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the way we see it

Global Chief Procurement Officer Survey 2009

Responding to the Challenges of Economic Meltdown

Contents

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Foreword

The third Global Chief Procurement Officer (CPO) Survey marks Capgemini's continued commitment to understanding the trends and issues affecting the procurement executive. Given the seismic upheavals in the financial markets and their inevitable impact on commerce, it has never been so important to assess and understand what this means for procurement within organizations.

The intent of the Global CPO Survey is to provide executives with insight into both macro issues and focus areas so they may be better informed concerning the challenges they face and the decisions they make.

The Global CPO Survey is based around responses from more than 150 organizations spanning Europe, North America and Asia Pacific, mainly represented by senior procurement executives. This Survey provides a temperature check on the world of buying in 2009 and gives a comparison of findings from previous Surveys conducted in 2007 and 2008.

The Survey also represents a diversity of industries ranging from Energy to Pharmaceuticals and Manufacturing to the Public Sector. What is common to all respondent organizations is the continuing theme of having to manage and drive value out of third party expenditure.

As we indicated in last year's Survey, the pressure on the procurement function continues to grow exponentially. If anything the global financial crisis has only accelerated this focus as cost reduction becomes key to sustained profitability and in many cases long-term survival.

Paramount to this is reacting in the right way. Winners in the current climate will be those procurement professionals who are able to focus on the real issues and demonstrate an agile approach to adjusting rapidly to the unprecedented challenges facing them.

The Survey has been conducted in the main through one-to-one interviews with senior procurement executives from around the world.

Capgemini would like to take this opportunity to thank each participant for their time, contribution, openness and candor regarding their issues, areas of focus and future plans. Without their cooperation and investment, research of this nature would not be possible.

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Capgemini Consulting is the strategy and transformation consulting brand of Capgemini Group

A note of thanks

Capgemini Consulting would like to extend its thanks to the senior procurement professionals who made time to be interviewed for this global survey. Besides the organizations listed here, a further 64 companies participated in the survey but requested that they remain anonymous.

Participating Companies and Organizations

AEGAEGON Nederland N.V.

Alliander

AREVA T&D Canada

Astellas US LLC

Astra Zeneca Plc

Atlas Copco Compressor Technique Service Division

Ballast Nedam

Bank Austria

Barilla G. e R. Fratelli

Bayer CropScience

BD

Boral Ltd

BP Plc

BSH Bosch u. Siemens Hausgeräte GmbH

BT

CABOT Corporation Europe

Caltex

Capgemini NL

Carphone Warehouse

Chemion Logistik GmbH

Claas KG

Cognis GmbH

Consip – Government Agency for Purchasing in PA

Dell APAC and Japan

Department for Children Schools and Families

Deutsche Bank

Deutsche Post World Net

Downer EDI Rail

DSM

Elders Rural Services Limited

Essent

Faurecia Autositze GmbH & Co. KG

G4S

GASAG Berliner Gaswerke

GEA Air Treatment Service GmbH

Gebr. Becker GmbH

Goodrich Corporation

Heijmans

Her Majesty's Revenue and Customs

Hewlett-Packard

Houghton Mifflin Harcourt

HydroOne

Inalfa Roof Systems

Invitel Távközlési Zrt

Jarden Corp

Karl Otto Braun GmbH & Co. KG

Koninklijke BAM Groep nv

Landesbank Hessen-Thüringen Girozentrale

Lantmäteriet

Lekkerland

Libro

LloydsTSB

MAG Powertrain Europe

Manutencoop Facilities Management

Mattsson Metal

Mercury Marine / Brunswick Corp

Metropolitan Police Services

Microsoft Deutschland GmbH

MTU Friedrichshafen

MVV Energie AG

News Corporation

North Lanarkshire Council

NS

NSW Department of Education & Training

Oesterreichische Post AG

OMV AG

Optus

Prysmian

PSPI

Raiffeisen International Bank-Holding AG

Rexel

Road and Traffic Authority

RWE Services

SABIC Europe

Saint-Gobain Deutsche Glas GmbH

Saipem

Sandoz

Schindler Management AG

Schweizerische Post

SGL Carbon

Siemens Healthcare

Snam Rete Gas

Spherion Corp.

s-Proserv

Stielfelkönig

Swedish Tax Authority

Syngenta

Takeda Pharmaceuticals North America, Inc.

Tata-Corus Steel Group

Tessenderlo Chemie, Business Group Chemicals

TETRA Technologies

The Scotts Company

The University of Sydney

Toyota Motor Europe

TRW Automotive

Valentino Fashion Group

Value Wales

Van Gansewinkel Groep

Vattenfall Europe Transmission

Versicherungskammer Bayern

WestLB AG

Whisson

Executive Summary

As a major lever of cost control, procurement is clearly in the spotlight

Top of the list of current initiatives for procurement is the tactical re-negotiation of existing contracts in an attempt to slash spend and reflect reduced demand

Characteristics are consistent with the harsh environment in which procurement and organizations are currently having to operate

This year's Survey provides insight into the impact of the global recession on procurement executives, with nearly 7 in 10 participants acknowledging that the current economic recession was having a significant impact on them: increasing targets, altering focus areas and shortening planning time horizons. For many, savings targets have doubled from those that prevailed when we last conducted the Global CPO Survey, and in some cases are a clear requirement for survival.

Clearly as revenue performance diminishes companies are seeking to reduce operating costs to support the balance sheet, and as a major lever of cost control procurement is clearly in the spotlight. The response to this focus appears to comprise short-term objectives in the main: top of the list of current initiatives for procurement is the tactical re-negotiation of existing contracts in an attempt to slash spend and reflect reduced demand. The other main activities being pursued target enhanced supplier management and raising the profile of procurement across the organization. Even these can be tracked directly to short-term goals as opposed to more strategic, longer-term objectives.

One of the concerns we regularly encounter from company to company is that of unforeseen bankruptcies within the supply base. The fear is the unquantified effect this would have on downstream product and service provision. The response around supplier management therefore is far more attuned to risk mitigation as opposed to the more traditional aims of development and innovation.

Equally the desire to raise procurement's profile can be traced back to a need to work better with stakeholders, internal customers, suppliers and end user groups to drive lower cost fit-for-purpose specifications.

We would conjecture that part of this is to move procurement behaviors from buying what is wanted to buying what is needed.

All of these characteristics are consistent with the harsh environment procurement and organizations alike are currently operating in. These results are consistent regardless of industry sector or geography and show the true nature and impact of the global economy.

When turning our attention to areas of investment and improvement being pursued by CPOs, we see significant consistency with the themes from last year. The key findings being represented by:

- Organizations continuing to struggle to unlock the intrinsic value within IT solutions. More than 60% of respondents acknowledged that less than 20% of spend utilized eProcurement tools despite significant investment made in technology.
- Perhaps connected to this, spend visibility remains a key problem and for the second year running is the top issue facing CPOs.
- The issue of talent continues to be a front of mind issue and, along with the pressure for economic results, has become more acute for procurement functions struggling to execute effective strategies.

- Supplier management has come into focus as organizations recognize the risk of vendor failures within the supply chain.
- Organizational design continues to adapt to circumstance as respondents seek to balance end user intimacy with the needs for control and consistency.

What is striking about the issues raised by senior procurement executives is the consistency with findings from previous years.

It seems that while the problems are now well recognized, progress with resolving them is occurring at a slow pace.

One possible explanation for this is a common failure to see the integrated nature of such problems. Rather activities are focused on solving what are seen as discrete issues leading to unsustainable solutions.

In the current climate of short-term goals and targets driven by what many market watchers see as the worst economic slump in living memory, the question of how much capacity organizations have to affect change has to be raised.

Lasting solutions seem to be evading companies in the main. While this continues it will serve only to denude organizations of the effective deployment of tools, capabilities and operating models to address the long-term strategic agenda. For those who can break out of this detrimental cycle there is a clear opportunity to drive competitive advantage for their respective organizations.

In no small measure these businesses will help define the winners and losers that emerge from the current economic cycle.

Impact of Global Economic Downturn on Surveyed Organizations

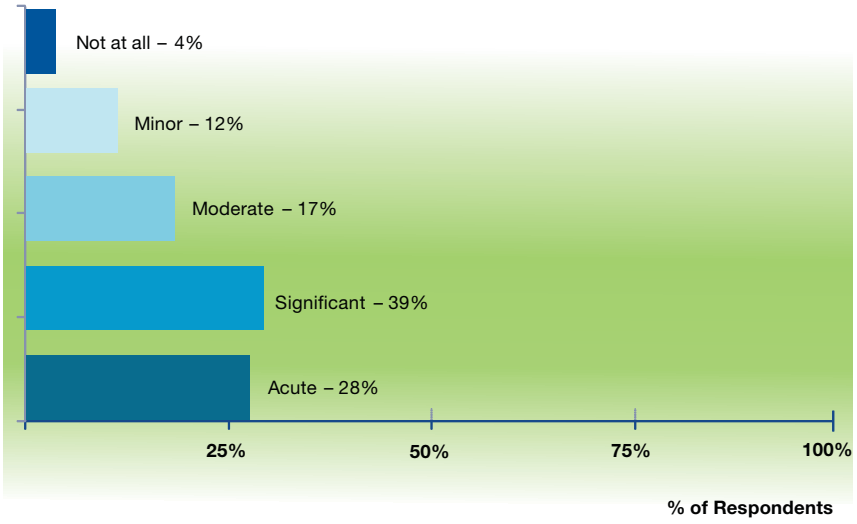
Given the significant turbulence affecting the world economy, part of the Survey for 2009 was focused on better understanding how this was impacting procurement activities across organizations.

Perhaps unsurprisingly, some 67% of respondents rated the impact of the current economic challenges as having either an acute (very high) or significant (high) impact on their current activities and focus. A mere 4% of surveyed organizations saw no impact at all.

Given the uncertainties faced, this would seem an understandable reaction. However the natural conclusion is to re-focus the behaviors and mindset on more tactical activities at the expense of longer-term strategic initiatives which, by their nature, take time to implement and deliver.

What was prevalent in discussions was an overall shortening of the planning time horizon compared with the stable period of growth preceding the current economic slowdown.

Figure 1: To what extent are the current economic conditions affecting Procurement's goals and objectives



When asked how the economic downturn was affecting the planning horizon for procurement activities and strategy, the majority of organizations highlighted it as a challenge to look beyond the short to medium term.

To better understand what this shift in the time horizon meant, we asked organizations to highlight the activities they were pursuing.

Top of the responses was a focus on re-negotiating existing contracts with vendors, which was being pursued by 1 in 5 of the surveyed businesses. The second dominant activity was improving the management of vendors as a counter to potential supply disruption caused by bankruptcies within the supplier community. The third major area of attention was fixed on raising the profile of procurement across the organization and the value it could bring to fiscal performance.

It was also interesting to note that less than 4% of the Survey respondents perceived redundancies within the procurement function as a likely response to the 'credit crunch' and need for cost savings.

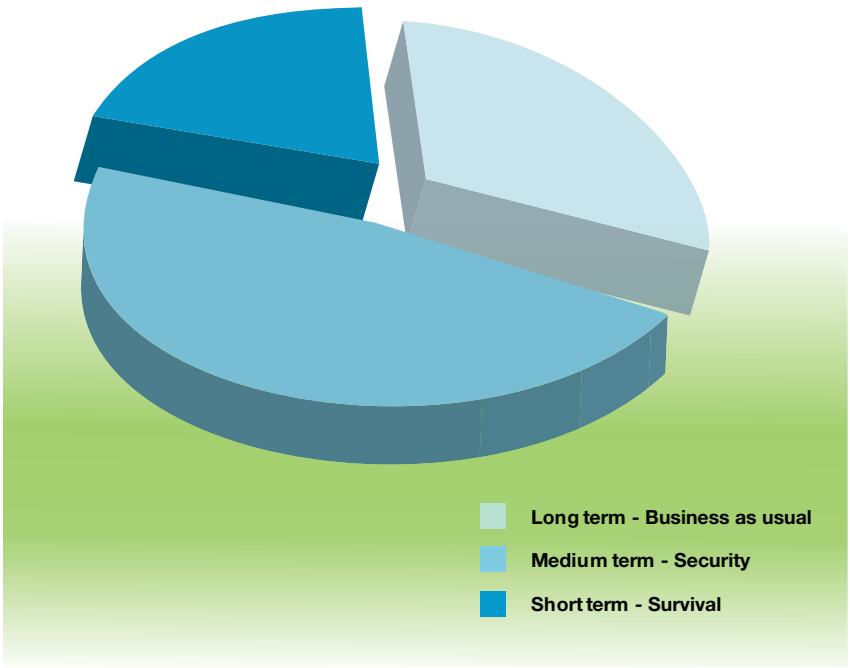
Indeed a number of organizations commented that far from being pressured to reduce headcount they were actively being encouraged to recruit more buyers and high caliber personnel.

We take this to be an encouraging sign that procurement's position as a major lever to cost control is being recognized within organizations as revenues tighten.

Finally we were interested to see whether these developments were filtering into the savings expectations on procurement. In last year's Survey more than 70% of organizations highlighted a savings target of 5% or less. This year the number of organizations targeting that figure has reduced to 47%. Those tasked with saving from 6-10% doubled from 19% to 39% of the respondent organizations between 2008 and 2009, while those chasing double digit reductions also doubled from 7% of respondents to 14%.

Clearly many organizations are chasing short-term gains from third party spend to help support the balance sheet. While investment seems steady, with little sign of reductions in resource capacity, the reducing planning horizons and rising targets appear to be at the fore of the procurement executive's consciousness and may help to explain why so many see the impact of the slowdown as being significant or acute.

Figure 2: Time Horizon



Further evidence to support this comes from the respondents' perception of how long the difficult times will last. Almost 40% believe that the current economic downturn will be with us for between one and a half and two years and 75% for a year or more. Only one in four believed that we would see an upturn within the next year.

To counter this, however, there was a similar profile for major input prices. Some 75% did not expect to see rising prices for major raw material commodities (e.g. steel), energy or oil over the next year and nearly one in three did not anticipate a recovery in the mid term (the next one and a half years).

It is clear from the Survey that sentiment is reasonably gloomy for the next year or more in terms of revenue recovery. The focus is therefore evidently on cost control where procurement is a major contributor. The current downturn has clearly placed greater expectations on procurement performance and the challenge has been set. The performance of the function and how it responds will contribute significantly towards the continuing rise in the perceived importance of procurement by organizations.

In short, the economic slowdown has presented procurement with the opportunity to show its worth.

Key Survey Findings

eProcurement – Use and Penetration

Given that electronic enablers for procurement have now reached a reasonable state of maturity, we were interested to understand how effectively these were being employed by organizations.

The technologies we refer to are those which support source to contract activities such as eRFI, eRFQ and Auctioning together with transactional eProcurement platforms covering catalogs and workflow approvals.

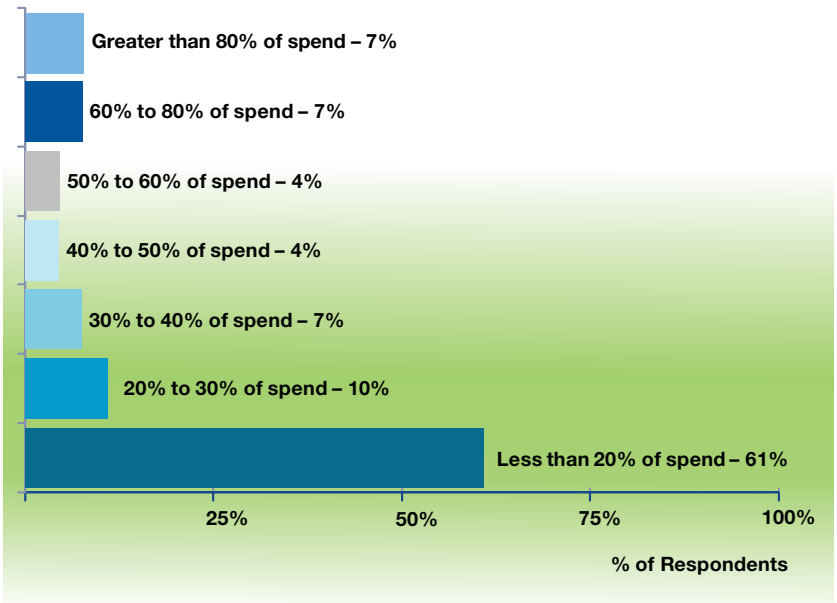
Given these have been about for more than ten years, we expected to find a healthy amount of use of – particularly in the large organizations ($1bn plus revenues) which made up the majority of respondents. What we found was quite the opposite.

More than 60% of organizations stated that less than 20% of their spend was channeled through applications of this nature. Conversely, those declaring a significant use of such applications (with 80% or more of their spend subject to them) represented a mere 7%.

Some 80% of those organizations surveyed put less than half of their spend through such applications. What is interesting is that while the majority of organizations possessed some form of eProcurement applications, the use and application to ensure third party expenditure coverage is sub-optimal in the current climate.

Only one of two conclusions can be drawn from the findings. Either that the applications do not best serve the needs of procurement functions or, more likely, that organizations are

Figure 3: How much of your spend utilizes eProcurement technologies?



struggling in terms of how best to apply them.

In trying to unravel this conundrum, it is best to consider the transactional and sourcing applications independently. The issue for the transactional applications primarily focuses on penetration. In our experience once obvious areas of indirect spend are enabled, such as stationery, IT hardware, promotional goods and IT consumables, organizations start to struggle. As one respondent commented, "my eProcurement platform is no better than a stationery ordering system."

The reality is that most indirect spend relates to services that do not easily lend themselves to a structured catalog format. Instead these areas of spend rely on form-based functionality which can be highly effective and user-friendly in capturing demand requirements, but is often overlooked as too hard when configuring the solution in many organizations.

In parallel, these applications often suffer from issues of compliance amongst employees.

Building a solution is one challenge but getting people to use it is another. Too often people find ways to bypass the system and revert to traditional ways of transacting; for example employing the phone as an easier medium. Unless a robust compliance strategy is in place, the amount of spend directed through a system is likely to remain low. The knock-on impact can be that the significant investment in these applications actually hinders the ability to manage, monitor and control compliance effectively.

Finally, a contributing factor to the low uptake of transactional eProcurement systems may relate to how they 'fit' into the overall landscape of enterprise applications. Too often the self service eProcurement platforms are bought and implemented with a perception that they will provide the 'one stop shop' for all spend. In truth some areas of spend are simply not suited to this type of application and are better served through the use of other channels such as standard ERP functionality or purchasing cards. A simple example would be utilities where the transaction count is very low and payment tends to be made through call off and then cross charging to business units.

To be effective the eProcurement application needs to be positioned appropriately as one of the channels for transactional management within an overall spend management solution. The key to robust use of such a solution is to have it focused on the high transaction non stock areas of spend and integrate it into the wider suite of applications used to manage spend.

While this might seem obvious it is clear from observation that this tends to be omitted by many organizations leading to confusion of the exact remit of such eProcurement solutions.

Turning our attention to the more dynamic commerce applications of eProcurement such as eRFX and auctioning, it appears that a similar lack of focus prevails. One respondent commented that they found it difficult to understand how to apply the tools available to areas outside low value, non strategic spend aspects.

From discussions during the Survey we pinpointed several issues impacting broad scale adoption of these applications. Firstly, integrating the tools into the sourcing process and migrating them to a business as usual standing rather than applying them on a case by case basis. In effect changing the buyer's mindset from one of 'when to apply' to one of 'when not to'. Too often the eProcurement applications available to the procurement professional do not seem to be employed in the situations where they would provide the most benefit, such as complex types of procurement, or as a tool to gather more significant information to help enhance informed decision making.

Last year we raised the talent challenge as a consistent issue facing procurement. We found that the majority of procurement functions were faced with an issue of finding the right caliber of resource to help execute strategies and sourcing activities. It is possible that part of the problem with applying eProcurement applications for optimal benefit is the level of procurement capability of some members of the procurement community - and their ability to understand how and when to use eProcurement. This seemed to be borne out by some of the comments we picked up during discussions with respondents who highlighted this as a contributing factor.

To overcome these twin issues we would recommend that organizations integrate such applications into the DNA of day-to-day activities, while at the same time launching appropriate classroom and on-the-job training for buyers to help familiarize them with the tools at their disposal and improve the understanding of the value-add that can be achieved.

In an era where time-to-savings is paramount, we feel it essential that organizations seize the opportunity presented by such tools to improve results and productivity.

Procurement Organizational Development – *Evolving Models*

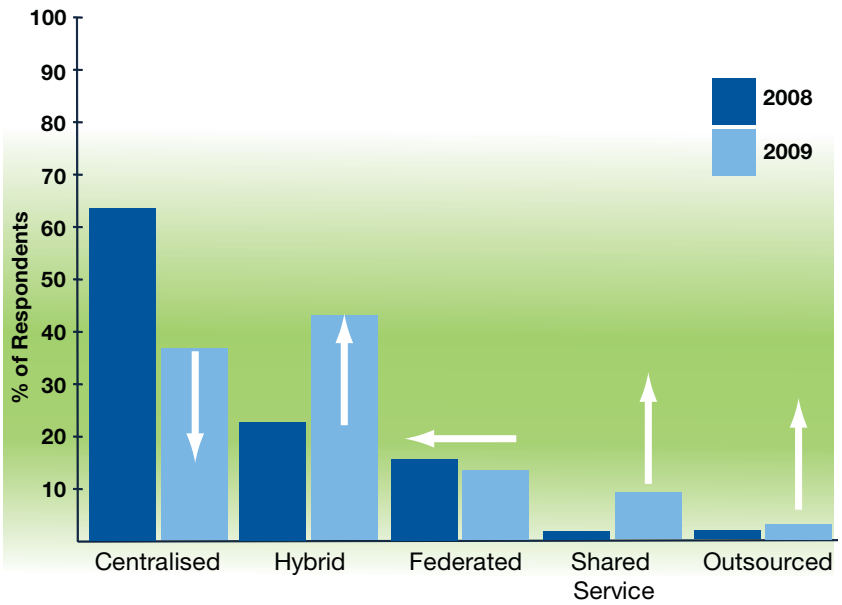
Last year one of the major trends we assessed was the organizational models that procurement employed. In this year's Survey we checked on the associated developments in this space.

The findings revealed a significant shift towards a hybrid model from more centralized vehicles.

In the 2008 Survey we found 63% of organizations favored a centralized model. In this year's Survey that number fell by over a third to just 36% of organizations. We found that the use of hybrid models rose significantly from 22% in 2008 to 41% this year. Those choosing to employ a federated model remain reasonably constant at 12% dropping only 3 percentage points from the previous year. Further interpretation of these findings draws out some interesting trends.

We found last year that the drive towards more centralized models was

Figure 4: Organizational models in Use by respondents



being fuelled by a need to gain control over direction and priorities. This is a natural reaction to the evolution from federated models where decisions tend to be taken locally and therefore can create challenges in coordination.

However the primary shortcoming of a centralized model is the difficulty of interfacing with end users to help shape requirements and control demand. It is perhaps unsurprising that there has been a shift towards a hybrid model that helps address this issue while maintaining coordination and direction.

A hybrid model combines the features of central direction with distributed service provision for procurement. Given the pressures to drive benefits, the need to ensure close proximity to end user communities rises in importance.

It was also interesting this year to note the emergence of new organizational models, notably shared services and outsourced operations, which accounted for 1 in 10 of surveyed organizations. The specific organizational drivers behind each of these models are different but we would conjecture that they include a need to deliver economic benefit as well as provide a more efficient and effective self-service options to all procurement end users.

The shared services model is driven by the need to secure greater efficiencies in procurement operations by removing duplication and thus driving down the overall cost of operations. It is particularly effective for the more transactional elements of procurement activity and helps to amortize the cost of operations. Where organizations are seeking to find cost efficiencies the move to utilize shared service concepts is understandable. However, it remains to be seen how well this shared services model will fare in integrating into local business units as the model unfolds.

By contrast outsourcing has its imperative in a different direction. With the 'dash for cash' pressure on businesses, many are now turning to service providers who offer the opportunity to accelerate benefits through established deals and efficient transactional processes. In effect, rather than trying to build your own solution the outsourced provider extends the opportunity to buy into a ready-made solution in exchange for some of the potential buying benefits inherent within an organization. We have found this to be of particular appeal in non-strategic areas – particularly in indirect spend categories. Our experience of the market also shows momentum to apply such models in the transactional purchase-to-pay (P2P) space leveraging offshore low cost solutions backed by on-demand technology platforms.

The issues with outsourcing, however, are how to effectively integrate the service into an overall procurement strategy and organizational structure, while still creating a sizeable service package that will attract providers.

For those contemplating using a form of outsourced vehicle as part of service provision, the question is therefore not 'whether to' but 'what to'; in short, trying to identify those areas of spend or process that would benefit from accelerated speed to benefit. Identifying 'non-strategic' activities that are more easily outsourced can be subjective; the optimal approach is to build a fact-based analysis of what spend areas and processes are to be outsourced, and why.

Also, in talking to outsourced providers we have found that the attraction of an arrangement is very much governed by size and economy of scale. Taking on a small number of categories or a discrete process often frustrates the ability to leverage economies of scale and holds little attraction because the difference to the overall bottom line is minimal. In this situation neither the service provider nor the customer gains real benefit.

Despite the challenges, we expect to see a significant increase in market activity with respect to the use of outsourcing over the coming cycle. As the global downturn continues to bite, this growth will be fuelled by an agenda driven not only by cost cutting but in equal measure the speed to deliver tangible benefit.

Spend Visibility – *Improving the Line of Sight*

It seems from this year's findings that poor visibility of expenditure and performance continues to dog the procurement professional.

The top area of focus for investment by surveyed organizations this year is on improving the quality of spend information and its availability. This remains consistent from the findings of the 2008 Survey where it also ranked as the top priority.

It would seem that despite the spotlight on this over the past twelve months, the availability of quality management information remains an Achilles heel for the procurement professional.

The focus is understandable. Procurement is expected to deliver significant, tangible and rapid cost reductions in third party spend. In order to deliver on this the procurement professional must be well informed. What is spend? Who do I spend it with? And what are the fundamental starting points that many struggle with?

Having detailed reliable data is the bedrock of effective procurement. It fuels the ability to construct innovative strategies to secure optimum value for money in the market, to track anticipated savings to the bottom line and to provide the means to monitor supplier performance. Without this data these areas become too reliant on guesswork and gut feel.

The all too common problem is that what information is available is poor, too high level and poorly aligned to meeting these needs.

This continues to cause concern given the amount of IT investment that procurement has enjoyed. As we mentioned in last year's report there is no shortage of systems to manage data within most businesses. Yet despite the investment in ERP applications and 'best of breed' procurement solutions, poor information remains a perennial problem. The only question that should be posed therefore is 'why?'

Poor information is invariably the result of broken master data. The issues with master data management (MDM) include:

- Fragmented governance to drive consistent data entry with blurred accountabilities and ownership.
- Incomplete descriptions and classifications.
- Misclassifications of spend types.
- Lack of consistent schemas and data hierarchies.
- Inconsistent taxonomy and part numbering between locations.
- Classifications and descriptions captured at too high a level frustrating the ability to understand spend at a grass roots level.
- Disparate procurement platforms employing differing data structures in a non integrated way.

These problems are particularly acute in non stock areas of spend and for services. As one CPO mentioned during the Survey, "I am not sure whether my indirect spend is €1bn or €3bn as the reports are so inconclusive."

It is difficult to see how procurement can raise the agenda beyond a tactical cost saving focus when it is starved of information. Such information holds the key to a range of significant benefit areas such as driving higher degrees of standardization, aggregating across business units and geographies and helping to drive cost of capital reductions through better management of stock holdings.

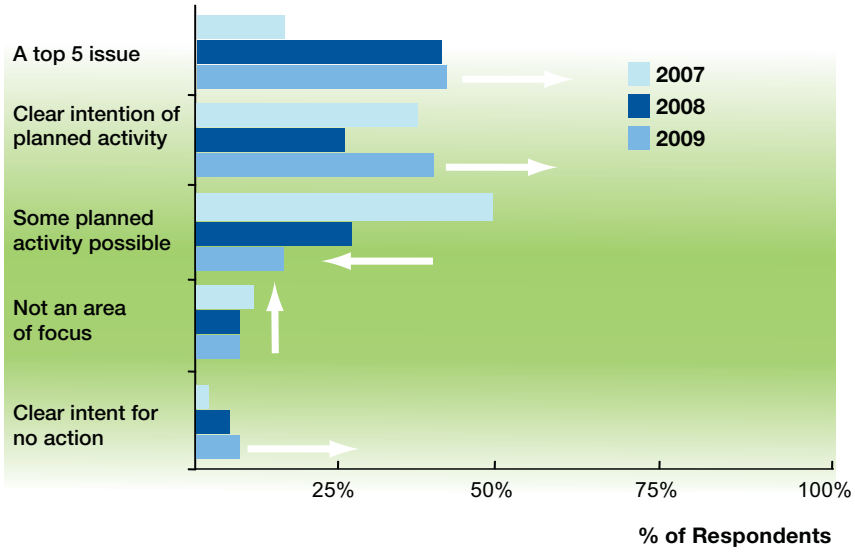
From our discussions during the Survey and our work with organizations, it is clear that the problem of MDM is systemic across all sectors and regions.

In last year's Survey we found improving information a dominant theme. The results this year demonstrate that this focus is intensifying. In 2008 67% of surveyed organizations declared improved information to be a clear area of intended action or a top 5 issue for them. In the most recent Survey this had increased to 81% - an increase of almost 42% in the surveyed population.

around new or incremental IT solutions or indeed manual intervention. Such an approach fails to address the underlying issues.

Our second hypothesis is that there is a distinct failure to recognize the inter-related issues which cause such breakdown in information. Rather than adopting holistic organization-wide solutions businesses have defaulted to point solutions that address only part of the problem and are not sustainable. This is neither tied into the overall enterprise of procurement integration nor will it address the end game through effective compliance monitoring and management.

Figure 5: How important is information and availability - 2007 to 2009 results



While the focus on resolving this problem is increasing it also appears that previous efforts have not yet delivered successful results.

Given that this has ranked as a key issue for the past three years we must ask why so little progress appears to have been made.

Our first hypothesis is that organizations continue to treat symptoms rather than the root causes of poor MDM. In effect, responses to the inherent problems have revolved

Finally the issue of data integrity is not exclusive to procurement. Management of data, data input, systems and IT platforms, bills of materials and classifications regularly sit outside of procurement with other functional areas. In effect, procurement is a customer of information, not an owner. If solutions are to be effective then organizations must recognize that an integrated pan-organizational response is required.

Effective Supplier Management – *Managing Risk in the Supply Base*

While cost reduction remains at the fore of the procurement agenda, the risk of supply disruption from financially distressed vendors is not far behind.

Inevitably the economic turbulence is affecting buyers and suppliers in equal measure. While procurement executives are chasing significant cost reductions in spend to help support balance sheets, there is also a growing recognition of the inherent risk posed by distressed suppliers.

The effects of the credit squeeze, reduced order books from inventories being run down and lower demand are all having an effect on suppliers. While many will weather the economic storm, for others it will spell disaster. Business failures are on the increase and the impact on buying organizations in the main is poorly quantified.

The Survey results showed that a focus on supplier management to avoid business disruption from bankruptcies in the supply base was the second highest area of activity for organizations responding to the economic downturn. It is therefore no real surprise to see that 65% of respondents indicated improved supplier management as either a top 5 initiative or an area of planned activity. Only 12% of organizations stated that they had no intent to improve the existing supplier management approach.

Typical supply bases can run into many thousands of vendors. Although a small number of these can account for the majority of spend – perhaps a few hundred – risk does not necessarily restrict itself to solely fiscal considerations.

If we consider a small supplier who represents less than 1% of total spend, it's true to say that on financial terms the supplier would not be deemed critical. However, seen through another lens things can appear quite different. If they supply a critical compound, component or material for finished goods then their importance rises exponentially. While this may seem obvious, it raises a number of challenges for the procurement executive.

Challenge one is getting to understand the relative strategic importance of vendors across the supply base. While an obvious list of candidates will always exist, understanding the complete picture can be somewhat more complicated.

Often intelligence on relative importance does not reside wholly in procurement but requires close cooperation with end user groups. Successfully affecting and influencing this requires strong stakeholder management and cross functional working.

Once the supplier portfolio is thoroughly understood the procurement team is then faced with ensuring that such vendors can be evaluated on a regular basis. This should consider a range of factors from financial to operational using robust tools, techniques and methods – not all of which may be in place.

The final area of challenge is then to work in concert with business units to create contingency plans that mitigate supply disruptions.

We anticipate that these challenges will result in organizations segmenting their supply bases to understand strategic, bottleneck, leverage and administrative supply areas of spend. This will provide the basis for organizations to then align tools and techniques of supplier management appropriately with the characteristics of supply and to manage spend more on a portfolio basis than is done today.

There are also implications for the capabilities needed by procurement. A good buyer does not necessarily make a good supplier manager. While the former concentrates on creating

innovative go to market strategies and exploiting these, the latter depends on good relationship and operational management skills.

We have found that one of the biggest challenges to embedding robust supplier management within procurement is differentiating these skill sets and having the differences recognized by the organization.

We will discuss the continuing talent problems in the next chapter but one of the keys to successfully pursuing effective supplier management in the current climate will be aligning the right relationship and analytical skills with the tasks at hand.

Finally, trying to understand the 'at risk' suppliers within any vendor base goes well beyond simple financial analysis. It will need a 360° assessment. Organizations need to be considering not just the relative strength of vendors' balance sheets but their downstream exposure within the vendors' own supply chains, their operational competencies and defined contingency plans as well.

Upstream the procurement executive will need to consider effective in-house contingency plans to overcome areas of possible supply disruption. These may include finding alternative sources of supply (where feasible), switching costs, buy-outs for certain types of constrained supply, changes to specifications and the accumulation of strategic stocks.

All in all, the current environment demands a higher degree of scrutiny and wider consideration of factors than would be typical in a more benign economic climate. In building future supplier management capabilities the organization will face the challenge of bringing on board comprehensive tools and techniques as well as finding, training and deploying the right talent to execute effectively.

The Talent Gap – *Continued Issue of Appropriate Competence and Capability*

We highlighted last year that the CPO continues to see a dearth of talent as a major obstacle. Despite the focus over the past 12 months this issue appears to have shown no signs of easing.

Second only to improved information, capability improvement and talent management rated highly as a focus area for the second year running. Of the surveyed organizations, some 65% of executives considered this to be a top 5 (30%) priority or a key spotlight area (35%).

This demonstrated an increase in emphasis over last year where only 27% saw it as a top 5 and 30% as a clear area of focus. From comments collated during the Survey process we would surmise that the raised expectations on procurement to deliver increased cost savings has re-emphasized the need for talent to execute.

In our analysis last year we drew attention to the shortage of top talent in procurement with most organizations searching for the same people, which was further complicated by the emergence of new global players from India and China.

When considering that few organizations have sought to reduce their procurement functions as a result of the economic downturn it is perhaps no surprise that the talent pool remains constrained.

Indeed, as mentioned earlier we found that a high percentage of CPOs were seeking to or continuing to augment their functions' skilled resources. Such a combination would explain in part the continued focus on developing, retaining and recruiting talent.

Our prediction in last year's Survey that any economic slowdown would lead to an intensification of the 'talent war' appears to be being borne out this year. The acute need to cut costs has

only demonstrated to board executives the importance of procurement as a lever of cost control.

As a consequence the CPO is under increasing pressure to deliver faster, larger results. To do this they will need the right talent to execute differing approaches capable of satisfying this demand.

Given that growing the right talent is a slow business, requiring time to train and develop mature experience, this presents a real challenge to organizations. The conundrum is of course that many do not have the time to wait given they need to be delivering results now.

Faced with such a dilemma the only alternative would appear to pursue one of two short-term strategies:

- Recruit
- Use interims/contractors

The issue with recruitment is of course the shortage of talent. It appears that despite a shrinking jobs market, top procurement talent still commands an economic premium and is universally hard to find.

Those in possession of talented and experienced resources seem to be more focused on retention in the current climate and the uncertainty has also made professionals reconsider job changes. So it would seem that effective recruitment opportunities are limited in the current market.

The use of interims also poses issues for organizations. While it presents ready access to qualified and experienced staff it has clear drawbacks.

Such resources are temporary and the experience they accumulate with the host organization is lost when contracts come to an end. Equally, given their temporary status, it can be difficult to integrate such resources into the business as usual environment.

However, with the pressures on procurement executives to deliver results and the difficulty to recruit appropriate talent in the market, the use of interims presents a ready solution to securing the needed firepower necessary to address spend in the short term.

What is perhaps of more interest is the developments that need to be pursued in order to alleviate the long-term problems surrounding capability.

There appear to be six key steps:

1. Review the portfolio of resources available and profile the talent within it based on established and potential.
2. Determine the areas of capability needed to execute procurement's remit: sourcing, supplier management, analysis, major contracting, category management etc.
3. Create the appropriate classroom training needed and the follow-up on-the-job training alignment.
4. Understand the gaps and create a clear strategy to address these through recruitment and home grown talent.
5. Create a clear retention strategy for key resources and top quartile personnel.
6. Evaluate the changing role of procurement and consider future skill areas needed.

These simple steps should form an integrated approach. Doing one or two in isolation is not likely to materially change the talent problem. We uncovered elements of these during the interview process but seldom in any holistic sense.

If we as a community are to deal with this fundamental problem then it will take a fundamental and cohesive approach rather than simple mono focused initiatives. Doing what we have always done will simply yield what we have always had.

Supporting Articles

It is relatively common for procurement professionals to have little visibility into real market price developments, as most procured products or services do not allow for effective global or local trading exchanges that establish market prices

Managing Commodity Price Fluctuations and Volatility

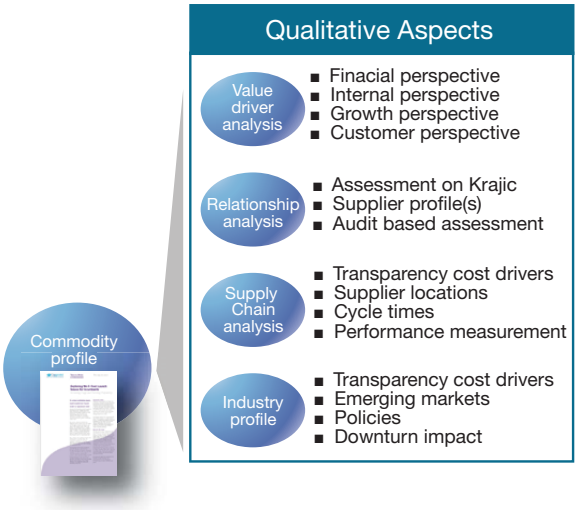
Colin Hartog, Managing Consultant – Procurement, Netherlands
Hamish McKechnie-Sharma, Principal – Procurement, United Kingdom

We are in rapidly-changing and unpredictable times, in which commodity prices are being driven to extremes on a regular basis. This is the dawn of an increased requirement for flexibility and agility where procurement functions large and small need to confidently manage cost reduction in an accelerated fashion. As highlighted in this Survey, improving the line of sight remains a critical activity for procurement professionals, yet the task at hand is heightened in complexity with the current economic shifts and patterns.

The Survey findings indicated that contract renegotiation is the largest strategy being adopted to mitigate current economic challenges, with 20% of all responses highlighting this. Additionally, participants were unclear about when the stabilization of prices would return to more established levels, with 27% of respondents feeling this would be in excess of 2 years from now. Given these challenges, procurement departments are questioning how best to deal with price changes and revisions against new contracts.

While contract renegotiation is a core part of each procurement organization's function, it is no new phenomenon. During periods of economic expansion, we have seen suppliers maintain year-on-year price increases, yet in periods of economic downturn, suppliers typically follow general inflationary indicators. It is relatively common for procurement professionals to have little visibility into real market price developments, as most procured products or services do not allow for effective global or local trading exchanges that establish market prices. As a consequence negotiated price agreements are likely to be validated by the facts at hand, and are wholly dependent on the competence and capability of the professional buyer.

Figure 6: Market development versus price changes



Managing switching and administration costs are additional complications buyers often have to handle effectively with suppliers, where more often than not organizations absorb the price increases directly. Increasingly, suppliers have the balance of power. The challenge, therefore, lies in how to address the bargaining power by increasing the buyer's market insight in order to influence the factors for both pricing and those price development rules affecting contracts due for renewal.

Market Development Versus Price Changes

The difficulty for a CPO and his professional purchasers rests in the fact that if price changes are fluctuating often and erratically, how can these be understood effectively during supplier negotiations? How easy is it to create and maintain a price revision formula that could support the renegotiation of contracts? And what is happening in the environment in which the supplier is operating?

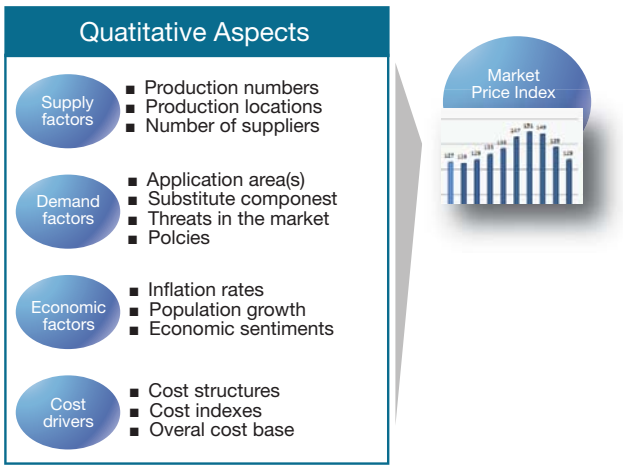
An extensive commodity profile report for any given product or service that an organization is buying should, ideally in collaboration with the cross functional teams and the supplier, identify and expose the basic cost elements. Deep analysis increases the quality and maturity of commodity knowledge across supply and demand areas such as development of production numbers and locations, usage and availability of raw materials, supply chain lay out and application areas of the products or services. In addition, economic, technology and other external market forces will all have a part to play in the pricing model for a supplier.

Introducing Market Price Indexing

By using a recently developed Capgemini Consulting support tool known as "Market Price Indexing (MPI)", we believe that procurement departments will be able to benefit from further transparency in understanding costs and their respective drivers as close to a real-time basis if needed. The outcomes of the commodity profile are used to derive an index figure that provides an overall direction on the development of the pricing for a commodity.

Capgemini Consulting maintains a significant historical database that contains a comprehensive collection of cost drivers and economic indicators ranging from the Baltic Dry Index through to the Japanese inflation rate and the Chicago Purchase Managers Index. There are also sufficient data

Figure 7: Introducing market pricing indexing



Procurement intelligence can be used to improve the procurement organization, but in order to make this a successful tool organizations often face a number of critical challenges

sources publicly available for similar information to be extracted and ensure a fairly accurate MPI.

Having earlier identified the cost drivers and indicators that will most likely influence the pricing for a suite of goods or services with a supplier, the sources for these drivers are then assessed and assumptions are agreed on the level of influence. Once complete the interdependencies are entered in the MPI support tool that then also models the historic development of an indexed price: the Market Price Index. Once in place this allows for the regular monitoring of those goods and services that are pertinent to the procurement organization.

Using the MPI

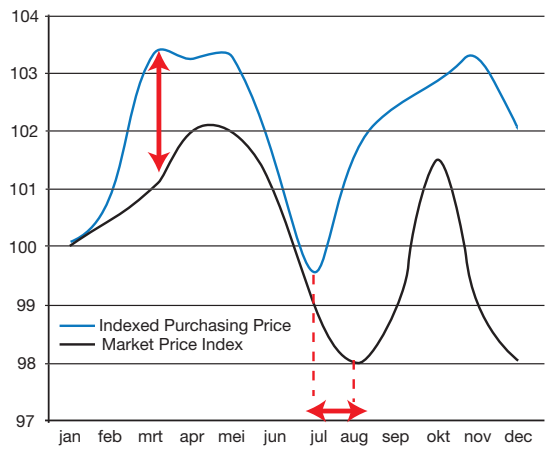
After creation of the MPI – with or without the input of a supplier – the data can be shared between the buyer and supplier. When a supplier contradicts a cost driver or the level of influence, the MPI can be easily amended to levels that are in line with the perception of the supplier. If the price development for that supplier still shows a difference with the calculated index, the buyer is well armed to initiate effective price negotiation discussions with the supplier. The data provided would allow for the buyer and supplier to have an open discussion on both mark-up and profitability. Ultimately this allows for an increased level of dialog between both parties in what are turbulent times for organizations focused on cost reduction. The MPI can, as the graph here shows, question both the level of a price change and its timing. If an indexed price for a commodity is showing a more rapid increase than the MPI, there is a reason for dialog. Such tools being used collaboratively between buyer and supplier will drive a greater level of professionalism in the discussions when revisiting price negotiations and revision formulas.

Displaying and maintaining the MPI

Displaying the cost driver database or MPI data in a web-based environment across an organization's intranet enables all procurement professionals to converse with the supply base in a consistent and coherent fashion. Even if it is not possible to arrive at a precise definition of an MPI, but a list of appropriate indices, cost drivers and rates can be provided, this alone will provide an improved level of procurement intelligence, awareness and maturity throughout the organization.

Centrally maintaining the data for the MPI is, in our view, the most efficient way of data collection. This allows for

Figure 8: Market pricing index



limiting any data redundancy stored locally and other such challenges when individuals leave organizations. This collaborative way of working keeps value-added procurement activity at the heart of a procurement organization.

We would recommend regular updates to the MPI-based data depending on the requirements of the procuring organization and the volatility properties of a respective commodity.

Why use the MPI?
Many job descriptions in the strategic procurement area are focusing on aspects like "responsible for monitoring market change…", "monitoring market dynamics", "lead internal and external benchmarking..." or "market knowledge owner for the category…". The MPI tool, the accompanying approach of in-depth commodity profile knowledge, and above all a low maintenance solution, will improve the bargaining power of the procuring organization. In addition it brings insight as to how and when prices can be revised.

Procurement Intelligence and Market Information are on the agenda for a large number of organizations. The 2008 Survey already showed this as a critical top 5 issue for over 35% of the respondent organizations, and this year's Survey continues in the same vein. Having a cyclical approach to maintenance of data and commodity profiles will also assist procuring organizations in managing risk more effectively across the supplier base. Understanding the development of the players within your ecosystem will augment supplier relationships to the next level of maturity.

Using Procurement Intelligence to Improve Procurement's Success

Procurement Transformation team, The Netherlands

Procurement intelligence can be divided into a number of key focus areas: spend intelligence; procurement performance measurement; supplier performance measurement; and commodity intelligence. Most senior procurement executives cite spend intelligence as the number one priority. For the third year in a row in the Capgemini CPO Survey, the improvement of spend visibility remains one of the CPO's top 5 initiatives – this is not a coincidence.

Focus Areas for Procurement Intelligence
The four main focus areas of procurement intelligence are defined as follows:

- Spend Intelligence: the collection and subsequent analysis of various third party expenditure across the company. This information is typically used to leverage purchasing and supplier rationalization in strategic sourcing, budgeting and planning functions and for contract compliance. It provides the procurement organization with the ability to monitor purchase movements, ensure continuous improvements and subsequently realize these improvements
- Procurement Performance Measurement: measuring and analyzing the most important procurement indicators within the organization. These indicators need to be based on the organization's mission and strategy, and aligned to its overall performance management structure.
- Supplier Performance Measurement: a proactive process of setting and monitoring expectations and targets with suppliers. It uses both mechanized metrics and non-mechanized measurements, and is a strategic tool to support continuous

improvement across the performance of the supply base with respect to quality, cost, delivery, development, innovation and management.

- Commodity Intelligence: the collection and analysis of supply market data and key market drivers. In contrast with the other three areas, this area has an external focus and often uses data sourced externally to the organization.

Spend intelligence makes use of the basic data in an organization and should be the first area of consideration for improvement before embarking on other procurement intelligence areas.

Basic Requirements for Successful Spend Intelligence

Before spend intelligence can be put to optimum use, CPOs need to fulfill three basic conditions: effectively and efficiently extract data from multiple sources; ensure the use of high quality and consistent data; and identify the user requirements.

At one time people believed that spend intelligence involved nothing more than extracting data from accounts payable systems, using a classification scheme such as UNSPSC, eClass or any other proprietary coding scheme, and creating a data warehouse and a spend cube for analysis and reporting. This is far from accurate and is difficult to achieve without the organization addressing the three critical challenges:

Challenge 1: Effectively and efficiently extracting data from multiple sources

Retrieving the data from systems is the first spend intelligence challenge. The figure below shows a spend intelligence architecture and the different steps needed to obtain and analyze typical spend data.

This data is often extracted from various sources (e.g. Legacy, ERP, AP, MRP, P-Card, Third Party Systems, Suppliers etc.), and it needs to be migrated (from encoded data to descriptions) and integrated (data needs to be cleansed). The integrated and cleansed data is stored in a data warehouse, together with historical data. Reporting and presentation tools are used to retrieve the data from the data warehouse and it is then used for reports and analysis.

Reporting data is often analyzed within a dashboard environment, which is typically created to generate self

Figure 9: Extracting data from multiple sources

Automating tactical processes allows companies to focus on strategic initiatives

managed reports at pre-defined intervals. These intervals can be yearly, quarterly, monthly, weekly or even daily depending on the real time capability of solutions available. It is not always possible to refresh the data daily and this may not be necessary in some instances. Spend intelligence can be used for strategic decisions that have long-term planning implications. It can also be used in operational processes – for example to monitor compliance – where the daily updates might be somewhat more favorable. For this to be successful, it is important to ensure the right infrastructure is in place given solutions may range from complete system overhauls to ensuring all linkages are in place.

Challenge 2: High quality and consistent data

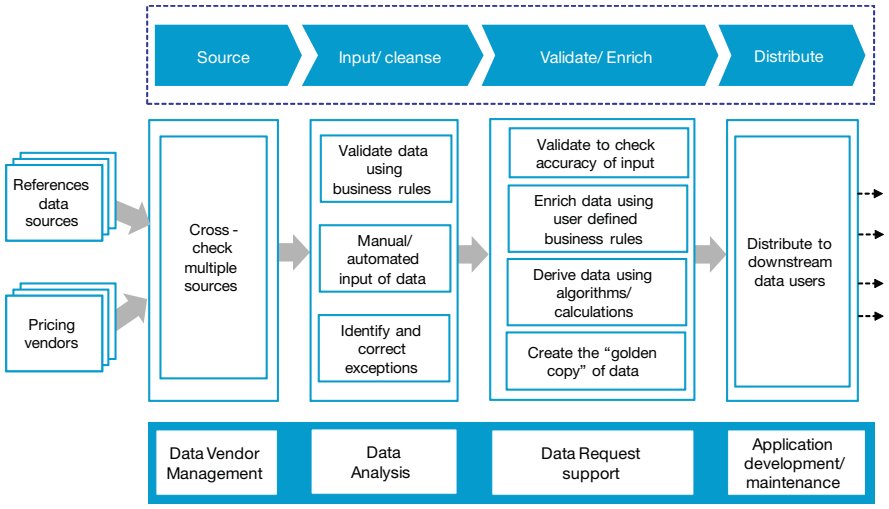
The second challenge is the quality of the data that is used across third party spend intelligence. Data quality is notoriously unreliable and therefore the data would usually undergo a cleansing exercise. This would typically transcend through the following:

- Completeness – there are few to no missing records
- Records themselves are complete within their fields
- There are no duplicate records
- Obsolete, out of date and unwanted records are removed
- Values are standardized
- Data is consolidated and made consistent often across multiple sources.

Data is usually retrieved from different systems with varying data models. The earlier consensus was that solving the data quality issue at source would be the answer, but it has ultimately created silos of information across ever expanding systems. This issue is compounded further in the current economic climate where merger and acquisition activity is becoming an increasingly regular occurrence, particularly in larger organizations with multiple ERP backend and procurement systems. A regularly occurring obstacle is that many companies continue to omit transactions from their system capture which feeds into reporting. Data encryption remains equally important.

To resolve this issue, many companies have developed in-house applications containing numerous rules for cleansing and classifying data. Although these solutions serve an initial purpose, they are often expensive to maintain and provide limited possibilities for data enrichment and scalability over time.

Figure 10: Data management programs



An alternative and increasingly preferred option to solving the data quality issue is the adoption of advanced cleansing engines. These use algorithms and sophisticated mechanisms to detect, understand and identify the patterns across data from multiple sources. Although the resulting data is not perfect, it is often easy to attribute common outputs and behaviors. These engines are not only able to cleanse a large part of the data automatically, but are also capable of enriching the data by using external data such as product data catalogs.

All the issues above are caused by poor data management and the use of master data management (MDM) could be a helpful solution as highlighted in the next article in this Survey report. MDM can be used to address a number of concerns including poor data quality, lack of common data standards, the need to improve operational efficiency and lack of resources for data management. However, to succeed, it remains important to prioritize areas that will have the greatest impact on current operations. The areas where costs are associated with inaccurate data or customer dissatisfaction should be handled first.

The Capgemini Data Management solution framework shown here illustrates an example of how MDM can be implemented in the organization. The data needs to be sourced, based on multiple data source references and vendor data, before it is cleansed. The cleansed data should be validated and enriched. After that, the data can be distributed among its users.

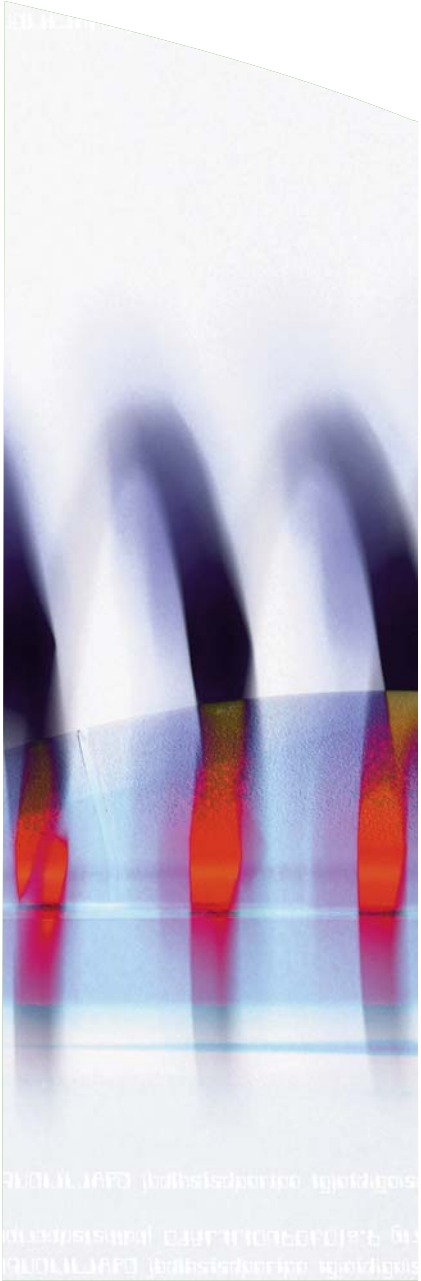
Challenge 3: Identify user requirements

The third and final spend intelligence challenge concerns user requirements. The key stakeholders of spend intelligence need to be identified and involved to make sure that the spend intelligence solution is fit for purpose. The requirements gathered from these stakeholders can be used as input for the reporting and analyzing tools. In general, key stakeholders are part of the day-to-day business and as such are best placed to understand the types of data required to maintain and run an organization's operations. Summary reports and dashboards continue to provide a good overview of the most important data, although if extra analysis is necessary, more detailed reports should be made available.

When embarking on any journey associated with improving spend intelligence, it is often unclear as to what the data exactly means, even though there is a perceived understanding of this within the business. Greater insight can be achieved where key stakeholders and the IT department work intrinsically together. It remains a continuous process and will eventually lead to a better understanding and comprehension of procurement within an organization.

How to improve your procurement organization

When the three basic requirements are met, organizations can use spend intelligence as a successful tool. It will improve procurement's ability to provide timely, consistent and accurate spend data. This data can be used by all departments that have supplier relationships, but the procurement and finance departments will find it the most useful. As with any category management process, the procurement department can use the spend data to improve contract management, identify savings opportunities, track benefits and analyze the total cost of ownership. The finance department can utilize the spend data as input for its budgets and compliance monitoring, which in turn can drive effective procurement activity.



Procurement Master Data – The Bedrock of Success

Jim Abery, Vice President – Global Procurement Transformation Leader

Information is built on data. The quality of master data ultimately dictates the integrity of output information and reporting. In our experience organizations are continually hampered in their efforts to optimize the performance of their procurement activities because of the paucity of information and availability of reliable data. In effect too many procurement activities are executed when 'driving blind' or made on the basis of 'gut feel' or 'best guesstimates'.

Poor master data management (MDM) leads to a cycle of detrimental events. It starts with often laborious methods for gathering data from various systems and employs some degree of manual cleansing to create an acceptable level of consistency. With this, a 'snap-shot' analysis becomes possible, although this represents merely a moment in time rather than real time.

Consequently the disparate nature of underlying data and the inherent data gaps that frequently exist provide the formulae for sub-optimal and/or misleading analysis. Take a moment and consider the following questions:

- Is detailed, granular understanding of expenditure available across all major areas of direct and indirect spend categories?
- Can I compare consistently spend information at supplier, commodity and line item level across sites, divisions, locations and geographies?
- Do I know definitively what I spend, with whom and on what in real time without the need for resorting to spreadsheets and manual intervention?
- Can I track savings consistently?
- Do I have clear visibility of the compliance levels within my organization against preferred contracts and suppliers?

If the answer to one or more of these questions is anything other than a resounding 'yes', then you almost certainly suffer a problem with master data.

Despite the age-old nature of this problem, improvements to MDM have been slow in coming.

Capgemini has identified a number of reasons behind the lack of progress in rectifying this fundamental issue for procurement success.

The ten drivers of poor master data
While no two organizations are identical, the issues with procurement master data typically come down to a combination of one or more of the following factors.

1. Poor Data Entry: lack of data entry discipline is a common issue. This can take a number of forms. Regular problems include; assignment of "other" or "miscellaneous" as a major expenditure category, use of incorrect categorizations, incomplete application of part numbering or supplier description details in master records, duplication of entries and miscoding.
2. Legacy Systems and Classification structures: many organizations have grown through mergers and acquisitions or have devolved their business units (BUs) to recognize distinctive product offerings or markets. Through this process, data structures have often been silo'd with no overarching direction or approach. Hence a "hard hat" at one location becomes a "yellow hat" at another and a "safety hat" at a third – the organization now has three products when in reality there is just one. While data structures may be consistent within individual BUs, harmonized enterprise-wide information is frustrated.
3. Data Structures and Schemas: it is not uncommon to find a lack of a consistent schema (or its

application) within an organization defining material and service group hierarchies. Multiple classification approaches are typical, mingling 'home grown' with industry standard structures. These tend to undermine consistency. In simple terms, when two things that happen to be the same are called something different they become two different items as far as reporting is concerned. Although use of schemas such as eClass and UNSPSC has become more commonplace, consistent application and coverage remains problematic. Without a common data structure to drive uniformity in data entry, inconsistencies rapidly arise and persist.

4 Governance and Accountability: responsibility for data management is fragmented with unclear lines of accountability. Common governance determining roles, responsibilities and accountabilities for data entry, management and integrity are also a major contributing factor. Rigor and clarity provide uniformity and consistency. Conversely, their absence leads to multiple approaches within the enterprise providing an opportunity for conflicting data standards and ambiguity.

5 Over-reliance on IT: despite significant improvements in the available IT solutions to help resolve master data problems they are not a panacea. However good the technology platform is, it relies on process discipline and application. Perceiving IT as a 'silver bullet' negating the need for non-technology activity simply contributes to the problem and holds back progress.

6 Scale of the Issue: The scale of data issues for some can be daunting, leading to paralysis of action.

7 Visibility: poor spend data is regularly ignored as a significant issue within organizations. Its relative importance is frequently not understood or underestimated by executives. The issue of poor data is disguised by a willingness to manage with what is available on the part of line management. The focus is too often on what can be done and not on what is ideally needed.

8 Quantifying the Benefits: the benefits from rectifying master data do not reside with master data itself but from what is done with the resulting improvement in information. When master data is seen as an IT issue the link to enabling business benefit is seldom made, destroying the economic case for investment.

9 Perception: MDM is not seen as the most glamorous or strategic of topics. This can give rise to a 'Cinderella' attitude towards it, relegating its relative importance down the pecking order for investment.

10 Cost and Effort: while benefits have regularly been difficult to attribute, costs have not. Investment in tools, technology, expertise and man hour effort at the enterprise level has often acted as a barrier to act. Delay in tackling MDM over a prolonged period of time allows the issue to become exacerbated, reinforcing inertia through the scale of investment needed.

Issues with procurement master data arise through a combination of the factors referred to above. They can be summarized however through a combination of outcomes. Complacency, lack of ownership, poor rigor and an inability to clearly see and quantify the impact for high procurement performance and ultimately the balance sheet are but a few.

Vast increase in efficiencies and effectiveness can be obtained using a structured, disciplined, and rigorous approach

Quantifying the Nature of Poor Procurement Master Data

One of the reasons why poor master data is so widespread within procurement is an inability to either highlight or quantify its nature and impact. Making the connection between what is often regarded as a

mundane problem and top line performance has escaped many, despite how seemingly obvious this is when a moment is taken to consider it.

Organizations thrive or struggle based on the decisions they make. Decisions should be informed and based on fact, which in the normal course of events requires analysis to draw conclusion. This 'chain' of activity lies behind all rational decisions and its bedrock is accurate reliable master data. If the data upon which analysis is conducted is inaccurate, misleading and/or unreliable, then by definition the whole of the decision making hierarchy becomes contaminated.

In organizations where master data is poor, problems compound problems; poor data results in inaccurate analysis which in turn is used to make decisions that can be fundamentally flawed. Ultimately, this drives up risk of failure, sub-optimal performance and uncertainty.

Issues with master data, in a procurement context, normally circulate around four primary areas:

1 The consistent recording of **supplier data** relating to vendor description. It is not uncommon to have the same supplier represented as multiple 'suppliers' as a result of inconsistent data entry. To illustrate, 'Capgemini' becomes 'Capgemini', 'Cap Gemini', 'capgem', 'CG UK Ltd', 'Capgemini Consulting', 'Sogeti', 'Cap-Gemini plc' and so on.

2 **Part** or **SKU** data. Here a range of problems are evidenced covering descriptions, taxonomies and part numbering consistency. A single manufacturer part which in location A is classified as a '123', is 'XYZ' at site B and 'ABC' at location C. De facto, we now have three separate parts when we analyze.
Equally MDM issues affect descriptions. This is particularly prevalent with non stocked items where bill of materials rigor is absent. Actual description lines can be poor or nonexistent ranging from incomplete description strings (e.g. 'stainless steel bearing') to ones that are inconsistent across business units (e.g. "bearing, stainless steel, 3cm diameter" versus 30mm bearing, steel bearing)

3 The third common issue relates to **categorization**. These normally split into two distinct aspects. Firstly, those with their roots in inconsistent data hierarchies and secondly those with their roots in non classification. All areas of expenditure, whether physical goods or intangible services, belong to category families (e.g. Facilities), which can in turn be broken into commodity groups (e.g. Cleaning) which can again be driven down to sub-commodity groupings (e.g. Cleaning Consumables). When these are not applied consistently it undermines the ability to create robust spend hierarchies. A printer cartridge in one location is categorized as 'Office Supplies' while a sister site has categorized it as 'IT Consumables'. These problems are most pervasive within indirect expenditure areas and can thwart visibility of spend.
More worryingly, however, is where spend is not categorized at all. This normally goes by a number of names; 'other', 'non classified', 'miscellaneous' to name but a few. Often these classifications arose to deal with low value one-off spend requirements but over time they have been abused because of either ease or lack of rigor over data standards and have become a catch-all. In one example organization around 20% of total spend was categorized as 'other'.

4 Finally, MDM issues also affect procurement **performance** data. Suppliers are monitored regularly with respect to delivery. However, the recording of suppliers' 'promised' dates by the buying organization are often confused

with the 'required' date fields. If the buying organization is ordering late and out of lead time it is often common to insert the required date into the promised field. Consequently suppliers are seen as 'late' before they have even started to fulfill the order, affecting accurate rating and monitoring of suppliers.

So, what does all this amount to? After all, companies have long operated with these problems. In short it comes down to effectiveness and efficiency and how this translates into opportunity. The problems with master data described above manifest themselves in a number of frustrations that thwart this opportunity, undermine the effectiveness of a procurement function and erode performance.

The impact of poor MDM determines the difference between top quartile buying performance and average performance. This becomes abundantly clear when we consider the consequences of each of the above areas in turn and extrapolate the impact.

Defining the opportunities from MDM

Despite the challenge that poor MDM can pose, the prize for procurement is significant and demands action. These opportunities depend on accurate, consistent and reliable master data. Benefit on its own does not come from improved master data management, but from what is done with the resulting information and what it makes possible. This link is crucial to justifying investment.

The six primary opportunities arising from improved master data are as follows:

1 Supplier leverage: consolidation of supplier records and consistent descriptions provides the ability to better exploit purchase volumes. Moving from a perception of spending £5m with twenty suppliers to spending it with one makes for a completely different discussion with that vendor during commercial negotiations.

2 Supplier rebates and discounts: utilizing the same improved data as '1' above regularly provides opportunities for quick wins once master data is cleansed. Better understanding of total spend by vendor can increase the spend on which rebates are applied. Equally the same information can help exploit existing pricing models by 'tripping' the buying organization into greater discount bands by recognizing formerly fragmented volumes. These savings can be significant, quick and helpful for covering the investment cost of rectifying MDM issues.

3 Line item leverage: homogenizing part descriptions and numbering provides the ability to exploit differentiated pricing across the organization. Once parts are established as being the same item or service, pricing can be compared across different business units, locations and functions. Once pricing is understood, harmonization with the lowest paid rate becomes a simple and often lucrative exercise.

4 Standardization: similarly, improved line item detail and standardized information opens up the opportunity to standardize requirements to lower cost, but fit-for-purpose specifications. The opportunity to standardize relies on consistent, transparent data to allow comparison and understanding. Standardization typically represents significant cost savings of anything between 10 and 30% but is only possible if MDM is consistent, reliable and robust.

5 Cost of Capital: utilizing the data to drive standardization also provides the ability to improve stock management and the associated cost of capital. Removing inconsistent categorization and part numbering provides the ability to better leverage stock. In

an example from a Capgemini project, a client saved over €400,000 by avoiding the purchase of packaging at one site through leveraging stock surpluses at another. The former regime would have perceived these as disparate parts leading to the continuation of unwanted stock at one site and incurring a capital cost, and significant capital expenditure at another site.

6 Productivity: better visibility of stocked items through consistent part descriptions and line item classifications also improves productivity. Improved data consistency provides part availability for maintenance activities through harmonized records across the stores network. Availability is improved by exploiting duplicate stock holdings in differing stores by removing inconsistent part numbering. Better availability of maintenance items leads to improved up time for plant and thus improved productivity.

We estimate that these opportunities collectively represent one of the most significant financial opportunities for an organization. The scale of benefit may fluctuate from organization to organization, but the scale for large business is likely to run into tens of millions of Pounds, Euros and/or Dollars. When translated to the balance sheet the impact is material, improving gross and net profit, earnings per share and potentially the company's overall rating as measured from a price to earnings perspective.

Exploitation of these opportunities, however, is based on the ability to link master data improvement to a procurement program. The data provided by the former affords the later the ability to drive commercial benefit and gain. As a consequence they represent a symbiotic relationship which, if broken, thwarts opportunity and progress. However, once this link is established, the case for change becomes both compelling and tangible.

Resolving the Master Data problem

Addressing procurement master data requires a 'look back–look forward' approach. Looking back recognizes the legacy of corrupt or inconsistent data that needs to be addressed. Parallel to this is the need to create a sustainable environment for future master data collection. This forward-looking focus is required to rectify the root cause issues of poor master data. These twin areas of focus require a range of integrated activities representing a holistic solution to this endemic problem.

The checklist of critical activities includes:

- A **business case** that clearly links the tangible opportunities from improved procurement data and information to the cost of rectifying the MDM problem.
- A clear **strategy** and **implementation plan** that recognizes the interdependencies across activities, sequences tasks appropriately, and sets the right priorities.
- Determination of the most appropriate **data cleansing** approach for the situation in hand balancing the use of software accelerators with the need for human intervention.
- Clarity about how corrupt or inconsistent legacy data will be **quarantined** from new records until it has been cleansed.
- Setting priorities and scope to maximize cost to benefit, while determining an optimal approach to dealing with the legacy low spend but high volume **tail** of SKUs and suppliers that is unlikely to form part of the cleansing scope.
- Determination of the key **management information** requirements for procurement and the associated prioritization.
- Design and implementation of an **operating model** and associated **governance** required to bring consistency, ownership and accountability for managing master data records.
- Review, definition and execution of **system** and **technology** requirements needed to support management of standardized and effective procurement master data.
- Execution of an effective **change management** program to support consistent primary data inputs by stakeholders and help colleagues understand the link between data entries and business performance.
- Development and implementation of a **compliance** approach to revised data capture and entry standards devised as part of the program of change.
- Finally, define and embed the consistent **data structures**, **hierarchies** and **protocols** to optimize management information and exploitation of business benefit.

Dealing with the legacy problem can be a daunting challenge, but a well considered, pragmatic and integrated approach to change can break down the problem into manageable components and drive momentum.

Summary

The focus on controlling costs and reducing expenditures is a perpetual challenge to organizations of all nature: public, private, large and small. Speak to any procurement professional and they will always pinpoint information as one of the key determinants of success. If progress is to be made in this area then the start point must be the tangible demonstration of fiscal and performance improvement represented by change.

This will require the integration of traditional technology-centric strategies with the opportunity provided by exploitation of resultant management information. In such a context the case for addressing master data becomes powerful. Without the link it remains at best a low priority mundane topic likely to be shunned by senior management attention.

While resolution of master data issues can be daunting due to scale and complexity, the size of the prize in most instances demands action. If a pragmatic well thought through comprehensive approach is taken, with the end requirement always to the fore, the 'elephant', to use a well known analogy, can be eaten in bite-size chunks.

Leveraging the supply base as a source of innovation can accelerate an organization's innovation initiatives and provide it with an increased sustainable competitive advantage.

Innovation-Driven Procurement – *Innovation and the Role of Procurement*

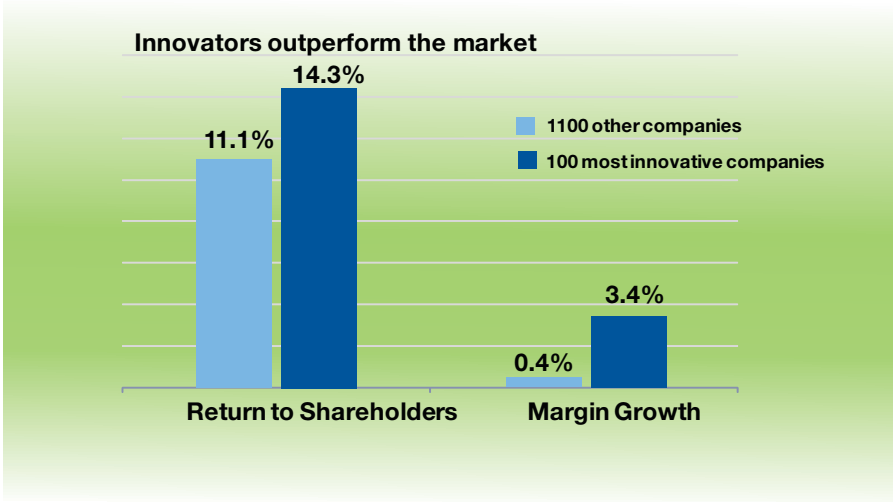
Robbert den Braber, Senior Consultant - Procurement, Netherlands

Innovation may not be the first word that comes to mind when people think about the economic downturn. But previous downturns (and upturns) have proved that companies that continue to invest in innovation gain market share and increase their margins (see figure 11[1]). Nor is Procurement the first word that pops up when one thinks of innovation. But innovation is no longer the domain of the R&D department alone, the most successful innovations arise from networks of people, universities and not in the least: suppliers. Leveraging the supply base as a source of innovation can accelerate an organization's innovation initiatives and provide it with an increased sustainable competitive advantage.

its upsides; it keeps competition at bay and good R&D teams will bring great products to market. However, it does not make full use of external knowledge, suppliers, research institutes and new ventures. Nor does it allow for an open view on other markets and is often rigid in terms of the envisioned application and market. A good example of how this concept has continued to fail over and over again is the Hard Disk Drive Industry[2]: market leaders in this industry stayed close to current customers' wishes by developing the technology purchase. These established firms toppled in succession when successful disruptive technologies were introduced by entrant firms. It is illustrative for today's rapidly changing environments; markets may have shifted well before ideas reach commercialization. This is where Open Innovation[3] comes in, which enables:

- Connecting to both internal and external knowledge bases (i.e. Universities, Venture Capitals);

Figure 11: Innovators outperform the market



What is Open Innovation?

Innovation used to be the domain of closed internal R&D departments harboring all knowledge internally, protecting IP from outside viewers and developing it all the way from idea through to commercialization. This has

- Deciding whether to make-or-buy in each phase of development (spin out and in);
- Leveraging cross pollination between markets, both in development and application;

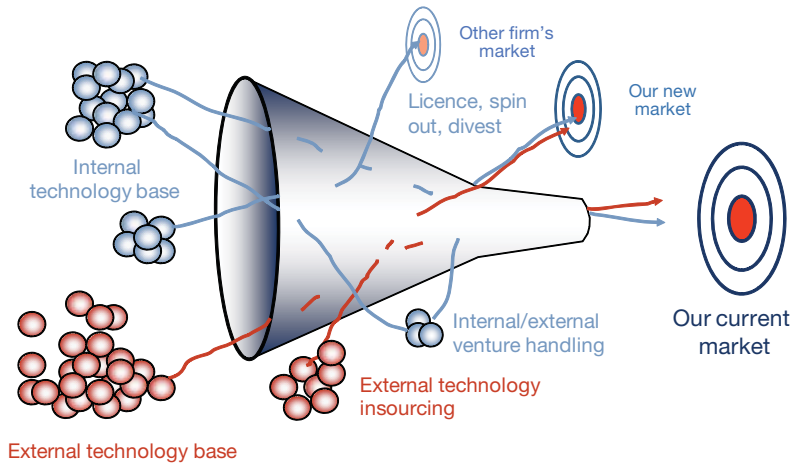
1 Capgemini S&P 1200 1995-2005 research
2 The Innovator's Dilemma - When New Technologies Cause Great Firms to Fail, Clayton M. Christensen, 1997
3 Open Innovation - The New Imperative for Creating and Profiting from Technology, Henry Chesbrough, 2006

- Scouting for technology in related and unrelated markets;
- Enabling the suppliers to leverage technologies in other markets;
- Focusing on today's and tomorrow's customers (i.e. crowd sourcing, networking).

The graph below illustrates the concepts of the Open Innovation funnel[4].

This open focus does not only bring in new ideas into companies, it also allows for a better leverage of technologies. This is something that is difficult to achieve for companies focused on one type of end customer, but easier and more attractive for suppliers who have a portfolio of industries to serve. Allowing suppliers to conduct innovation activities will provide economies of scale, as well as new ideas from other industries.

Figure 12: "Open Innovation funnel"[4]



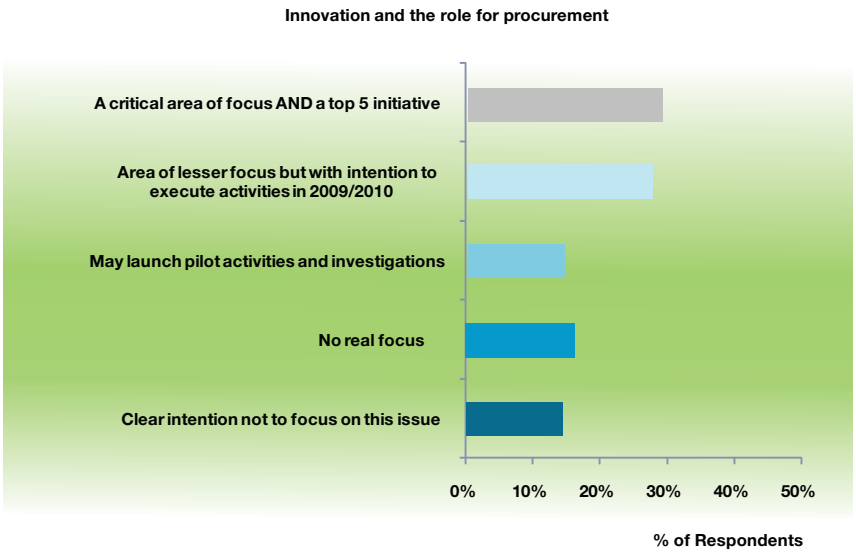
Innovation Driven Procurement

In this years' survey, 29% of participants have supported these notions and indicated that innovation and the role for Procurement is a top 5 focus area for this year, with a further 27% indicating the initiate such activities in the coming year. An in depth piece of Capgemini and Dutch University research[5] finalized early 2009, showed there currently is only a limited contribution to innovation processes by procurement. Procurement functions are either not up to the task yet, or are not asked to take up the task. At the same time, we observe an increase in outsourcing R&D to upstream suppliers, forced by economic pressure to reduce the cost base and increase flexibility. This brings into play an important question: how can Procurement support and stimulate these open innovation connections, and add value to innovation processes?

Adopting Open Innovation concepts will impact a company's business model. The relationships with suppliers will change, and the value added activities may need to be rearranged. Suppliers can generate more value and better time-to-market thanks to sales to other sectors, and adoption of technologies from other sectors. Open Innovation changes the role of the suppliers from mere contractors (however strategic they may be) to partners in bringing innovations to the end market. The very same happens internally; procurement changes from a mere supplier of risk mitigation, contractual agreements and efficient call-off procedures to a partner in managing

4 Open Innovation: Renewing Growth from Industrial R&D, 10th Annual Innovation Convergence, Minneapolis, Henry Chesbrough, 2004
5 Strategic Purchasing & Innovation – Master thesis, Casper ten Kate, Utrecht University, Capgemini, 2009

Figure 13: Innovation and the role for procurement



the relationships internally and externally and finding the right external partners to serve the end customer.

The shift in the collaboration between the three main actors Suppliers, Procurement and Business (i.e. Marketing, R&D, Production, etc) can be illustrated best with the Business Model[6] shown below. This model depicts the relationship between a customer, which exists for the sake of a compelling value proposition (offer) created by a combination of resources (i.e. a company and its suppliers). In more detail it also specifies the capability map of the resources, and what is done by partners to create the offer. On the customer side it details the interactions with the customer and the way this affects the value proposition.

In a traditional Closed Innovation setup, the high level business model of Procurement will be as follows (from right to left):

- Customer: The Business is the (internal) customer of Procurement. The Procurement department has processes and systems in place which guide the Business through the purchasing processes, including a mandatory Procurement involvement in some form
- Offer: Procurement offers risk reduction, cost effectiveness and efficiency to the Business (internal customers). The Business profits from this by ensuring contracts are in place with agreed suppliers from which they can efficiently call off via purchasing needs
- Resources: Procurement has a set of capabilities which enable it to service the Business, among which are negotiation skills, relationship management and category expertise. Together with Suppliers (Procurement's partners), Procurement provides the offering for the Business

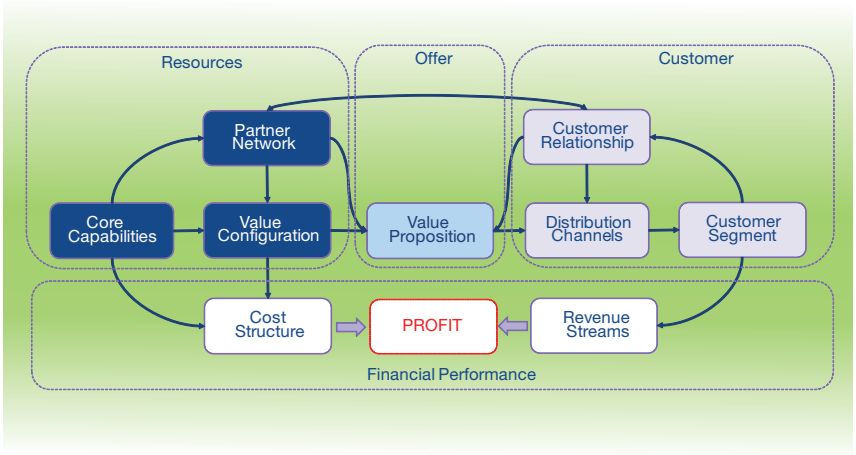
This model makes perfect sense, but it poses major risks with respect to innovation processes. This setup places Procurement and the Suppliers in front of the Business, which in turn has a business model focused on the external client. From this position, it is difficult for Procurement and Suppliers to fully understand the drivers of the external client. There is a translation between what the business offers to external clients, and to what Procurement offers to the Business. Our 2009 research mentioned before

6 Adapted from Alexander Osterwalder

showed there is only a limited contribution to innovation processes by procurement. What is striking is that business departments have not yet found a suitable partner in Procurement to source innovation and to meet their objectives. To fill the void, business departments have built up procurement capabilities to scout, source, contract and manage suppliers for R&D programs. At the same time, Procurement will struggle in servicing business departments.

- **Resources:** Procurement, the Business and the Suppliers all partner to create the offering as one Resource group. Aligned as one team with a single goal, this is where all capabilities are combined and focused. This is also where things get complex: the resources need to align capabilities to be effective (all required capabilities need to be present) and efficient (overlapping capabilities should be limited). The value created in this partnership model is shared among the partners and made transparent.

Figure 14: Open Innovation model



An Open Innovation business model for Procurement would be as follows:

- **Customer:** The external customer is the focus of all departments involved (including Procurement), this results in a direct translation of the customers' needs into the offering provided. This means Procurement needs some form of access to the customer.
- **Offer:** A translation of what the (future) customer requires. This can be anything like short time-to-market, new products, quality, cost, service, flexibility, lead time, etc. The offer is not a pure Procurement offer, but a combined offer to which Procurement contributes directly. Traditional Procurement offerings such as risk reduction become a part of the bigger picture.
- All partners involved must benefit from the offering's success.

Procurement has capabilities in store that fit Open Innovation processes perfectly well. We have seen many companies where Procurement is organized around categories, making Senior Buyers experts in certain products (basically a Business capability) and conduct continuous scouting activities. In the same companies we found R&D officers managing supplier relationships (NB a Procurement capability). This is excellent, but only when it is the result of careful positioning of these capabilities in a market centric team. Otherwise, one will find these parties working more against than with each other.

Organizations are extending their sourcing improvement initiatives into more complex areas to increase spend control and reduce costs. The low hanging fruit has been sourced and negotiated, the larger opportunities are found in the complex indirect categories.

A market centric team structure will force companies to carefully select and position the required capabilities for an innovation initiative. The roles and responsibilities that come with it can vary, depending on where expertise is built up and planned. Some examples of capabilities that require mapping between the Resources:

- Scouting for innovative technologies, companies and products;
- Assessment of innovation programs in each phase of development;
- Supplier management on the levels of Relationship, Technology and Operations;
- Networking and scenario building for new market perspectives;
- Supplier performance management;
- Project management.

How can companies organize for Innovation effectiveness?

We have seen that innovation practices have changed in recent times, from a closed process mostly ran by one or two departments, to an open network approach driven by make-or-buy decisions. We have also seen that Open Innovation brings suppliers and hence Procurement into play, but that the current Procurement business model does not fit with end market focused innovations. Finally we have given a high level picture of the Procurement business model. To organize innovation in cross company and department teams, companies should:

1. Analyse the value chain, company and department business models, stressing the offerings for the end market;
2. Analyse trends and developments affecting these now and in the future;
3. Define the future business models focused around the end market offerings, including a detailed capability mapping;
4. Determine which actors in market centric teams can add value in the business model and deliver the required capabilities;
5. Set up organizational structures supporting the defined business models and market centric teams;
5. Recruit, build and combine the required competencies in innovation teams.

On first glance, these changes are not much different from the developments Procurement has made in adopting category management: obtaining a greater understanding of the internal client and working together to get the product they expect. Yet innovation processes demand more than good category management. It requires a market centric business model, a mapping of unique capabilities, strong teams based on that and embedment in the organization. This will ensure proper supplier involvement in innovation, whilst maintaining control over processes. Procurement involvement in innovation is crucial as procurement capabilities can contribute to accelerated innovation programs, increased cost effectiveness, proper supplier management programs and mitigated risk at the same time. However it is not easy and straightforward to achieve Procurement involvement, it demands a structured approach and strong performance management for Procurement to earn its spot in where it belongs: facilitating value creation through interaction between internal and external parties.

Complex Indirect Category Sourcing – *A Missed Value Opportunity*

Dan Zoltowski, Randy Smith, Dobson Schofield, Charlotte Baratti – Procurement, North America

Many organizations across the world achieve significant cost savings each year as a result of following a standardized strategic sourcing process. Most often the savings realized from these sourcing activities are associated with what will be referred to hereafter as standard (e.g. office supplies, express mail, etc.) or frequently targeted categories. This article highlights the savings opportunities missed when procurement organizations do not pursue sourcing initiatives for more complex categories that are considered off-limits for a variety of reasons. Through sourcing project experience, Capgemini has found that complex categories represent a sizable and increasing area of spend across an enterprise that is not strategically managed and has no procurement involvement.

Mature companies continuing to pursue reduced costs through strategic sourcing generally look to standard categories or managed categories with expiring contracts for additional savings potential. While the sourcing of these categories typically leads to year–on-year value savings, there are times when additional categories are left untouched for perceived complexity or political reasons.

Organizations often have the mindset that complex categories will be too difficult to source and the effort required to obtain results will outweigh the expected benefit. Historically, stakeholders have chosen not to invest the time and resources necessary to unlock the value from these types of categories. Now, however, increasing pressures to achieve additional bottom-line cost savings have resulted in organizations seeking to address the "untapped" opportunities associated with complex category sourcing. Additional drivers for expanding the sourcing scope to complex categories include disparate pricing for services throughout the organization and poor visibility of detailed spend and supply base information.

Figure 15: Critical success factors for realization

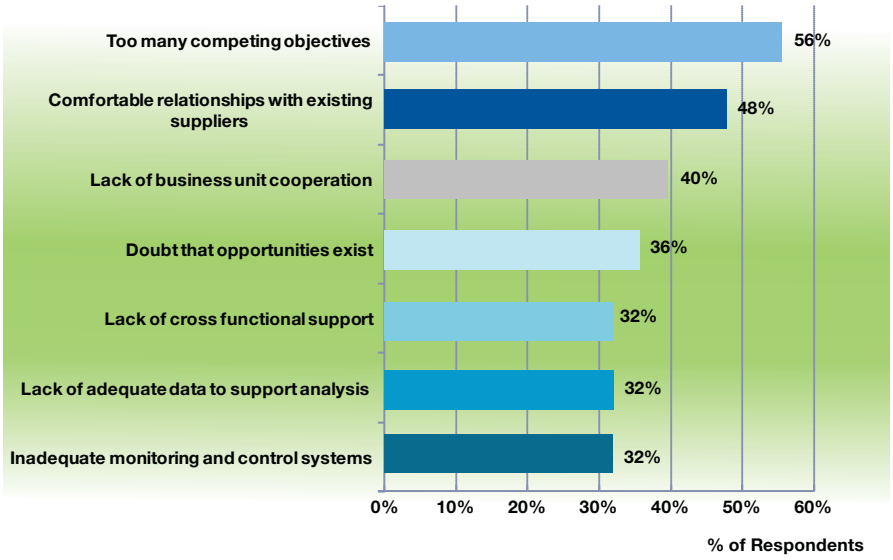
Success Factors	Mobilize Initiative	Profile Category	Analyze and benchmark pricing &process	Confirm category opportunities & develop category strategy	Implement category strategy/ Manage change	Review executed category strategy/ Benefits tracking
Detailed Spend Analysis		✔	✔	✔		
Clear understanding of Category & Supply market		✔	✔	✔		
Proper sourcing approach				✔	✔	
Clear understanding of savings opportunities			✔	✔		
Organizational support/ Alignment	✔				✔	✔
Sustainability	✔				✔	✔

What defines a complex category?
Despite the current state of the economy, Capgemini has found that companies expect to maintain or increase spend for complex spend categories in comparison to standard categories where spend is expected to remain static or decrease. As organizations continue to redefine their core competencies, restructure their supply chains and address reduced operating budgets, it is necessary for them to extract savings from sources such as complex categories. Indirect complex categories can be defined as those that require the consideration of a multitude of non-price factors during the sourcing process, including the following: stakeholder preferences, availability of substitutes, service providing suppliers (e.g. legal, consulting, outsourced processes), advanced analytical requirements, specialized sourcing approaches, and regional regulations. While most organizations have addressed their direct material and standard indirect category spend there continues to be a challenge in addressing complex indirect categories.:

- Legal services
- Advertising services
- Business & IT consulting

Procurement functions continue to face increasing pressure to enhance operational efficiency, decrease cost of goods and services, and improve supplier performance to provide additional value for the enterprise. These pressures require organizations as well as their suppliers to be able to quickly respond to changing business needs and supply chain requirements.

Figure 17: Complex indirect category sourcing



Critical success factors for value realization include:

- Detailed spend analysis
- Clear understanding of the category and supply market
- Proper sourcing approach
- Clear identification of savings opportunities
- Organizational support/alignment
- Sustainability

Does your company have untapped, unmanaged complex categories?
In order to stay competitive and identify additional areas for cost savings, organizations must think beyond the norm and look for opportunities not addressed in previous sourcing initiatives or in categories not already managed by

It is a well known truth that costs arising from insolvencies can be significantly reduced or eventually avoided if likely alternative candidates are identified early enough and appropriate counter measures are consequently implemented on time

procurement. An overall spend analysis by category and supplier can help initiate the process of identifying complex categories worthy of sourcing. Undeveloped relationships between procurement and other areas of the company may indicate that increased synergies will lead to additional sourcing opportunities.

The majority of companies in North America are still not systematically addressing complex indirect categories but continue instead to focus on obtaining additional value from the categories that were already sourced in the last several years. These companies face the law of diminishing returns. Capgemini has found that the barriers highlighted in the diagram shown here need be resolved and the aforementioned critical success factors need to be addressed in order to unlock the value of complex category sourcing.

The 2008 Capgemini CPO Survey showed that organizations continue to focus on ways to transform their sourcing processes and improve the availability and visibility of spend information. These two objectives support a company's ability to improve its competitive position, increase spend under management and work continuously with its suppliers to meet cost improvement goals. To meet customer, market and internal cost improvement goals, organizations must look internally and work with functional stakeholders who control complex category spend.

At Capgemini we use our project experience combined with the governance and change management components previously discussed to understand the nuances of complex indirect category sourcing. We help stakeholders to effectively identify and realize cost and service improvements. The key to our success with complex category sourcing is our strength in collaboration and cross functional facilitation. We enable internal and external communication, while continuously educating stakeholders through the change components and adoption of the success factors within the sourcing approach.

Conclusion

Complex category sourcing is intricate and there is no such thing as a standard approach or 'one-size fits all' solution. Each complex category has its own nuances and each organization's sourcing maturity is different. However, CPOs are aggressively trying to build procurement functions that can unlock savings potential from complex categories. All barriers must be addressed during this type of initiative. Organizations that build a robust approach can equip their employees with the right skills and tools to be better positioned than their competitors for the realization of benefits from these spend categories.

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Supplier Risk Management – *How to Manage Within the Current Crisis and Learn for the Future*

Stefan Becker, Principal – Procurement, Germany

The risk of insolvent suppliers is rising dramatically
The newspaper headlines these days spell out a clear message: the risk of insolvent suppliers is rising dramatically. Our experience at Capgemini Consulting suggests that 1 to 3% of a company's suppliers are facing acute insolvency risk. This represents 5 to 12% of the total purchasing spend.

In many cases the current credit crunch is the major catalyst for the financial problems of vendors. In the mid-term run, however, other factors will probably intensify the danger of supplier failures. Among these are a decline in global demand, the need to cut prices, high inventories, constant pressure from competitors in low cost countries etc. Taken together these issues will result in a higher number of insolvencies and will be accompanied by a harsh decline in economic growth of the industrialized countries.

To avoid direct impact on its customers, products and operating results, the procurement department is well advised to start pro-actively managing the risks of its suppliers instead of reacting to insolvency cases.

Proactive management of supplier insolvency risks
We believe that for a procurement function to deliver efficient risk management, it has to address three key objectives. The early detection and recognition of insolvency risks is the most important objective and, at the same time, the most difficult one to achieve for a lot of organizations taking into account their large number of suppliers and global supply chains. Furthermore, the procurement itself is clearly limited in terms of resources as, especially in an economic crisis, it is playing a vital role to keep product costs at the lowest level possible.

The second and third objectives are an effective handling of occurred insolvencies and the consequent transfer of insolvency costs to third parties such as partners, customers or insurance providers. As most organizations are experienced in managing operational issues as part of their daily business, it comes as no surprise that if a supplier insolvency is likely to occur or has already occurred, most procurement departments know how to handle them, even at a high cost.

Early detection of insolvency risks
It is a well known truth that costs arising from insolvencies can be significantly reduced or eventually avoided if likely alternative candidates are identified early enough and appropriate counter measures are consequently implemented on time. Following Capgemini Consulting's three-step-approach, suppliers are firstly assessed regarding their potential impact. In the second step, only those suppliers with a high to very high impact are analyzed regarding their likely probability of failure. Finally, the "blacklisted" candidates are then closely monitored until the company has a clear and validated picture of which measures, if any, have to be taken. Any other approach would, we believe, tie up too many resources from procurement and other business functions without providing any better results.

Considering the potential impact of damage caused by this risk, two criteria are of key relevance. Firstly, the direct financial impact caused by a loss of revenues and contribution margins of products. Secondly, the operational impact of production stops or even slowdowns should be analyzed taking relevant data out of the company's ERP system. For both criteria, existing second or multiple sources and stock levels should be considered, too.

With regard to the probability of failure, again two criteria appear on the list. The first one is well known and obvious: financial scorings, balance sheets and self-assessment questionnaires provide information about a supplier's financial health. The issue here is that the data is external, sometime self-assessed and historic, but it is what it is – a first indicator to screen the candidates on the list. The second criterion is the supplier performance as the result of an organization's ongoing supplier performance evaluation process.

As a result of our two-stage-evaluation, only suppliers with a high or very high impact on a company's results and operations and with a high probability of failure are carried forward for an individual in-depth analysis. At this stage, detailed information about the financial health and market performance is collected, enriched and assessed. In addition, supplier facing company staff should start reporting any information that indicates a change, for example, key staff resigning, late delivery, claims of sub-suppliers etc.

Finally, and probably the most important step in this process, procurement has to alert the company's management if high impact suppliers are about to start encountering difficulties – then it is time to propose and decide about counter measures.

Taking preventative counter measures

When considering preventative counter measures to supplier insolvency, procurement has two basic choices: strategic or operational measures. Whereas strategic counter measures aim at independence from the supplier, the operational ones pursue the prevention of the failure.

In general, re-sourcing or the development of a second source, in-sourcing as well as taking over of the supplier can all be seen as strategic counter measures. As re-sourcing is probably the most common one, procurement has to insure – as an early preventive action – the company's full estate, for example property, patents, tools, equipment and devices.

Operational counter measures, by contrast, comprise financial support, for example the modification of the terms of payment, reverse factoring, credits or acceptance of temporary higher prices, as well as the transfer of know-how regarding cost reduction, process optimization, financial knowledge or miscellaneous measures such as binding agreements on quantities ordered. However, two aspects should accompany the consideration of operational measures. Firstly, the supplier must open his books, the causes of his problems must be clearly identified and he must truly

collaborate on their resolution by implementing the committed actions. Secondly, other key customers must be on board unless they are totally dependent from the single company.

Conclusion

The risk of supplier insolvency is rising. Due to the close interconnection of supply chains with tier 1 and tier 2 suppliers, this also increases the risk of disruptions in the provision of supplies for buying companies. To protect against these disruptions, the procurement function has to follow the strategies of early risk recognition and preventive counter measures, a straight forward handling of supplier insolvencies and transfer of resulting costs to third parties such as partners, customers (if they impact the supplier), or insurance companies.

Procurement needs to analyze the supplier portfolio regarding insolvency risks according to pre-set indicators on a regular basis and establish a risk management process with direct management access when decisions and investments are needed. In case of acute insolvency risks, preventive strategic and operational counter measures are at procurement's disposal.

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