

Value Sourcing

The resurgence of procurement excellence as a source of sustained competitive advantage

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Sustained value growth over short-term cost reductions

The procurement function is often torn between hard-to-reconcile goals. Procurement costs may need to be reduced in order for a company to remain internationally competitive. But the company also needs to build up and coordinate an effective, long-term supplier network, one that not only guarantees reliability and quality, but also facilitates jointly developed innovations.

Oliver Wyman's Value Sourcing approach applies tools that are designed to create long-term value gains, as a complement to the customarily applied strategic procurement optimization techniques. While we use traditional techniques such as volume bundling, e-procurement, and best-practice sharing in our Value Sourcing approach, we also work to optimize the long-term value contribution of the procurement function, drawing on our deep, global expertise.

The potential value contribution of the procurement function depends on the particular needs of a company. Manufacturing companies, for example, have pared their production operations significantly over the past decades. As a result, they have no choice but to engage in close cooperation with their suppliers in order to develop new products and/or optimize their value-creation processes.

Apart from customary purchasing criteria such as price, quality, and reliability, it is increasingly important for the procurement organization to cultivate long-term relationships with system partners and key suppliers and make good use of their particular expertise. This is the best way to jointly develop new products and devise alternative ways to create value in the future.

A strategic, long-term perspective does not mean that Value Sourcing will cost more than it returns in the short run. Oliver Wyman's project experience has shown that investments in Value Sourcing programs often pay for themselves in seven to nine months.

The integral role of procurement in the value creation strategy

Growing strategic importance of procurement

To keep pace with intensifying global competition, companies are compelled to concentrate on their core competencies. However, this increases the proportion of value created externally, making the company more dependent on its suppliers. Aside from considerations of price, quality, and reliability, supplier dependency also extends to a company's innovation capacity.

Consequently, companies will have to be adept at creating value in cooperation with their suppliers. In this respect, most sourcing strategies are short-sighted because they focus on reducing procurement and process costs, instead of forging a role for procurement as an integral link in the value chain. As a strategic tool, Value Sourcing is certainly effective at lowering costs quickly and effectively; but beyond that, it can also be used to permanently improve profitability across the value chain. Value Sourcing can address three critical areas: achieving sustained cost leadership, creating value growth jointly, and boosting innovation within the supplier network.

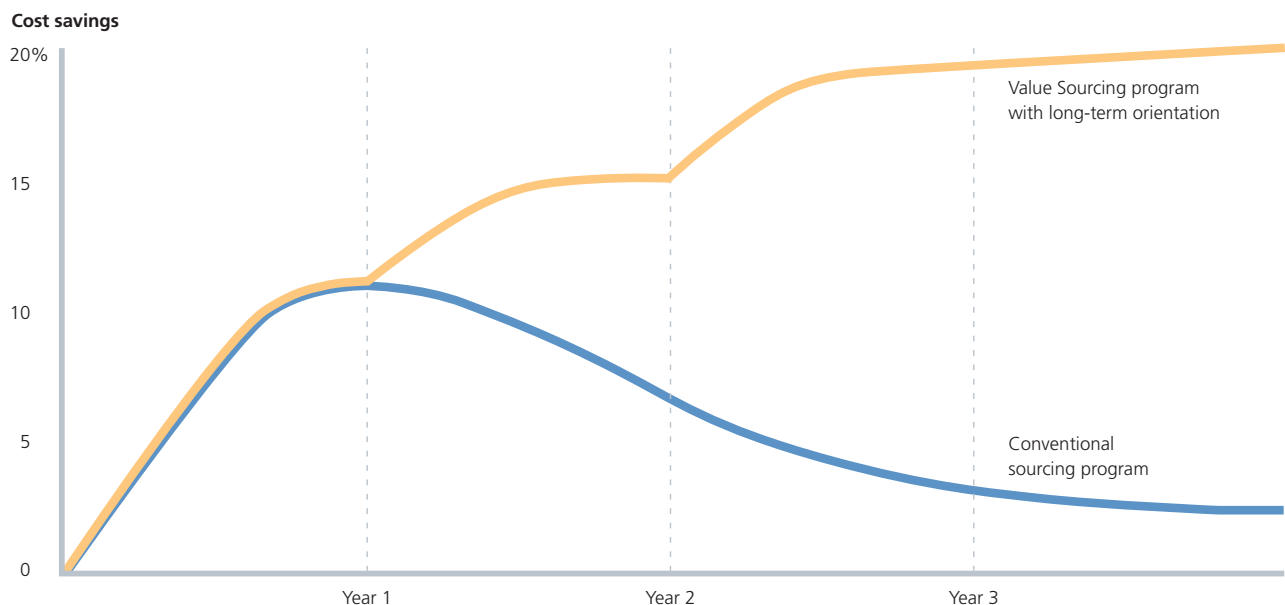
Long-term cost reduction

Purchased inputs account for more than half of the production costs of manufacturing companies, on average. Given this situation, even conventional sourcing optimization techniques can yield a profit improvement of 10%. However, these gains often fizzle out after a year. Under the Value Sourcing approach, on the other hand, one's vision extends further out and seeks to create structures that will permanently improve profitability across the value chain. For this to happen, the cost structures and processes of the entire supplier network need to rise to world-class levels. This requires continuous monitoring and benchmarking of both internal and external links of the value chain.

New growth potential

Other sourcing programs tend to reduce the role of procurement to cost efficiency, delivery reliability, and quality. But this narrow scope neglects the strategic potential of procurement as a growth engine. In many industries, sustained value growth hinges on having deep knowledge of supplier capacities, competencies, and reliability. Successful compa-

Value Sourcing achieves maximum and sustained cost savings



Increasingly complex products and firm specializations raise the importance of long-term cooperation within value creation networks.

nies such as Toyota, H&M, and Acer continually monitor the external links of their value chains in order to identify new growth opportunities. The procurement function can help create new markets for the company by always looking for new cooperation possibilities. And established supplier relationships can be exploited for mutual referrals, joint bids, innovations, and exclusivity rights.

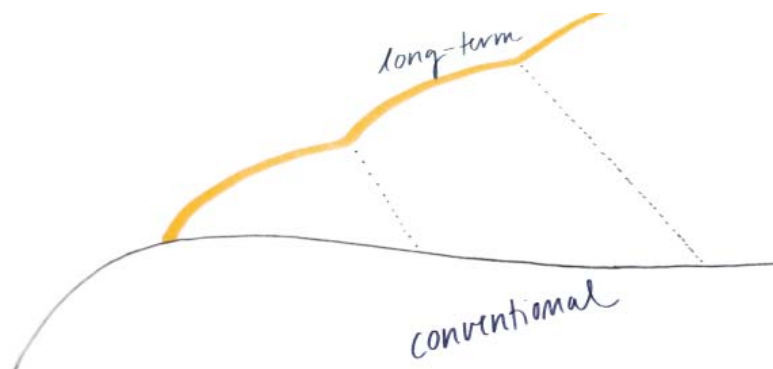
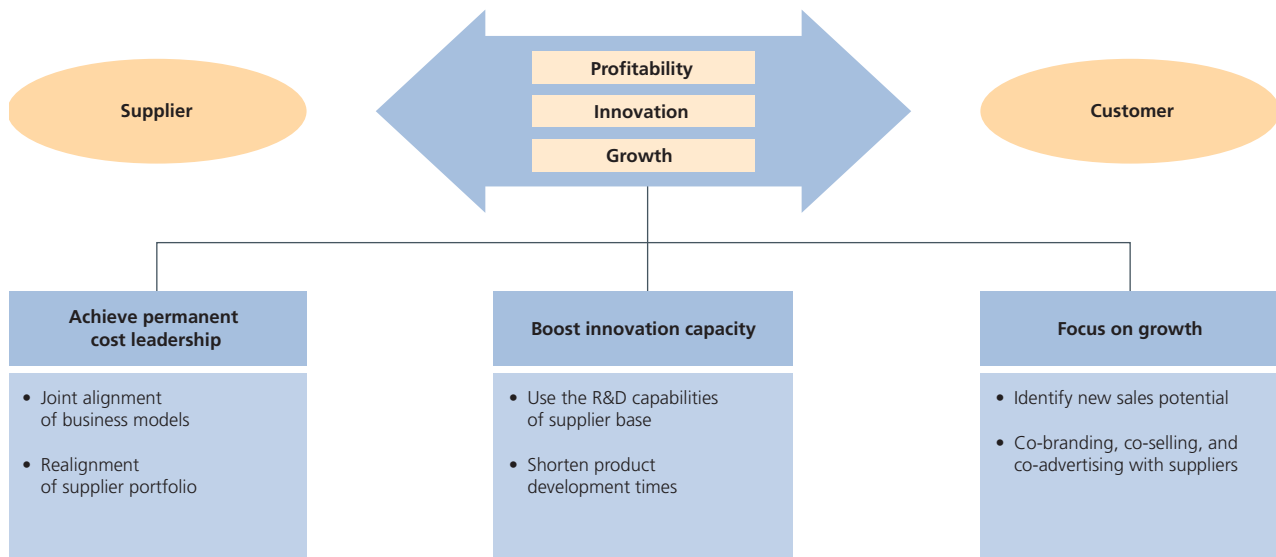
Innovative partnerships

In most cases, technologically revolutionary products and innovative processes are brought to market without the active cooperation of suppliers. Today, as the depth of in-house development and production continues to shrink, the innovation capacity of any company depends on the quality of relationships in the supplier network. The ability to create results-oriented innovation partnerships thus is becoming a critical success factor.

Creating long-term network structures

To meet these challenges, the procurement function must be reconceived with an eye to establishing and effectively managing supplier networks. And the new procurement organization will need a completely different competency profile, one that emphasizes collaborative attitudes, open communication, and faith in the customer-supplier relationship. Best-practice companies routinely involve their supplier network in their planning processes for product development and marketing. The institution of suitable processes and structures is an integral objective of Value Sourcing programs.

Value Sourcing strengthens profitability, innovation, and growth



Seven levers for sustained value growth

Effective Value Sourcing programs use seven levers to generate sustained value growth, regardless of the industry. The object of each lever is to design the entire value chain, from raw materials to final product, for maximum value growth. A drawback of conventional sourcing programs is that they are often too narrow in scope, addressing only the stages directly before or after a given link of the value chain.

Each Value Sourcing lever comprises a portfolio of proven tools that can be selected to reflect the scope of the program in question. All of the levers have a common goal: to transform the procurement function so that it is geared to long-term value growth instead of short-term cost reductions.

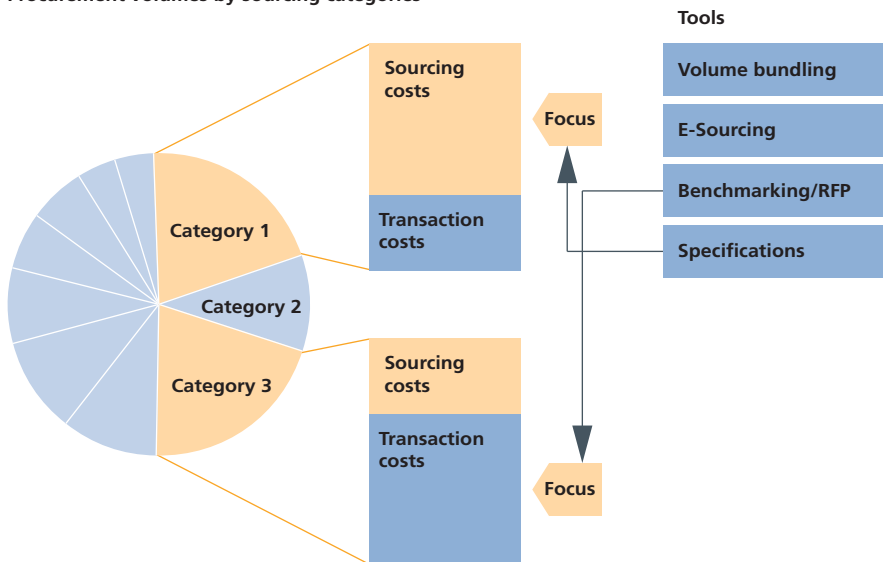
The first step of any Value Sourcing program is to assign the goods and services purchased to sourcing categories. Grouping by higher-volume categories makes it easier to analyze and track the company's need for and consumption of purchased inputs.

One consequence of such grouping is that procurement teams acquire specialized knowledge of their respective sourcing categories. Value Sourcing entails a wide range of skills and abilities in procurement. In the case of commodities, traditional tools such as master agreements with progressive price reduction clauses can be used. But in the case of strategically vital sourcing categories, where suppliers are expected to make innovation contributions as well, the procurement organization will have to perform a network management function overseeing the interfaces with key suppliers and looking out for situations that benefit both parties, instead of just managing prices and quality.

The choice of levers and the intensity of their application will depend on the nature of the company's business and a given project. What all Value Sourcing programs have in common is that they look beyond the current cost position and seek to establish highly effective, long-term procurement strategies.

1. Category sourcing

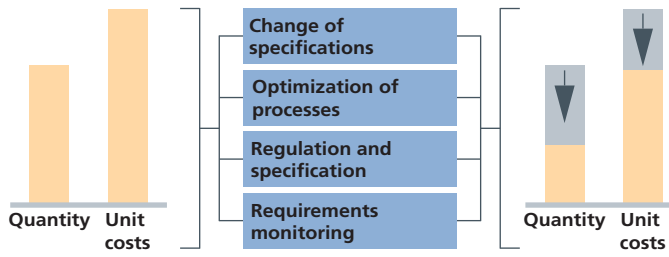
Procurement volumes by sourcing categories



Category sourcing begins with the definition of groups of related inputs, which can be components, systems or services. Then, each group of purchased inputs is carefully analyzed to determine the existing structures and potential. The tools to be applied in every group can then be selected with an eye to achieving the best results. These tools may include measures aimed at volume bundling, improved methods of price negotiation, or the simplification of processes within procurement and in related functions.

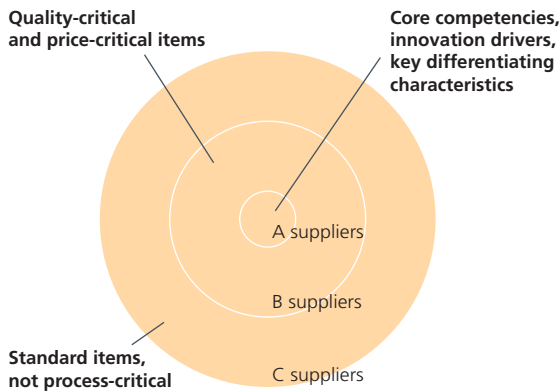
Quick sourcing gains are just as quickly exhausted. By contrast, Value Sourcing can help to achieve permanent cost savings.

2. Consumption management



Consumption management begins with identifying and tracking the company's supply requirements. All too often, procurement departments do not really know what quantities are needed in what areas of the company. As part of consumption management, those needs are identified and analyzed as the basis for developing minimum supply strategies. This is also a good time to review the existing specifications and optimize ineffectual procurement processes. Whenever possible, the company will want to critically examine the required quantities and quality parameters and formulate practicable alternatives.

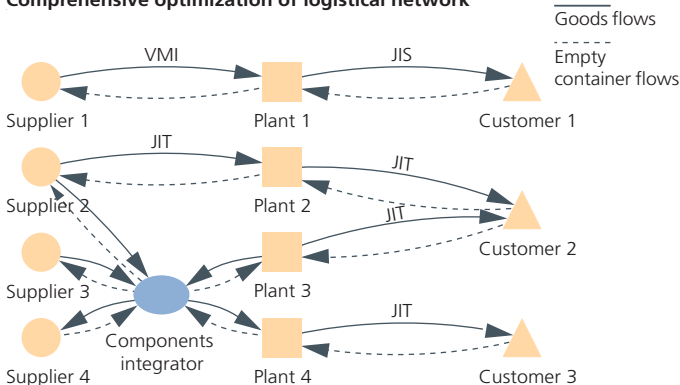
4. Supplier relationship management



Supplier relationship management begins with the definition of three supplier categories. "A" suppliers deliver products and services that are critically important to the company's differentiation in competition and which give rise to innovations. The company needs to maintain long-term relationships with its A-level suppliers. The products and services delivered by suppliers in the B category are important for maintaining quality and competitiveness. In the C category, the most important criterion is price. Each one of these supplier categories requires particular knowledge and abilities, which the company needs to establish and maintain.

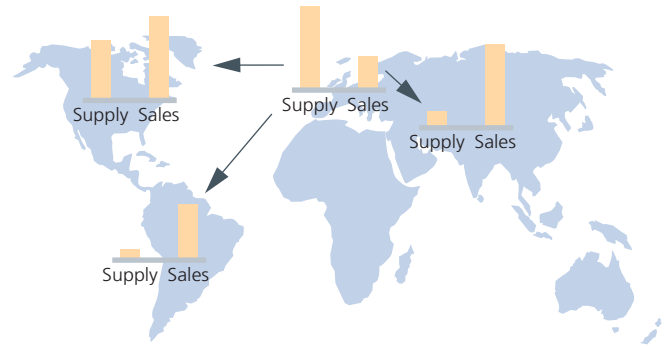
6. Supply chain optimization

Comprehensive optimization of logistical network



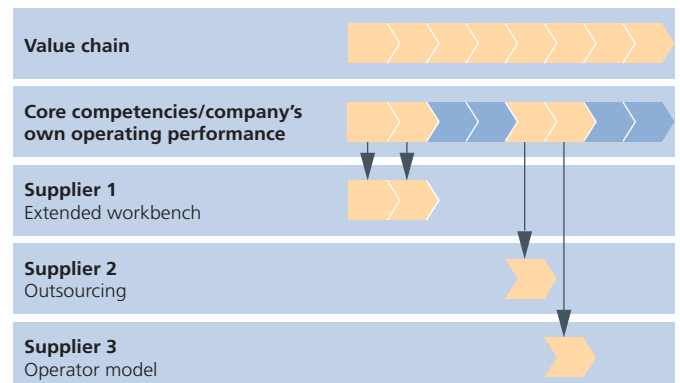
Supply chain optimization begins with understanding the end-to-end supply chain, including the material, information, and cash flows from suppliers to customers and back. With an eye to the total cost of ownership (TCO), procurement can and should play a strategic role in helping to shape transportation and logistics strategies across the company. Example strategies may include network and/or flow optimization, just-in-time (JIT) and just-in-sequence (JIS) logistics, core carrier programs, and vendor managed inventory (VMI).

3. Emerging markets sourcing



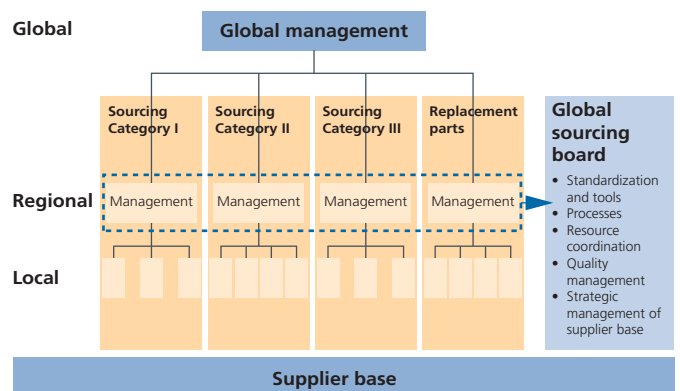
The basic principle of emerging markets sourcing is simple: You should buy where the prices are lowest. At present, most companies still purchase the bulk of their supplies in their home region. In emerging markets sourcing, a distinction is made between local and global sourcing. The company will want to research alternative sources for given supply categories, assess the risks associated with purchasing from those countries, and evaluate potential suppliers. Emerging markets sourcing is especially worthwhile for labor-intensive inputs and in countries where the supply exceeds the demand for such goods.

5. Value chain restructuring



Value chain restructuring begins with the definition of the company's key goods and services and core competencies. The question of the optimal depth of production is closely related to the company's positioning and its core competencies, and to the question of the optimal division of work along the value chain. Value chain restructuring may entail the use of part-sharing or modularization strategies, and/or the deliberate cultivation of new supplier relationships or even partnerships, as a means of introducing greater flexibility in production.

7. World-class organization and processes



The basis for reorganizing any procurement organization is the classification of internal competencies by sourcing categories. Centralized management makes it possible to implement standardized processes, strategy-driven supplier management, and stringent resource allocation. Proven sourcing methods such as the lead buyer principle, cross-country sourcing, or supplier base sharing may be introduced. Particular attention is given to information sharing in order to promote effective knowledge transfer among all areas of the procurement organization.

Conception and implementation

Every project is designed individually

A key advantage of the Value Sourcing approach is its modularity. Depending on the objectives and context of a given project, Value Sourcing can be applied by itself or as an adjunct to a more comprehensive value growth project. Value Sourcing has been applied successfully both in conjunction with successful restructuring projects and as a stand-alone lever for reengineering the procurement function to maximize long-term advantages. The question of what levers to use, whether alone or in combination with others, concurrently or in succession, will depend on the project objectives and the company's situation.

Focus on sourcing categories

Every project begins with a clearly structured analysis and data consolidation process. In this phase, the strategy consultants work with key personnel in procurement, development, production, sales, and logistics to identify those sourcing categories that hold the greatest potential for value enhancement, whether in terms of productivity, innovation, or growth. Appropriate instruments are then chosen and applied to these categories in order to produce quick, measurable results and maximize the earnings impact.

Selection of levers and identification of measures

After selecting the sourcing categories to be targeted, the most appropriate improvement levers for each category are identified. The result of this second phase is a tailored optimization program, one that combines the three dimensions of profitability, innovation, and growth, weighted according to the overall project objectives. Detailed project plans, milestones, and partial objectives are defined for each sourcing category.

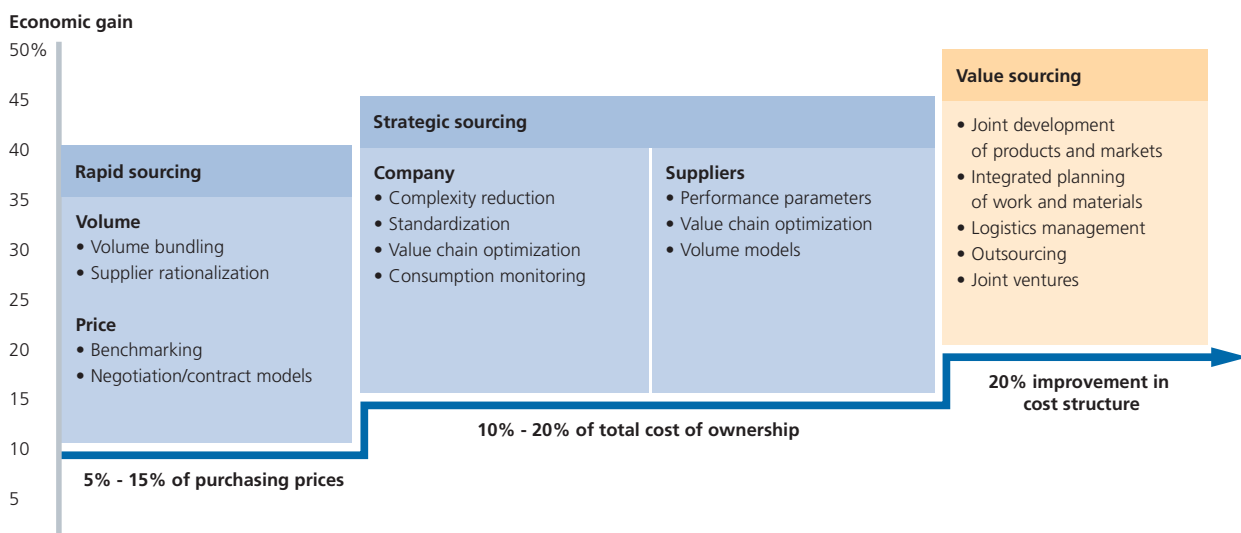
Cooperation with selected suppliers

Once the project has been defined, the key suppliers in each sourcing category are brought into the optimization program. The process of cooperation begins with hosted workshops and other information-sharing instruments, in preparation for reaching concrete agreements on joint improvements.

Continuous monitoring of results

The value enhancement potential for each sourcing category was determined in the analysis phase. An appropriate controlling instrument is developed to measure, evaluate, and assess the efficacy of quantitative and qualitative factors. By this means, management can promptly intervene and take corrective action to overcome cultural barriers, ensure that the firm achieves the desired results, and protect the established cost budgets.

Three levels of sourcing, each building on the other



The ability of a company to work closely with its suppliers is becoming a critically important competitive advantage. Accordingly, companies need to establish, maintain, and further develop long-term relationships with system partners and key suppliers.

Oliver Wyman's expertise

Specializing in sustained profitability

Oliver Wyman is a business strategy and operations consulting firm that emphasizes growth strategies in general, not just sourcing optimization strategies. With our Value Sourcing platform, we identify and exploit any and all opportunities associated with the procurement function, as the basis for sustained, profitable growth. In most cases, Value Sourcing yields significant improvements in the cost position of procurement operations, so that project costs are quickly recouped.

At home throughout the world

Oliver Wyman has an experienced, globally networked Value Sourcing team consisting of 30 partners and more than 80 dedicated Value Sourcing experts. Our local expertise in all the important markets also allows us to anticipate worldwide trends and incorporate them in our projects for clients. The ability to recognize and take advantage of dynamic global trends is often the key to the successful implementation of value-oriented procurement strategies.

Investments that pay for themselves

Our clients' investments in Value Sourcing programs have more than paid for themselves. In most of our projects, the break-even point is reached after only seven to nine months. Just as important, our Value Sourcing programs can generate a sustained, appreciable momentum for innovation and growth. This is where Oliver Wyman's special talent for growth strategies comes into play.

Tailored solutions

The wide-ranging Value Sourcing approach makes it possible to tailor our projects to address specific problems. Thus, primary emphasis can be given to growth, innovation, or cost optimization. Value Sourcing can be applied either as part of a comprehensive, post-merger program or as the first step in building up a best-in-class development and production network.

Reliable results

Value Sourcing is not a theoretical construct but rather a toolbox that has proven effective in many circumstances. Oliver Wyman has many years of international project

experience in a wide range of sectors. As an example, our Performance Program for an automotive OEM led to an average cost reduction of 20%. In another project for one of the leading U.S. airlines, that airline achieved cost savings of approximately 15% for technical spend and near 30% on its non-technical products.

Multi-industry expertise

Global airline – Our comprehensive procurement transformation and Value Sourcing initiative has delivered more than \$1.5 billion in ongoing cost savings as well as highlighted revenue growth opportunities through more effective business designs.

Major power company – We identified and implemented Value Sourcing cost savings of a new procurement organization and supporting processes, contributing to \$2 billion in cost savings over three years.

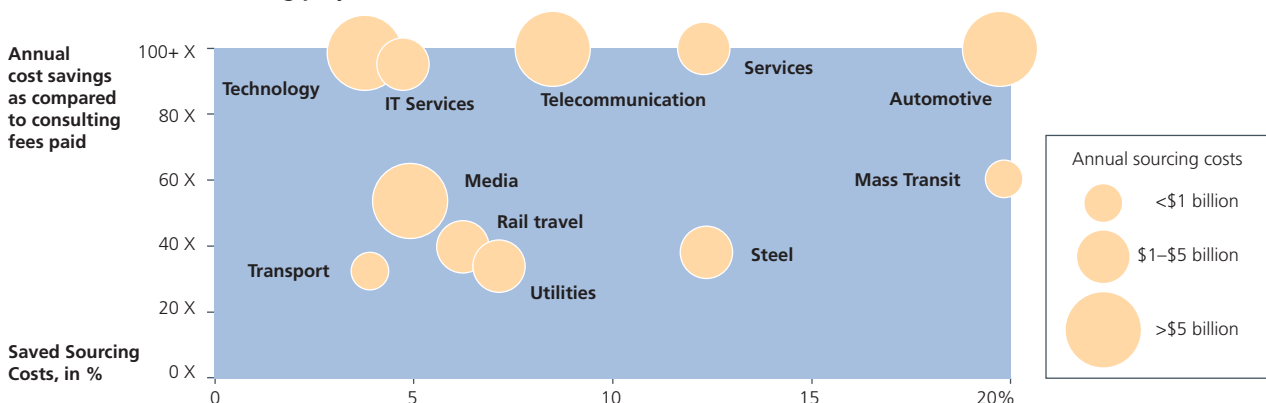
Global technology leader – We worked with the procurement team of this industry leader to develop detailed Value Sourcing strategies for five core purchasing categories, and then supported implementation to achieve \$160 million in savings.

Major freight railroad – We designed and successfully implemented a new procurement strategy and Value Sourcing initiatives for its parts and maintenance procurement processes; the Value Sourcing initiatives identified annual savings of 20-30% for the core commodities.

Major U.S. financial institution – We led the design and implementation of an enterprise-wide Value Sourcing initiative focused on indirect costs and administrative overhead costs; together we delivered cost savings of 12-25%+ for individual cost categories.

Leading telecom carrier – We worked with this major carrier to develop a blueprint for an enterprise-wide Value Sourcing and procurement transformation initiative that encompassed all key categories of network infrastructure, equipment, terminal devices, services, and indirect costs; the Value Sourcing initiative identified aggregate annual savings of 15%.

Results of recent Value Sourcing projects



Industry-focused senior practitioners



Roger Lehman – **Aviation Practice**, assists airlines and service providers in innovating their business models and transforming their operations. With more than 16 years in supplier/business partner identification, deal structuring, deal negotiation, and performance management—as well as extensive experience with complex technical spend categories—he frequently advises senior clients on multi-billion-dollar sourcing negotiations and cost-reduction initiatives.



L.C. (“Mitch”) Mitchell – **Communications, Media & Technology Practice**, specializes in cost transformation and business model/operations improvement for telecom carriers. Over the past 25 years, he has worked with more than 60 carriers around the world and has led the design, development, and successful execution of numerous Value Sourcing initiatives. These initiatives have generated more than \$1B in client economic benefits. He has worked with network and handset OEMs to provide a “supply side” dynamic of Value Sourcing strategies.



Andrew Patterson – **Energy Practice**, specializes in the power sector with deep functional expertise in Value Sourcing and procurement excellence. Over the past 17 years, he has worked with numerous gas and electric power companies on the successful implementation of procurement management transformation initiatives, sourcing strategies, inventory and logistics streamlining, and cost reduction programs. He brings unique expertise supporting procurement requirements for nuclear power generation, and served as a senior executive with deep involvement in developing sourcing strategies for one of the U.S.’s largest utilities.



John Seeliger – **Lean Six Sigma Operations Practice**, integrates Oliver Wyman’s operational excellence, Lean Six Sigma, and continuous improvement capabilities into comprehensive cost/productivity improvement transformation programs for major companies. During his 18 years of consulting, he has worked with clients across several industries to design and implement Value Sourcing initiatives that have extracted more than \$1 billion in client economic benefits. He also leads a major initiative to use Oliver Wyman’s Lean and Value Sourcing capabilities to support major financial services industry cost-transformation initiatives around the world.



Eric Vratimos – **Manufacturing, Transportation, and Energy (MTE) Practice**, specializes in supply chain optimization and operating performance improvement across a broad set of industries. Over the past 14 years, he has focused on the assessment, design, and implementation of value creating strategies for major industrial products, oil and gas companies, technology, and consumer packaged goods (CPG) manufacturers, surface transportation carriers, and global logistics providers.

Key advantages

1. Long-term focus

Value Sourcing goes far beyond short-term cost reduction measures. Although profit and cost pressures are intensifying in all industries, short-term gains should not be allowed to dominate the project agenda at the expense of permanent improvements. Successful companies combine short-term efficiency gains with the implementation of forward-looking strategies.

2. Concentration instead of breadth

The growing share of value creation shifted to suppliers is fueling an inexorable increase in the complexity of the procurement function. For that reason, success comes not from working on many sourcing categories at once, but from concentrating on each procurement category to achieve far-reaching improvements.

3. Focus on innovation

In today's environment of global competition, innovation has become a critical success factor. Therefore, Value Sourcing seeks to initiate continuous improvement processes and joint development projects with suppliers, to promote the success of both sides.

4. Partnership and trust

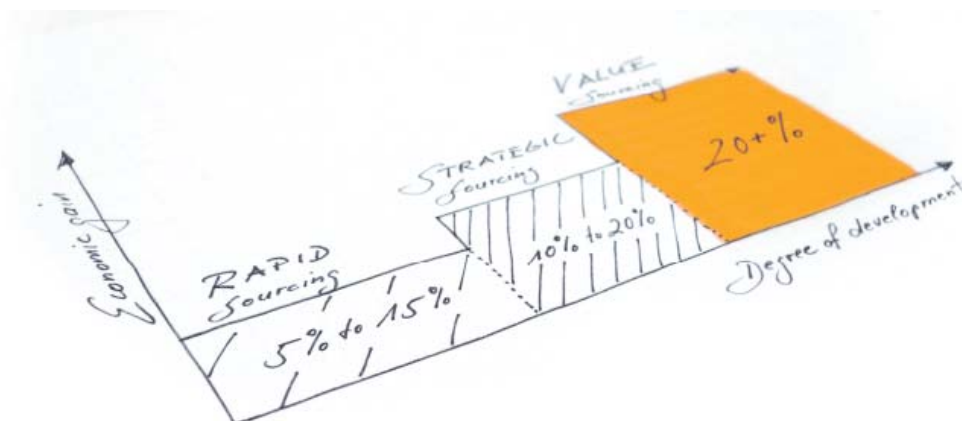
Building a supplier network that is among the best in the world with respect to cost, quality, and speed is a long and difficult process. Value Sourcing relies on partnership and trust, instead of one company exploiting its market power to gain short-term advantages at different links of the value chain.

5. Global orientation

Successful sourcing knows no boundaries. In this era of globalization, physical distance is no longer a barrier. No corporate function is feeling this transformation more directly than procurement. An enterprise that does not take advantage of global markets is wasting vital opportunities for productivity, innovation, and growth.

6. Continuity

The continuous evolution and growing dynamism of markets have a direct impact on procurement. Therefore, Value Sourcing should be understood not as a single project, but as an ongoing value enhancement process. This is the only way to attain and preserve competitive advantages over time.



About Oliver Wyman

With more than 2,500 professionals in over 40 cities around the globe, Oliver Wyman is the leading management consultancy that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational transformation, and leadership development. The firm helps clients optimize their businesses, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman is part of Marsh & McLennan Companies [NYSE: MMC]. For more information, visit www.oliverwyman.com.

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