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PROCUREMENT: FROM A TRANSACTIONAL TO A STRATEGIC FUNCTION

The Procurement function has evolved tremendously over the past four decades. From fulfilling a simple “buyer” function in the 1980s, to now playing a key strategic role in today’s leading organizations. Procurement has come a long way over time and continues to grow increasingly sophisticated.

This evolution from a transactional to a strategic role has taken place progressively:

1. In the 1980s, Procurement divisions started becoming more common in organizations. The automotive sector and other manufacturing industries were at the forefront of this change as they started to track Procurement in a more systematic fashion
2. Procurement divisions became increasingly structured and professional in the 1990s, as new technologies were being introduced into the workplace. In the early 2000s, Procurement steered away from its “cost-cutting” image through the emergence of strategic sourcing and the recognized need for well-educated sourcing professionals who possess solid project management skills as well as true Procurement expertise
3. Today, Procurement continues to undergo significant changes and leading organizations have already integrated the function at the core of strategic considerations, understanding that it will play a central role in transforming the value chain. In order to play this role however, Procurement cannot limit itself to being an independently operated entity. It needs to become an agile function, deeply rooted in the organization’s DNA and involved upstream in cross-functional decisions

In any given organization, the Procurement function will typically go through a series of transformations after its initial “genesis.” These intermediate stages of development take place before Procurement reaches the “agility” phase: the point when it becomes a strategic function, one that drives a competitive advantage and delivers significant benefits in the long term.

Going through this series of transformations will significantly increase the long-term ROI of the Procurement function, which would otherwise see its ROI decreasing over time as low-hanging fruits become already picked. Not only will a transformed Procurement function be able to deliver on cost: it will also take a larger role in risk management and contribute to the overall growth of the company by enabling open innovation.

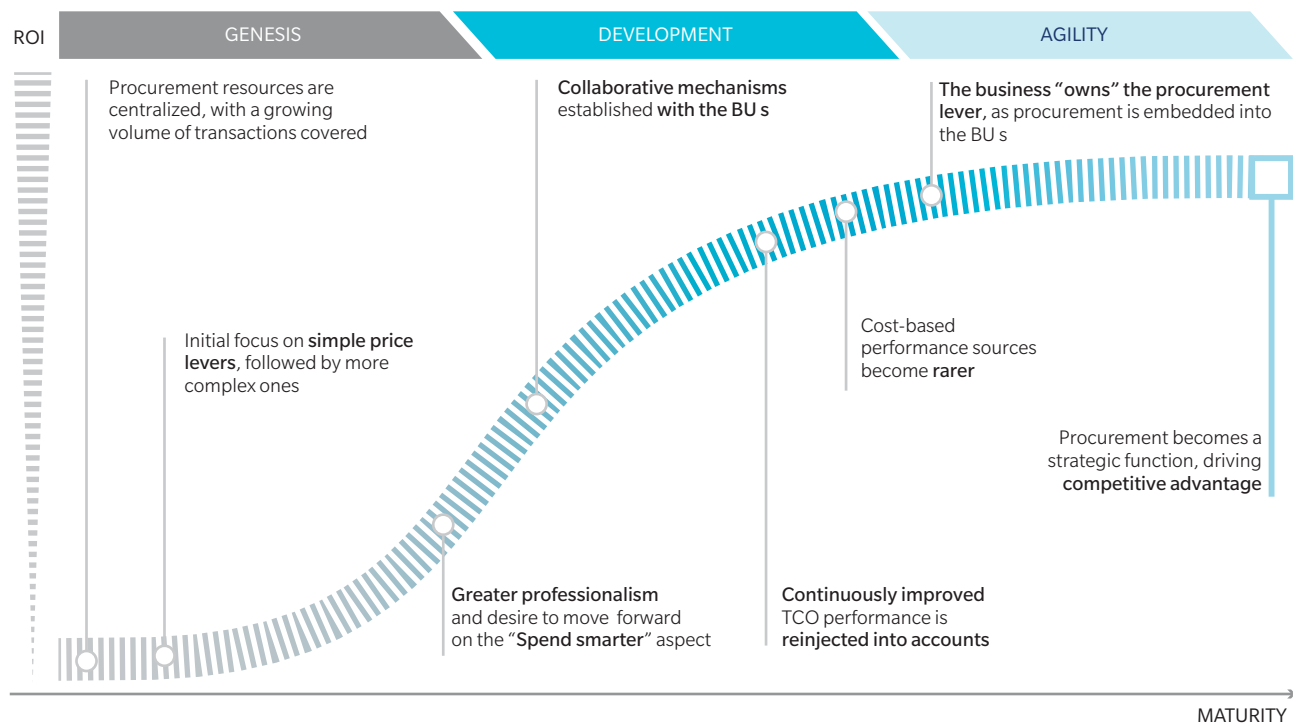
At first, Procurement resources are centralized into the nascent Procurement function. From there, successive steps need to be taken to increase the value delivered and to help the function mature. As the Procurement function makes its way up the maturity curve, it engages in more advanced, sophisticated, and cross-functional activities, while its ROI increases.

In the ultimate stages, once Procurement is truly embedded in the organization’s culture, resources and processes are once more disseminated into the business so they may lie closer to the pulse of the organization. Procurement, then, is still embodied by a function—but has transformed into a truly cross functional system involved upstream in key strategic decisions, allowing it to realize significant savings and generate sustainable value.

We shall examine the maturation process step by step in order to understand how an organization can arrive at this destination.

“Our goal was shifting from a reactive function to a proactive business partner”

Exhibit 1: Evolution of Procurement ROI with function maturity



Note: The maturation of the Procurement function is reflected in the continued improvement of its ROI

A TRANSFORMATIONAL JOURNEY

GENESIS PHASE: EARLY DEVELOPMENT AND “PUSH” MODEL

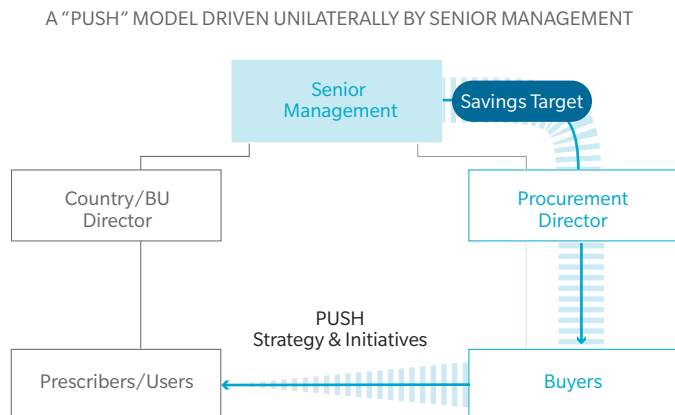
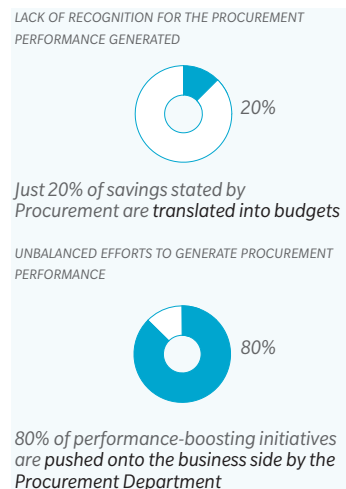
The “genesis” phase is the first development stage of the Procurement function. It is usually characterized by a low level of trust in the Procurement system, and a lack of recognition for the performance generated. Of the savings that are stated by the function, only a low proportion (~20%) is actually translated into budgets, and the performance is only loosely tracked.

This phase can be described as the “push” model phase: Procurement is assigned performance targets unilaterally by top management, and it then needs to “push” these targets onto the business side. A large majority of performance-boosting initiatives are forced onto business stakeholders by Procurement during that phase.

Naturally, this model is far from ideal because it reduces Procurement to a transactional function that is only involved downstream. Detaching Procurement from the core business greatly hinders its capabilities, making it challenging for the function to have any leverage with respect to specifications, needs, and consumption. In this situation, Procurement’s means of action are restricted to taking margin from the supplier.

To address these shortcomings, the reach of Procurement has to be extended in two directions: firstly upwards, so as to engage senior leadership, but also sideways in order to kick-start cross-functional collaboration and to access more sophisticated levers.

Exhibit 2: “Push” model



Note: In the first development phase, trust in the Procurement system is low, reflecting the limits of the “push” model



DEVELOPMENT PHASE: INFLECTION POINT AND TRANSITION TO THE “PULL” MODEL

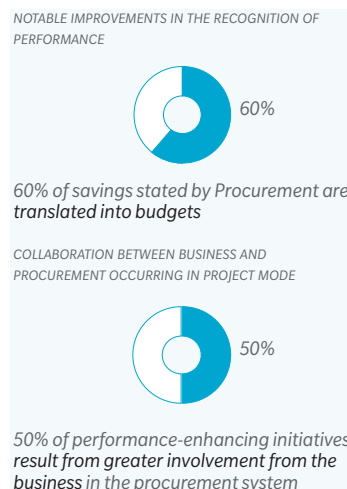
The inflection point that characterizes the transition from “genesis” to “development” is reached when the organization’s senior management understands the importance and the need for a change. CEO, CFO, and CPO need to concurrently agree on the path forward, for Procurement to thrive and evolve into a key strategic function.

One key indicator of the transition, alongside numerous others, is the level of trust that is shown with respect to performance reported by Procurement functions. Often, at stages of lower maturity, Procurement organizations claim very significant savings that are not always recognized by finance and the business. In some extreme cases, Procurement statements are completely disregarded and the ROI of the function comes under challenge from finance and the business.

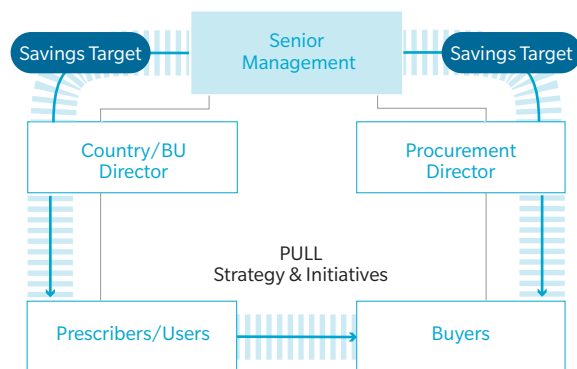
Once the inflection point is reached, a significantly larger portion of Procurement’s performance is translated into budgets and tracked into the company’s balance sheet and P&L. By that point, in essence, finance and business stakeholders are playing an active role in the performance of the function—hence they are more inclined to recognize their own efforts. Typically, the proportion of performance objectives shared with the business by Procurement and of cost savings translated into budgets will increase from 20% before the inflection point to some 60% afterwards.

The “development” phase is characterized by greater cross-functional collaboration. During that phase, top management assigns shared objectives to business stakeholders and Procurement. These objectives are not distinct and cumulative; they are truly similar, encouraging business stakeholders to turn to Procurement for help in order to reach their targets. They are now in a “pull” mindset; collaboration takes place in project mode.

Exhibit 3: “Pull” model



ALIGNMENT OF OBJECTIVES, WHICH DRIVES THE “PULL” MODEL



Note The move to a “pull” model is characterized by aligned objectives and cross-functional working practices



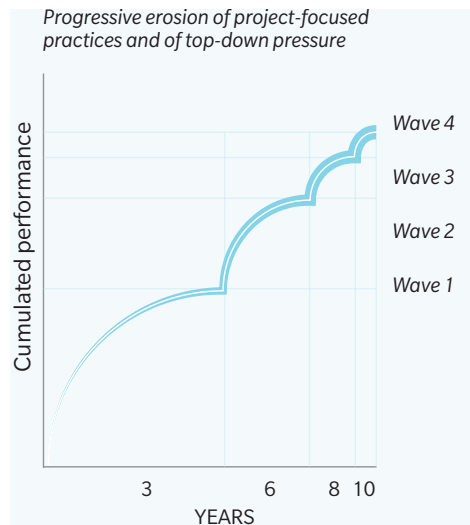
AGILITY PHASE: SUSTAINABLE INTEGRATION INTO THE BUSINESS AND “EMBEDDED” MODEL

The maturation journey doesn't end at the “pull” model.

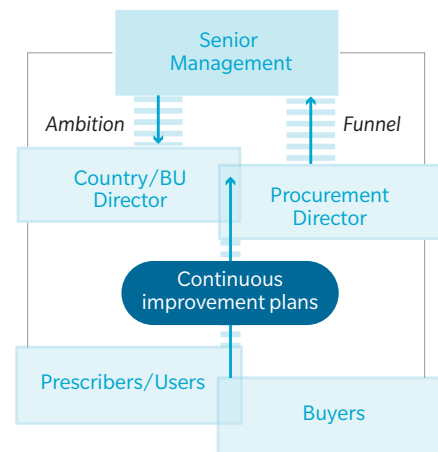
Crucially, during the development phase, the collaboration between Procurement and the business tends to be project-based. Even though this stage is truly necessary, as the entities are progressively taught how to work together, performance will erode over time if there is no further evolution. Moreover, as the focus of top management evolves and top-down pressure diminishes from year to year, there is a risk that the organization will fall back into the “genesis” stage.

The only way to mitigate this risk is to truly embed best practices into the organization in order to create a virtuous cycle. Procurement must be physically embedded into the business functions, and it must co-build continuous improvement plans with them, so as to deliver on a shared ambition.

Exhibit 4: “Embedded” model



A VIRTUOUS CIRCLE OF SUSTAINABLE INTEGRATION INTO THE BUSINESS



Note The “embedded” model drives the transition to greater balance

DIFFERENCES BETWEEN “PULL” AND “EMBEDDED” MODE

The following table highlights a few major differences between the “pull” and “embedded” models.

PULL MODEL	EMBEDDED MODEL
Annual objective of Procurement performance, aligned with the budgeting exercise	Multiannual ambition of Procurement performance, taking into account the complexity of identified levers
Action plans/Initiatives defined without input from business units, regarding resources and efforts required	Feasibility is secured and resources are committed as a result of cross-functional dialogue
The Procurement community reports directly into the Procurement function	The Procurement community is disseminated outside of the Procurement function and represented by “ performance leaders ” inside business units
Performance metrics are strictly defined and significant efforts deployed to reconcile the Procurement performance and financial statements	Performance metrics are streamlined and mostly based on trust (business partnership)

In essence, the journey of the Procurement function can be translated into these three different phases: from a “push” model to a “pull” model, which eventually needs to become “embedded”.

There is tremendous value at stake for organizations that decide to take the path towards strategic collaboration, which justifies the effort required to get there. The progression is linear in the sense that it is not possible to jump directly from “push” to “embedded” without transitioning through the intermediate “pull” step. Moreover, this journey requires a constant dedication and effort, especially around the inflection points that mark a transition from one phase to the next.

The rewards, however, tend to be significant across the board:

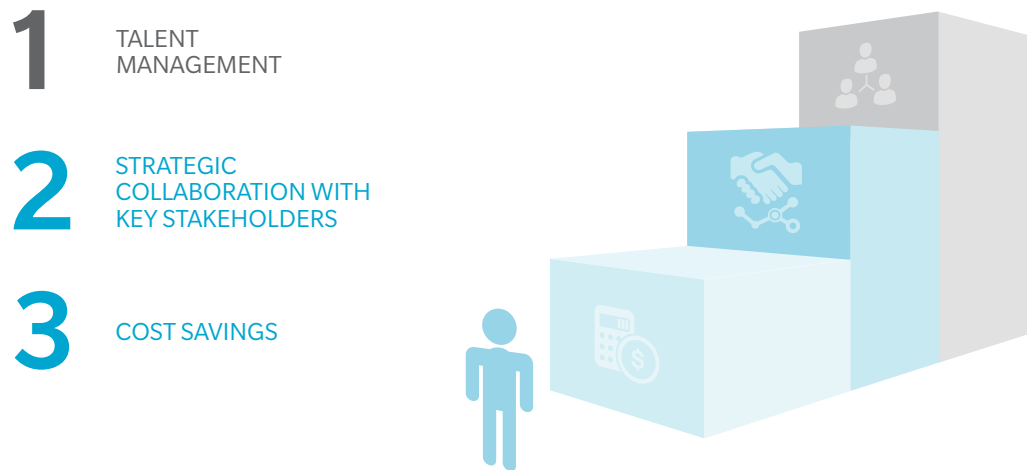
- For organizations as a whole, who see an increase in their long-term performance as they benefit from a sustainable decrease in cost structure, a more systemic management of risks, and growth that is sustained by open innovation
- For Procurement functions, which clearly demonstrate their value and get elevated in the organization
- For Procurement professionals, who gain visibility and are offered more career options on account of their elevation
- For CPOs, who tend to take on more strategic roles—this explains why it is increasingly common for CEOs to be ex-CPOs

The new digital revolution is so disruptive of the whole value chain, that Procurement will play a major role across all industries. Therefore, the “embedded” strategic collaboration model is relevant to every organization across all fields.

A CRITICAL FIRST STEP

The 2015 Procurement Maturity benchmark conducted by SIG and Oliver Wyman found that this notion of strategic, cross-functional collaboration is not foreign to CPOs. In fact, CPOs clearly understand the value that lies in reaching that state, but they also perceive the required change as one of their main challenges today.

Exhibit 5: Most common challenges today



Top challenges as indicated by CPO participants

In order to develop strategic collaboration in their organization, CPOs must recognize that, although they may be an agent of change, they cannot get there on their own. It is crucial for them to on-board senior executives along the way.

Indeed, the first key step in the shift towards strategic collaboration consists of a significant change in the operating model and governance around the Procurement function. As with all topics related to cross-functional changes and governance in general, CEOs are best positioned to lead the transition and to address some of the main challenges, which may include identifying the best way to engage with stakeholders and creating the right conditions to give Procurement a seat in all relevant discussions.

Concurrently, CPOs need to ensure that their organizations are able to actually step up to the challenge—and, once the opportunity arises, to demonstrate value and strategic thinking.

Likewise, a critical role is played by CFOs as they establish the appropriate conditions for building trust through transparency and through the tracking of performance.

Exhibit 6: Pre-requisites to strategic collaboration development

HOW TO OVERCOME PERFORMANCE BARRIERS?



When CEOs, CFOs and CPOs are aligned, they will create the conditions for success together.

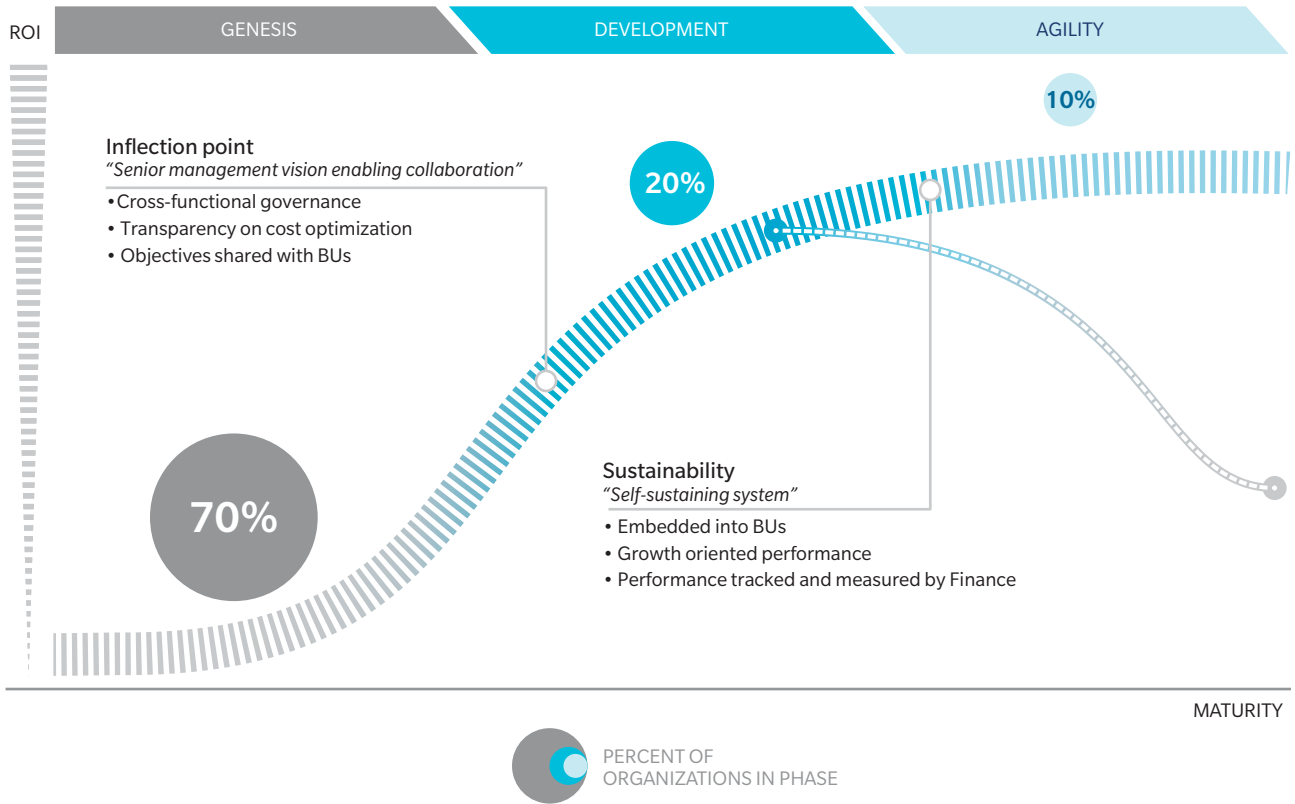
Getting to this alignment stage, however, is no easy feat. The 2015 SIG/Oliver Wyman survey found that most organizations have not yet reached that point, remaining instead on the brink of transitioning from “genesis” to the “development” phase. Around one fifth of players have passed the inflection point of materializing this alignment and are now positioned in the “development” phase.

Moving to the third stage is equally difficult, as the state of “agility” requires that organizations have made these changes sustainable. The evolution from “genesis” to “development” is often accomplished in project mode, without transitioning project approaches into a “business as usual” mindset. The difficulty is that, if the shift into “business as usual” does not occur, performance will eventually decline and organizations may actually fall back into the “genesis” stage—making sustainability an issue of the utmost importance.

“We told the same thing to the same people again and again”.

According to the SIG/Oliver Wyman Procurement maturity benchmark, around one in ten companies are operating at the “agility” level.

Exhibit 7: Distribution of organizations along maturity phases



HOW TO GET STARTED

Procurement has evolved tremendously over the past 40 years from being a “buyer” to becoming an essential strategic function that drives a competitive advantage. In order to stay ahead of the game today and prepare for the challenges of tomorrow, **organizations must engage in strategic collaboration** around Procurement.

IN ORDER TO DO SO, THEY MUST PROVE THEY CAN:

- **Engage senior management** on the Procurement vision
- **Make the change systemic by breaking down silos** in order to make the Procurement system visible and appealing to all stakeholders
- **Build a truly cross-functional system** that makes Procurement and business stakeholders “business partners,” equally involved and equally accountable
- **Translate the overall company’s objectives** and equip Procurement leaders with the means to share and implement this vision while deploying the Procurement system
- **Ensure the new system’s sustainability** by making it a part of the company’s DNA and by fostering cross-pollination of talents in and out of Procurement

TO KICK-START OR RE-IGNITE YOUR JOURNEY, HERE ARE THE **NEXT STEPS**:

- **Assess where you are today**, applying a hard, honest look at your organization and your function in order to know where you are starting from and what your priorities may be
- **On-board your leadership**, using value-based demonstrations
- **Outline your plan with a clear timeline** and identifiable milestones, and have a target and measurable ROI
- **Employ a project approach with a clear transition to “business as usual”** by designing your organization accordingly in terms of resource allocation, skills and capabilities, and tools and systems
- Continuously **track and report progress**

CASE STUDY

ONE OF THE LARGEST NEWS AND MARKET DATA PROVIDERS

Six years ago, the CPO had already understood the need for a change and the challenges linked to a transformation of the function. It was his first experience leading this type of change in a Procurement department, and he was well aware that this transformation was going to be a demanding endeavor. The objective was clear to him: “Our goal is shifting from a reactive function to be a proactive business partner”.

To initiate the process, he organized internal workshops to build heat maps of opportunities and create awareness around the transformation that was taking place within the organization. This allowed him to lay the ground for the definition of major work streams, which were identified as implementing technology, creating an organization and developing category management

Getting to this point took the CPO and his team several years, partly because his efforts were not always met with great enthusiasm internally. On several occasions, his attempts to initiate a more in-depth collaboration with other departments were met with apathetic reactions, “I have to get this marketing campaign out, and you are slowing me down”. Indeed, convincing other functions within the organization that they needed to start involving Procurement in their processes seemed unnecessary to certain businesses, or even perceived as a direct threat by others who feared it would decrease their productivity. Furthermore, used to working on their own, certain business units were afraid it would cause them to lose credit for what they doing.

The organization had grown so fast over the years that there were still people who had been with the firm since the beginning. Even in the company’s entrepreneurial-oriented culture, the transformation required was significant and called for a great deal of change

management. The CPO and his team had to repeat the same thing to the same people over and over again to win their support.

An additional difficulty for him was that he had to operate without having a clear mandate: he had to sell the change to each business unit by putting together a business case. His team designed a one-page business case with four sections that outlined a description of the actions, the path to success, the benefits already achieved and customer testimonies (from legal, R&D ...). These business cases progressively helped sell category management to business stakeholders and senior management, which constituted a major step towards strategic collaboration within the company. Indeed, when top management understood the value that lies in involving Procurement in key strategic decisions, collaboration with the function progressively increased and Procurement received more and more requests for assistance from businesses in order to help meet their targets.

The CPO knew this was a major win for Procurement. A top manager within the organization told him that in the past, he would have pushed back to involve Procurement in his activities, but now, he would not do anything without them. With these changes, Procurement is now getting involved in new areas such as T&E and Vendor Risk Management. Outlined by a transition from a project-based collaboration between Procurement and the business units to a sustainable integration of Procurement into the business units, this large news and market data provider has started to embed strategic collaboration into its culture, which is the final major step in the Procurement function’s maturation journey.

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AUTHORS

Gregory Kochersperger, Europe, Middle East, and Asia Head of Operations

Damien Calderini, Partner

Celia Spanidis, Partner

Stephan Picard, Principal

CONTACTS

Lars Stolz

Global Head of Operations

lars.stolz@oliverwyman.com

Michael Lierow

Head of Supply Chain

michael.lierow@oliverwyman.com

Greg Kochersperger

Europe, Middle East, and Asia Head of Operations

gregory.kochersperger@oliverwyman.com

Brian Prentice

Head of Manufacturing and Process Operations

brian.prentice@oliverwyman.com

John Seeliger

Americas Head of Operations

john.seeliger@oliverwyman.com

Alex Lyall

Head of Digital Operations

alex.lyall@oliverwyman.com

Xavier Nougues

Head of Value Sourcing

xavier.nougues@oliverwyman.com

www.oliverwyman.com

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