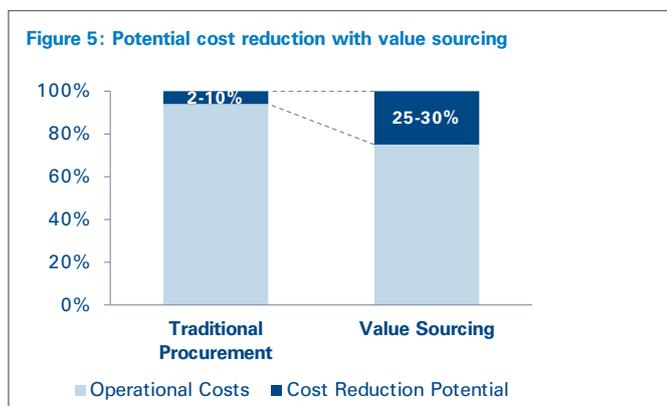
Besides travel & transportation, other industries such as financial services, insurance and energy & utilities can greatly benefit from such online transformation solutions.

Using value sourcing for competitive advantage

Reconsidering the traditional function of procurement as an operational tool is key for the performance of a company. An **integrative solution** of the procurement within the strategic alignment of the company increases the leverage on costs and therefore the competitive advantage. It is shown that in practice the new approach of value sourcing can **gain savings of up to 25-30%** depending on degree of maturity of the organization compared to marginal savings possible with established procurement methods (2% - 10%).

Arthur D. Little has helped a number of clients implementing cross functional value sourcing in multiple working areas and industries and helping positioning procurement as a value driver. Our consultants consistently develop enduring next generation solutions to master our clients' business complexity and to deliver sustainable results suited to the economic reality of each of our clients.

Figure 5: Potential cost reduction with value sourcing



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Arthur D. Little

As the world's first consultancy, Arthur D. Little has been at the forefront of innovation for more than 125 years. We are acknowledged as a thought leader in linking strategy, technology and innovation. Our consultants consistently develop enduring next generation solutions to master our clients' business complexity and to deliver sustainable results suited to the economic reality of each of our clients.

Arthur D. Little has offices in the most important business cities around the world. We are proud to serve many of the Fortune 500 companies globally, in addition to other leading firms and public sector organizations.

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