

ATKearney

Supplier-Driven Innovation and Sourcing in the IT Category

23rd CPO Executive Roundtable

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A.T. Kearney's 23rd Chief Procurement Officer (CPO) Executive Roundtable focused on the topics of supplier-driven innovation and sourcing in the IT category. Both subjects demonstrate how procurement can add value by partnering with other internal functions to obtain greater value from the supply base. The event also featured a presentation by A.T. Kearney's Global Business Policy Council on the implications of our most recent Foreign Direct Investment (FDI) Confidence Index®.

This document offers highlights from the interactive presentations and roundtable discussions that took place over the course of the CPO Roundtable's two days.

Day One

Supplier-Driven Innovation: Practices of Leading Innovators

Speaker: Paul Carrannanto, partner, A.T. Kearney

With procurement increasingly contributing value beyond cost, the function now keeps abreast of potential innovation from the supply base and serves to link innovation-focused suppliers with the business. The earlier suppliers can be brought into the product and service development process, the more quickly new offerings can be launched. A relentless focus on execution and the establishment of long-term relationships to get the best possible supplier innovations are vital.

Exploiting the supply base's innovation capability through a systematic innovation management process helps create products and services with shorter time to market, lower execution risk, higher quality, and ultimately, more profitable commercialization. Finding which suppliers to involve requires a formal, wide-ranging scanning process. Open-mindedness is also essential; companies have enjoyed significant successes by partnering with nontraditional suppliers, often from noncompeting industries, that bring new "outside-the-box" ideas. Increasingly, companies are heavily weighing innovation capability in their supplier evaluation process.

While suppliers are not the sole source of external innovation, they are consistently cited as essential contributors to idea generation, product and process development, and implementation and launch. Sources such as customers, academics, and market research are more typically involved in ideation activities.

Creating incentives for suppliers to contribute to innovation efforts can be challenging. Companies that have traditionally approached suppliers in a highly competitive manner often find that earning supplier trust takes time. The question of what kind of rewards suppliers should receive is also very important: How can they share in a success, and who ultimately owns intellectual property and patents from joint efforts? Long-term contracts are often used to secure exclusive rights to technologies for a predefined period.

Focus Forward: Campbell Soup Company's Leading Practices Case Study

Speaker: Brian Freedman, senior manager, procurement, Campbell Soup Company

The Campbell Soup Company places a strong emphasis on open innovation by making use of what the supply base and other external parties are working on. Campbell's procurement team strives to deliver value beyond cost by acting as a respected partner to the business.

Like many long-standing companies, Campbell Soup initially resisted the idea of open innovation after decades of in-house efforts. The high costs of research and development (R&D) and sheer amount of innovation taking place outside of the company were important factors in moving it toward a more open model with multiple entry and exit points. Procurement and finance have worked with the brand to form teams that define needs up front.

The company considers open innovation to be the key to spurring sustainable top-line growth, as it significantly enhances its own in-house R&D capabilities while reducing risk and investment. Innovation efforts can be targeted at specific or broad challenges or simply be exploratory in nature, and can span several months to several years. Partners include the general public via crowdsourcing through its innovation portal; innovation intermediaries that solve specific, well-defined challenges that the company is not equipped to research; peers that engage in process-driven innovation; and suppliers.

With so much value-added work, the procurement function has become a **stimulating place to work**. Now it must do more to **attract talent** from other areas.

Recent open innovation efforts have yielded the Go Soup line of soups in microwavable pouches and Campbell's Fresh-Brewed Soup K-Cup packs for use in the Keurig coffee brewing system. Another yielded a new trailer design that is 20 percent lighter than standard shipping trailers, allowing the company to increase the amount of product in each outgoing shipment without exceeding load limitations.

Sharing around gains and intellectual property has proved to be a challenge in initial collaborative efforts. Campbell views both as points to be negotiated rather than aspects to be handled through a blanket policy.

While Campbell Soup is still relatively early in its open innovation journey, enthusiasm for it is high across the company. In part because it already had a robust supplier relationship management program in place, suppliers have been major contributors to these collaborations—and have been willing to bring ideas to Campbell first. Although cost remains an important component in supplier evaluations, innovation capabilities are increasingly emphasized. So long as the company can continue to clearly articulate its wants, needs, and challenges, it expects to deepen results moving forward.

Economic Inflection: Global Foreign Direct Investment Implications for the United States

Speaker: Erik Peterson, partner, A.T. Kearney, and managing director, Global Business Policy Council

The global economic outlook is shifting, in large part due to three factors: the reigniting of the global economy, the new realities of energy production, and the race for competitiveness. Observers express cautious optimism that the world's developed economies have placed structural issues behind them, making for a positive picture over the longer term in the United States, Europe, and Japan. China's economy is receiving a boost from middle-class consumption, and it is expected to eclipse the U.S. economy as the world's largest by the end of this decade.

The United States is now producing more oil than Russia and is poised to serve as the piston of global economic growth. Developing countries continue to use increasing amounts of oil, and the United States is projected to become the world's largest oil producer. Other countries with unconventional sources of oil and gas are at least a decade behind the United States in accessing them.

Just as companies are succeeding through cooperation to achieve innovation, countries across the world will benefit from increased engagement among their government bodies, the private sector, and civil society. Countries that minimize or streamline regulations will attract business.

A broad-based economic recovery is projected worldwide through 2018, with China, India, and a number of African countries expected to post high levels of growth. However, the International Monetary Fund (IMF) notes that the global economy is still in "low gear" due to failures of leadership. The United States remains at the center of events, with a potential growth rate of as much as 2.4 percent in 2014, thanks to resumed growth in the housing market, increased household net worth, and higher energy production. For the first time in 11 years, the United States topped the most recent Foreign Direct Investment Confidence Index, an annual study conducted by A.T. Kearney's Global Business Policy Council.

A number of important trends will affect the future economy, including:

- The global digital economy, which already accounts for 13.8 percent of all sales globally and will continue to grow as an additional 5 billion consumers start shopping online in coming years
- Hyper-mobility, with mobile devices overtaking personal computers as the most commonly used device to access the Internet, continuing to pressure retailers to find the right ways to interact with information-empowered consumers
- Increased strategic use of big data by businesses
- Governmental and corporate reactions to online cyber attacks by state and non-state actors
- The growing effects of automation in the workplace, including worker displacement
- The massive shift in global energy production to the United States
- The effects of resource volatility in the face of ever-increasing demand for food, water, and energy, with environmental degradation and extreme weather adding to agricultural volatility

- Shifts in workforce composition, including a shortage of university-trained individuals
- Growing governmental dysfunction, including continued pressures to keep abreast of rapid advances
- Urbanization, with the majority of the world's population now living in urban settings

Open-Forum Discussion

Moderator: Dave Donnan, partner, A.T. Kearney

Talent was a topic of intense interest during the open-forum discussion on day one. All attendees have had staff members recruited by other parts of the business, a natural outgrowth of procurement's heightened position at most companies. While there are advantages to seeding the company with procurement "expatriates" who can serve as ambassadors for the function, bringing them back to their original jobs is always a challenge. Some companies require transferees to remain in their position for a defined period of weeks or months, while others vary this time frame based on the projects that these individuals are working on. Succession planning is important; keeping the process manageable requires an understanding of the criticality of each role in the procurement organization.

In order to import more talent from elsewhere in the organization, procurement needs to increase its internal marketing activities. With so much value-added work happening, the function has become a stimulating, rewarding place to work. Bringing in people to do category work related to their functional expertise is one way to help them make the transition—for example, someone with a marketing background can be brought in as a media buyer. Where solid processes and tools are in place, smart, ambitious people can be taught procurement, especially when they have a background that can be applied to a specific category.

Although procurement brings a unique combination of service, quality, and cost to the organization, these contributions are not widely understood at some companies. The function's return on investment, along with its many accomplishments and creative projects, needs to be better promoted using terminology that the organization understands. At companies where procurement has not yet been involved in efforts to grow the top line, increasing awareness of how competitors are obtaining innovation from the supply base can help build the case for similar efforts.

Mergers and acquisitions are enhanced by procurement's contributions, starting with involvement in identifying acquisition targets and conducting due diligence to unearth synergies. Center-led procurement organizations are especially adept at this activity because category knowledge is centralized, making it easier to understand a potential acquisition's spend structure.

As large law firms continue to struggle, the legal category appears to be a relatively easy spend area to crack. But the general counsel function is often reluctant to move away from firms that it has worked with for years or even decades. Sourcing legal spend can begin with some of the more commoditized services, such as documentation and discovery services, and then letting success build upon success. Some companies auction off entire legal projects, including specific pieces of litigation, and build in incentives for swift closure of matters.

Day Two

Developing and Executing a Strategy for Sourcing the IT Category

Speaker: Eric Stettler, partner, A.T. Kearney

Because information technology (IT) evolves so rapidly, IT sourcing succeeds best when handled as an ongoing activity rather than a periodic one. Managing this category starts with a robust strategy to determine how much of the service should be outsourced. Because megadeals in which all of a company's IT services were outsourced to a single vendor failed to live up to promises, determining which services to outsource to which providers is also crucial. IT expertise must be retained internally to manage vendors, and strong collaborations between IT and procurement are needed to ensure that the best in both service and cost are being delivered.

The IT supply management framework is highly complex, with multiple stakeholders from the business units and corporate functions. Supply strategy, category management, and relationship management may all be within the domain of other parts of the business, while the sourcing strategy remains within procurement's scope. Similarly complex is the IT category itself, which easily encompasses more than 50 different spend areas across hardware, software, network carrier services, consulting and technical services, and staffing. IT sourcing decisions center around which parts of IT are actual differentiators and which are simply a commodity spend. The potential trade-offs in terms of service and cost are tremendous; companies must carefully consider the implications of service interruptions and other potential calamities to their business. Hardware, operating systems, and the network all work together; no single area can be "gold plated."

New delivery models offer huge potential to **improve performance** and **reduce costs**.

While companies are somewhat reluctant to aggregate their spend too heavily across the many facets of IT due to past problems with mega-supplier deals, proven strategies can still yield value in IT sourcing. Infrastructure services can be competitively bid, with maintenance services negotiated separately from the service itself. Software requires active management around demand, license terms, and actual license usage: As company head counts change, the number of licenses owned can come to exceed the number used. Telecommunications spend will be fragmented because each national market has different providers, but equipment and service delivery can be standardized.

IT transformation efforts can bring a step change in both cost and capability. Technology assets, processes and tools, and people must be properly aligned to achieve the desired business outcomes. New delivery models offer huge opportunities to improve performance while reducing costs. Online software as a service (SaaS) solutions are replacing many traditional, maintenance-heavy enterprise applications. Custom applications are being abandoned where possible in favor of off-the-shelf solutions. Much of the data that has traditionally resided in corporate data centers is moving to internal or external cloud-based storage. Some data will likely remain on corporate servers due to a combination of regulations, security concerns, and customization, but much of IT's future is in the cloud.

Sourcing the IT Category at Dow Chemical

Speaker: Benjamin Brock, director of global purchasing, Dow Chemical

Dow's IT model was traditionally vendor focused, with 80 percent of its total IT spend going to suppliers. Some of these supplier relationships extended back a decade or more, which provided the company with steady quality at reasonable rates. When a 2010 benchmark showed that the company could obtain better rates, leadership reacted with initial surprise but fully supported the proposed cost reduction program. Aggressive targets were set, with quick wins built in to help establish momentum. A chief goal was to develop long-term strategies that ensure competition on a regular basis to avoid falling back into old patterns.

By disaggregating contracts, Dow was able to tailor negotiation strategies to individual services according to their criticality and the degree of market competition. In order to help prioritize the company's efforts, extensive analyses were performed to determine which agreements could be exited without incurring significant termination fees. The presence of credible alternative suppliers gave Dow a hedge against incumbents. Supplier switching costs were of minimal concern to the company; the goal was to secure competitive prices for the long term.

The discipline instilled by Dow's centralized procurement and IT functions was important to the effort—compliance with the process was mandatory, and executive support ensured that employees followed through. The company presented a unified face to suppliers, even in instances where the Dow people who worked with the suppliers on a day-to-day basis strongly preferred to retain a particular supplier.

Dow remained disciplined in the face of resistance from some suppliers and achieved significant savings. In many cases, the incumbent suppliers were retained under terms more favorable to Dow. The length of new contracts varied widely in order to keep the timing for the next wave of negotiations manageable. Service levels stayed the same or even improved; in some cases, the services themselves were transformed as part of the sourcing effort as Dow took a strategic look at its current and desired states. Breaking the spend into smaller parts is expected to increase innovation from the supply base, as suppliers have a new awareness of Dow's intent to continually improve.

Open-Forum Discussion

Moderator: Dave Donnan, partner, A.T. Kearney

Varied cost and pricing structures around the world sometimes cause global companies to accumulate significant offshore cash positions, and when that happens, procurement may be asked to find ways to "free" these funds. While invoices for purchases in one country cannot ordinarily be paid from another, global expenses can be. Companies frequently opt to staff decision makers in certain tax-advantaged locations in order to reduce their tax liabilities, but the correlation between these individuals and the revenues that flow through these offices must be clear. The laws around such practices are continually evolving; expert advisory services are a must for those considering such moves.

New procurement policies, such as requirements that all spend over a certain threshold be put up for competitive bidding, can be challenging to roll out across the company. Compliance can be encouraged by utilizing scorecards and making sure that top management reviews them to

see where the program is—and is not—being followed. Many procurement tools have robust reporting capabilities that can generate these scorecards.

A new U.S. Securities and Exchange Commission rule requiring publicly held companies to disclose the use of “conflict minerals” (such as tin, gold, and tungsten) from the Democratic Republic of the Congo or adjoining countries presents a new challenge for procurement, as it must look into the supply base to identify any suppliers that use these materials. Many companies are turning to third-party auditors and certification bodies for this purpose.

While supply risk management has long been a concern for direct categories, indirect suppliers are increasingly a source of potential risk as well. Many activities can be prohibited through contracts, but a contract cannot protect against reputational damage should a supplier engage in illegal or otherwise unacceptable practices. Information privacy is also a major concern in areas such as IT and human resources. In an effort to reinforce the work that was done during the initial supplier vetting process, some companies periodically audit suppliers that use their sensitive data.



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