Innovation In Procurement

A new era of innovation in procurement process
Firms that include their suppliers in the early stages of innovation projects seem to substantially outperform their peers that do not. Yet a large proportion of companies, does not include suppliers in over 90% of their New Product Development projects. This is based upon our initial findings from World Café sessions and survey respondents.

Over the past decade we have seen a significant increase in turnover in procurement as companies focus on core capabilities and outsource others. This has increased the influence of the procurement function – typically controlling all spend one way or the other. At the same time, the nature of innovation – recognized by most successful companies as the key to sustainable growth – has evolved from a purely internal capability to something to be delivered in collaboration with the external network of supply partners. From this concept of Open Innovation, Capgemini expects two key developments: 1) A greater focus on value chain optimization and interaction, and 2) A broader role of supply partners in the innovation processes. In practice, however, these two developments have not emerged as prominently as expected. In fact, the role of procurement in managing supplier involvement in innovation continues to be very limited.

Recently, some leading procurement organizations have embraced and pursued the concept of being a key player in seeking, fostering and delivering innovation in collaboration with other functions. From this, these leaders have found that this type of capability requires them to play a completely different game in terms of organization, skill sets and processes.

As companies realign and focus on becoming more open by leveraging a wider knowledge base for sources of innovation, the total supply base – both current and potential suppliers – should be utilized. Companies should consider identifying and developing a supply base with complementary capabilities that drive value through collaboration. From this, a joint development process can emerge to support more innovative products through a more innovative value chain. Consequently, this drives down supply management costs and drives up value for the end customer.

Depending upon the product category, the innovation relationship continues throughout the product/service lifecycle. This process of continuous improvement will continue to yield new ideas and opportunities for further value creation. In short, the key is to find supply partners, jointly develop capabilities and improve products through close collaboration.
1 Evolution of Procurement Operations
For procurement to play a role, it needs to redefine its activities. Traditional Procurement departments focus on delivering savings, contract coverage and operational supply risk mitigation by regularly sourcing categories. Given this focus, Procurement’s natural involvement in innovation is limited to work on cost/risk reduction by sourcing and contracting suppliers. In practice, this means Procurement is involved once all specifications are set in stone and the innovation is ready for ramp-up. Although usually working in team structures, silo-thinking remains prevalent.

The handover to Procurement usually occurs well after supplier involvement by R&D and beyond a point where a significant impact can be made on cost reduction and value creation of the product. At this point it is too late to deliver new innovations or significantly increase development speed.

The only variables remaining are cost and risk reduction, and even these have been compromised. Procurement can no longer fully influence cost or risk as the specifications are largely set, and suppliers have been deeply involved in the design process. Furthermore, traditional procurement targets (such as savings, continuity of supply, contract coverage and compliance) conflict with project targets. This conflict may compromise the value of the end product for the customer. Delays in the innovation project are likely to occur through these or other conflicts.

Leaders in the market have recognized that for innovation projects the traditional Procurement departments have to transform into Innovation Driven Procurement (IDP) groups. IDP groups are able to support the business strategy in pursuing innovation targets such as:

- Delivering more innovations in less time
- Accelerating design and launch cycles
- Improving product / service price-quality ratio
- Increasing the end customers’ experience / satisfaction

IDP groups fundamentally differentiate themselves on three key dimensions:

1. They are able to help find scarce sources of innovation capabilities. These capabilities are not easy to find in part because suppliers typically are used to being mere contractors delivering according to specifications and directions. Finding sources of innovation supply requires knowledge of markets and technology. Besides being able to find the right supplier, the buying company needs to make itself attractive enough to the supplier in order to ensure resources are actually secured for the buyer rather than its competitors.

2. They are involved in innovation projects from start to finish. Procurement will have to re-align its value proposition to innovation projects as the values to measure success (time-to-market, product success, project efficiency, ROI) are very different from what Procurement traditionally delivers (savings, contract compliance, risk reduction). Furthermore, Procurement must adapt to the chaotic and uncertain environment of early innovation stages with the right organization, people and processes.

3. They are able to manage supplier involvement collaboratively. This requires early procurement involvement in innovation projects to set supplier involvement strategies and drive them all through the project and possibly beyond. Procurement, as the owner of the interface between the company and its supply base, will have to make sure collaboration within the innovation project is enabled and monitored. It should be a win-win for all parties involved.

Innovation Teams & Organization

All of this requires a fundamentally different way of working with procurement as it becomes an integral part of the innovation process inside the company. This has a major impact on the business model of procurement – shifting the customer focus from internal client to external customer, the role in innovation teams and the way Procurement organizes:

- **Organization & Process:** The organization should model the characteristics of innovation projects. The processes in each stage of innovation will include scouting technologies, setting up supplier involvement strategies and managing continuous involvement.

- **Planning & Control:** The performance metrics will transition from cost and risk related KPIs to value and innovation related KPIs.

- **Human Resources:** The innovation process is new in both workload and content, meaning extra resources will be needed with different skill sets. The people needed to conduct IDP will have stronger competences in internal and external relationship management, better product knowledge and a strategic mindset.

- **Preferred Customer:** Procurement will ensure the company is attractive to its most important sources of innovation – changing the partnership, risk/reward and relationship management structures.
IDP Research Approach
This research focused on what differentiates recognized innovators from others in the market on the aforementioned themes. First, we identified the top innovative players with a base in The Netherlands and Germany. The CPOs and CIOs of these companies were invited to discuss the four themes in a series of workshops entitled World Café. Through an analysis of the output from these sessions, a set of measures was identified for each theme that these innovators recognized as a key contributor to success.

Second, we conducted the first wave of the IDP survey (50 firms) for other regions of the world in which we assessed perceived performance, relative innovation success, outcomes of the four themes and differences between well and poorly innovative suppliers. We analyzed the respondents’ performance and innovation models as follows:

- **Performance Scores**
  - Respondents were asked to rate their performance in terms of overall gains such as growth, ROI, profit, competitiveness, and on innovation performance such as time-to-market and product success.

- **Open / Closed Innovation**
  - Respondents indicated to what degree their innovation process is open to supplier inputs. In this study we defined an Open Innovator as a company that involves suppliers in early innovation stages for more than 90% of innovation projects, and a Closed Innovator as a company that involves suppliers early in less than 10% of cases.

- **Analysis of Outcomes**
  - High performance companies are those that conduct open as well as closed innovation, resulting in a mixed view of high performance companies when we examine their business model in detail.

This IDP survey approach enabled us to test what the World Café innovators regarded as levers of success. In some cases it validated our findings across industries, and in others it yielded some interesting surprises.

We will be complementing this initial IDP survey with a larger round in early 2012. The collective output will focus on major emerging patterns or themes. A full analysis of the research will be presented in the final report.

### IDP Overview (Preliminary)

In this initial report, you will find a part of the output generated by the first wave of 50 surveys. Overall, we saw a clear distinction between top and bottom performers measured on financial results and innovation success. From this it is clear that with higher performance, we see more IDP elements implemented. However, there is still some variation among the responses, mainly around the degree of Open Innovation. For the purpose of this study, Open Innovation is measured by a high percentage of innovation projects in which suppliers and Procurement are involved from the beginning. Interestingly, high performance is found in both open and closed innovators. However, there is a big difference in the degree to which open innovators receive exclusivity of innovations from their suppliers, which can clearly be a competitive advantage.

Just as in our selection of World Café innovation leaders, we noticed a wide variety of industries among the top performers.

This supports the notion that IDP is not limited to any particular industry or sector, it is a trait or foundational element of the best performers in the market. We focused the findings below on both performance and openness of innovation. An overview of industries is given in figure 1.

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**Figure 1: Industry Segmentation**

![Industry Segmentation Chart](image)
Key Findings: Organization & Process

In the World Café session, we found various operating models successfully supporting the innovation process. All Procurement functions were involved in varying degrees with innovation processes. Although for some, this was determined on a case-by-case basis. Involvement consisted of virtual teams, dedicated resources within Procurement or category managers were involved in early design phases. In the case of category teams, they were organized around innovation projects. Procurement in these companies was seen as a change agent, helping the organization to become more open and work together to connect to supplier capabilities.

IT was leveraged as an enabler to systematically share knowledge across the value chain. Sharing information with external partners depended primarily on the contract terms and conditions. Key takeaways from the World Café session:

- Set up shared responsibility for R&D and Procurement with shared KPIs
- Use a small group of dedicated innovation procurement personnel and leverage the network of capabilities around you
- Set up a plan for each project in the innovation funnel in which you decide about supplier and Procurement involvement
- Act as a wedding planner in connecting supply base capabilities with customer demand

Similarly, the survey revealed that having dedicated resources as a Procurement department is an effective approach. However, budget constraints and economic realities may force some respondents to establish virtual teams instead of assigning dedicated personnel.

In figure 2, we found that open innovators are much more focused on advanced structures to manage innovation with suppliers.

At a minimum, involvement should be early in the innovation lifecycle and should consist of regular meetings with R&D. Most respondents have already established this. A key point in figure 3 below was the participation in supplier innovation meetings. This external coordination with the extended value chain was significantly higher for open innovators.

As more formal roles and organization are established, Procurement’s support to innovation can become more effective. Among open and closed innovators, we saw a clear distinction in the way these companies organize procurement for innovation (figures 2 and 3). As part of this, top performers and open innovators are explicit about the objectives and realization. Further, incentives were important to open innovators but surprisingly not a differentiator for performance. Finally, leveraging IT for systematic knowledge sharing was done only by open innovators.

Figure 2: Organization of Supplier Innovation

![Figure 2: Organization of Supplier Innovation](image)

Figure 3: Role of Procurement in Innovation

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Key Findings: Planning & Control

Shared KPIs among Procurement and R&D were a dominant factor for the World Café participants, indicating the level of importance and focus these companies give to innovation. Innovation and Procurement Planning were integrated, and targets were derived from the planning of individual projects. Traditional Procurement metrics were set aside, and project-focused innovation targets emerged. Top rated KPIs noted:

- **Overall Project Value**
  - Value creation
  - Material efficiency

- **Supplier Involvement**
  - Sales realized from projects with supplier involvement
  - Number of projects completed in conjunction with suppliers
  - Number of innovation events with suppliers
  - Supplier satisfaction

These targets illustrated the difficulty of measuring innovation-related gains, especially if it was to be distinguished for every team member. About half of the targets for Procurement focused on the effort, not on the outcome. But a target set based on both effort and outcomes balanced the needs of getting everyone engaged/focused on customer value and at the same time contributing to the goal or expected result.

The survey outcomes clearly differentiated between top performers and the rest. Shared targets were formalized among most top performers, and the targets they apply were largely in line with those mentioned. However, there were strong differences even among the top performers on the use of target sets. Top performers in the survey scored high on the number of ideas brought forward by procurement (see figure 4), whereas the World Café leaders clearly chose a stronger focus on the effort to connect suppliers with R&D.

Among open innovators we clearly saw a distinction in the planning measures and some of the KPIs (see figure 5: Planning Measures). Although the overall score was not very high, we saw a structural connection between procurement and innovation made by open innovators. Among the KPIs, there was little differentiation except for the three shown in figure 4. Material efficiency appeared to be one of the starting points for Procurement involvement as those with limited open innovation were focused on this.

This area was subject to much debate as Procurement tries to move away from traditional targets in innovation areas. However, the overall performance of the Procurement group is still being measured in some cases with traditional metrics. Clearly, this created issues at all levels within the department – confusion, reward structure, goal alignment, etc. In order to address this, top management commitment and ongoing support for open innovation and IDP overall were critical.
Key Findings: Human Resources

World Café leaders stressed the importance of managing employee career development carefully. Competence and attitude based selection and growth of personnel was essential, especially with the rather untraditional skill set required in this innovation area. Establishing innovation related KPIs at all levels was seen as a powerful tool. Recognition of contribution in this area and as a criterion for career development was also viewed as essential for continued growth/development of personnel. Key takeaways from the World Café session:

- Actively assess and manage the capabilities of the department / company
- Procurement staff should be the change agents in the company, defining a new way of collaborating in the network
- Required skill sets
  - Understanding of technology
  - Coaching suppliers to present themselves
  - Engagement and collaboration skills deployed in the network and within the company

Among the required skill sets noted by survey respondents for successful IDP were the following:

- Strong relationship building
- Facilitating, moderating and influencing skills
- Entrepreneurial business driven attitude
- Broad skill set (technical)

These skills are in line with Procurement’s change agent and relationship management roles previously mentioned. The same was true regarding the tools used to ensure success – joint training programs and co-location of Procurement and R&D. All World Café participants were focused on stronger integration across the enterprise.

Among the survey respondents, there was a high degree of variation in the area of co-location and joint training. These were applied exclusively by top performers and primarily by open innovators. Specialist knowledge was clearly required more by open innovators – recruiting engineers or demanding specialist knowledge gain through virtual teams (e.g., marketing, legal, and others).

In terms of project management skills, we found a low differentiation among the respondents. This seemed to indicate that this was viewed as a core competency for innovation management regardless of industry, whether open/closed innovator or top/bottom performer. Clearly, more is needed than just managing innovation as a project; it’s the relationship that counts.

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**Figure 6: Knowledge & Skills**

![Knowledge & Skills Graph](image-url)
Key Findings: Preferred Customer

Leading firms tend to engage in buyer-supplier relationships that move away from the more traditional view on procurement where the supplier persuades the buyer. Instead, an important aspect of IDP is that buying firms persuade innovative suppliers to provide. Typically, the buying firms target unique skill sets or capabilities that suppliers possess. Therefore, specific IDP strategies often focus on strategic or key suppliers rather than on suppliers of commodity goods. As we have seen in this research and others, a firm’s ability to build close relationships with innovative suppliers is directly correlated with the firm’s successful innovation performance. Key takeaways from the World Café session:

- What attracts an innovative supplier?
  - Growth opportunities
  - Risk / cost / resource / reward sharing
  - Help to enter new markets

- What keeps innovative suppliers satisfied?
  - Chemistry / cultural fit / firm relationships (on personal level)
  - Trust: stick to commitment, manage relationship at all levels
  - Top management commitment, accessibility and business alignment

Responses from the IDP survey and the feedback from the World Café session indicated that supplier attractiveness and satisfaction were important criteria for successful innovation programs. Figure 7 depicts the benefits companies received from collaborating with their suppliers against the level of customer preference they perceived to have. Companies with high preference from these key suppliers enjoyed better availability of supplier innovation resources, stronger exclusivity of innovations and in times of shortage (bottlenecks) they were provided more resources than their competitors.

Figure 7: Gains from Customer Preference

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<thead>
<tr>
<th>Gains from collaboration</th>
<th>7</th>
<th>6</th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
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<td>Innovation resources</td>
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<td>Exclusivity of innovations</td>
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<td>Bottleneck preference</td>
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y-axis: 7-point Likert scale; 1 being lowest, 7 being highest
Attractiveness to suppliers for the World Café leaders meant not only being one of the market leaders (i.e., considerable size and growth opportunities for suppliers), but also it had to do with the business culture or way of doing business. The ability to share both risk and reward with suppliers requires a large degree of flexibility in managing a wide variety of innovation opportunities to the benefit of all parties involved. The reputation for being a partner that can get things done is also very important. It is also something that is difficult to change when the market perception is negative.

The leaders recognized that strong capability to manage short time-to-market windows was essential. This of course again calls for early procurement involvement, to manage supplier involvement effectively throughout a project.

The IDP survey responses supported the idea of what makes a buyer company attractive (see figure 8). Also, this was what differentiated top performers from the rest.

It was interesting to see that very few companies were willing to take risk and left it all to their suppliers. Capgemini believes this model is unsustainable during a time when resource scarcity is increasing, and when competitors are recognizing that their attractiveness matters. It was also where open innovators most clearly stood out against the field. Interestingly, open innovators seemed more willing to promote and emphasize the concepts of trust and fairness with supply partners.

According to World Café participants, supplier satisfaction was subject to factors relating to financial stability, such as a steady supply of business flowing to the supplier. The ability of the buying firm to place trust ahead of profit was also an important factor – making a solid commitment to the relationship even in hard times. Finally, good chemistry on all levels of the relationship was deemed important along with top management commitment. This emphasizes the need to carefully orchestrate and manage relationships across the value chain.

Figure 8: Sources of Attractiveness
From the survey results, it appears that top management commitment was mentioned as a lever by nearly all respondents (see figure 9). This supported the idea that it is essential but not enough to ensure performance.

Clearly, trust and chemistry result in higher attractiveness and satisfaction for which the type of innovation was irrelevant. The true differentiator in this area can be found in the ability to help suppliers innovate within the supply chain or extended value chain. Capgemini sees this as critical and it should be managed on all levels (e.g., project deliverables, resource commitments, expectations, results, etc).

Additional insights on the attractiveness and satisfaction elements of becoming a preferred customer can be found in the Appendix. This research was conducted by the University of Twente in the Netherlands.

Figure 9: Sources of Supplier Satisfaction

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<th>Source of Supplier Satisfaction</th>
<th>Performance</th>
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<tbody>
<tr>
<td>Help suppliers innovate</td>
<td>7%</td>
</tr>
<tr>
<td>Top management committed</td>
<td>50% - 90%</td>
</tr>
<tr>
<td>Manage expectations</td>
<td>10% - 50%</td>
</tr>
<tr>
<td>Unknown</td>
<td>&lt;10%</td>
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Conclusion

The findings from the World Café session and the survey responses all indicated that IDP needs to be explicitly organized. We found clear differences in success ratings and the way of organizing procurement and measuring its contribution. Selecting, developing and rewarding employees for capabilities in managing complex relations and projects is critical. From the World Café session and the IDP survey both, it is abundantly clear that successful innovation programs start at the top – commitment from executive leadership. This message must be communicated to all levels of the organization and positioned as an integral part of the achieving enterprise-wide goals. In keeping with that concept, KPIs should be realigned to measure the contribution and impact of groups contributing to innovation projects. An important part of this is attracting and retaining the right talent in the procurement organization – personnel with strong relationship building, facilitation and moderation skills. Finally, our research clearly indicates that true supply partnerships drive increased innovation, and this becomes a differentiator in the market.
Appendix

Background: Innovation driven buyer-supplier relationships

This appendix is written by Niels Pulles (PhD researcher) and Prof. Dr. Holger Schiele (Chair of Technology Management - Innovation of Operations) from the University of Twente, The Netherlands.

Leading firms tend to engage in buyer-supplier relationships that move away from a more traditional view on procurement where the supplier persuades the purchaser to buy. Instead, an important aspect of IDP is that buying firms persuade the innovative supplier to provide. The objectives of procurement function in these relationships are typically outside the scope of exchange of goods or services. Often the buying firms aim for unique skills or capabilities that suppliers possess. Therefore, a buying firm’s strategy often not aimed at satisfying or attracting every single supplier. Most often, the concepts relate to a situation in which buying firms want to attain preferential access to those resources that will give them an innovation advantage over their competitors. Therefore, specific IDP strategies often focus on strategic or key suppliers rather than on suppliers of commodity goods.

Competition for innovative suppliers

As we have seen in this research and others, the capability of firms to build close relations with innovative suppliers positively impacts a firm’s innovation performance. However, often key suppliers are shared with main competitors. As a consequence, firms frequently find themselves competing for a key supplier’s best resources. These resources can take different forms, and may refer either to tangible materials or to production capacity in times of scarcity or high demand. Innovation resources can also refer to the suppliers’ best ideas, most experienced engineers, and latest technologies. When, for example, four major competitors share one key supplier, this supplier can only share its best resources (e.g. best ideas, newest technologies, scarce materials, most experienced personnel) with only one of the four competitors. Recent research has shown how a preferred customer status (i.e. a buying firm that obtains preferential resource allocation from suppliers) leads to a higher innovation contribution of suppliers.

The figure above shows that by becoming a preferred customer, firms could significantly improve the supplier’s contribution to their innovation projects. In fact, in some cases it could be argued that a preferred customer status is even more important than the innovation capabilities of the suppliers. Another important finding is that being a preferred customer status can lead to benevolence in the pricing behaviour of suppliers. In other words, these findings seem to indicate that firms can acquire better innovation resources than competitors without paying significantly more.
What can Procurement do to attain better commitment from innovative suppliers?

An important part of a larger round of surveys will have the aim to provide more exhaustive insights into how the allocation of skills and capabilities from shared suppliers relates to a firm’s innovation performance. Furthermore, an upcoming survey aims to provide more answers on what Procurement’s role might be to attain better innovation resources than competitors. The World-Café session already gave some insights on what leading firms do to commit innovative suppliers. The session was based on two main topics: Customer Attractiveness, what do firms do to attract innovative suppliers, and Supplier Satisfaction, what do firms do to satisfy innovative suppliers.

Customer attractiveness, supplier satisfaction, and preferred customers strategy

Concerning customer attractiveness, the participants considered three issues to be most important: (1) the potential business opportunities for suppliers, (2) a reputation for collaboration of the buyer, and (3) a supplier’s expectation of an ease to do business with the given buyer. Three main drivers for supplier satisfaction were identified by the participants: (1) a durable business approach, (2) a buyer’s relationship performance, and (3) a fit between the firms.

The discussions during the World-Café session made it clear that leading firms actively apply a preferred customer strategy. Although they might refer to it differently (e.g. becoming a customer of choice), the participants acknowledged the importance of committing key suppliers. For example, the CPO of a food and beverage multinational explained how his firm recently implemented a world-wide supplier satisfaction index. Another example was given by the delegate of a global player in the tire industry, who described how his firm allows suppliers access to test facilities in exchange for access to latest technologies.

Customer attractiveness, supplier satisfaction, and preferred customer strategies can be considered as important concepts for IDP functions. When applied properly, preferred customer strategies might make the difference in successful supplier integration for better innovation outcomes.
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