

DESIGNING THE PERFECT PROCUREMENT OPERATING MODEL



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When it comes to defining the most efficient and effective operating model for procurement functions there are, unfortunately, no easy answers.

The operating model of a procurement function needs to be consistent with a company's overall strategy, global organization, and culture. It also needs to be aligned to its supplier market. Balancing internal and external pressures is a difficult task – and the target is often a moving one!

Indeed, procurement functions must adapt, perhaps more frequently than the rest of the company, as they are impacted by changes such as new corporate strategy, evolving manufacturing footprint, disruptive supplier innovations, changing supplier panels, and higher savings objectives, all of which require increased flexibility.

In our conversations with CPOs, we often hear the same questions: should my organization be centralized or more locally managed? The company is continuously evolving, how should I adapt the procurement organization? What is the right sizing of my organization? Should I consider outsourcing part of my organization?

LOCAL MANDATES VS. CENTRALIZED ORGANIZATIONS

There are three key structural dimensions that drive the thinking on designing the procurement operating model: supplier market, user needs, and stakes. Each of them will shape the operating model differently, for each procurement spend category:

Exhibit 1: Three dimensions to balance between local and central

	Staffing and set-up will depend on
Supplier market	<ul style="list-style-type: none">• Market structure: local, continental, or global structure• Relative weight of company to market (more centralized if larger)
User needs	<p>Three pertinent elements:</p> <ul style="list-style-type: none">• Regularity of need (more centralized if more regular)• Customization required vs. market standards• Homogeneity of overall company needs per location
Company stakes	<p>Highly strategic categories may best be managed closer to the business it impacts, whereas less strategic categories may be managed at corporate level to maximize standardization of needs</p>

- 1. Supplier market:** on this dimension, you will be looking at two main things: how the overall supplier market is structured and what the relative weight of the company is to this market. A supplier market is typically local, continental or global, and the weight of a company's purchase ranges from insignificant to significant. Obviously, the level of emphasis (staffing) and the set-up will depend on these factors. The more significant the overall weight of a company's spending and the more global the supplier market, the more centralized the procurement organization. When the supplier market is very fragmented and the spending is relatively small, local mandates are very relevant.

2. User needs: here, three elements are at play:

- The regularity of the need: is it a yearly one-off that can be managed locally or does it involve daily consumption that should be handled centrally?
- The level of customization required against market standards: are you buying market standards (centrally) or do you require a high degree of customization at site level?
- The overall homogeneity of your needs: is it one-size-fits-all for the entire company or does every site need custom specifications?

Answering these questions will allow you to decide if a category should be addressed locally or dealt with at the corporate level.

3. Stakes: you need to assess what the actual stakes are for the company, for each procurement category. If a category is highly strategic, you may consider managing it close to the business it impacts, in a decentralized manner. On the contrary, categories that are least strategic will often be managed at a corporate level to maximize standardization and allow efficient demand management.

Many organizations tend to over-emphasize the importance of the first dimension and attempt to perfectly “mirror” the supplier market. However, that often comes at the expense of an increased integration with the rest of the company and limits the procurement function’s ability to truly engage in advanced and collaborative levers (e.g. influencing specifications and consumption, challenging needs, encouraging standardization).

In many ways, these three drivers may seem to call for conflicting decisions: consolidate and disseminate, align to internal stakeholders as well as to suppliers.

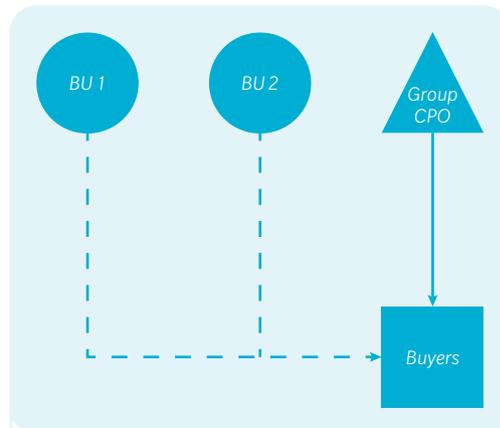
In reality, no organization can strike a perfect balance along these three dimensions. A choice must be made to focus on a given dimension depending on the company’s DNA, culture, organizational model, and overall level of maturity.

PROCUREMENT ORGANIZATION MODELS AND CONTINUOUS ADAPTATION TO THE COMPANY’S PROCUREMENT MATURITY

We have observed four main organizational models, depending on the level of centralization of the function and the level of reporting of buyers to the Procurement organization (linear or functional).

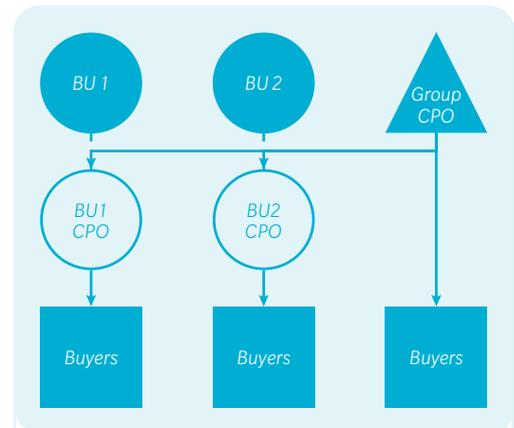
Exhibit 2: Procurement organizational models

CENTRALIZED MODEL



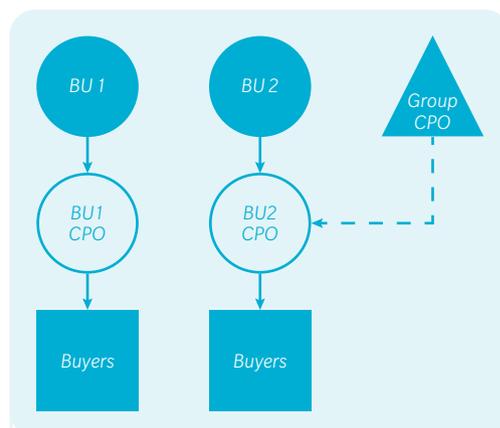
- Buyers report to Group Procurement Dept., which makes decisions over all Procurement strategy

MATRIX MODEL



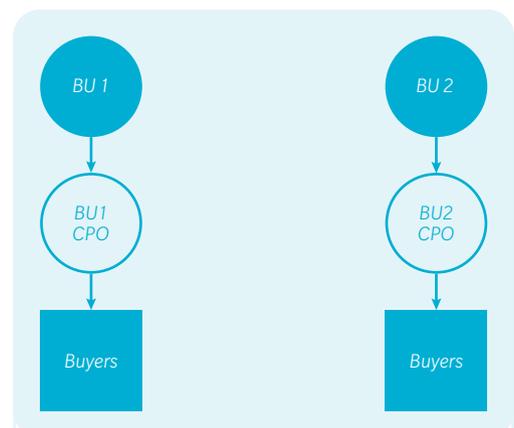
- All buyers report to Group, which co-arbitrates with BUs
- Some buyers are hosted by BUs; some are transversal

COORDINATED MODEL



- Buyers report into BU Procurement structures
- Group Procurement provides coordination, guidance

DECENTRALIZED MODEL



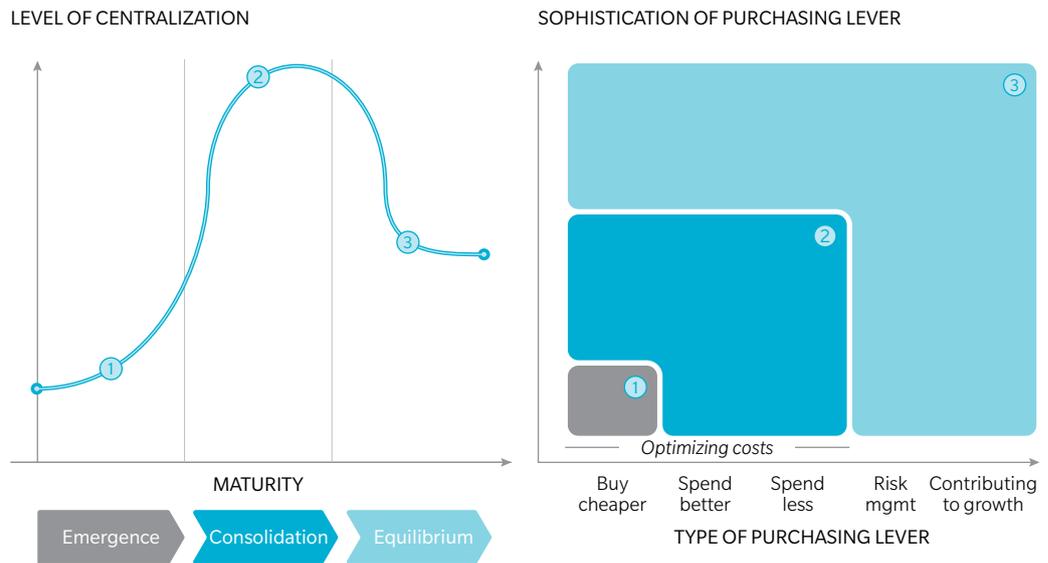
- Buyers report to BUs (no Group Procurement Dept.)
- Coordinated initiatives may exist between the BUs

Again, the best organization will be the one that is adapted to your company's DNA and strikes a balance between the constraints of the supplier market and the organization of key internal stakeholders.

But, the really important piece is evolution, as the models are in flux – a sort of “balancing act” is underway between centralization and decentralization as Procurement continues to mature.

We distinguish three different stages of maturity: the emergent phase, the consolidation phase, and the balance phase.

Exhibit 3: Procurement organizations are observed to mature in three major stages enabling levers of increasing complexity



- 1. The first phase is the emergent phase:** At first, users are acting as buyers and are, by essence, largely scattered across the organization, with no real involvement of professional buyers. Then, top management becomes aware of the potential and decides to professionalize and formalize the procurement function. The underlying idea is that a new role – the professional buyer – must emerge to challenge line managers in their often historical relationships with suppliers. This is a phase that typically sees Procurement organizations start as a “coordinated model”: relatively small teams and still somewhat decentralized. At this stage, the focus is mostly on trying to influence internal stakeholders and progressively expand scope, as well as quick wins. During the emergence phase, the nascent Procurement function is focusing on a limited scope while there exist many “acting-as” buyers in the business. Sizing of the Procurement function and need for a CPO is a key topic.

Exhibit 4: Key sizing issues to consider



2. The second phase is the consolidation of the new procurement organization:

The procurement function is now given ambitious economic objectives based not only on price levers, but also on the mandate to challenge needs. This ramp-up of procurement is often a source of friction, but forces the emergence of collaborative work with line managers and helps demonstrate the value in upstream decision-making processes. It embeds the “buyer-user” tandem in the DNA of an organization. During the consolidation phase, increasing coverage rate is a priority for CPOs. Coverage rate, however, is soon not enough as the most mature companies begin focusing on the effectiveness of their coverage.

Exhibit 5: Focus on coverage rate

INCREASING COVERAGE RATE

CPOs tend to build an operating model with the “coverage rate” in mind – and rightfully so, to a degree, as CPOs now have the mandate and they need to deliver and expand their scope

Best-in-class companies see >90% coverage with Procurement involvement as natural

TWO MAIN LEVERS TO INCREASE COVERAGE RATE:

- 1 New mandates on spend categories**
Major efforts to promote Procurement internally can help convince the entire organization of its value
- 2 Increased geographical prerogatives**
For successful global expansion, key local constraints must be identified & understood

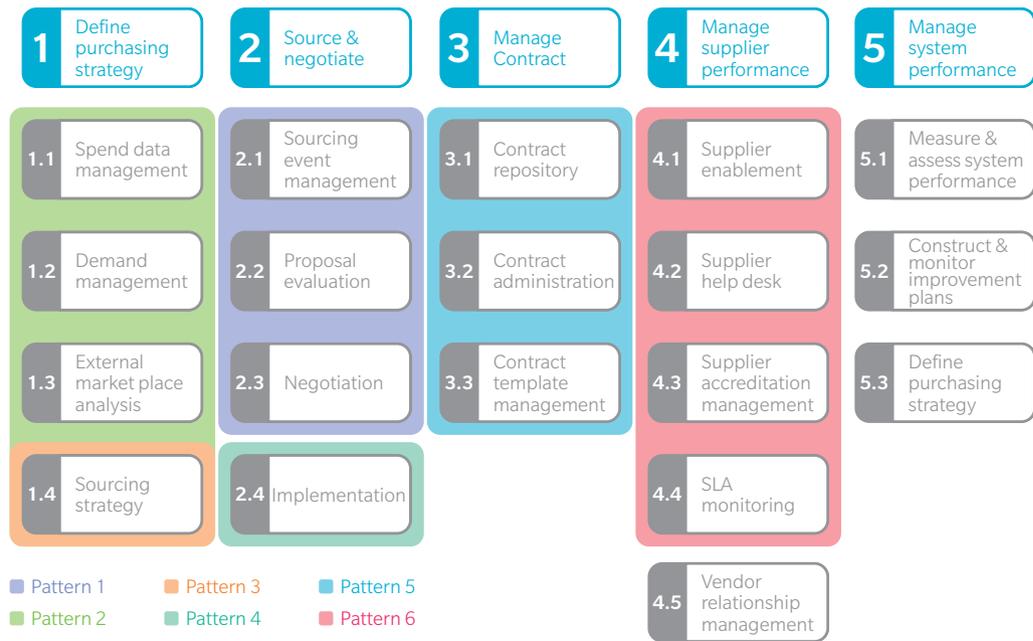
THERE ARE THREE KEY INDICATORS TO TRACK:

- 1 Early involvement**
Procurement is involved once users and influencers first express needs
- 2 Short-list**
Procurement is involved in short-listing suppliers after needs are expressed
- 3 Downstream**
Procurement helps to select suppliers and to negotiate/ draft agreements

- 3. Then comes the equilibrium phase:** after consolidating procurement activities, recognizing the central role of the function and formalizing essential operational processes, most mature companies tend to re-distribute parts of strategic sourcing directly into their business units. The procurement function then morphs from a central organization to a fully integrated and embedded function, closer to business units and stakeholders. More complex collaborative levers are used at the level most appropriate; Procurement is not only involved in optimizing cost, but also in managing risks and contributing to growth.

Once the Procurement function is mature, CPOs often consider opportunities offered by outsourcing, which can cover many different patterns of tasks. Deciding whether to outsource is analyzed per category at sub-process level and important questions to consider include: When do I outsource? How do I outsource? What do I outsource?

Exhibit 6: Processes & tasks eligible to Procurement Outsourcing



KEY TAKEAWAYS

The ideal operating model for Procurement is never a one-size-fits-all solution, and is a moving target. There are three key structural dimensions that drive the thinking on designing the Procurement operating model: supplier market, user needs, and stakes.

We have observed four main organizational models, depending on the level of centralization of the function and the level of reporting of buyers to the Procurement organization (linear or functional).

However, the really important piece is evolution, as the models are in flux. Typically, Procurement organizations go through multiple phases, from increasingly centralized before reaching a more sophisticated equilibrium.

We find that most advanced Procurement functions reconsider their organization every two years, as their overall companies evolve, supplier market change and performance levers become increasingly sophisticated. This effort usually starts by a thorough review of the current organization and a mapping of the potential gaps. The outcome is not necessarily a major change but can also be targeted improvements.

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AUTHORS

Gregory Kochersperger, Europe, Middle East, and Asia Head of Operations

Xavier Nougès, Head of Value Sourcing

Damien Calderini, Partner

Laurent Guerry, Partner

Stephan Picard, Principal

CONTACTS

Lars Stolz

Global Head of Operations

lars.stolz@oliverwyman.com

Michael Lierow

Head of Supply Chain

michael.lierow@oliverwyman.com

Greg Kochersperger

Europe, Middle East, and Asia Head of Operations

gregory.kochersperger@oliverwyman.com

Brian Prentice

Head of Manufacturing and Process Operations

brian.prentice@oliverwyman.com

John Seeliger

Americas Head of Operations

john.seeliger@oliverwyman.com

Alex Lyall

Head of Digital Operations

alex.lyall@oliverwyman.com

Xavier Nougès

Head of Value Sourcing

xavier.nougues@oliverwyman.com

www.oliverwyman.com

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