

# The Purchasing Chessboard

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64 Methods to Reduce Cost and Increase Value with Suppliers

 Springer

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*“Our success as consultants will depend upon the essential rightness of the advice we give and our capacity for convincing those in authority that it is good.”*

Andrew Thomas Kearney  
(1892-1962)

# Preface

The basic idea for this book was conceived in December 2005. At the time, various models for structuring sourcing strategies could be found in the literature. As different as many of these models were, they all restricted themselves to describing the content of sourcing strategies. What we felt was lacking was a tie-in between sourcing strategies and the specific situations confronting business enterprises. After experimenting with structures classified by industry, position in the product lifecycle, or concentration on the supplier market, we finally hit on the simplest structure of all: supply power versus demand power. What worked in the bazaars of Babylon, raised trading powers like Venice to greatness and formed the basis of the British Empire is still valid today!

The two axes of supply power and demand power offer an ideal approach for structuring sourcing strategies and classifying them in a logical manner. By January 2006, we had already isolated some 60 markedly different sourcing strategies and sorted them between the two axes. To provide a clearer visual distinction, we colored the fields in alternating colors in a chessboard pattern. Initial tests in coordination with clients in Austria, Germany and the USA proved highly promising. The logic of supply power versus demand power seemed to dovetail with the thinking adopted by executives themselves, and facilitated the tie-in between purchasing issues and corporate strategy.

Since then, we have further refined our Purchasing Chessboard™ and tested it extensively. It has also been applied in practice by clients in Australia, Austria, China, the Czech Republic, Finland, France, Germany, Italy, Russia, Slovenia, Spain, the UK, Ukraine and the US. The relevant sectors included automotive manufacturing and supply, military equipment (tanks), construction equipment, packaging, steel, transportation, foodstuffs, pharmaceuticals, energy utilities, telecommunications and banking.

This book has a highly ambitious goal: providing a comprehensive strategy for tackling any and all challenges in the field of purchasing. To this end, we have drawn on the collective experience and insights of A.T. Kearney. In the last three years alone, A.T. Kearney has carried out over 500 purchasing projects, involving the market placement of more than 500 billion dollars in spend. Despite the most sophisticated knowledge-management systems, we have found that face-to-face contact is still indispensable for exchanging information. Of all the colleagues who gave us valuable assistance as discussion partners in the writing of this book, we would like to particularly thank the following: Íñigo Aranzabal (Madrid), Thorsten Barkmann (Düsseldorf), Jan Fokke van den Bosch (Amsterdam), Dirk Buchta (Dubai), Stephen Fowles (London), Patrick Dolisie (Paris), Stephen Easton (London), Joachim Ebert (Chicago), Jules Goffre (Munich), Martin Haubensak (Düsseldorf), Kurt Hoch (Vienna), Günter Jordan (Munich), Theo Klein (Düsseldorf), Ruslan Korsh (Moscow), Robert Kremlicka (Vienna), Rick Kozole (Detroit), Lian Hoon Lim (Hong Kong), Dietrich Neumann (Berlin), Jean Dominique Rey (Paris), Thomas Rings (Munich), F. Nikolaus Soellner (Düsseldorf), Oliver Scheel (Düsseldorf), Sieghart Scheiter (Düsseldorf), Peter Wessmann (Düsseldorf) and Andrej Vizjak (Ljubljana/Munich). Our gratitude also goes out to our editorial team, especially Marianne Denk-Helmold, without whom this book would not have been possible.

We are confident that we have created a work that will be equally useful to all those involved in business purchasing – from the CEO to the staff in the field. We hope it will stimulate our readers to make real and effective improvements in their purchasing procedures. Enjoy!

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Michael F. Strohmer  
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# 1 Purchasing: between a rock and a hard place?

The point of departure for this book was a perceived change in mood on the purchasing front. In our many talks with purchasing managers and senior executives, we increasingly gained the impression that a paradigm shift was in progress. Purchasing strategies that were successfully used for decades are no longer working. Suppliers are unilaterally increasing prices but are unwilling or unable to accompany higher prices with a guarantee of supply security. Buyers are in fear of losing face within their companies. Accustomed profit margins are collapsing.

Our first step was to analytically underpin these perceptions by taking stock of purchasing throughout industry. The methodological framework for our survey was provided by the “seven factors for success in purchasing” as defined by the observations of A.T. Kearney:

1. Purchasing must be an interdisciplinary, top-management task. The purchasing department must hold an equal rank alongside sales, R&D and production in the formulation and implementation of corporate strategy.
2. External communication must be a key element in purchasing. The company must speak to suppliers with one voice.

3. The purchasing department must work with analytical tools and strive to be better informed than suppliers. The traditional “arm wrestling” between purchasing and suppliers is therefore no longer necessary.
4. Based on the company’s demand power and the suppliers’ supply power, purchasing must develop a tailored strategy for each sourcing category in order to cut costs and add value.
5. Purchasing must be integrated seamlessly, directly and equally alongside sales and production when it comes to demand and capacity planning.
6. Purchasing must have appropriate information systems at its disposal, and be able to ascertain at any time “who buys what from which supplier.”
7. Purchasing must be staffed with a sufficient number of technically and commercially competent personnel, and must be seen as a desirable career stage within the company.

## **1.1 Survey results: the state of purchasing in industry**

As part of the purchasing survey, 600 CEOs of industrial companies were asked to rate the degree to which the “seven factors for success in purchasing” were being applied at their firms. Of these 600 CEOs, 200 responded. The companies surveyed were active in automotive supply, mechanical engineering, foodstuffs, pharmaceuticals, transportation, raw material processing and energy grid operations.

At over 30 percent, the response rate was well above the average for surveys of this kind. This already provides a clear indication of the importance accorded to purchasing by top-management today.

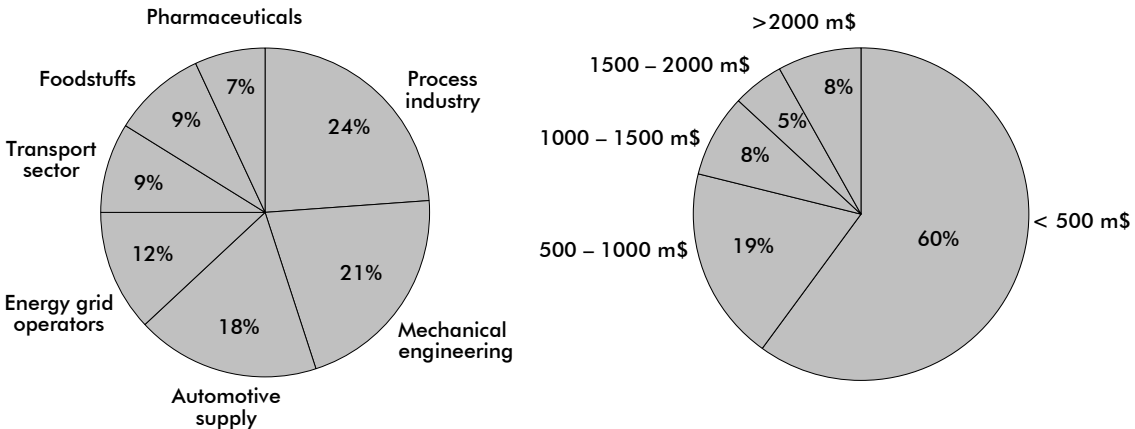


Fig. 1. Segmentation of participants by industry and revenue size

(The letter we sent out asking each company to participate was addressed to the CEO or Managing Director.)

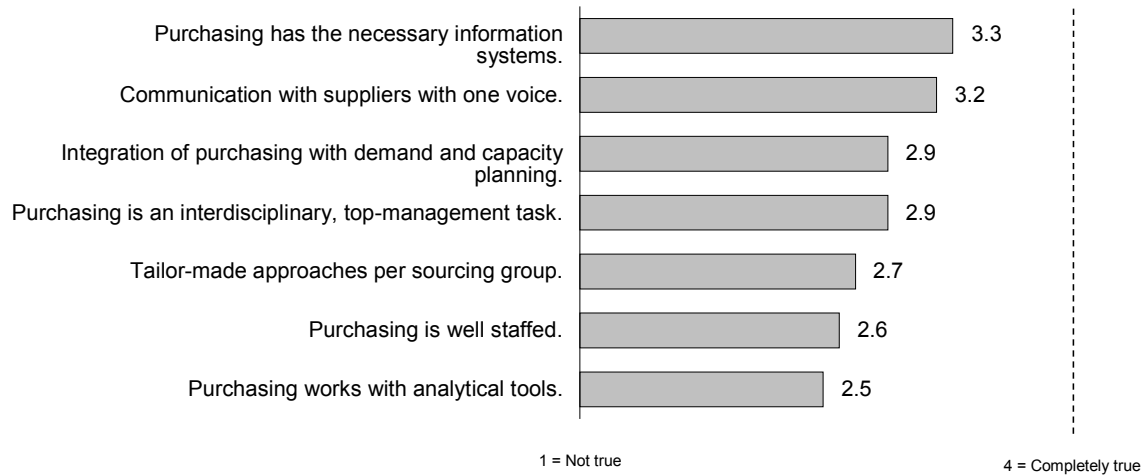
## Purchasing in industry

The arithmetical mean of all the responses from companies suggests that their purchasing departments are already highly developed. The range of possible responses was as follows: "1 – Not true," "2 – Partially true," "3 – Mostly true," "4 – Completely true."

## Information systems support effective purchasing

With 3.3 out of a possible 4.0 points, the question about appropriate information systems produced the highest concurrence. Today's companies, many of which have grown through acquisitions, produce a variety of





**Fig. 2.** Respondent's rating of their company's purchasing

similar and/or different products at a large number of locations, supported by frequently differing IT systems. Therefore, purchasing needs a consistent and highly integrated IT system that enables transparency over purchases across the organization and answers the question "Who buys what from which supplier?". Top-managers unanimously gave their existing information systems a positive rating.

### Targeted external communication with suppliers

With 3.2 out of a possible 4.0 points, the question about targeted external communication with suppliers also produced a high level of concurrence. In the worst case, purchasing is confronted with the situation where a supplier has already been pre-determined, for example, by specifying a customized product. On the whole, industry is in good

shape as far as targeted supplier communication is concerned; it manages to avoid twin-track strategies that can be exploited by savvy sales people from the supplier's side.

### **Demand and capacity planning must be observed**

With 2.9 out of a possible 4.0 points, the integration of purchasing in demand and capacity planning was generally rated as good. Reconciling anticipated customer demand with capacities available from the company's own production facilities and from suppliers requires a rolling planning process, one in which sales, production and purchasing must all be assigned equal weight.

### **Adequate involvement in strategic issues**

With 2.9 out of a possible 4.0 points, purchasing is widely perceived as an interdisciplinary, top-management task. Most of the cost structure of products and services is determined during the early phases of strategic planning. In order to give purchasing a formative role in this context, it must be included as an equal partner alongside sales, R&D and production in the formulation and implementation of corporate strategy.

### **Tailored strategies for each sourcing category need to be strengthened**

With 2.7 out of a possible 4.0 points, the use of tailored cost-cutting/ value-adding strategies was given a medium-to-low rating. Depending on the demand power of the company and the supply power of the suppliers, highly differentiated strategies are needed. And yet consulting experience

has shown that purchasing often works with just a handful of similar strategies, such as volume bundling or long-term contracts. This leaves a great deal of untapped cost-savings/added value, and also harbors the risk of unduly close ties to monopolistic suppliers.

### **Inadequate staffing**

With 2.6 out of a possible 4.0 points, the question of purchasing staff received the second-lowest level of concurrence. Purchasing can only participate equally in strategic planning, produce substantiated analyses or develop differentiated strategies for cutting costs and increasing value if it can draw on a sufficient number of highly qualified, technically and business savvy employees. As reported in the media, companies are currently finding it difficult to hire qualified candidates. Moreover, purchasing is not yet perceived as an attractive career stage at many companies, so that internal recruitment channels have not been very successful either.

### **Analytical deficits**

With 2.5 out of a possible 4.0 points, the ability of purchasing to use analytical tools was given the poorest rating in the survey. Modern purchasing combines technical and commercial information with knowledge of the supply markets and is therefore well prepared for negotiations with suppliers. The goal is to know more about the subject matter of the negotiations than the supplier does. However, we can still find buyers in many companies who view negotiations primarily as a psychological game and use this approach to conceal knowledge deficits on their own part.

## 1.2 A paradigm shift in purchasing

Our survey of purchasing in industry showed that decision makers were increasingly uneasy with the strategies, analytical capabilities and human resources in place at their purchasing departments. How should we explain this?

Ever since the 1980s, today's generation of purchasing executives has been accustomed to operating on a predominantly buyer's market with falling material costs. In the past, relatively simple methods such as tendering, bundling volume and concluding multi-year contracts enabled purchasing to obtain price cuts from suppliers of between one to three percent per annum. This "golden age" of purchasing is now over, however, and we find ourselves at the start of a seller's market. There are three main reasons for this:

- Increasing concentration on the supplier market.
- Rising energy prices.
- Hunger for resources on the part of emerging economies.

### Increasing concentration on the supplier market

The cost pressure that could be consistently exerted in a buyer's market only intensified the already existing trend towards concentration. To be able to use economies of scale and thus cope with cost pressure, suppliers were increasingly forced to consolidate via merger and acquisition. Especially those suppliers who were passing on their full productivity gains to customers (at the expense of their own profitability) frequently found themselves taken over by competitors. From this point of view, buyers can be said to have been a bit too successful. As a result, the supply power of the remaining suppliers has risen dramatically compared to previous years.

## **Rising energy prices**

For many years, the rise in energy prices was ignored as a temporary anomaly or explained away as the result of extraordinary circumstances (e.g. tension in the Middle East). By now, however, the debate on sustainability and global warming, along with the growing shortage of fossil fuels, has made it clear that high energy prices are here to stay. Some forecasts even predict an oil price as high as 200 dollars per barrel. On the other hand, agile companies can exploit high energy prices for their own benefit, for instance by supporting technological innovations to solve the crisis. Nonetheless, most suppliers simply use price increases as an argument for raising their own profits.

## **Hunger for resources on the part of emerging economies**

Along with concentration on the supplier market and surging energy prices, the demand for resources by rapidly growing economies such as Brazil, China, India (and in future, Russia) is one of the main drivers of changing background conditions. We are already seeing developments inconceivable only a few years ago. For instance, steel is becoming scarce, while Europe is thinking once again about investing in coal production. Meanwhile, Africa, with its abundant deposits of raw materials, suddenly finds itself once again at the center of foreign ambitions.

As a result of these three factors, buyers are confronted with suppliers who calmly demand price increases of five percent and more, yet are still unable or unwilling to guarantee the necessary supply security.

The simple techniques that used to be so effective on the buyer's market of previous decades (e.g. tenders, bundling volume and concluding multi-year contracts) are largely useless against these new forces. Thus, many

companies already find themselves “between a rock and a hard place” in terms of purchasing. As our survey of purchasing in industry has shown (see above), this fact has not gone unnoticed by top-management.

## 2 From four basic strategies to 64 methods

To help purchasing meet the new challenges of the seller's market, A.T. Kearney has developed the Purchasing Chessboard™. This represents the condensed experience and insights acquired by A.T. Kearney from over 500 purchasing projects carried out all over the world during the last three years (in which a spend of over 500 billion dollars was placed on the market), as well as from thousands of similar projects conducted over the last three decades. The Purchasing Chessboard™ has the goal of assisting buyers in all kinds of relations with suppliers. Its basic concept derives from the relationship between supply and demand.

Clearly, supply and demand are two economic forces that have helped determine the rise and fall of dominant civilizations throughout history. The bazaars of ancient Babylon, the Roman Empire, Venice in its heyday, the British Empire, the emerging world power of the USA the unification of Europe via the Coal and Steel Community, the EEC and the EU – all these historical developments were steered to a great extent by the laws of economic supply and demand. There is no reason to believe that these laws are less relevant today than they were in preceding millennia, or that this is likely to change in the foreseeable future.