

Procurement

Go Right to the Source

Flashpoints

The purchasing department should be managed as a strategic supply chain center rather than as merely a place to beat down costs.

An effective way to stay on the same page as your suppliers is to share transactional information with them.

Simplifying your product line can lead to a more efficient supply chain flow.

Change management is a key enabler of effective cost containment efforts.

Collaboration ensures that procurement savings don't vanish before a company is aware of them.

While not necessarily used interchangeably, the terms *procurement*, *purchasing*, and *sourcing* all describe one of the main supply chain management processes. As Larry Paquette, author of *The Sourcing Solution*, describes it, the role of sourcing is “to locate the one company out there that can provide needed product better than anyone else.”¹ In *Essentials of Supply Chain Management*, author Michael Hugos gets right to the point when he notes that, by tradition, the main activities of a purchasing manager are “to beat up potential suppliers on price and then buy products from the lowest cost supplier that [can] be found.”² Any mystery about the role of the purchasing manager is dispelled immediately in the title of Patricia E.

Moody's book *The Big Squeeze*.³ At any rate, the notion that purchasing does the dirty work for accounting has been popularized early and often throughout supply chain circles.

Concurrently, there's also a long-standing perception that purchasing plays second (or third) fiddle to the star performers in a company, typically finance, sales, and marketing. However, warns Dave Nelson, retired vice president of global supply management at automotive supplier Delphi, "the practice of allowing purchasing to be an underachiever is an expensive approach to global supply management because it underpowers a vital contributor to corporate profits and growth. Unfortunately, examples of low expectations (and low results) in procurement are common." When companies fail to recognize the positive impact good procurement practices can have on their bottom line, it makes it that much more difficult for significant and enduring supply chain improvements to take effect.⁴

Fortunately, the word has gotten out that by collaborating with your key supply chain partners, rather than relying on the traditional supplier squeeze and taking a "we know what they want better than they do" attitude toward customers, the purchasing department can become a strategic corporate advantage rather than merely a necessary evil.

A Formula for Success

If you ask anybody outside a tight circle of supply chain directors about the role of the procurement department, you'll probably hear that "they're the ones preoccupied with controlling and reducing costs." And yet, while cost reduction will always be a top priority for procurement, it's no longer their sole claim to fame. Some procurement managers, in fact, pride themselves on their ability to create solutions and foster innovation, not merely pinching pennies.

"Many procurement organizations have reached the upper limit of cost reductions possible in categories they are actively sourcing today," explains Chris Sawchuk, leader of consulting firm Hackett Group's global procurement advisory practice. "So they're looking for ways to reinvent their value proposition. A key part of this is expanding their influence, and taking a lifecycle approach to category management. This requires working more effectively with spend owners, executives, requisitioners, suppliers, and other stakeholders. It also calls for skills that are outside procurement's traditional areas of expertise." He points to a Hackett Group study that found that procurement departments are attempting to raise the level of awareness of their contributions by monitoring, measuring, and reporting on their value contributions.

For instance, Eastman Chemical, a producer of specialty chemicals, takes a very pragmatic approach to supply chain management, as its ultimate

objective is to be a reliable supplier to its customers. That approach, basic though it may be, served the company well when it transitioned from producing commodity chemicals to becoming a provider of specialty chemicals. Getting to that point required a full-scale change in Eastman's sourcing function, as the nature of the company's procurement function shifted toward strategic supply management.

As Mike Berry, the company's vice president of global procurement and chief procurement officer, explains, Eastman has a five-point strategy to ensure the company's sourcing practices meet the needs of its customers:

1. *Integrate procurement with supply chain operations.* Supply chain processes are cross-functional, and Eastman follows a talent management strategy that moves employees through various functions and departments within the company.
2. *Collaborate with internal business partners.* In addition to its cross-functionality strategy, Eastman aligns procurement resources with sales and operations planning (S&OP) teams, to better share market insights across departments.
3. *Develop supplier strategies.* Not all suppliers are alike, and neither should be your procurement approaches to them. Berry points out that, with commodity suppliers, Eastman focuses on cost, while with strategic suppliers, the company focuses on driving value and innovation.
4. *Continually develop and improve capabilities to deliver results.* Eastman automates its supply chain processes using inventory optimization and other technology solutions. The company is also investing in staff development to better train its next generation of leaders.
5. *Contribute to the company's success.* "We in procurement are known as nontraditional thinkers, even contrarians, in our approach to analyzing markets," Berry says. "We focus more on market insights and business strategy than traditional procurement." For instance, when appropriate, the procurement department has leveraged alternate methods and sources of supply, and has found competitive advantage through creative contracts that engage Eastman's suppliers in ways that drive innovation.

"Procurement must know how to document its own innovation and the impact it has on enterprise growth and be able to convince the rest of the organization that procurement's expanded value proposition is real," Sawchuk observes. He adds that procurement's role in risk mitigation efforts should be better appreciated and leveraged. No other department is in a better position to identify early signs of financial distress among suppliers, he notes. Procurement can also evaluate alternative sourcing arrangements, and develop what-if scenarios to recognize supply network risks while building resiliency.⁵

Managing the Changes

In a study of purchasing patterns, the Center for Advanced Purchasing Studies found that a high percentage of procurement actually takes place outside of the purchasing department. Although it's generally a purchasing manager assigned to the task of procuring products, whether it's components used in manufacturing a product or finished goods that are sold on retail shelves, it's usually the domain of the logistics manager to make other important supply chain buying decisions, such as the procurement of transportation.

That's not necessarily a best practice, according to supply chain consultant Tom Mulherin, particularly if transportation purchasing is being handled by somebody who lacks transportation expertise. From his perspective, Mulherin believes that transportation purchases lack the rigorous process that companies typically apply to the purchase of materials. With transportation, he says, it's often just a matter of switching carriers on the basis of cost alone: "This carrier is going to give me a 5% discount, so let's switch over to them."

A company needs to appreciate that changing a carrier or a supplier will result in a change in the company's organization as well, he points out. The nature of supply chains today means that carriers, as well as other suppliers, are integrated into a company's cost structure and operations, so any kind of significant change will have ripple effects. Any supply chain professional who is intent on making a sourcing change of any kind needs to ensure that the change will have a positive impact on at least one critical cost area of the company. That will require that companies get better at managing change itself. "Change management," Mulherin observes, "is becoming a primary enabler of effective supply chain cost containment efforts."

To effect change management, he suggests companies stick to simple, easy-to-understand measurements that encourage appropriate behavior. Measure only key performance indicators, and determine that the benefits of reporting metrics are greater than the cost of gathering them. You'll need to involve the users in the process as well, which means having them be a part of the process of developing and rating supplier qualifications, going on site visits, and taking ownership of the final decision.⁶

Keep Your Friends Close and Your Suppliers Closer

Keep in mind, however, that just as manufacturing companies are getting much more choosy about whom they want to do business with, so too are their suppliers becoming more particular about whom they want as customers. The philosophy in purchasing circles for several years, particularly in the automotive industry, has been to reduce the total number of suppliers to a manageable core of key partners. As Dave Nelson, Patricia E. Moody, and

Jonathan Stegner describe in the book *The Purchasing Machine*, “Reductions in the supply base from thousands to hundreds of excellent suppliers will continue as intra-enterprise alliances focus on only the proven, strong performers, for whom finding new customers will be no problem, leaving marginal producers to scratch for a range of customers.” The contrast, the authors continue, will grow even sharper in the coming years “as the best suppliers will pick the customers that bring them the most money, the best technology fit, and the most manageable schedules, all with the preferred lowest ‘paperwork’ or service costs.” Rather than shifting from one customer to another, good suppliers will find a winning team and endeavor to stay there.⁷

One of the most effective ways of ensuring that suppliers find your company worth their while is to do what supply chain leaders such as Walmart and Dell have done for years: share transactional information with them. Ford Motor, for instance, centralized its supply chain information and functionality into a single global material manufacturing system, which gives the automaker’s suppliers and customers direct access to real-time inventory and shipping data, updated on a daily basis.⁸

As a result, Ford was able to reduce the number of days it takes to transport vehicles to dealerships. The average lead time required for material procurement was cut, as well as the number of people needed to contact suppliers. In addition, inventories at Ford’s vehicle assembly facilities and the supply base are significantly smaller than in the past. Through the use of technology, Ford has been able to provide more accurate and timely information to manage its internal and external business processes to a Six Sigma level of capability (see Chapter 6). Furthermore, the company can provide its dealers with better information about their specific vehicle locations. These efforts include reducing inbound carrier discrepancies, such as parts deviations caused by shipment overages, and reducing how often it uses expedited shipments (the most expensive type of shipping). Ford estimates that these efforts alone have saved the company more than \$1 million.

Looking Backward to See Forward

Prior to its split-up into two companies, high-tech manufacturer HP managed a spend of about \$50 billion annually. For direct materials (i.e., core supplies and materials used to make HP products), the company had nearly 90 distribution hubs, about 700 key suppliers, and roughly 120 logistics partners, according to Greg Shoemaker, HP’s global head of supply chain, central direct procurement services.

“With that amount of spend comes a significant amount of leverage,” Shoemaker notes. “One of the things we discovered is that size alone isn’t what gets you the best result. Obviously, size gives you a lot of leverage and

a lot of ability to manage a very big spend base, but it's how you manage that. Even small companies can have an advantage if they are using the right approaches and the right techniques and stay on the cutting edge."

As an example of a best practice any company can focus on, Shoemaker cites procurement risk management. Using analytical tools, HP was able to look backwards over time at such variables as price, supply, and demand, and then predict what those volatile numbers might look like in the future. "In a very volatile pricing area, for example, we would predict ranges of prices that we might expect. Or in a volatile demand portfolio, we would predict what our demand numbers—the highs and the lows—might be." That helped to educate and empower HP's procurement professionals to spread the risk between HP and its supply base.

The typical mantra in the high-tech industry used to be, "Mr. Supplier, you bear all the risk, and we'll buy from you," Shoemaker remembers. "That's not necessarily a long-term winning strategy for us or the supply base because there's so much consolidation that's occurred in the high-tech industry." With fewer suppliers and fewer high-tech giants, it's no longer in a company's best interest to be so transactionally oriented, he points out.

HP uses risk management tools that allow the company to manage risk from a statistical basis. DRAM (dynamic random access memory) chips used in computers, for instance, are a very volatile commodity, where the prices can vary wildly from week to week. Using risk management, Shoemaker notes, "we might structure a deal with a supplier that allows us to say to them, 'We're going to guarantee you a certain volume level, and in return for that, we'll ask you for a price cap.' Or we might agree to a price floor, and in return for that guaranteed amount of volume, they've got something they can depend on, and we can get some pricing conditions that we can depend on."

HP has saved a lot of money over the years thanks to its adherence to best procurement practices, but that doesn't mean it ever gets any easier. "The challenge that we have is that nobody just comes to us and says, 'Here's your price.' You've got to work for every penny of it," Shoemaker notes. For a high-tech manufacturer, a lot of the purchasing process is driven by market conditions and technology. "For instance, when a semiconductor fabricator goes to the next smaller die size, which reduces the price, it effectively does it for everyone. So what are you doing to manage that differently and get a better result?" That's what procurement is all about—not just getting the best price, but the best possible results.⁹

Ensuring a Healthy Supply Chain

How's this for a public relations nightmare: You're a major pharmaceutical wholesaler and you discover that, unbeknownst to you, you've been

purchasing and distributing counterfeit drugs, which results in lawsuits against your company. That nightmare scenario is exactly what happened to McKesson, when it discovered it had purchased fake Serostim, a drug to treat AIDS patients. It's also what happened to AmeriSourceBergen, when it bought more than \$4 million worth of heavily diluted Epogen, a medication for patients on dialysis with anemia. The same thing happened to Cardinal Health, when it bought \$2.4 million worth of tainted Procrit, another anemia drug.¹⁰ And Baxter International found itself at the center of the worst-possible scenario when hundreds took ill and dozens of people died due to contaminated heparin, a blood-thinning drug.¹¹

The discovery of fake Serostim served as a wake-up call for McKesson, explains consultant Greg Yonko, formerly McKesson's senior vice president of purchasing. "At that point we immediately took very stringent steps to tighten up all of our purchasing processes," he says. Birth control pills and HIV drugs had long been favorite targets of counterfeiters, but according to Yonko, the Serostim incident was the first time a high-priced injectible growth hormone entered the marketplace as a counterfeit product.¹²

"Over the last few decades, increasing globalization and supply chain complexity have posed risks to pharmaceutical safety, ultimately impacting businesses and, most importantly, patients," notes consultant Jay Hauhn, former chief technology officer with Tyco Integrated Security. "Today, materials are procured from multiple countries, manufactured somewhere else, potentially packaged in yet another country, and distributed and sold globally." Although the US Food and Drug Administration (FDA) heavily regulates and monitors the pharmaceutical food chain, counterfeiting continues to worsen every year. It's been estimated that 40% of the drugs sold in the United States are manufactured outside the United States, and that 80% of the active pharmaceutical ingredients in those drugs is produced offshore.¹³

According to Interpol, roughly one million people die each year due to counterfeit medications, and it is estimated that up to 30% of all pharmaceutical products sold in emerging markets are counterfeit.¹⁴ As a result, the FDA has launched numerous initiatives involving the use of various technologies to better track and trace drugs throughout the supply chain lifecycle. For instance, the FDA has urged the adoption of radio frequency identification (RFID) technology to track and trace all pallets and cases of pharmaceuticals, and in certain situations the agency has required that this technology be applied to every package as well. The goal is to ensure that every drug has a unique serialized identifier that will allow all pharmaceuticals to be trackable.¹⁵

In 2013, the FDA introduced the Drug Supply Chain Security Act (DSCSA), a 10-year program requiring various stakeholders in the pharmaceutical industry—manufacturers, repackagers, wholesale distributors, dispensers, and third-party logistics providers—to adopt an interoperable

system to manage records of ownership and transfer of prescription drugs in the United States. Over the course of the program, companies under the Act are expected, among other things to: provide lot-level product tracing information; establish systems to verify and handle suspect or counterfeit products; and confirm authorized trading partners.¹⁶

Besides RFID, companies are also actively investigating the use of blockchain technology to track and trace prescription medicines. The MediLedger Project, for instance, involves a consortium of pharmaceutical industry leaders—including AmerisourceBergen, Bayer, Cardinal Health, Genentech, McKesson, Pfizer, Walgreens, and Walmart—working together to develop blockchain-based solutions to comply with the DSCSA.¹⁷

Thanks to blockchain's distributed ledger capabilities, the MediLedger Project uses cryptography techniques that allow trading partners to securely exchange change-of-ownership information, helping to ensure all interactions throughout the supply chain are based on trust. In 2020, the consortium announced it had completed a pilot test demonstrating the viability of using a blockchain-based network to validate the authenticity of drug identifiers and the origin of saleable products throughout the supply chain. According to Matt Sample, vice president of manufacturing operations at AmerisourceBergen, the MediLedger pilot demonstrates the power of a connected network of authorized trading partners, including those without direct business relationships. The use of blockchain enabled a shared 'phone book' of authorized trading partners, locations, and connection points that enabled that network.¹⁸

Similar efforts are also underway to enable the traceability of various foods as part of the Food Safety Modernization Act, which was passed in 2011. As with the drug supply chain, technologies such as RFID, blockchain, the Internet of Things, artificial intelligence, and other solutions are being deployed or pilot tested to improve the ability to share product lifecycle information in a secure manner. (See Chapter 13 for more details on supply chain technologies.)

While technology can be used to identify and track authentic products, the larger issue threatening the pharmaceutical supply chain is what's known as the secondary market—small and loosely regulated wholesalers and suppliers whose products occasionally enter the mass market, sometimes to fill in the gaps during an inventory shortage and sometimes because their products are priced significantly lower. Most of the counterfeit drugs have come through these small distributors, which are typically state-licensed entities that are supposed to be inspected by the pharmacy board, notes Dr. Thomas McGinnis, former director of pharmacy affairs at the FDA and currently chief of pharmaceutical operations with the Department of Defense's TRICARE Management Activity. However, "a lot of them are very small businesses that are approached by somebody with product

to sell. They don't have a business relationship with them. They've probably never done business with them before. And yet they buy the product without making a phone call to the manufacturer or to the FDA to ask if this [company] who has a great deal is legitimate."

McKesson only buys drugs directly from pharmaceutical manufacturers, and of the hundreds of millions of products that go through its system every day, less than 1% are from the secondary market. According to Yonko, the company has an active business relationship with several alternative-source vendors, and initiates a rigorous due diligence process, including background and security checks as well as site visits, before it will purchase products from these vendors. The large drugmakers, meanwhile, have proactively taken their own steps to reduce the likelihood of counterfeit drugs entering the market. Many drug companies, including Pfizer, Johnson & Johnson, and Eli Lilly, require that their distributors only purchase drugs directly from them or from authorized resellers.¹⁹

It Seemed Like a Good Idea at the Time

Back in the days of the late 1990s dot-com boom, virtually every discussion of supply chain management began with an evaluation of the importance of online marketplaces. The premise was both seductive and simple: Manufacturers would be able to purchase parts, supplies, and components directly off the Internet, thanks to the emergence of procurement software and sufficient security protocols that would safeguard any online transactions. These e-marketplaces (also known as online trading exchanges or net markets), which seemingly sprouted up out of nowhere about the same time that user-friendly web browser software (e.g., Netscape and Google) became widely available, enabled companies to buy and sell raw materials and other products in real time via the Internet.

The hook that tantalized so many businesses was that companies would be able to save tremendously on their regular purchases of both direct materials (the core supplies and materials manufacturers require to make their products) and indirect materials (commodities that companies need to run their business, but that aren't necessarily part of their production process, such as office supplies) through *reverse auctions*. Let's say you were a glue manufacturer and you needed 10,000 tubes by the end of the month. You would post your specifications on a public exchange, where all of the tube suppliers who had been properly vetted could bid on your business. After a predetermined period of time, the auction would conclude and you could decide whether to accept the lowest bid or a slightly higher bid if you harbored doubts about the low bidder's ability to actually deliver the products.

When the Internet bubble burst in the early 2000s, taking down many high-flying startups fueled almost entirely by venture capital and irrational exuberance, many of the online exchanges were swept away in the flood-tide of failure. However, the *idea* of online business-to-business marketplaces was a good one then and it remains a good one now; it was mostly the lack of *execution* that led to their quick fadeout from the public eye. That, and the hubris that convinced these fledgling companies they could “insert themselves between established trading partners and take a piece of the action,” as author David Taylor puts it. “As soon as the potential of exchanges became apparent, the major buyers and sellers set up their own captive exchanges, bypassed the start-ups, and took their markets back.”²⁰

An Online Car Wreck

There are several types of online marketplaces, and the more flexible they are in their functionalities, the more useful they are to businesses. Before the Internet era even began, there were private exchanges, one of the best known being retail giant Walmart's Retail Link, which in those pre-Internet days used a proprietary electronic data interchange (EDI) pipeline to communicate transactional data between the retailer and its suppliers. Aerospace manufacturer Boeing was another early adopter of the private exchange model with its Part Analysis and Requirements Tracking (PART) page, a website that provides airlines and their maintenance contractors with a direct link to half a million airplane components. Because these types of exchanges were by definition private, they didn't really make headlines (at least not until reporters began taking a much closer look at what made Walmart so successful).

Thanks largely to eBay, public exchanges captured the imagination of American consumers, who were alternately fascinated and amused by the idea of being able to sell virtually anything to anybody. Amazon, never one to miss a trend, took eBay's basic idea to heart and introduced its Amazon Marketplace, which allows third parties—often individuals or mom-and-pop sized shops but also larger companies—to use the Amazon platform to sell both new and used products. At first glance, Amazon Marketplace doesn't seem much different from eBay, but actually the chief difference is an enormous one: All products are searchable through the basic Amazon.com website, so the entirety of Amazon's customer base, in effect, has access to Amazon Marketplace. That's made it possible for companies of all sizes to buy and sell both commodity and specialty items on a single-transactional basis. Numerous other B2B marketplaces have emerged, either spun out of existing consumer sites or launched to address specific markets, such as

China's Alibaba, DHGate, and Global Sources; India's IndiaMart and TradeIndia; and the United States' eWorldTrade.

For a time in the early 2000s, another type of digital marketplace looked like it would become a dominant purchasing mechanism, and this was the consortium-based exchange. These online marketplaces briefly threatened to turn all the old assumptions of purchasing on their head, and involved major OEMs teaming up (or at least, attempting to team up) to create common platforms for their industry—aerospace, chemicals, consumer goods, pharmaceuticals, you name it. And the biggest consortium exchange of them all, at least in terms of potential and mindshare, was Covisint, an attempt by General Motors, Ford Motor, and Chrysler (back when Chrysler was a standalone company) to link up their supply chains through one common online procurement platform. This effort, they hoped, would allow them to get much better prices on components from their suppliers, many of whom sold to all three of the Detroit Big Three.

Problem was, the automakers failed to ask their suppliers what they thought about the idea of having their products commoditized on an exchange where price presumably would be king. So Covisint never got buy-in from the suppliers, and that same lack of supplier interest also doomed many of the other big consortium-led exchanges. Their proponents claimed that members would save millions on their procurement costs, but they never took into consideration that the suppliers had so much to lose from the concept that they'd just refuse to play ball.

As Thomas Stallkamp, former president of Chrysler, observes, "Covisint was a horrible idea. Nobody thought it through. [Trading] exchanges are fine, but Covisint and the way it was done was an absolute failure—it never got off the ground."²¹ Adds economist Stan Liebowitz, "The laws of supply and demand are not so fragile as to be overcome by anything so small as a new method of communicating with each other."²²

A Rating Service for Buyers and Sellers

What ultimately derailed the consortium model, and relegated the public exchange model to the back burners, was the simple reality that spot-buying direct materials from companies you have no relationship with is a bad idea. However, using the web as a medium to conduct transactions and to communicate with suppliers is, in fact, a very good idea so, not surprisingly, online marketplaces targeted to specific industries are still flourishing. For instance, electric car manufacturer Tesla Motors uses online marketplaces that specialize in bulk parts, such as metal castings, plastic molds, and small subassemblies.

According to Mitch Free, founder and former CEO of online exchange MFG.com, buyers typically can access these exchanges for free, whereas suppliers usually pay a subscription fee to be listed on an exchange. One key element to the popularity of these types of sites plays into the same community spirit that websites like eBay and Amazon have fostered: Suppliers are rated by buyers for such things as timely delivery, customer service, and product quality. Buyers, similarly, are rated on such factors as timely payment, quality of technical data, and how easy they are to do business with. “The community can be an extremely powerful force in policing and evaluating the participants of an online marketplace,” Free says.²³

Sustainable Sourcing Pays Off

The community is also a powerful force in promoting sustainable sourcing practices, which involve the application of corporate social responsibility (CSR) principles when determining where to purchase and source raw materials and products from. Spurred on by pressure by their customers and the market, most if not all large companies now produce annual CSR reports along with traditional financial reports that indicate their triple bottom line (people, planet, and profit) performance over the preceding year. Manufacturers and retailers alike report on how well they’ve been able to reduce how much water they use, how much energy they consume, how much scrap they recycle, how many acres of trees they reforest, and other activities that help to bring a company as close as possible to zero waste and net-zero consumption of natural resources—what’s known as the circular economy.

Indeed, some of the best managed and most highly regarded companies in the world today are, not surprisingly, also among those considered best-in-class at sustainable sourcing, i.e., purchasing raw materials in a way that doesn’t exploit the workers or the land where the products derive. Consumer packaged goods giant Unilever, for instance, was named the number one supply chain in the world by analyst firm Gartner in 2018, earning a perfect 10 for its CSR efforts.²⁴ With its Sustainable Living Plan, announced in 2010, Unilever was one of the first major CPG companies to commit to shifting its sourcing of palm oil to only certified sustainable and traceable sources. The company also has pledged to reduce the environmental impact of its manufacturing practices in half by 2030. The efforts are paying off at the cash register, too; as of late 2019, Unilever’s Sustainable Living product lines were growing 69% faster than the rest of the business.²⁵

Companies are getting more insistent that their key suppliers disclose environmental data related to their supply chains, particularly as it relates to climate change, water usage, and deforestation, according to the Carbon

Disclosure Project (CDP), a nonprofit organization that helps companies measure their environmental impact and manage their supply chains more responsibly. Over 150 companies, such as HP, Nike, Procter & Gamble, Unilever, and Walmart, who account for a combined procurement spend of over \$4 trillion, participate in the CDP's efforts to urge greater transparency throughout the global supply chain.

"Global corporations have supply chains that wrap around the globe, touching millions of people, and by holding the purse strings they have the power to drive impact at scale—incentivizing a behavior shift in the companies that supply them," says Dexter Galvin, CDP's global director of corporations and supply chains. "With emissions in the supply chain being on average 5.5 times higher than a company's direct emissions, the buyer-supplier dynamic will make or break whether our economy can reach net-zero by 2050."²⁶ (We'll look more closely at CSR efforts throughout the supply chain in Chapter 14.)

Closing the Loop

According to consulting firm Bain & Company, external purchasing is the largest single expense category for most companies, averaging 43% of total costs. A world-class procurement department—one that has been empowered to think strategically about what the company is purchasing—can help reduce a company's purchasing costs by 8% to 12%, and can also deliver additional annual savings of as much as 2% to 3%. "But many organizations wall off procurement from the rest of the business, treating it as a non-strategic service," observe Bain consultants David Schannon, Sam Thakrar, and Klaus Neuhaus.

Collaboration—closing the loop between various departments—is the key to making sure that procurement savings don't vanish before the company is aware of them. It's vital to keep the finance department in particular well aware of any gains made through procurement practices. "Procurement managers seek to cut category costs that typically span multiple budgets, so the savings are difficult for finance to track," observe the Bain consultants. "As a result, procurement claims large savings that never show up in the company financials," which is a major point of frustration for chief financial officers, supply chain managers, and other business unit managers. However, when procurement works together with finance and the other departments, "they can create systems that reliably capture these gains, delivering real cash savings to management."

For example, when medical device manufacturer Boston Scientific decided to revamp its indirect material procurement process, its executive team wanted to capture the savings in real time. They also needed

to determine whether it would be better to reinvest in growth or to apply those savings to the company's bottom line. To do that, the company had to break down the silos between procurement and finance so that the finance department was made fully aware of where the savings were being generated from, budget by budget.

Using cross-functional teams and category-sourcing plans, Boston Scientific was able to put systems in place that allowed finance to track category-level savings into specific departmental budgets. The payoff, as the Bain consultants note, was significant: Boston Scientific delivered \$30 million in savings tied to specific budgets.²⁷

Notes

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