


# Value Generation



As a business discipline, P&SM is and in many cases has shifted in focus from tactical and reactive to strategic and proactive.



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## 1. Learning Outcomes

“Procurement and Supply Management (P&SM) isn’t what it used to be”.

“Does talent and creativity matter in P&SM”?

These propositions raised in recent studies by Bain & Co and McKinsey respectively, argue that savvy supply management can increase shareholder value, but only if you reinvent the P&SM concept in this the 21st century. At the same time, recruiting better people in P&SM, with clearer performance aspirations and strong sourcing cultures, enables purchasing to be extremely beneficial to an organisation, in ways far removed from the traditional role and view of P&SM.

The purpose of this practice guide is to ensure that people working in P&SM recognise and then demonstrate that they can deliver to shareholder value by delivering value adding activities as well as savings, and that CEO’s and FD’s in organisations accept and understand the true and changing evolution of the role and skill sets of their P&SM function.

Change is constant and P&SM professionals need the agility and speed to operate in this complex environment as this will often dictate the fine line between success and failure. As a business function, P&SM management has never been better placed to play its part in business success.

This paper will provide an easy to read perspective to the area of value generation; provide definitions of value and value add; explore the enablers and barriers and provide hints and tips on how to implement in your organisation.

## 2. Introduction

As a business discipline, P&SM is and in many cases has shifted in focus from tactical and reactive to strategic and proactive. As technology has automated many of the more procedural aspects of the P&SM function and as supply side management has evolved, the higher levels of value generation and added value have opened up. John Sunderland, Chairman of Cadbury Schweppes and president of the Confederation of British Industry contends:

“Procurement departments have been a neglected source of added value for too long – and their impact is along the whole spectrum from revenue to capital expenditure”. (Walking a tightrope, CPO Agenda, Autumn 2005).

It is now well publicised that the potential for innovative and proactive ideas in the world of P&SM is vital to business success. In the same way, growth and therefore the significance of strategic procurement and a fully optimised supply chain for driving real added value for the business has increased too. Many CEO’s are faced with decreasing margins due to the pressures of globalisation, and accelerating pressures to deliver top line savings, because companies are being merged and acquired on a daily basis.

A well developed and well managed P&SM organisation should be the suppliers’ ‘customer of choice’. Suppliers will want to work with them and develop new products, and improve current processes in order to maximise any manufacturing efficiencies and of course maximise the value from the supply chain.

So what is the purpose of a Purchasing and Supply Management function to an organisation? Historically it has been focused on delivering bottom line savings, often reporting into the finance director, who wants the function to buy what the company needs for the least possible cost. Yet in today's complex and consumer driven world, purchasing is changing to supply management, and its role, as I have already mentioned, is to deliver increased shareholder value, as well as ensuring that there is an uninterrupted flow of goods and services to the organisation. Add to this the fact that today's finance director will have to report on the intangible elements of their balance sheet; one can see where and why organisations need a savvy supply management team, not just a purchasing team.

In a similar way to the operations and manufacturing functions, P&SM has the capability to add value from a wide range of initiatives and processes, both tactical and strategic if managed and lead well. The challenge here for the Chief Procurement Officer (CPO) is to identify which activities will have the most beneficial impact taking in to consideration the specific strategy of the organisation, its size and sector. These priorities must be built into the strategic plan, ensuring that P&SM has a significant influence as well as full alignment with the overall business strategy. In managing risk, P&SM have to look at the impact of the supplier base so ask yourself these questions:

- "If P&SM did not exist in an organisation, who would manage the supplier base"?
- "What is the impact of failure on the company's operation"?
- "As well as the supply – what sort of market is it"?
- "How many suppliers are there and what is the cost of switching"?

Clearly these are not directly measurable activities, but demonstrate the crucial role that P&SM has in managing the supplier relationships that an organisation has.

### 3. Definition

Value generation is intangible, it is not quantifiable, unlike money; cash saved can be counted and touched!

Value means different things to different people. However for the purpose of this guide, we shall use the following.

The Oxford English Dictionary defines  
"Value" as:

'The regard that something is held to deserve; importance or worth.'

"Added Value" can be defined as:

'The difference between a particular product's final selling price and the direct and indirect input used in making that particular product.'

Value can change. It can be based on time, or a place and or people in relation to their changing environmental factors. It is a creative energy exchange between people and organisations in our marketplace and the commercial environment that we work in. There is an element of creativity needed to be more savvy than traditional in the way that P&SM needs to develop and grow.

The areas that P&SM can help deliver on additional value to the supply chain can be:

- Improvement in the product quality, for example this could mean there are no product recalls for any of your products;
- Improvement in the levels of customer services provided, for example the outsourcing and management of call centres to ensure that the high standards to the customers are met by a specialised team/company;
- Reduction in time to market and cycle time, for example managing a just-in-time process with your key suppliers;
- Assurance of supply so that there are no time delays for a manufacturing line;
- Management and audit of suppliers corporate social responsibilities;
- Management of sustainability – a key area for CIPS in the future;
- Increased new product development
- Allowing suppliers and the P&SM to work in an environment that allows the development of a creative concept for the organisation or a client.

### 4. How P&SM adds value

John F Kennedy famously said “ask not what your country can do for you; ask what you can do for your country.” This question might be put to those working in P&SM – “ask not what the organisation can do for you; ask what you can do for the organisation”.

In contemplating Kennedy’s proposition and reflecting on our ability to ‘add value’ to the organisation, consider for a moment, where “discretionary” effort comes from. It is those ideas put forward in meetings, the person prepared to walk the extra mile, who will add value to their organisation!

The shift in the UK from a manufacturing to a service economy has in most organisations changed the role of purchasing. Traditionally, buyers would source commodities, and spent most of their time nailing down prices and arguing about contracts. But now as purchasers become increasingly involved in high-value services, from marketing, HR and legal services to IT, facilities and management consultancy, the role has changed to include helping their internal customers buy more effectively.

In this exciting new world, many traditional purchasing skills are not only redundant, but can also be career limiting. The rigid, uncompromising, hard-ball - even, sometimes, downright abrupt - approach some purchasers have employed when dealing with external suppliers, achieves nothing when applied to heads of marketing, HR or legal departments in their own organisations. This is particularly the case when some of them are already prejudiced against purchasers because of their association with cost cutting.

Two recent surveys conducted by Bain & Co and McKinsey illustrate the changing role to savvy supply management.

In a survey of procurement practices at 156 large companies, Bain & Company (Business Strategy Review Spring 2007) found that 22 per cent of organisations stood out significantly from the rest. They had growth rates of over 20 per cent per year and their supply management functions seem to be in “hyper drive”. The P&SM team at these companies were delivering significantly more incremental revenue than their counterparts at the lower performing companies. They were achieving greater reductions in cycle lead times and they were much more likely to bring innovation to the company, be it in processes or products,



either on their own or working with their suppliers. The Bain & Co study found that high performing organisations had “reinvented” supply management along the following lines.

The leaders of P&SM looked and acted differently from their more conventional counterparts. They did this by pursuing P&SM’s traditional goal of cost reduction, but did so in a variety of innovative ways. Rather than simply offering higher volume, lower-priced contracts to a select group of suppliers, they fostered new competition for existing suppliers by continually searching for new suppliers and developing alternatives, including in sourcing.

They performed independent analysis of the market and of suppliers’ cost structures and returns, simulating the impact that greater purchasing volumes can have on per-unit costs. This helped establish sound target prices in advance of any negotiations.

Another characteristic was that they forecast and demanded continuing cost reductions year after year. Analysis shows that cost per unit in most industries declines between 20 per cent and 25 per cent for every doubling of accumulated experience, which charts as a downward-sloping curve. The procurement leaders expected that some of those savings would flow through to them, year in and year out.

They also put a premium on speed, quality, and flexibility and assured supply. The CPO’s would model supplier industry dynamics in critical categories, along with the position of the various suppliers within the industry. This would then enable them to see which suppliers were expanding or the most innovative, this deterring the suppliers that are the most likely to be the strongest horse in a supply chain race.

The P&SM teams look different in the way that they are structured and in their relationship with the rest of the company. They are no longer the discrete function that they were; it is more like a continuous, company-wide exercise.

There is a visible change on the management of supply management organisations. The P&SM is no longer a repository for “time servers” and others on the slow track. It is more likely to have fast-rising corporate leaders coming out of P&SM.

The world-class supply management organisations made a point of viewing their P&SM teams as a source of innovation. The study found that there was a variety of different approaches to this:

- Design products to cost – get involved at the very start of a new concept because as much as 80 per cent of the total cost of a product is determined during the design phase;
- Tap supplier knowledge for new and improved products;
- Expanding the supplier universe in search of innovation. Inviting suppliers to a meeting and asking them for their innovative ideas on products and how to reduce costs in the supply chain.

The study concluded that today’s supply management at many companies is a complex function that is critical to business success, with responsibility for total costs, quality, delivery and innovation throughout a company’s entire supply chain. A sign of the times: the strategic contribution of supply management is measured not only in terms of cost savings, the traditional metric, but also increased shareholder value by delivering added value.

Crucial to the success of the new savvy P&SM function are the people that work in supply management. The second of these reports – a McKinsey global survey of purchasing executives

at over 200 companies (The McKinsey Quarterly 2007) found that those setting the pace in purchasing best practice differ from ordinary companies along three different 'talent' dimensions:

1. Hire better people in P&SM
2. Set clearer performance targets for them
3. Create a strong sourcing culture that allows the P&SM function to align their purchasing activity with the company's overall corporate strategy.

The payoff for these companies was that they enjoyed annual cost savings from their overall sourcing efforts that were nearly six times greater than the annual savings of their competitors. As the pressure for increased globalisation intensifies, the winning P&SM teams were already positioning themselves for broader strategic gains as well. There was a 60 percent difference between the financial performances of the two classes of companies.

The study assessed the performance of the respondents' companies against recognised good practice in P&SM by analysing responses along four dimensions:

1. The capabilities and cultures of purchasing professionals and their organisations
2. The corporate structure and systems that support purchasing
3. The management techniques and business processes supporting it
4. The contribution of purchasers to their companies and the extent of the alignment between purchasing and corporate strategy.

What both the Bain & Co and McKinsey studies show is that by developing the people and the function, P&SM will deliver better results, for both the individuals involved and for the organisation as a whole. It takes a level of investment in training and time, but the rewards were far higher than the investment required.

A further challenge for purchasers buying services is that they have to earn a mandate to do so. Traditionally, they would buy goods and materials to an exact specification. "The stakeholders were well defined - that is, buyer and seller - and the role of purchasing were well understood. In the services arena, their role, though potentially far more valuable, is more amorphous, the internal customer base more diverse and the value they add harder to define." (Supply Management March 2006)

In response to a poll by Supply Management in October 2006, 81 per cent of the 100 buyers polled said they expected their role to increase, while 14 per cent said it would remain static and 5 per cent expected a reduction in workload. Many said while cost reduction is important, there are many more ways in which they can and should help.

Sustainability, demand management, examining the potential benefits of shared services and finding more opportunities to add value were cited. Some said they were being called on for more help and guidance at a strategic level as well as to train others with buying responsibilities." Procurement needs to continue to develop from dealmakers to supply chain managers to deliver real added value," said Paul Hooft, manager of the materials management department at engineering company ABB Lummus Global. "An historical focus on cost reduction targets is not sufficient. We will have to take full responsibility for developing supply chains that are strategically aligned with the business objectives," added Dominic Jephcott, managing director of procurement organisation Vendigital.

Others expected procurement's role to grow because of its improved profile. One said buyers are now seen as "key players in the commercial success of a business," while another stated that "for the first time all spend over £50,000 in her firm must go through purchasing".

In the 21st century, professional procurement teams have to and are starting to lead the way in organisations to deliver increased revenue and shareholder value. P&SM is recognised as a complex function that is essential to the success of the business, with responsibility for total cost ownership, quality, delivery and innovation throughout the entire supply chain.

### 5. CIPS Position

- CIPS recognises that as a business discipline, purchasing and supply management (P&SM), has shifted in focus from tactical and reactive to strategic and proactive
- In order to make the greatest impact and create value, the leaders of P&SM must look and act differently. They will do this by:
- Using a variety of innovative ways to meet the traditional goal of cost reduction such as fostering new competition, collaborative relationships and so on
- Providing independent analysis and advice of markets
- Placing a premium on speed, quality, flexibility and assured supply
- Influencing behavioural change towards the P&SM function to accept it as an important part of the fabric of the organisation.
- P&SM teams should be structured in a way which encompasses the whole organisation and provides flexibility to meet organisational objectives

Organisations should see P&SM as a source of "value generators" and "value protectors"<sup>1</sup> rather than a repository for "time-servers" or "policeman"

- It is an imperative for the leaders of P&SM to hire and develop better people, give them clear performance targets aligned to corporate goals and give them opportunities to grow and develop through experience, education and responsibility.

### 6. Positive Impacts

For purchasing to be seen as supply management, it is imperative that an open dialogue is held with both the CEO and the FD of an organisation about the change in role. They have to accept and understand the changing environment, and one of the factors in the success or failure of the P&SM will be the support from the organisations senior management.

When you are looking to sell to the CEO and FD, the concept of moving from the traditional P&SM model to the supply chain management model, the positive impacts of delivering against value generation can be the following:

- Strategic alignment of the organisations corporate goals and that of P&SM. Understand and ensure that the objectives of both the organisation and that of P&SM match each other's;
- Security of supply of goods and services to ensure that there are no delays are caused to the manufacturing and running of the organisation;
- Innovative and new products continually being developed so that there is pipeline in place to aid the long term future of the company;
- Increase in profit to show a return to shareholders and the City (if a listed company);

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<sup>1</sup> As commented by Prof Paul Cousins, Manchester Business School.

- Increased awareness of environmental impact by ensuring that everyone involved in the supply chain knows the effect of their actions;
- Support of the development of sustainability by managing the supplier base to ensure compliance to the sustainability framework that is in place;
- Become the 'customer of choice' with the 'suppliers of choice'. This ensures that suppliers will want to work closely with your organisation;
- Good and improved relationships with internal stakeholders, as P&SM are "not just focused on saving money", and the stakeholders can see that P&SM play and add value across a multitude of different areas;
- Shared ownership and collaborative relationship with preferred suppliers, therefore developing a co-destiny relationship with them;
- Increased speed to market for products, hopefully beating any competitors and therefore obtaining the benefit – financial and from an advertising/PR stance of being 'first to market';
- Supply chain analysis. By adopting this new way of working, the organisation will now understand what is involved in the production of its end deliverables, be there goods or services;
- Warehouse management and stock management efficiencies, by ensuring that stock levels are low and that lean warehouse processes can be put in place;
- Competitive advantage by being quicker, smarter and better than the competitors;
- Management of any potential risks and vulnerability in the supply chain, ensuring that no delays are caused by the supplier base;
- Increased reputation in the company and its brands and this in turn affects areas such as market valuation and brand reputation;
- Increased cash flow to the bottom line and the increase in cash can be used to invest in the future, or staff training and development, or as a dividend to investors;
- Reduction in operating costs and therefore the overhead costs of running the organisation, which in turn increases profitability;
- Enhances and supports the organisations corporate social responsibility targets by working closely with suppliers to ensure that everyone is aware of their actions, and how activities can be improved to ensure that the organisation and its partners keep on any governance guidelines and support the community and the world at large;
- Supports potential global sourcing by maximising and leveraging the relationships with suppliers, to ensure that both parties benefit from increased activity;
- Enables the analysis of whole life costing and total cost ownership by breaking down the component costs of goods and services, which allows detailed analysis and opportunity analysis to take place and
- Supports any merger and acquisitions activity by placing P&SM at the heart of delivering real added value to the new company going forward, and working with the senior management team on any due diligence before a merger or acquisition, and in activities to capture the value after the merger or acquisition.

As can be seen, from the foregoing, it's not just about cost! P&SM professionals are at the heart of developing added value for their organisations; and the two key areas that they need to concentrate on initially are the dialogue with senior management and ensuring that the short and long terms goals of P&SM are aligned with the corporate strategy.



## 7. Enablers and Barriers

The McKinsey study detailed above highlighted the fact that the high performing P&SM teams were the ones that had the strongest sourcing culture and aligned their activities with the corporate strategy.

There are a number of enablers that need to be in place, for a P&SM function to implement a value generating mode:

- Existing P&SM skill sets. It would be useful to conduct a skills analysis to establish what expertise and knowledge the existing P&SM team may have;
- Experience of delivering added value ideas, whether this be gained from working in another organisation or in a different function of the organisation where generating added value was actively encouraged;
- Definition and agreed measures of value, and ensure that everyone buys in these (from the top down), and progress is measured against them and communicated on a regular basis for example quarterly;
- Market and category knowledge in the P&SM team. The McKinsey study found that one of the attributes of the high P&SM performers was a deep knowledge of a particular category for example marketing;
- Excellent supplier relationships, especially when looking at the area of new product development and clear and personable communication with the supplier base;
- The ability to manage markets, using the skills and the knowledge of an experienced P&SM professional. It is imperative that the P&SM teams know their categories and the markets that they trade in;
- Thinking and utilising creative skills when looking at traditional procurement processes and ways of working. Think outside the box, don't worry that the P&SM are getting creative. Encourage a relaxed environment for P&SM teams to work in.
- Ability to manage change and transition with suppliers and within an organisation. This may be having project management skills, or the ability to manage change on a regular basis;
- Being able to be objective when thinking about value generation, as opposed to subjective and "that won't work here".

Thinking about value generation brings a whole new perspective to the world of P&SM, encourage the adoption of it;

- Understanding risk management by closely working with the supply chain, the P&SM function are able to identify potential risks and implement strategies to mitigate vulnerabilities in the supply chain;
- Talent development of the P&SM team. Ensuring that training the team receives is tailored for example functional rotations through the organisation ensure that the P&SM team get broad business experience.

Encourage, promote and provide regular appraisals and feedback to the team;

- Analytical and problem solving environment by providing the tools and the support to allow the P&SM to work on and develop value generating ideas;
- Continuous development of P&SM practice by staying abreast of good practices in the market place;

- Utilisation and possible flexibility of any e-sourcing systems used. Be aware of technological changes and any new systems launched that could help the P&SM in delivering added value;
- Strong internal client relationship, to ensure that they buy in to any proposed changes in ways of working. This is key and should be amongst the top five actions to rolling out value generation;
- P&SM managers must participate and often lead the cross functional teams needed to deliver added value. Supplier's representatives may even be included in these teams, as well as the R&D, finance, marketing and other departments.
- Development and in depth knowledge of the supply chain, by working closely with the internal clients to understand how the manufacture and the delivery of the goods and services works.

Conversely, there are barriers to a P&SM function implementing a value generation way of working. These could be:

- The culture of the company. The organisation could be a solutions provider and not a manufacturing operation and areas such as supply chain may not totally be applicable;
- The senior management team need to understand and lead the rest of the P&SM function through these changes. They need to work together and provide an united front;
- The ethos and direction of the organisations senior management team. Too often this is where P&SM fall down as the senior management want P&SM to deliver on something different. They also need educating as to the benefits of looking at value generation; otherwise they will be a major barrier. The McKinsey study found that in the low performing organisations, their CEO's viewed purchasing as a limited support function;
- Reporting lines. If P&SM report into a finance department, are they interested in P&SM getting involved in areas that do not generate immediate cash savings? The FD needs to be involved in the change of direction;
- Who is running P&SM? The one person in charge needs provide the direction and the support for the new ways of working;
- Structure of the P&SM team. Is the team set up the best way to deliver added value? This could be by category for example facilities management or a group of categories for example services;
- Scope and autonomy of the P&SM team. Creating a high performing P&SM team starts with managing people and giving them the power that they need to deliver for the organisation;
- Level of existing P&SM skill set. Do they need any training? Companies that begin by focusing on the skills of the purchasers and the collaboration with other functions will reap the benefits;
- Time. The organisation has to make sure that P&SM got time to negotiate on added value areas, and not spend all their time on buying urgent reactive items and
- Using e-Sourcing technology often encourages a price focus; can the system also evaluate added value areas. The team should work with the software supplier to ensure that their system delivers on that.

This section has explored both the activities that can assist or slow down the change required in P&SM. As Mickey Rooney said "you always pass failure on the way to success".

Everything should be seen as a learning exercise, with the reward being broader strategic gains for the organisation and ultimately the shareholders.

## 8. Hints and Tips

There are a number of hints and tips that will allow your procurement department to start moving down the added value path:

- Get sponsorship and support from your CEO and FD. It is imperative that now that they can expect more from their P&SM than to cut costs;
- Alignment of the P&SM plan to the corporate plan;
- Agree the definitions and measurement of value generation categories upfront;
- Create the right environment for delivery by developing the skill set of the P&SM function.

Help them to develop as procurement professionals;

- Reward excellence – both with P&SM professionals and suppliers. You could organise an annual supplier of the year dinner or take an advertisement out in the FT showing your top 3 suppliers;
- Communicate to the internal client base about the different way that P&SM will be working. Keep them updated on a regular basis as to the progress being made. Involve them as much as possible;
- Win over your key stakeholders before you start working with the supplier base to ensure that P&SM are involved in the business planning stage as much as possible;
- Market the more strategic development and direction of the P&SM function;
- Consider and articulate the negative consequences of P&SM not being involved in the organisation. How will the P&SM team feel? It is not very motivating if highly skilled P&SM professionals are seen as an administrative or support function;
- Review your team's skill sets. A top flight P&SM team will need the following:
  - Interpersonal skills, including empathy, listening, persuasion, communication, facilitation and
  - Networking
  - Ability to pick up new concepts quickly
  - Problem solving and innovation
  - A broad business understanding
  - Deep category knowledge
  - Financial acumen
  - International exposure
  - An appreciation of value as well as costs
  - Courtesy and professionalism
  - A customer-focused attitude
  - Languages
  - Full CIPS membership

## 9. Conclusion

Savvy supply management is the future and this paper has illustrated that P&SM isn't what it used to be. Supply management has and will continue to evolve into a more complex activity as it meets the challenges of the modern business environment.

The key areas that a CEO, FD and CPO need to review and understand are acquiring knowledge and informing the P&SM team as well as stakeholders and suppliers that there is a new environment. One that rewards proactive, strategic thinking and creativity. Change mindsets in the way that P&SM is managed and perceived, as well as implemented is crucial. Think inclusive, collaborative and long term. Enable strategic and critical thinking by the P&SM team, key stakeholders and suppliers to think across different levels, be creative. "It's not just about

cost: talent, knowledge and mindsets are the future of P&SM” (Gerard Chick. CIPS. August 2007)

Decide on the right organisational structure for the P&SM team that will bring maximum added value delivery, as well as stakeholder buy in and involvement. World-class supply management organisation looks different in their structure and their relationship with the rest of the organisation.

Self-evaluation and reporting measurement of the delivery of the added value, both in terms of qualitative and quantifiable measures. Communicate the work that P&SM has done. This is essential for the continued growth and development of the organisation and for the motivation of the P&SM teams.

As recently as five years ago, the idea of strategic purchasing was regarded by many as an oxymoron, unsupported by real world data. But the world of supply management has changed dramatically.

Today, supply management at many companies is a complex function that is critical to business success, with responsibility for total costs, quality, delivery, and innovation throughout a company’s entire supply chain.

A sign of the time: the strategic contribution of supply management is measured not only in terms of cost savings, the traditional metric, but also increased shareholder value.

### 10. Further reading and websites

Prof. Paul Cousins, Dr Benn Lawson ( July 2006) “What you measure is not necessarily what you get: The role of socialization in managing supplier relationships” Manchester Business School, 18 October 2007, <http://www.mbs.ac.uk/research/supplychain/briefings.aspx>

Tom Alford, Prof. Paul Cousins (June 2007) “...you can’t please all of the people all of the time.” Manchester Business School, 18 October 2007, <http://www.mbs.ac.uk/research/supplychain/briefings.aspx>

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