OLIVER WYMAN

SPENDING SMARTER: THE UNTAPPED VALUE IN SOURCING

OLIVER WYMAN'S APPROACH TO UNLOCKING HIDDEN VALUE IN SOURCING

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EXECUTIVE SUMMARY

Oliver Wyman has assessed that **an initiative to reduce your external spend could have an EBITDA impact ranging from 150 basis points to more than 600 basis points**, depending on which industry.

Based on our extensive experience in external spend optimization, we have identified **seven common pitfalls** that typically preclude companies from achieving this value, ranging from near-sighted focus to lack of performance tracking to siloes within the organization.

SO, WHERE TO START?

In short: **sophisticated** levers, **cross-functional** collaboration, and **accurate** measurement of the value generated.

Many companies feel they know this theory. But the fact is **fewer than one out of six companies can do this in practice**.

Companies need to approach this as a **Transformation Journey to ensure sustainability and clear accountability from the entire organization**. When appropriately implemented, it delivers **significant and long-term benefits** and has proven to be effective across industries in various contexts.

In order to support our clients in this journey, Oliver Wyman has developed a truly unique value proposition – Spend Smarter – built upon state-of-the-art capabilities and deep industry knowledge.

1. SPENDING SMARTER MATTERS NOW MORE THAN EVER

Faced with lasting economic pressures, continued raw material price increases, accelerated technological shifts, intensified global competition from lower labor-cost countries and value migration, all firms must contain costs to protect their margins. Even industries that have managed to maintain high margins are constantly looking to reduce costs to free up additional cash for growth (e.g. accelerated go-to-market, innovations, geographical expansion).

In addition to these external factors, companies are faced with continuous internal changes that have significant impact on costs such as mergers and acquisitions, geographical expansion, organizational transformations, etc.

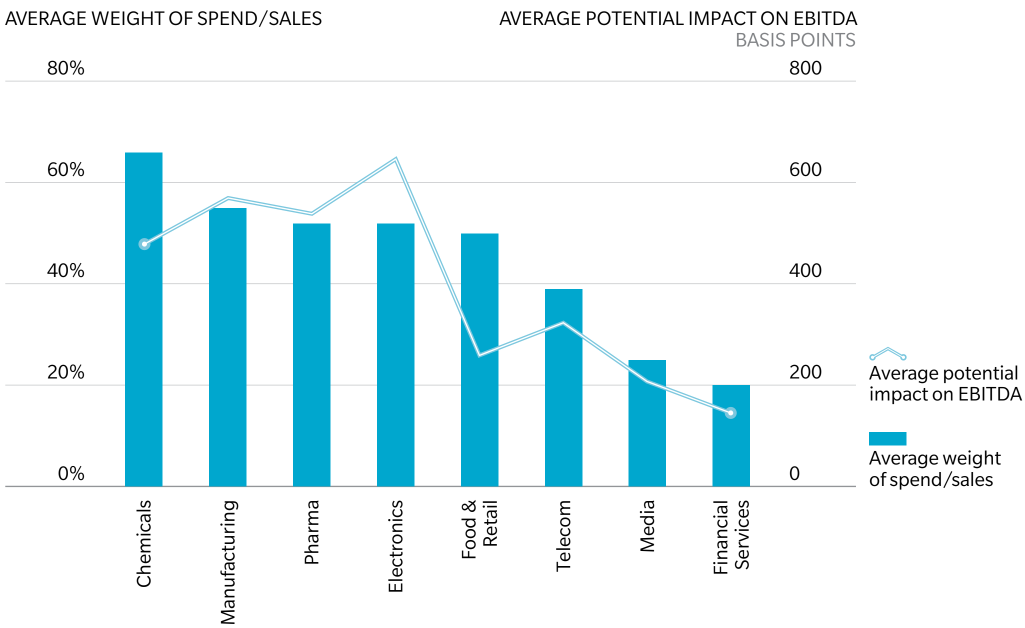
Because it represents such a significant portion of costs regardless of industry, optimizing external spend is a persistent concern that remains firmly in the crosshairs of top executives.

While most companies periodically focus their efforts on reducing external costs, they are unable to achieve their initial target and often see costs creep back very rapidly.

As a matter of fact, Oliver Wyman regularly meets with top executives facing a paradox:

- They are not satisfied with their company's performance related to optimizing external spend
- Yet they are convinced that they are doing all the right things to address this issue

EXHIBIT 1: REDUCING EXTERNAL SPEND CAN DRIVE MAJOR IMPACT ON EBITDA



Source: Oliver Wyman analyses

The following seven common pitfalls explain why companies often do not achieve high and sustainable performance.

1. **"Cost cutting is easy: let's stop spending"**
This usually means playing a "shell game" rather than addressing underlying causes. These efforts ostensibly cut spending in the near-term, but costs inevitably reappear as they cannot be maintained at lowest levels over time without damaging quality, impacting client satisfaction, or undermining employee morale.

2. **"Some spend areas are not worth considering"**
More often than not, companies partially address, if at all, significant areas of external spend either because they don't think they spend enough to optimize spend or because they view those areas as "protected" (e.g. IT, Marketing). However, opening those new territories delivers more value, as they have not been scrutinized with the appropriate focus in the past.

3. **"Our Procurement department can take care of cutting costs"**
Efforts are often launched by the company's Procurement department with inconsistent alignment and unclear accountability from key stakeholders. However, two-thirds of the value potential is not driven by price (e.g. standardizing specifications, reducing the number of SKUs, optimizing consumption) and therefore not in the purview of the Procurement department.

4. **"We're already very cost-conscious. There is not much more left to trim"**
Organizations may find themselves penny-wise but dollar-foolish. Bottom-up approaches will typically limit the value generated as most of the potential does not lie in the hands of single stakeholders. Our extensive experience tells us that when individual departments work together to identify opportunities for savings, even companies that are already "cost-conscious" will be able to tap into additional value. In fact, those organizations often generate superior value because they demonstrate more appetite to implement sophisticated levers.

5. **"We already squeeze 2% out of our suppliers every year"**
Such a statement probably indicates that initial price levels are too high – suppliers can easily give back significant rebates year after year – or that they are driven by deflating market trends. In any case, this approach is suggestive of a very transactional way to manage vendors and significantly increases mid-term risks (e.g. price upturn, supplier default). Once procurement basic coverage has been carried out and once price levels are set at reasonable levels, regular price optimization can only be obtained through deeper investigation of sophisticated opportunities involving internal stakeholders and suppliers.

6. **"Sourcing initiatives are self-supporting, by nature"**
Initiatives are often not sustainable because they are conceived in a vacuum. In fact, it is virtually impossible to separate performance from organizational issues. An efficient organization will seek buy-in from stakeholders beyond Procurement and will adapt existing infrastructure in light of new challenges to ensure that savings continue to be realized.

7. **"It's impossible to measure the value. It's really more an act of faith"**
According to a recent Oliver Wyman study, fewer than one out of five CFOs are currently satisfied with the way purchasing performance is measured. Under-investment in performance measurement results in loss of traction with the internal stakeholders, difficulty in reconciling Finance numbers with the performance claimed by Procurement, and an inability to measure the ROI of the procurement function. Ultimately, this is a key reason driving the failure of external spend optimization initiatives as business partners struggle to see the benefits there are receiving.

2. WHERE TO START: THE SMART THINGS TO DO

Spending smarter is not just about trimming the fat and tightening the belt during slow economic times. It doesn't only aim at creating immediate savings. It transforms the Procurement function beyond the purchasing activity to create long-term value. More importantly, **it aims at designing an overall performance-driven operating model where all stakeholders are collaborating to reach a shared objective.**

Faced with limited and unsustainable benefits from traditional external spend reduction efforts, organizations may wonder how to actually spend smarter. Based on our extensive experience and successes, we have identified a number of Key Success Factors. Three of them, specifically, are good area to start: (1) extend the reach, (2) create a new operating model and (3) monitor and measure the impact.

2.1. EXTEND THE REACH

To reach maximum margin improvement, companies must not only rely on traditional negotiation and supplier consolidation levers, but also explore the full set of purchasing and value sourcing levers:

- **Buy cheaper**: challenge price and payment terms conditions by leveraging scale, consolidating suppliers, and finding market opportunities (e.g. pool volumes, optimize supplier panel, investigate alternative sourcing, negotiate master agreements)
- **Spend better**: optimize specifications to tailor products and services bought to actual internal needs (e.g. standardized catalogue creation, TCO trade-offs, specification improvements, Make or Buy decisions)

EXHIBIT 2: OLIVER WYMAN HAS IDENTIFIED SEVERAL COMMON PITFALLS OF SPEND OPTIMIZATION AND WAYS TO ADDRESS THEM

WHAT WE HEAR FROM TOP EXECUTIVES	WHY IT IS A RISK TO HIGH AND SUSTAINABLE PERFORMANCE	WHAT CAN YOU DO?
1. *"Cutting costs is easy: let's stop spending"*	**Costs will inevitably reappear over time**	Extend the reach: • Investigate sophisticated levers • Increase spend coverage
2. *"Some spend areas are not worth considering"*	**Significant portions spend remain mostly untapped**	
3. *"We already squeeze 2% out of our suppliers every year"*	**Suppliers will fight back to protect their margins**	
4. *"Our Procurement department can take care of cutting costs"*	**Procurement department does not have mandate to "interfere" beyond price**	Develop a cross-functional operating model
5. *"We're already very cost-conscious. There is not much more left to trim"*	**Up to 60% of the savings potential requires transverse collaboration**	
6. *"Sourcing savings are self-supporting, by nature"*	**Savings will not be sustainable**	
7. *"It's impossible to measure the value. It's really more an act of faith"*	**Poor performance measuring is a key driver of failed external spend optimization**	Implement an accurate measurement system

Source: Oliver Wyman

- **Spend less**: monitor consumption levels to avoid waste and over-consumption (e.g. best practices sharing, consumption dashboard monitoring, internal benchmarks, budgets constriction)
- **Drive top-line**: offer access to newest innovations (e.g. technology, distribution), participate in market monitoring (e.g. R&D, Marketing, competitors intelligence), increase ROI on Marketing spend

Fewer than one out of six companies actually implement these levers sustainably and across a large portion of their spend as it requires deep changes in the operating model.

The other dimension to extend is the coverage of the Procurement function. Generally speaking, too many categories remain out of reach of the procurement function:

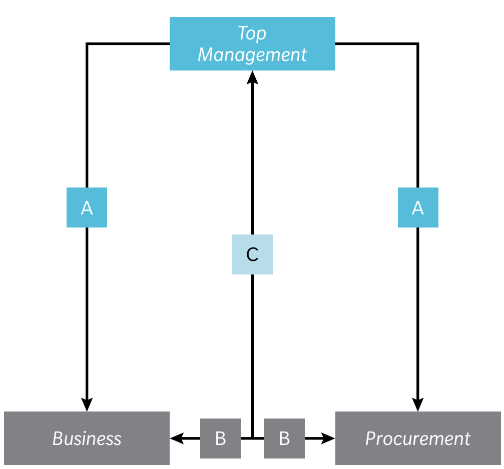
- Either because they are perceived to be "protected areas" in the hands of topic experts (e.g. IT, Marketing)
- Or because the impact is believed to be too low (e.g. office supplies)

2.2. CREATE A NEW CROSS-FUNCTIONAL OPERATING MODEL BY INITIATING KEY DYNAMICS

Prerequisite dynamics are needed to go beyond traditional levers and extend coverage:

- **Dynamic A – Assignment of shared objectives**
  Top management sets ambitious top-down objectives shared by the business and the Procurement department. These objectives should be built on a strong analytical rationale to achieve buy-in from all stakeholders and be sufficiently granular by business unit, geography and Sourcing category.
- **Dynamic B – Cross-functional collaboration**
  The shared objectives shift the relationships between the procurement function and the business operations. Procurement becomes an ally to meet the targets, and the interactions become "push and pull," with the businesses "pulling" assistance from Procurement and Procurement "pushing" new initiatives.
- **Dynamic C – Budget integration**
  The early inclusion of the overall target in the budget guarantees the involvement of the entire company and prevents this from becoming an isolated effort from a limited number of people.

EXHIBIT 3: A CROSS-FUNCTIONAL OPERATING MODEL IS BASED ON KEY DYNAMICS



2.3. SUSTAIN THE PERFORMANCE THROUGH MEASUREMENT

A reliable measure of the value delivered is critical to engage all stakeholders, hold the organization accountable, and ultimately sustain high performance levels.

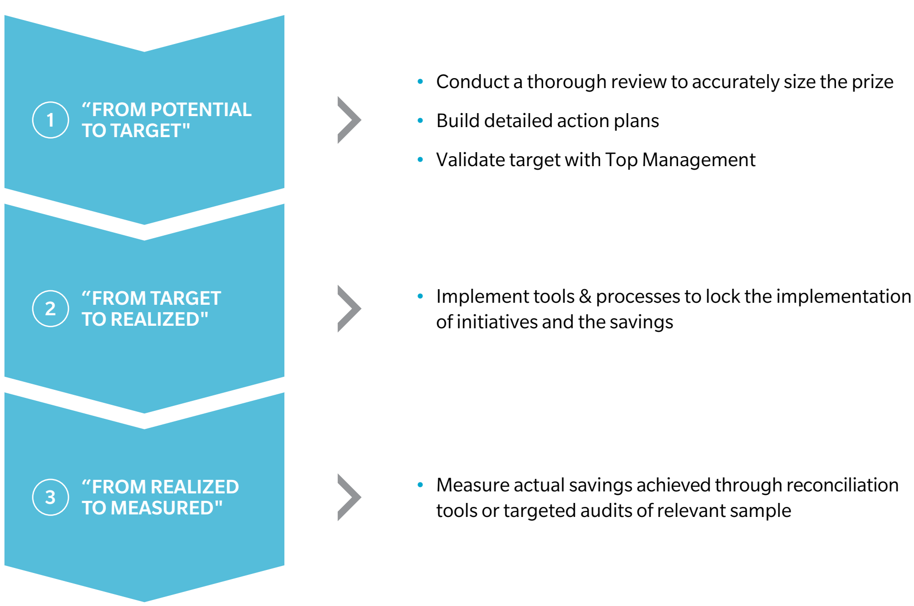
A comprehensive and robust performance measurement mostly relies on:

- Validation of some guiding principles by Finance and detailed value calculation rules agreed upon by all stakeholders
- Validation by Finance of the potential value associated to an initiative upstream, when identified and integration of the potential value upstream in the budgets
- Synchronization of purchasing and financial cycles to avoid "anticipated re-consumption" effects
- Clear identification of the impact in the P&L when it has occurred and recognition by all parties involved (including Finance)
- Dedicated tools and processes

In addition to engaging stakeholders, the continued tracking of the impact provides tangible data and high visibility on the value created to:

- Support business decisions such as the reallocation of value, cash vs. cost arbitrations, etc.
- Ensure timely implementation of actions to quickly realize value
- Measure the added value and ROI of the purchasing function
- Arbitrate on resources allocations depending on stakes

EXHIBIT 4: A RELIABLE MEASURE OF THE VALUE DELIVERED IS CRITICAL



3. HOW CAN YOU MAKE IT HAPPEN?

Putting theory to practice requires engaging in a real Transformation Journey. First, obtain the unconditional support from top management and involvement of key stakeholders to kick-start the transformation. Second, build tangible and analytically supported improvement plans to increase buy-in, ownership, and accountability of the entire organization. Finally, ensure an effective deployment of adequate organizational changes and dedicated tools and processes to lock-down of the benefits. Any organizational change should be considered as an enabler to a performance lever and be assessed against the value at stake.

3.1. A TRANSFORMATION JOURNEY

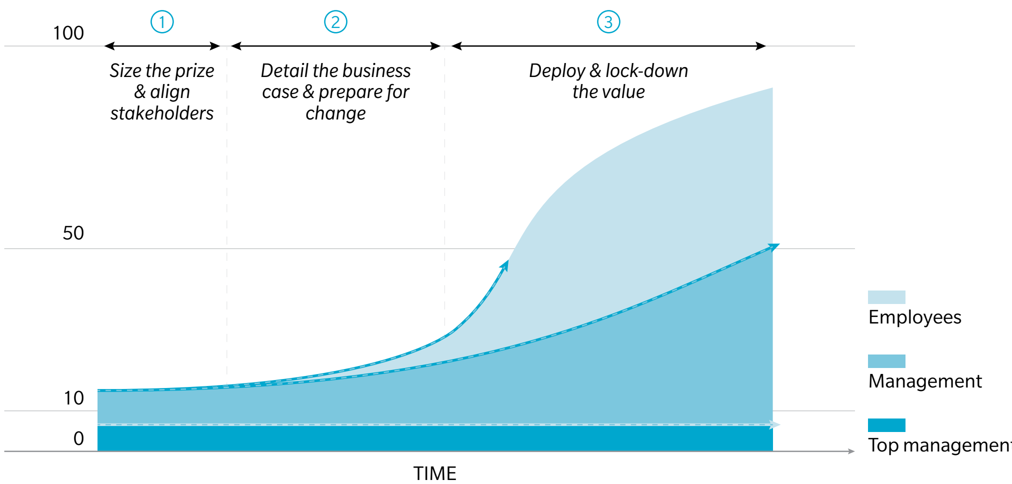
- **Step 1 – Size the prize and align key stakeholder**
  The potential must be quantified and agreed upon to align the top management – who will then set the global objective – and the main business stakeholders – who will take their fair share of the target and enlist relevant resources. A first step may therefore be required to assess the potential value within a given scope. Opportunities are identified and detailed for each category through global analyses. The main hurdles preventing a successful implementation also need to be highlighted as soon as possible.

- **Step 2 – Build tangible financial improvement plans and increase buy-in and ownership**
  This step is critical as it is the actual change management phase, designed to get the organization completely involved and committed to the success of this transformation. Based on the findings of step 1 and for each category, cross-functional teams of buyers, prescribers, and users develop shared strategies. They also define detailed action plans with related business cases, which then go through a thorough validation process by management and finance. In this phase, teams may start adjusting their ways of working to adjust to the hurdles identified in the previous step and formalize the terms of a sustainable collaboration.

- **Step 3 – Deploy and lock-down the value through the operating system**
  During this step, the company should be equipped with best-in-class processes and tools to accurately steer and measure the value delivered on external spend. This is also the time – and only then – to build an efficient operating model, shaped by the value at stake, sketched and tested during the previous phases: governance, processes and capabilities that consistently deliver the expected value, maximize the efficiency of the organization, and render progress sustainable.

This Transformation Journey that we call "Spend smarter" can be applied by itself or as part of a more comprehensive operational efficiency project. Oliver Wyman has applied it successfully both in conjunction with restructuring projects (e.g. global transformation projects, complete turnaround, mergers and acquisitions) and as a stand-alone initiative. Firms engaging in a transformation project will find spending smarter is a great first step: indeed, it generates value that can be reinvested in other cash demanding initiatives and encourages stronger transverse collaboration as well as increases overall business acumen across the organization. It sustainably upgrades capabilities and skills, increasing the readiness for changes without risking any major organization upheaval.

EXHIBIT 5: PROGRESSIVELY ENGAGE THE ORGANIZATION TO MAXIMIZE BUY-IN



3.2. SIGNIFICANT AND SUSTAINABLE BENEFITS ACROSS ALL INDUSTRIES

When successfully implemented, such approaches yield significant and sustainable benefits across all industries.

In order to illustrate the potential impact of Spend Smarter, we have listed how some clients have recently leveraged those capabilities and the benefits they've achieved.

- **Major retailer, engaging in a major transformation**
  - Context and scope: client shifting from a very decentralized and entrepreneurship culture to a consolidated and more efficient back office. Project focused on goods not for resale
  - Impact: $400 MM of savings over a 3-year period on a total GNFR spend of $3.7 BN, creation of a centralized GNFR function
  - Key success factor: refined processes and tools to measure benefits with high granularity
- **Key player of information and technology, recently listed on NYSE**
  - Context and scope: strong need to demonstrate operational excellence and fund a broad transformation program. Sourcing project covered all categories (Technology, People and Indirect), for a total of $120 MM of spend
  - Impact: a total of $15 MM savings identified and validated by all stakeholders
  - Key success factor: complete set-up of a functional procurement department in three months

- **Global pharmaceutical company, facing a significant market shift**
  - Context and scope: increasing pressures on margins (healthcare reforms, generic molecules, low cost countries, etc.). Sourcing project covered 40 categories, representing a total of $7.5 BN
  - Impact: $600 MM of savings identified over a 3-year period
  - Key success factor: very rapid intervention with new sourcing strategies built under two months, while multiplying identified savings potential by two
- **Leading telecom carrier in a market opening to competition**
  - Context and scope: transformation program to adapt a previously state-owned company from a holistic position to a highly competitive situation. The scope addressed was $2 BN
  - Impact: $150 MM of savings validated by all key stakeholders
  - Key success factor: The procurement organization was positioned as a real partner, capable of supporting the company on core spend areas, such as Network, Program contents, …
- **Major chemical companies, in the context of an international merger**
  - Context and scope: the overall project aimed at identifying potential synergies. The sourcing stream addressed $9 BN over all categories, with very mature existing capabilities
  - Impact: 75% of the synergies from the merger resulted from the optimization of the overall new sourcing spend
  - Key success factor: the project didn't just align both companies on the best practices pre-existing the merger but went beyond and made NewCo better than the sum of both
- **Leader in consumer packaged goods, with rapid growth**
  - Context and scope: turnover increasing by 15% every year for this global leader of Consumer Packaged Goods (CPG) with a strong geographical expansion and a changing manufacturing footprint (previous dominant geography went from 80% of revenues to 30%). The sourcing stream covered non-COGS categories for a total spend of $5 BN
  - Impact: $550 MM of savings across all geographies and business units
  - Key success factor: designed an agile sourcing organization (org. charts, processes) to face further evolutions
- **Hospitality and leisure leader in need to fund a new expansion phase**
  - Context and scope: extremely decentralized organization, facing increasing competitive pressures
  - Impact: focused on $1.2 BN of Indirect spend and a total of $105 MM of savings potential identified. Main hurdles to implementation clearly identified
  - Key success factor: the sourcing stream identified the required cash to fund further growth plans

ABOUT OLIVER WYMAN

With offices in 50+ cities across 25 countries, Oliver Wyman is a leading global management consulting firm that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation. The firm's 3,000 professionals help clients optimize their businesses, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities.

OLIVER WYMAN'S SOURCING CAPABILITIES

Oliver Wyman's global Sourcing practice is one of our key capabilities in Operational Efficiency.

In addition to our dedicated team, we have created a Sourcing Center of Expertise. Leveraging a wide internal and external network of experts, this Center of Expertise supports our teams on all key Sourcing topics, from category expertise to organizational focus.

Our approaches are built to deliver sustainability and avoid the black-box effect:

- Knowledge transfer: it is embedded in our way of working. Through formalized methodologies, supporting tools and processes and continuous coaching and training, we make sure each organization takes full ownership of our recommendations and is equipped to sustain them over time.
- Proprietary tools: Our approach is not a theoretical construct but rather a toolbox we have built a number of proprietary tools – from diagnostic (GSM Oliver Wyman tool ©) to consolidation (APD © and Levers periodic table ©) and performance measurement (SATT ©). This enables us to be immediately operational.

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