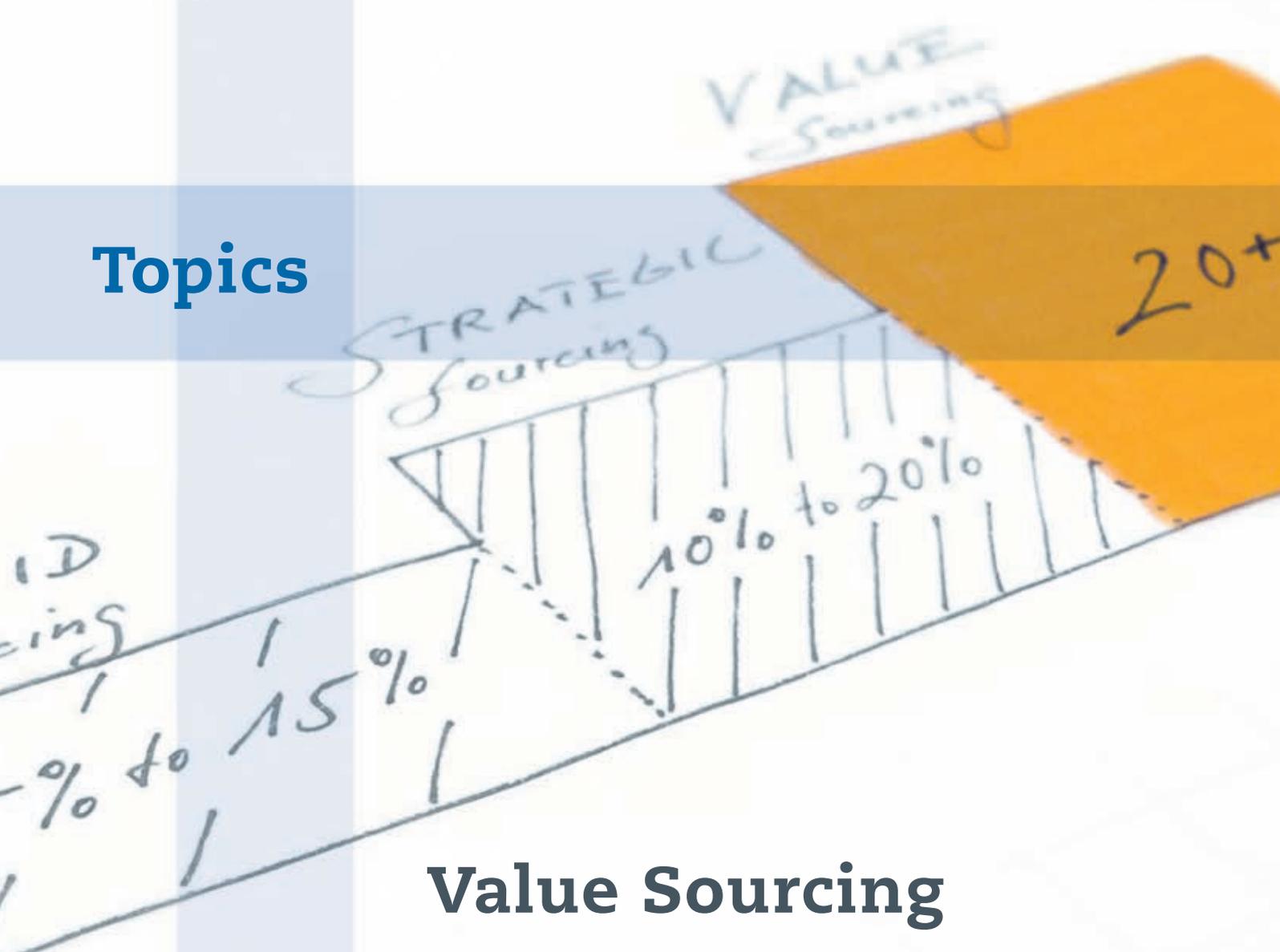


Industrial Products
and Services

Topics



Value Sourcing

The integral role of procurement
in the value growth strategy

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Sustained value growth over short-term cost reductions

The procurement function is often torn between hard-to-reconcile goals. To begin with, procurement may need to be lowered in order for the 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.

In its Value Sourcing approach, Oliver Wyman applies certain tools that are designed to create long-term value gains, as a complement to the customarily applied strategic procurement optimization techniques. In other words, we too use traditional techniques such as volume bundling, e-procurement and best practice sharing in our Value Sourcing approach, but in addition to that, we envision ways to optimize the long-term value contribution of the procurement function, drawing on the expertise of a globally active strategy consulting firm.

The potential value contribution of the procurement function depends on the particular needs of a given company. Manufacturing companies, for example, have reduced the depth of 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 and only way to create networks in which to jointly develop new products and alternative ways to create value in the future.

This strategically oriented, long-term perspective does not mean that Value Sourcing can only be expected to generate costs 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' time.

Sincerely,



Dr. Christian Heiss
Oliver Wyman



The trend towards increasingly complex products and specialization of companies makes a necessity of long-term cooperation within value creation networks.

Dr. Christian Heiss, Oliver Wyman, Munich

Strategic importance of procurement

The integral role of procurement in the value creation strategy

Growing strategic importance of procurement

To keep pace with intensifying global competition, companies are being compelled to concentrate on their core competencies. Yet this approach also has the consequence of increasing the proportion of value created externally, making the company more dependent on its suppliers. Aside from considerations of price, quality and reliability, this dependency also extends to the company's innovation capacity. To be successful in the highly competitive markets of tomorrow, companies will have to be adept at creating value in cooperation with their suppliers. In this respect, most sourcing strategies are too short-sighted, in that they are limited to reducing procurement and process costs, instead of actively facilitating the role of procurement as an integral link of the value chain. As a strategic tool, Value Sourcing is certainly effective at lowering costs quickly and effectively; but more than that, it can also be used to permanently improve profitability across the value chain, in a forward-looking and proactive manner. Value Sourcing can be said to address three critical aspects: achieving sustained cost leadership, focusing on joint value growth potential and boosting innovation within the supplier network.

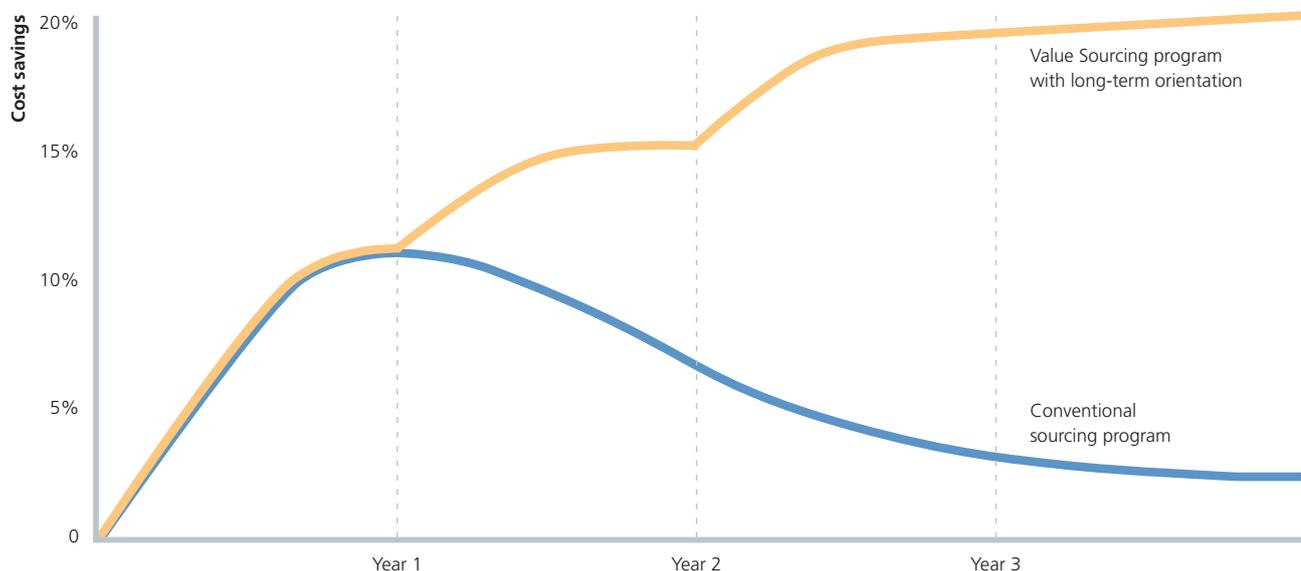
Long-term cost reduction

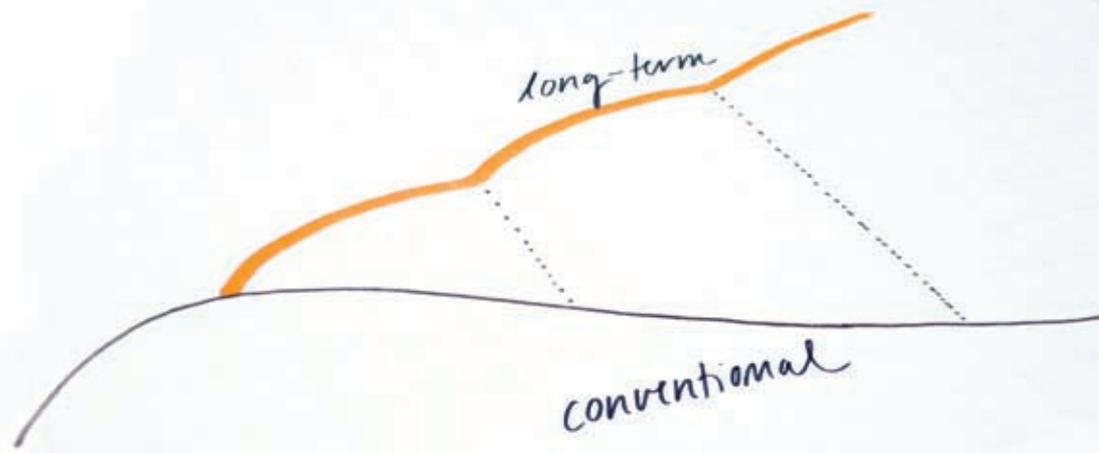
These days, purchased inputs account for more than 50% of the production costs of manufacturing companies, on average. Given this situation, even conventional sourcing optimization techniques can be expected to bring about a profit improvement of about 10%. However, these gains often fizzle out after a year or so. Under the Value Sourcing approach, on the other hand, the scope of vision is not limited to the company's current situation, but extends far into the future, seeking 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 be raised to and maintained at a world-class level. 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 of vision overlooks the strategic potential of procurement as a growth engine. In many industries, sustained value growth absolutely depends on having in-depth

Value Sourcing achieves maximum and sustained cost savings





knowledge of supplier capacities, competencies and reliability. The secret behind the success of companies like Toyota, H&M and Acer lies in their ability to 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 through an ongoing examination of new cooperation possibilities. And established supplier relationships can be exploited for mutual referrals, joint bids, innovations and exclusivity rights.

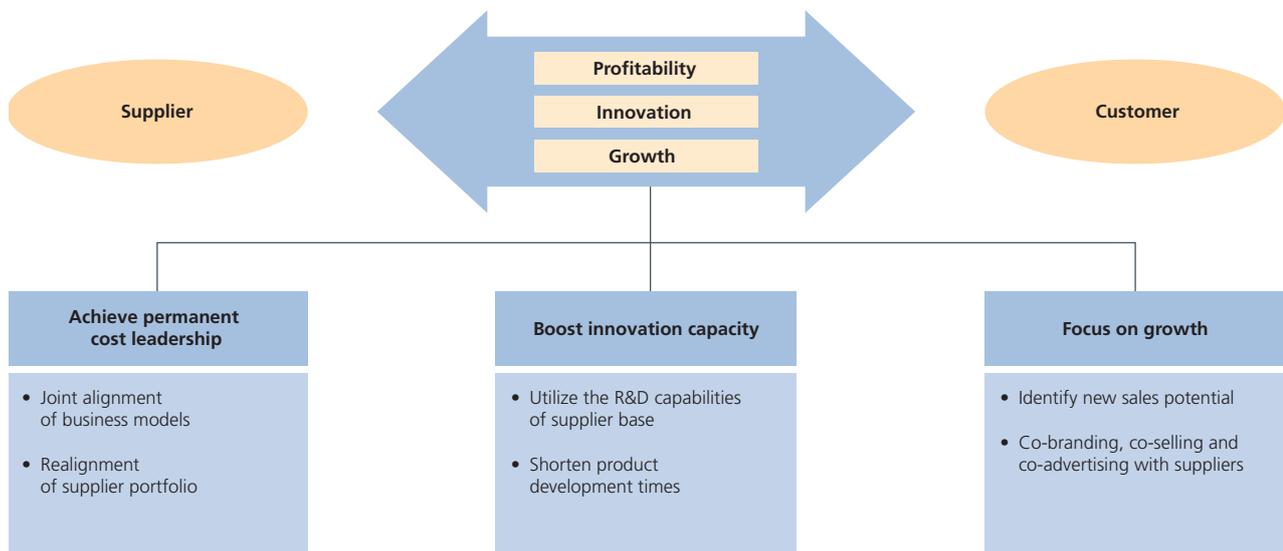
Innovative partnerships

There are only very few cases in which technologically revolutionary products and innovative processes have been 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 is very much influenced by the quality of relationships in the supplier network. Given this situation, it is absolutely necessary for companies to enter into cooperation with their suppliers. The ability to create results-oriented innovation partnerships is destined to be a critically important success factor in competition.

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, with an emphasis on collaborative attitudes, open communication both internally and externally and faith in the customer-supplier relationship. These are the key factors for the successful implementation of a Value Sourcing program. Best-practice companies routinely involve their supplier network in their planning processes, both in 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





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

Ray Tsang, Oliver Wyman, Shanghai

Value Sourcing

Seven levers for sustained value growth

Value Sourcing covers the entire value chain

Value Sourcing programs utilize seven levers to generate sustained value growth, regardless of the industry. The object of each and every lever is to design the entire value chain, from the raw materials to the 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 which can be selected to reflect the scope of the program in question. All the Value Sourcing levers have a common goal, to bring about a transformation of the procurement function, so that it is geared to long-term value growth instead of short-term cost reductions.

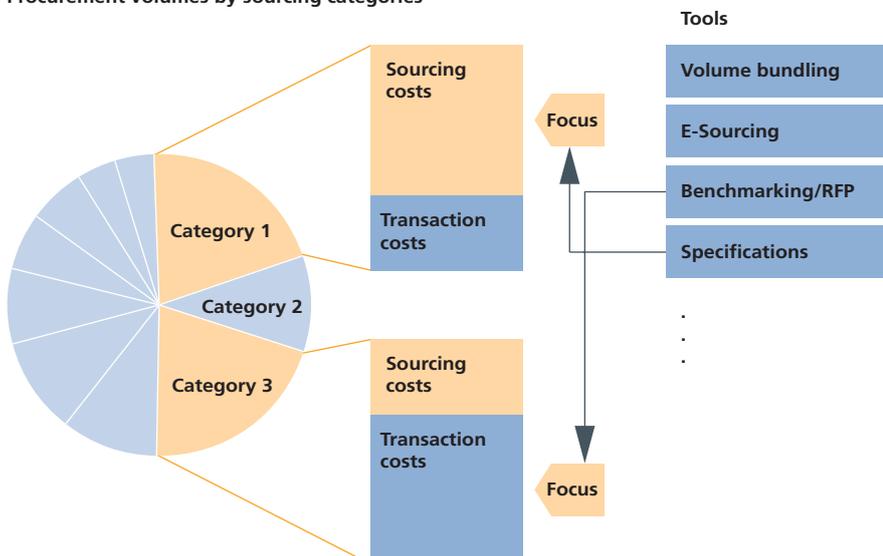
The first step of any Value Sourcing program is to assign the goods and services purchased by a given company into sourcing categories. By this process, purchased goods and services are grouped into higher-volume categories, making it easier to analyze and track the company's need for and consumption of purchased inputs.

As a medium-term consequence of grouping purchased goods and services into categories, procurement teams acquire specialized knowledge of their respective sourcing categories. Value Sourcing presupposes 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, will continue to be used. But in the case of strategically vital sourcing categories, the suppliers of which are expected to make innovation contributions as well, the procurement organization will have to perform a network management function as well, overseeing the interfaces with key suppliers and looking out for win-win situations, instead of just managing prices and quality. This aspect is especially relevant with respect to supplier relationship management.

The selection of levers to use and the intensity of their application will depend on the nature of the company's business and the definition given to 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.

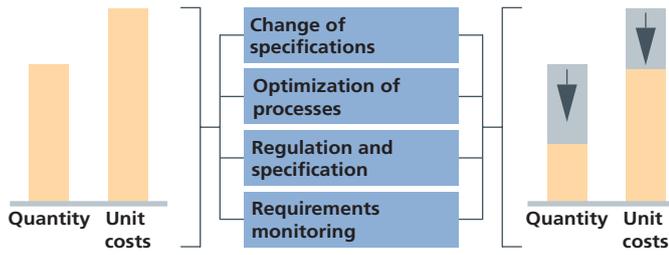
1. Category Sourcing

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.

2. Consumption Management



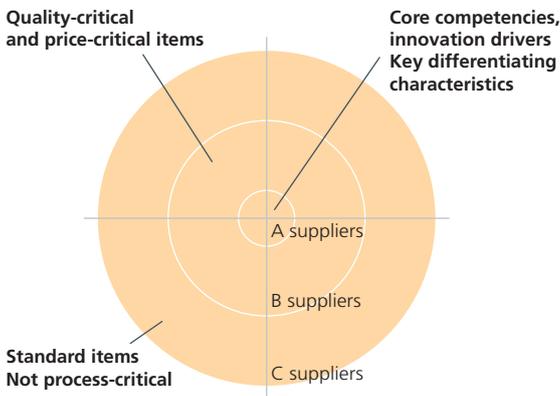
Consumption management begins with identifying and tracking the company's supply requirements. All too often, procurement departments do not really know what quantities are needed in what areas of the company. As part of consumption management, those needs are identified and analyzed as the basis for 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.

3. Emerging Markets Sourcing



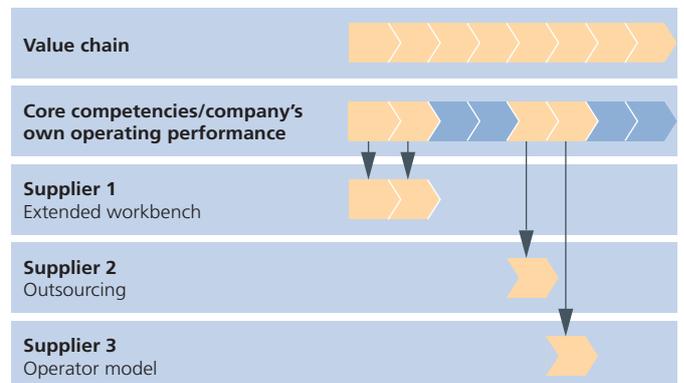
The basic principle of emerging markets sourcing is simple: You should buy where the prices are lowest. At present, most companies still purchase the bulk of their supplies in their home region. In emerging markets sourcing, a distinction is made between local and global sourcing. The company will want 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.

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.

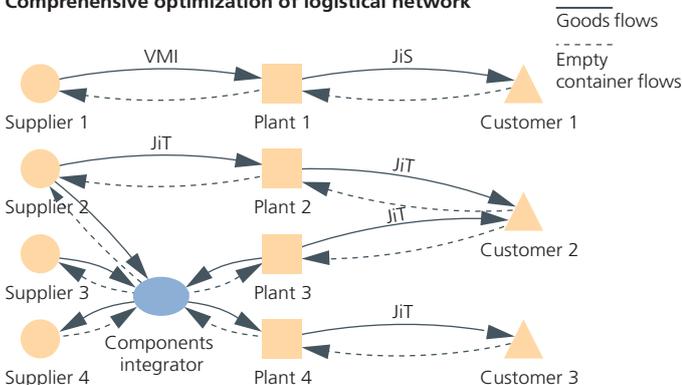
5. Value Chain Restructuring



Value chain restructuring begins with the definition of the company's core goods or services. 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.

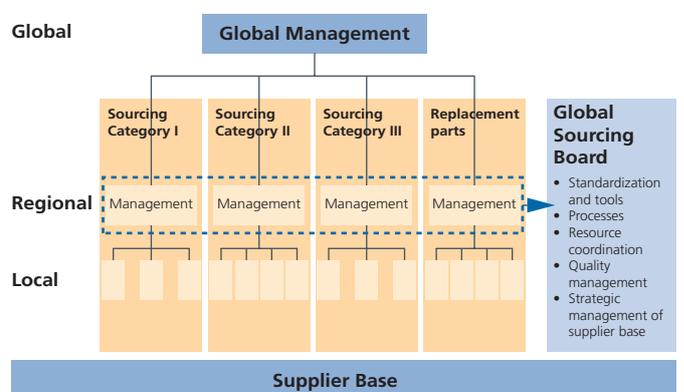
6. Supply Chain Optimization

Comprehensive optimization of logistical network



At most companies, physical transport routes are planned individually, without reference to the rest. Under supply chain optimization, the global structure of supply chains is viewed in its entirety, including all flows of raw materials, products and empty containers. Any and all optimization possibilities are considered, with regard to both suppliers and customers. As part of this process, the company will also want to review its logistical concepts and refine them or possibly replace them altogether, as with Vendor-Managed Inventory (VMI), for instance.

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.



In the future, the ability of a company to work closely with its suppliers will be understood as a critically important competitive advantage. Accordingly, companies need to establish, maintain and further develop long-term relationships with system partners and key suppliers.

Hanna Moukanas, Oliver Wyman, Paris

Project approach

Conception and implementation of Value Sourcing programs

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 at the time in question.

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 which can be expected to hold the greatest potential for value enhancement, whether in terms of productivity, innovation and/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.

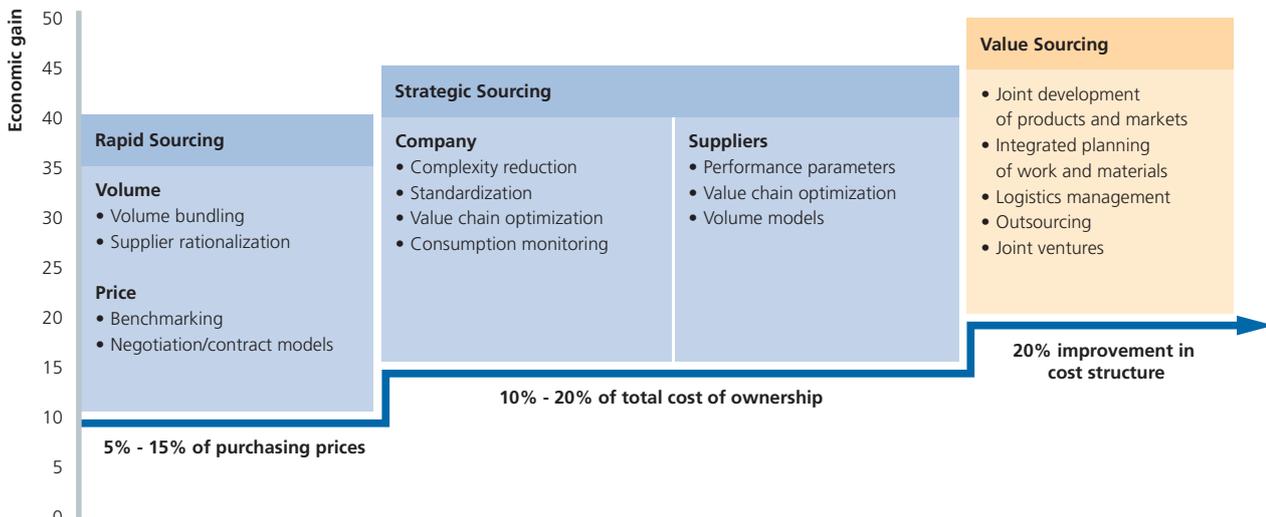
Cooperation with selected suppliers

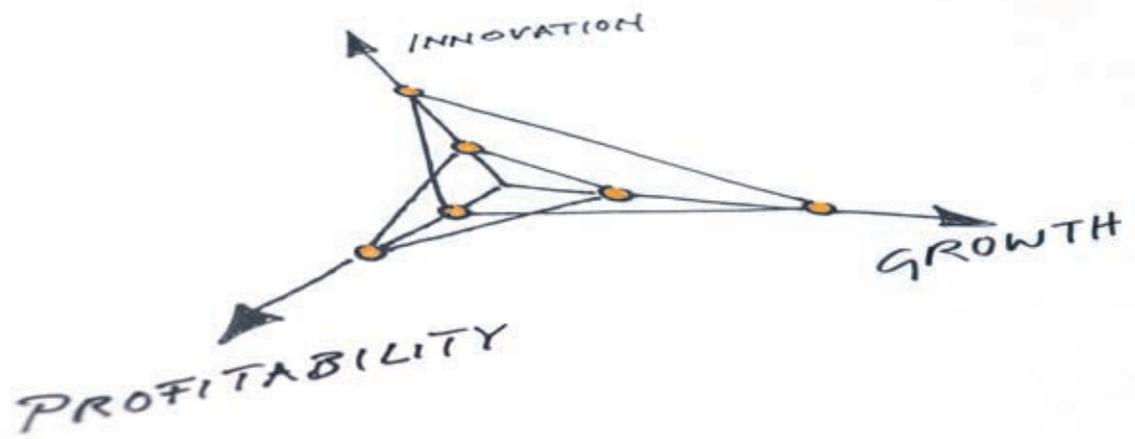
Once the project has been defined, the key suppliers in each sourcing category are brought into the optimization program. The process of cooperation begins with hosted workshops and other information-sharing instruments, in preparation for reaching concrete agreements on joint improvements.

Continuous monitoring of results

The value enhancement potential for each sourcing category is determined already 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, assure the achievement of results and/or protect the established cost budgets.

Three levels of sourcing, each building on the other





Project approach

Oliver Wyman's expertise

Specializing in sustained profitability

Oliver Wyman is a management consulting firm that specializes in growth strategies in general, not just sourcing optimization strategies. With our Value Sourcing product, we strive to identify and exploit any and all opportunities associated with the procurement function, as the basis for sustained profitable growth. In most cases, Value Sourcing brings about 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 Value Sourcing teams in China, India and Eastern Europe are capable of realizing cost savings of between 10% and 40%. Our local expertise in all important markets of the world also helps us to anticipate worldwide trends and incorporate them in our ongoing projects. 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.

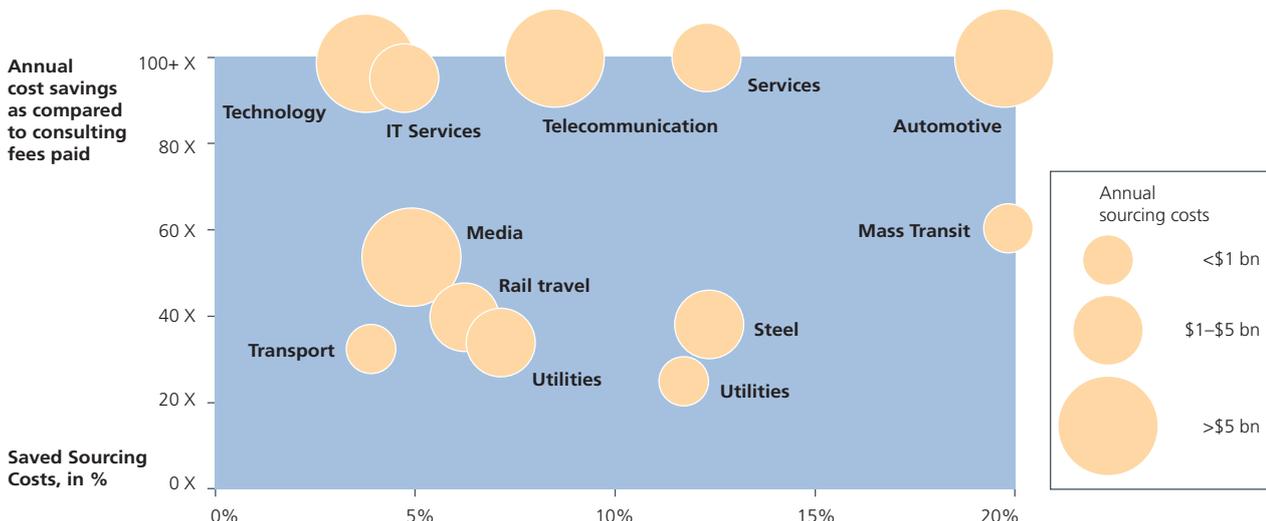
Tailored solutions

The wide-ranging Value Sourcing approach makes it possible to custom-design 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. It is more in the nature of a toolbox that has proven itself effective in numerous projects. Oliver Wyman has many years of international project experience in a wide range of industry sectors. As an example, our »Performance Program« for Nissan Motors led to an average cost reduction of 20%. In another project for one of the leading U.S. airlines, that company achieved cost savings of around 30% on its non-technical products.

Results of recent Value Sourcing projects



As a consequence of the trend of focusing on core competencies, the importance of procurement is on the rise. More and more, the procurement function is assuming the role of a central station for managing the entire value chain.

Dr. Christian Heiss, Oliver Wyman, Munich

Oliver Wyman project example

Automotive supplier

Value Sourcing in practice

Value Sourcing was a key factor in the success of a comprehensive growth initiative for a globally oriented automotive supplier. Because the company's liquidity and cost situation was under considerable strain, the Value Sourcing team initially focused on generating cost savings in procurement. That helped to improve the company's bottom line and stabilize its situation. In a second step, the company initiated a comprehensive, long-term growth initiative, in cooperation with strategic partners.

PHASE ONE:

Reducing the total cost of ownership

Value Sourcing techniques were applied to reduce the total cost of ownership for indirect sourcing categories by up to 32%. These cost savings were achieved on the strength of rigorous consumption management and a reorganization of procurement structures. In the direct sourcing categories, the project generated cost savings of between 8% and 15% per year. To this end, the global procurement network was deliberately expanded. More than one third of the suppliers involved in the program succeeded in expanding their procure-

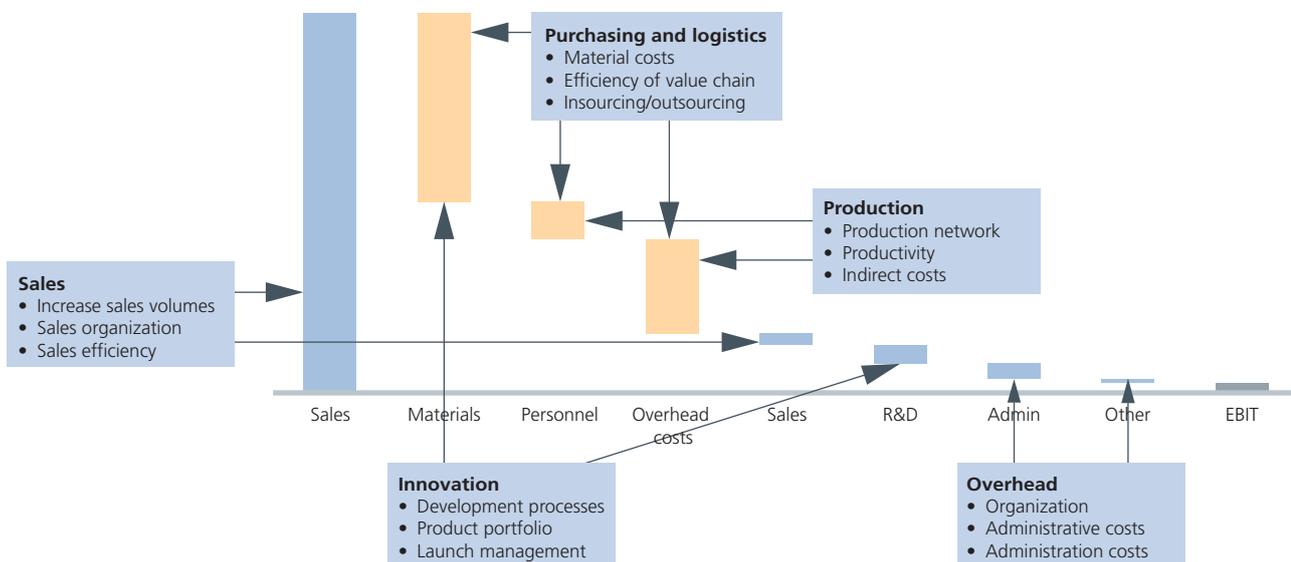
ment sources in India, Korea, China and Eastern Europe. Another third of the company's suppliers were able to identify and implement measures for bundling demand, standardizing parts and harmonizing materials. The remaining suppliers had already exhausted their cost efficiency and growth potential.

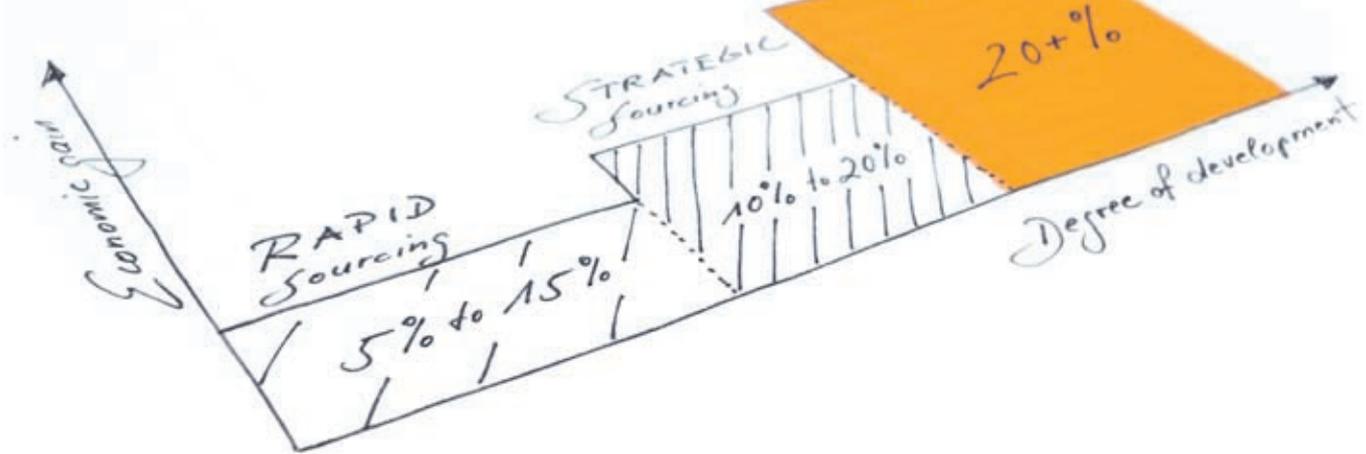
PHASE TWO:

Comprehensive optimization of the value chain

The next step, after the cost reduction program, was to optimize the procedures and processes of the procurement organization and get key suppliers involved in a comprehensive supplier management program. The logistical processes and production depth were optimized in collaboration with the suppliers. The long-term improvements were mainly conceived under the design-to-cost approach. The most important step in this process was a radical reduction in the large number of part variants and the development of joint component platforms with the key suppliers. These measures generated economies of scale in procurement and production, which also helped the company to extend its innovation leadership position.

Sourcing and logistics within the overall project





Success factors

Value Sourcing combines a number of 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 is not to be understood as a single project, but as an ongoing value enhancement process. This is the only way to attain and preserve competitive advantages over time.

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Oliver Wyman is building the leading global management consultancy, combining deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational transformation, and leadership development. The firm works with clients across a range of industries to deliver sustained shareholder value growth. We help managers to anticipate changes in customer priorities and the competitive environment, and then design their businesses, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities.

Oliver Wyman's thought leadership is evident in our agenda-setting books, white papers, research reports, and articles in leading external publications. To that end, the Oliver Wyman Institute connects the firm with prominent leaders of the academic community for joint research on frontier issues. In addition, our Executive Learning Center provides tailored programs in leadership development and executive education.

The firm's capabilities and intellectual capital are enhanced by our deep industry expertise, geographic range, analytical rigor, and hands-on, collaborative approach. Our professionals see what others don't, challenge conventional thinking, and consistently deliver innovative, customized solutions. We also work side by side with senior executives to accelerate execution through a blend of behavioral and management approaches. As a result, we have a tangible impact on clients' top and bottom lines.

As part of Marsh & McLennan Companies (MMC), Oliver Wyman is also able to draw on experts from our sister companies in the areas of brand and identity management, microeconomics, human capital strategies, insurance, and security.

For further information, please contact your local Oliver Wyman office or visit our web site at: www.oliverwyman.com

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