

# OPEN INNOVATION

HOW CAN PROCUREMENT CONTRIBUTE EFFECTIVELY?



# THE MEANING BEHIND THE BUZZWORD AND WHY CPOs SHOULD KNOW ABOUT IT

Open innovation is a hot topic for Procurement today. CPOs have heard the word many times and often talk about it, but without always knowing how powerful of a tool it can be or what transformation it entails for the Procurement function. The 2015 SIG/Oliver Wyman Procurement Maturity benchmark has actually shown that a majority of players have not yet engaged in Open Innovation in a meaningful way – and 47% of respondents have not done so at all.

On the other hand, the benchmark does highlight a long term trend of growing interest in Open Innovation from companies across sectors over the past 10 years. Among Open Innovation-savvy players today, very few had initiated their journey 8 years ago, with the vast majority engaging sometime in the past 4 years.

Henry Chesbrough, considered the father of Open Innovation, once defined the concept as “The use of purposive inflows and outflows of knowledge to accelerate internal innovation, and expand the markets for external use of innovation, respectively”.

The Open Innovation paradigm can in fact be understood as the antithesis of the traditional model of vertical integration: under vertical integration, internal innovation activities give rise to products and services that are internally developed and then distributed by the firm. On the other hand, Open Innovation is above all a company-wide project that is:

**Outside-in**, by encouraging internal innovation to rely on external output

**Inside-out**, by selling patents and technologies for which the company has no use, thereby creating new revenue streams and providing access to new markets

Over the past decade, developing new products and services internally has become increasingly expensive as R&D cycles have accelerated. In 2015, CPG, aerospace, and electronics companies generated a significant percentage of their revenue – around 11% – from products they had developed in the past year according to the 2015 APQC Product development benchmark. Keeping up with this pace requires sizable R&D investments which are continually rising.

While internal R&D still has a major role to play, substantial capabilities can be found within a company’s own supplier base. Pooled together, the resources of suppliers far outweigh the internal R&D firepower available to a company internally, and Procurement can help tap into this too often dormant wellspring of ideas.

As Procurement shifts from its traditional – and outdated – cost-cutting role towards more strategic responsibilities, top management is expecting CPOs to actively contribute to growth. The SIG/Oliver Wyman Procurement maturity benchmark has shown that the

10% most mature Procurement functions have already contributed significantly to their organization's growth.

Harnessing Open Innovation in today's market is becoming a growing necessity for CPOs in tackling current Procurement challenges and in better meeting CEOs' expectations of tomorrow.

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*“Procurement plays an increasingly important role in helping R&D collaborators set up the right ecosystems and the right partnerships, that will allow us to generate future innovations”*

SVP of a pharmaceutical company

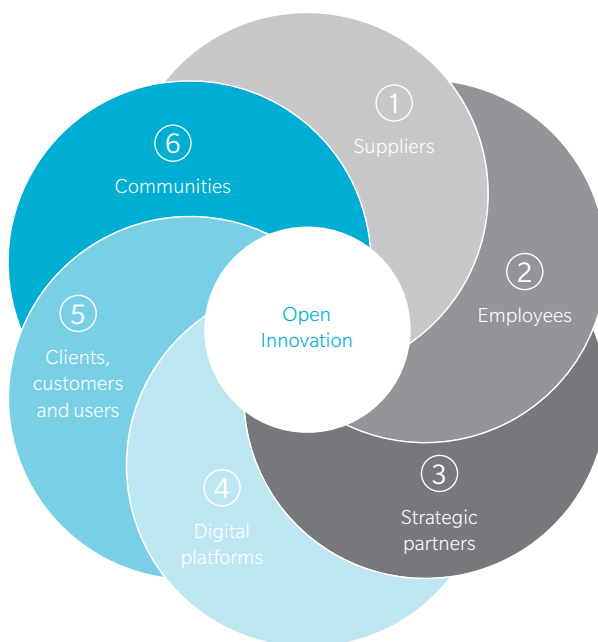
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## 1. THE POTENTIAL ROLE OF PROCUREMENT IN OPEN INNOVATION

Procurement can leverage a broad innovation network. Suppliers are naturally a part of it, but the network extends far beyond this subset alone.

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Exhibit 1: Procurement's Open Innovation network



CPOs also have a role to play in defining and engaging in partnerships with key players within this network:

- **Suppliers:** Procurement can obtain access to information collected by its suppliers and thus gain extensive insights into client and customer expectations in addition to new materials, components, and service; it can also engage in co-development with suppliers
- **Strategic partners:** Procurement is well positioned to define the terms of cooperation with Strategic Partners such as associations and universities, whose leading-edge academic teams provide access to new technologies
- **Digital platforms:** Procurement can help identify and source innovative digital platforms, which provide easy access to top ideas from nearly millions of students, engineers, and scientists
- **Communities:** Procurement's extensive external network makes it a potential actor for engaging with communities in order to stay abreast of emerging usages, new needs, and current trends or habits

Building a strong network of suppliers with whom companies can trustfully collaborate and engage in meaningful partnerships around idea sharing is the first key step down the path towards Open Innovation.

Once valuable partners have been identified, there are several strategies Procurement can leverage in order to launch Open Innovation initiatives:

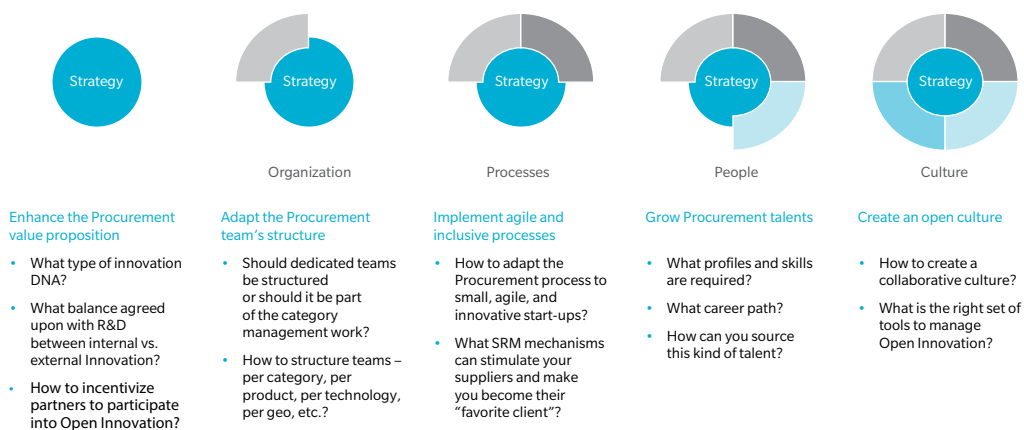
- **Outcome oriented goals without constraints:** Give opportunities to your suppliers to test ideas without constraints and reward good ideas without judging other suppliers
- **Innovation tour:** Organize visits to regions advanced in specific areas and encourage team to attend industry forums. This strategy is already being leveraged successfully by a mobile telecommunication company organizing regular visit to Asia
- **Innovation forums:** Organize forums inviting suppliers to propose ideas, commit to investments and provide spend visibility for winning ideas. A large cosmetics company developed the packaging and point-of-sale material for one of its products using this approach, inviting suppliers to provide suggestions and investing in the best ideas. Suppliers were highly engaged and attracted by the prospect of getting additional business. Over 4 years, this initiative led to the creation of 200 innovative products
- **True partnership with special relationship at CEO level:** Encourage CEOs to share their innovation strategy and vision and lead joint R&D efforts
- **Become your suppliers favorite customer:** Build long term mutually beneficial relationships with a few suppliers and ensure first hand access to "small" innovations

Procurement functions therefore clearly have a role to play in their organization's Open Innovation journey. In order to fulfill this role effectively, however, it is often necessary for CPOs to adjust the way the function operates.

## 2. HOW TO RETHINK THE PROCUREMENT OPERATING MODEL TO SUCCESSFULLY ENGAGE WITH OPEN INNOVATION

In order for Procurement to leverage Open Innovation efficiently, CPOs must rethink the function's Operating Model. Five key dimensions of the function must be examined: its strategy, organization, processes, people, and culture, as detailed in the exhibit below.

Exhibit 2: Key steps to rethink the Procurement Operating Model

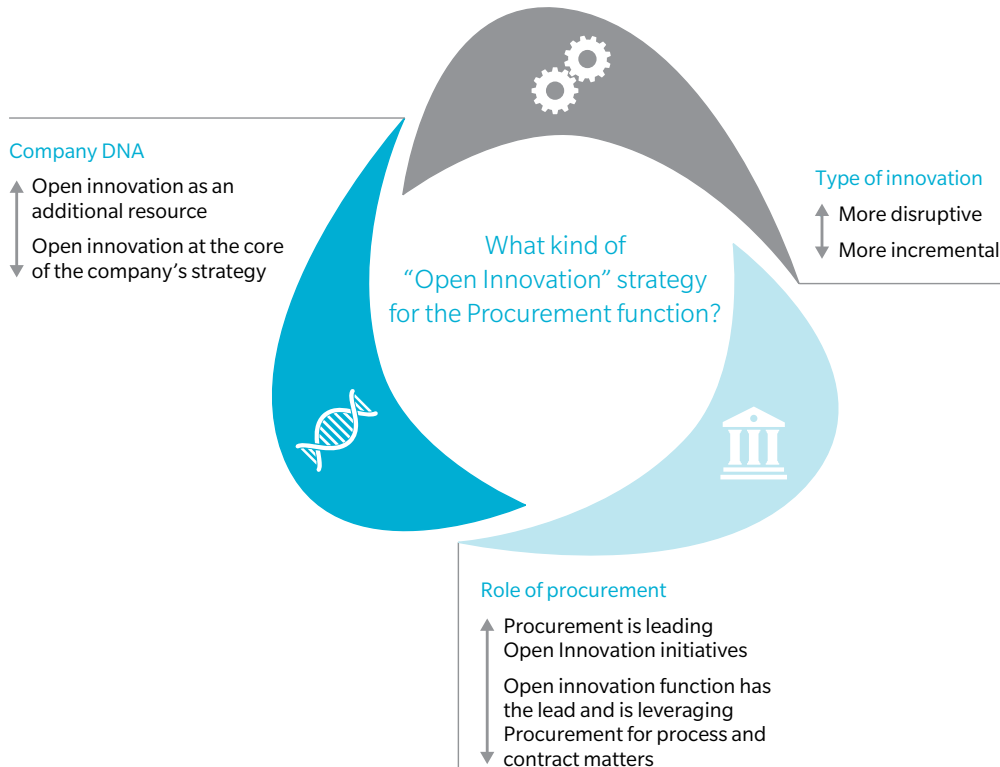


The following sections present a deep dive into each of the five dimensions and highlight the required adjustments to the Operating Model.

### 2.1. STRATEGY

The first major change pertains to the function's strategy, as Open Innovation significantly enhances Procurement's value proposition. The function must take into account the company's DNA and the desired type of innovation as Procurement defines the role it will play in Open Innovation initiatives.

Exhibit 3: Components of the Procurement function's strategy



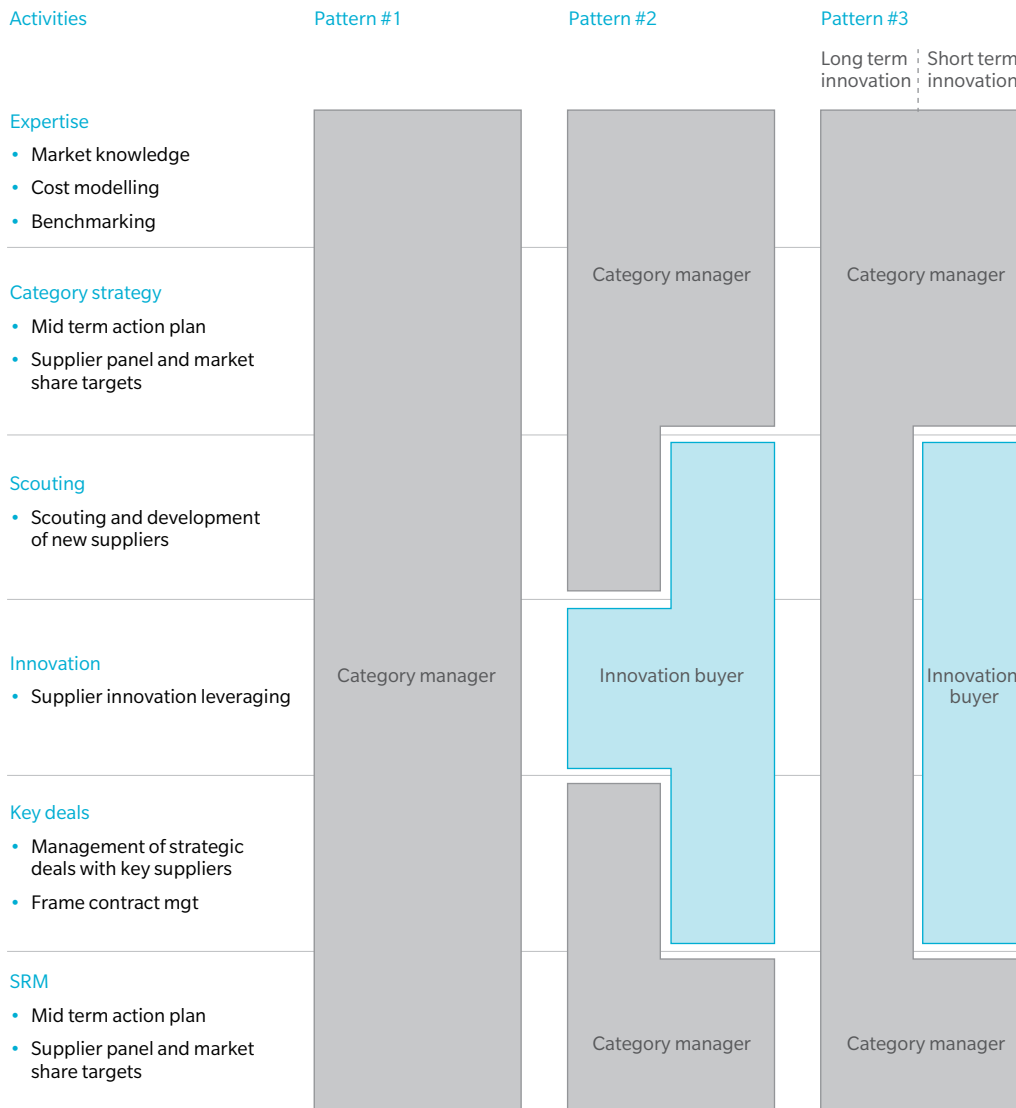
Company DNA is more of an input than an actionable lever, but this input is essential for Procurement in defining its role and vision for the organization's "Open Innovation strategy". Operating under a clear mandate with explicit objectives is helpful as Procurement will often be operating in "push" mode, trying to sell the Open Innovation model both internally and externally.

## 2.2. ORGANIZATION

Once the new strategy line is established, Procurement must adopt the internal organization that is most appropriate to the new value proposition. One of the key decision points revolves around whether Open Innovation should be part of overall category management and have dedicated resources.

The exhibit below presents three possible organizational patterns.

Exhibit 4: Three possible internal organization patterns



- Pattern #1:** innovation embedded in category management. This type of model often falls short as category managers tend to be too focused on category strategy
- Pattern #2:** innovation buyers. This model requires additional resources and seamless communication with category managers, but has proven to work well overall
- Pattern #3:** hybrid. Innovation buyers are in charge of short term innovation, and category managers are in charge of long term and disruptive innovation

We usually observe an evolution in Open Innovation adopters' organization from pattern 1 to 3. Companies typically start by adopting Pattern #1, testing and learning. However, they are not usually successful in the beginning stages, and as a result, they switch to the preferable Pattern #2 and dedicate specific resources to innovation. For instance, a building material manufacturer has tasked buyers to identify corporate and social responsibility innovations, as well as breakthroughs regarding heating capabilities of building materials.

Over time, they adjust the focus of Open Innovation resources to be concentrated on short-term innovations, leaving long-term initiatives to be handled directly by the category manager (Pattern #3).

## 2.3. PROCESSES

Over time, some companies have developed clear Procurement processes in order to be more efficient internally or to respond to regulatory requirements. Rigid processes, however, can greatly hinder Procurement's capacity to capture innovation from highly agile players such as start-ups. This is especially true in Financial Services where the emphasis on risk management and the heavily regulated environment have led players to develop intricate processes that prevent them from collaborating effectively with their most agile partners. In some cases, companies intentionally streamline their processes to facilitate interactions with these key partners.

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*“We are trying to bring fast innovation to the marketplace by partnering with incubators”*

CPO of a health insurance provider

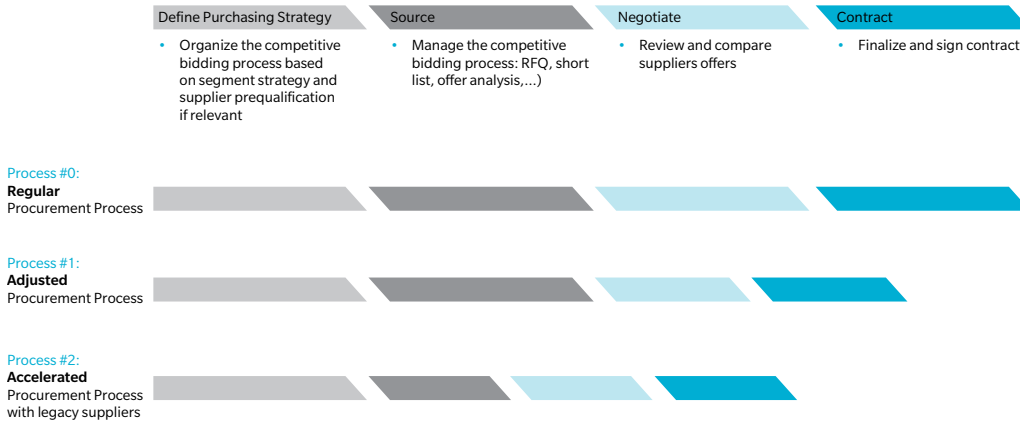
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Both Adjusted and Accelerated processes can result in a Proof of Concept; in both cases, engagement thresholds and validations must be settled to be risk compliant. These two processes offer a path towards greater agility, which often allows for capturing more innovation from suppliers. Their difference lies, crucially, in the question of speed, as every step in the process can be faster when there is a panel of legacy suppliers as in Process #2.



Procurement processes examples are shown in the exhibit below.

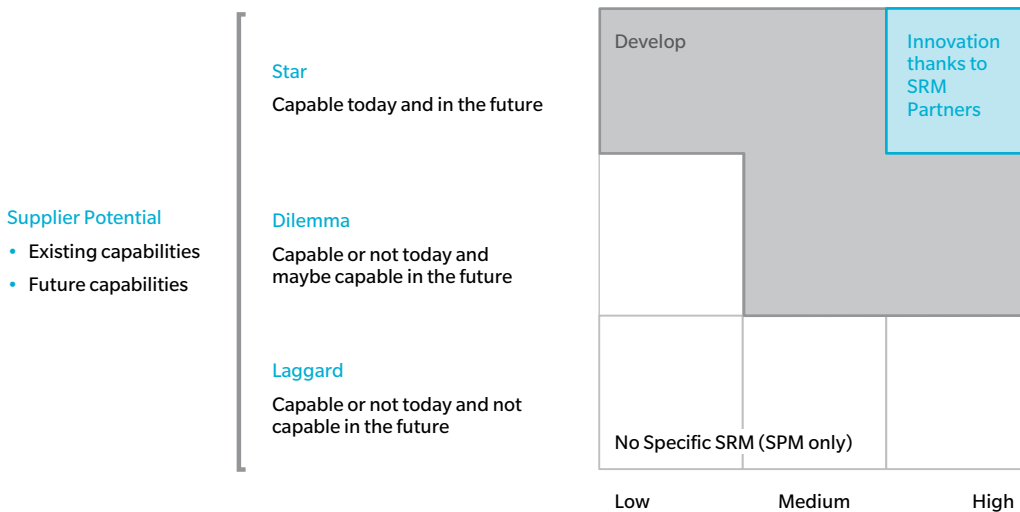
**Exhibit 5: Example of procurement processes**



To maximize these supplier benefits, Open Innovation must be embedded into the company’s approach to Supplier Relationship Management (SRM). SRM is a strategic topic that targets both existing and new suppliers – it should be preventive and forward-looking in nature. Open innovation is not a topic for suppliers that are only part of SPM (Supplier Performance Management).

Indeed, organizations have a lot to gain by becoming the “favorite customer” of a handful of key suppliers, carefully selected thanks to the supplier selection matrix shown below.

**Exhibit 6: Supplier selection matrix**



Supplier selection is often based on qualitative prospective vision – reference is best practice – and operated by senior representatives.

Developing privileged relationships with suppliers allows organizations to negotiate valuable benefits, such as first hand exclusive access to suppliers' latest innovations.

## 2.4. PEOPLE

In addition to adjusting internal processes, Procurement must build a well-rounded skillset in order to leverage Open Innovation effectively. Talent management is therefore paramount in allocating the right people to the new challenges that Procurement is facing today.

In addition to the core Procurement expertise, it is increasingly desirable for Procurement professionals to be:

- **Business oriented:** to better understand business expectations, competitor positioning, and what role Open Innovation plays within the organization
- **International:** to better understand and work within global innovation networks
- **Influence and leadership:** to sell and engage on Open Innovation visions both internally and externally with key partners
- **Impactful communicators:** to collaborate efficiently with internal stakeholders and suppliers

Some of the most advanced Procurement functions have been working on expanding their resources' skillset for over a decade by encouraging mixed career paths and making sure that their talent can have experiences outside of Procurement; for instance, working in R&D for a few years before returning.

Some CPOs have even set a 20% turnover objective per year to encourage profile diversity. CPOs seek out external hires for certain categories for their advanced skills, and make a mix of training modules available to develop the full spectrum of competencies.

Embedding Open Innovation objectives into compensation schemes is also essential. Compensation incentives push users to engage more actively than when there is no clear target. For example, a construction company has set concrete annual objectives of a minimum of two innovations per buyer, resulting in an end product developed by the company.

## 2.5. CULTURE

While established, traditional methods of working may sustain and grow the core business; they often fail in fostering an environment that is truly supportive of Open Innovation. All too often middle managers will learn of outside inventions, only to discard them in favor of the status quo.

Companies must accept that they cannot master all of the patents used in their products, and steer away from the “not invented here” mentality that causes them to reject outside advancements due to potential legal concerns.

Instead, they should lead employees to think of innovation as part of everyone’s job: everyone bears with the responsibility of innovation, not just those with the word in their job title. In order to do so, Procurement must develop the right set of tools to foster internal collaboration, interact seamlessly with suppliers, and ensure visibility on all interactions with suppliers across the company. Gradually, Procurement will need to transition from a project-based approach to “business as usual” in order to truly embed Open Innovation into the company’s culture and DNA.

### 3. PATH FORWARD

At a time when developing products internally is becoming increasingly expensive and CEOs expect CPOs to contribute to growth, Open Innovation appears as an attractive development objective for Procurement.

CPOs are ideally positioned to engage in idea sharing partnerships with a variety of agile players, including but not limited to suppliers, each of which provides a bountiful source of unexploited innovation.

In order for Procurement to become an agile Open Innovation partner and develop a diverse network of collaborators, CPOs must rethink the function’s operating model entirely.

This begins by clearly defining the new role Procurement will play within the Open Innovation process and onboarding the team on the vision for tomorrow’s more outward-facing Procurement function.

Once the team is engaged and understands the value at hand, the function must step back and rethink its internal organization and processes to adapt and prepare for the new role Procurement has to play within the organization. This includes defining who will be accountable and responsible for fostering innovation initiatives, rethinking Procurement processes to facilitate collaboration with agile players, and reevaluating needs in terms of skill sets and resources.

Finally, these operational changes must be accompanied by a change of mindset. Step-by-step, CPOs must take action to lead, with the help of other senior executives, a transformation of the organization’s culture in order for innovation to become second nature to all employees.

It is important however to keep in mind that the Open Innovation transformation within an organization does not limit itself to the Procurement function. It also entails collaborating more thoroughly with internal clients and thinking of them as “Business partners” rather than siloed entities, in order to better absorb supplier innovation.

Open Innovation initiatives must originate from a joint effort between Procurement and the various Business Units in the context of medium-term category management strategies, with a clear alignment between lead buyers and users.

Harnessing the power of Open Innovation elevates and gives visibility to Procurement within the organization. By offering CPOs a way to contribute to growth, Open Innovation initiatives extend the functions’ influence on their organizations’ key strategic topics.

Over time, Procurement will develop into an innovation and serendipity pole, core to the company’s development strategy. This Open Innovation mindset must become embedded in the organizations’ DNA to the point where every employee starts thinking to themselves, “We are all innovators”.

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