Christian Schuh
Joseph L. Raudabaugh
Robert Kromoser
Michael F. Strohmer
Alenka Triplat
Jim Pearce

The Purchasing Chessboard

64 Methods to Reduce Costs and Increase Value with Suppliers

Third Edition

Springer

The Purchasing Chessboard

Christian Schuh
Joseph L. Raudabaugh
Robert Kromoser
Michael F. Strohmer
Alenka Triplat
Jim Pearce

The Purchasing Chessboard

64 Methods to Reduce Costs and Increase Value with Suppliers

Third Edition

Springer

Christian Schuh
A.T. Kearney Ges.m.b.H.
Seitzergasse 2–4
1010 Wien
Austria
christian.schuh@atkearney.com

Joseph L. Raudabaugh
A.T. Kearney Inc.
227 West Monroe Street
Chicago, Illinois 60606
USA
joseph.raudabaugh@atkearney.com

Robert Kromoser
A.T. Kearney Ges.m.b.H.
Seitzergasse 2–4
1010 Wien
Austria
robert.kromoser@atkearney.com

Michael F. Strohmer
A.T. Kearney Ges.m.b.H.
Seitzergasse 2–4
1010 Wien
Austria
michael.strohmer@atkearney.com

Alenka Triplat
A.T. Kearney Ges.m.b.H.
Seitzergasse 2–4
1010 Wien
Austria
alenka.triplat@atkearney.com

Jim Pearce
A.T. Kearney Limited
Lansdowne House
Berkeley Square
London W1J 6ER
United Kingdom
jim.pearce@atkearney.com

ISBN 978-1-4939-6763-6 ISBN 978-1-4939-6764-3 (eBook)
DOI 10.1007/978-1-4939-6764-3

Library of Congress Control Number: 2016960675

1st edition (c) Springer-Verlag Berlin Heidelberg 2009
2nd edition (c) Springer Science+Business Media, LLC 2012

Printed on acid-free paper

This Springer imprint is published by Springer Nature
The registered company is Springer Science+Business Media LLC
The registered company address is: 233 Spring Street, New York, NY 10013, U.S.A.

“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

There are many reasons why people write books. For us, there are only two: We are passionate about procurement, and we want to help executives answer the three most common questions about procurement:

- How do we reduce costs and increase value with suppliers?
- How do we get suppliers to change their behaviors to help us capture a competitive advantage?
- How do we build a world-class procurement organization?

This book, along with *Supplier Relationship Management: How to Maximize Vendor Value* and *Opportunity and The CPO: Transforming Procurement in the Real World*, completes an A.T. Kearney procurement trilogy. Together, the three books have enough information to allow readers to introduce the concepts without any outside help.

The Purchasing Chessboard is inspired by the logic of supply power and demand power—a concept that governed the dynamics in the bazaars of Babylon, raised trading powers such as Venice to greatness, and formed the basis of the British Empire. Since publishing the first edition in 2008, we have seen that it works in any industry, for any category, anywhere in the world. Because it is intuitive and easy to use, it has become the main procurement strategy tool for most leading companies around the world.

The 64 squares in the Purchasing Chessboard® provide a rich reservoir of methods that can be applied either individually or combined to help companies reduce costs and increase value with suppliers. Because many of these methods are not customarily used by procurement, the Purchasing Chessboard is also the perfect tool for helping buyers to think and act outside the box and find new solutions.

Perhaps the most gratifying outcome is that the procurement profession has embraced the Purchasing Chessboard so widely. We never expected to be working on the second edition, much less this third edition, or for our work to be published in so many languages. So why did we set out to write this new edition? There were three compelling reasons.

First, following Porsche's lead in keeping its 911 fresh over many generations, we wanted to update our case studies. The examples from our client work are always growing in number, and we and our clients like to push the envelope in terms of better, faster, and bolder. We have also incorporated lessons learned across geographies and industries. The explosive growth in analytics and the rise of category specialists in our Procurement Practice have taken the Purchasing Chessboard to new levels. And our firmwide network of people who want to share their successes has enriched the assortment of examples. So chapter 4, although structured in the same way, has been refreshed with new examples.

Second, we wanted to make this book more relevant to the C-suite. We take the view that to be successful in deploying the Purchasing Chessboard, procurement needs to closely collaborate with cross-functional stakeholders such as product marketing, research and development, manufacturing, sales, and finance rather than operate alone. Ultimately, only the chief executive can unleash the full potential of the Purchasing Chessboard and turn the company into a fearsome competitor.

Third, we want to inspire practitioners to experiment with the Purchasing Chessboard. Using it to identify the right method to reduce costs and increase value with suppliers is only the beginning. There are many ways to reach other levels. Some have been unlocked by us, and some by our clients, with or without our help. And some levels are still unknown to us. Perhaps you will be the one to unlock them.

Another motivation for us is to strengthen the standing of procurement people. At A.T. Kearney, we have trained more than 100,000 procurement people who are still active in our engagements. As we want to do more, all royalties from this third edition will go to grants supporting the academic achievement of outstanding procurement talent. If you consider yourself qualified for this grant or if you want to sponsor a candidate, please email us at procurement.grant@atkearney.com.

We are confident the book will be equally useful to all those involved in the business of procurement—from the CEO to the staff in the field. We hope it will encourage our readers to make tangible improvements in their procurement procedures. We invite you to join these ranks and, when you are done, let us know how it went.

Enjoy the chess game!

Acknowledgments

As we publish this new edition we continue to recognize that we stand on the shoulders of giants. Without the work of Tom Slaight, Larry Kohn, Manfred Türks, and Niko Soellner decades ago, A.T. Kearney's Procurement Practice would not be what it is today. Our gratitude also goes to our editorial team, especially Patricia Sibo, without whom this book would not have been possible.

Christian Schuh
Joseph L. Raudabaugh
Robert Kromoser
Michael F. Strohmer
Alenka Triplat
Jim Pearce

Table of Contents

1 A CEO who thinks like a CPO who thinks like a CEO

Procurement comes in many forms. The most basic—albeit the one we most discourage—is that of a transactional function that executes commercial arrangements between business stakeholders and suppliers. This type of procurement, whether based on a mindset or behavioral model, is indicative of missed value-creation opportunities and talented procurement professionals relegated to lesser roles. If you are a chief executive and this is your view of procurement, you might as well fire your entire procurement team and replace them with Ariba, Oracle, or SAP. Transactional procurement is repetitive and boring, adds little to no value, and is perfectly suited to process automation tools.

Our view of procurement—or of what it should be—is much different. We envision a function that not only supports a company's strategy but also contributes to or drives the strategy. The CPO takes a big-picture perspective, leads by influencing key stakeholders, and has a tremendous impact on the company's wellbeing. Some call our ideas lofty, or nice in theory, or wishful thinking. We beg to differ; many CPOs successfully lead their procurement organizations in this way. Francisco Garcia Sanz, board member at Volkswagen Group, and Kevin Brown, Dell's chief supply chain officer, top our list.

To explain our view, let's take a closer look at the well-documented actions of someone we consider to be the world's best CPO: Apple's Tim Cook. What he has accomplished at Apple is what we point to when describing a CEO who thinks like a CPO who thinks like a CEO.

Strictly speaking, CPO is an honorary title for Cook, who never held that position. Before Apple, he was vice president of corporate materials at Compaq, where he was fondly referred to as "Attila the Hun of inventory" because of his ruthless approach. In 1998, Cook threw caution and logic to the wind when he joined the ailing Apple as senior vice president for worldwide operations. Under the previous leadership, Apple had diversified into all kinds of market segments with barely convincing products. It didn't take long for Cook to live up to his Attila reputation by bulldozing Apple's unwanted legacy of stale inventory.

Cook's philosophy during those early years is best described in a 2008 interview with CNN. "Manage it [inventory] like you're in the dairy business: if it gets past its freshness date, you have a problem," he said.

While Steve Jobs claimed the Apple stage to introduce new products that excited the masses, Tim Cook worked quietly behind the scenes managing suppliers, doing so in a very different way.

Apple's competitors typically focus on product architecture, design, marketing, and sales and are hands-off when it comes to operations. Original design manufacturers (ODMs) such as Taiwan's Foxconn, Wistron, Compal, Quanta, and Inventec handle most of the engineering work and virtually all manufacturing. This allows PC makers to operate with comparatively lean resources and therefore competitive cost levels for their products.

Under Cook's leadership, Apple has taken a hands-on approach. The company has become more prescriptive when working with suppliers—planning manufacturing processes, specifying the required equipment, tools, and fixtures, and sending armies of manufacturing experts into the ODM factories to manage execution.

Encouraged by the success of this hands-on style, Apple got bolder and ventured deeper into unique production methods and technologies. A good example is its adoption of computer numerical control (CNC) machining. The traditional laptop computer chassis frustrated Apple. With its fairly complicated geometry, the only feasible way to mass produce it appeared to be screwing or gluing together five to 10 individual parts. The problem is that with each additional part, production tolerances mounted. Squeeze a traditionally made laptop and you will hear it squeak.

Apple looked for an alternative way to make the chassis and came up with CNC machining. It was a fairly slow and expensive way of making small volumes of highly precise parts—or at least that was the conventional thinking. Apple defied this thinking, adopting CNC machining to produce high volumes of unibody chassis that are in every MacBook, iMac, iPad, iPhone, and Apple Watch produced today. The trick was to turn a small-volume technology into a mass-production process. Apple spent several consecutive years purchasing almost the entire worldwide production of CNC machines. Today, the machines are installed in Chinese factories owned by Foxconn and its competitors, giving Apple a considerable edge.

Everyone knows that Apple has significant demand power. What many people don't know is that Apple rarely just pulls the commercial lever to squeeze suppliers on cost. In fact, some suppliers compare working with Apple to signing on with the United States Navy SEALs. "Apple's supplier executives are extremely demanding, but at the same time, they know exactly what they are doing," explains one supplier. "By working with them, we have made such progress that it will help us tremendously when competing for business elsewhere."

Finally, every successful company has a unique purpose. Steve Jobs introduced Apple's purpose in January 2010. "We've always tried to be at the intersection of technology and liberal arts, to be able to get the best of both, to make extremely advanced products from a technology point of view, but also have them be intuitive, easy to use, fun to use, so that they really fit the users," Jobs said at the unveiling of the first iPad. "The users don't have to come to them; they come to the users."

This purpose, together with Jobs' perfectionism, resulted in an extremely streamlined product portfolio and the conditions from which Cook could unleash the full power of procurement. Instead of chasing myriad parts for disparate products, Cook drilled down deeper to better understand the most crucial product and process technologies—often understanding these better than Apple's suppliers.

Going for savings alone was never on the agenda. As procurement became an integral element of the company's strategy, products became even more desirable for customers. A company that was on the brink of bankruptcy in 1998 turned into one of the world's most valuable firms.

Can Tim Cook be cloned?

Apple illustrates what can be achieved when the CEO understands procurement and the CPO thinks like a CEO. But Apple is still quite unusual.

The findings of an A.T. Kearney study highlight the sorry state of affairs elsewhere. Among CFOs at 383 companies in North America and Europe, less than 20 percent say they are satisfied or largely satisfied with the performance of their procurement functions, while about 75 percent rank their procurement performance as poor, mixed, or undetermined.

All CFOs understand that procurement affects the bottom line. And most admit to calculating the returns that procurement delivers, dividing its annual value and savings by the cost of the procurement organization. Yet, when it comes to cutting costs, many CFOs fall back into their comfort zones—scrubbing sales, general, and administrative (SG&A) costs, operating costs, and direct and indirect labor. In our experience, companies that fail to take full advantage of procurement to reduce costs are also not capturing the full value from working with suppliers.

Analysts have also chimed in, correlating a company's performance since the 2008 financial crisis with the standing of its CPO. A look into most industries shows that when a CPO has a high ranking within a company—equivalent to the heads of sales, R&D, and production—the company consistently performs better than peer firms where the CPO ranks one or several layers lower. For companies that spend between one-half and two-thirds of their revenue on purchased goods and services, analysts like to know that a heavyweight CPO with political clout is running the show.

Finding a Tim Cook clone at the helm of an Apple-like company will not happen anytime soon. Then again, cloning is not necessary. Numerous enlightened CEO–CPO combinations are working their magic at companies around the world. We know this because we work with them every day, helping to deploy our Purchasing Chessboard®. These companies are doubling their savings on average and getting game-changing value from suppliers.

Get the C-suite aboard

The Purchasing Chessboard is a sure path to significant savings and value. But it does not work alone. If you are a CPO, our best advice to you is do not go it alone. Yes, you can work single-handedly and increase your savings and maybe implement one or two good ideas from your suppliers. But you will fall short of your potential and your company's potential.

Capturing significant savings and game-changing value requires working from the top and getting broad cross-functional support. One way to do this is to recommend this book to everyone in the C-suite. Tell them that they need only read the first three chapters and that it will take less than an hour. Better yet, copy the chapters and hand them out. Then take some time to define a vision of what you would like to achieve. Calculate the desired cost savings, and think about what additional value you would like to get from your suppliers.

Once the executive team is on board, pick a subset of people for a pilot program. Bring together your procurement team with their counterparts in other functions, and help them get their heads around the Purchasing Chessboard. Here, the focus should be on chapters 3 and 4—reading the case examples, the real-world strategies and success stories derived from our experience with clients, and reflecting on how similar strategies could affect your company. Finally, get team members implementing their strategies and then "lift the shade" so the executive team and others can watch, learn, and follow their progress. There is a lighthouse effect that inspires the rest of the company and later facilitates an organization-wide rollout.

The Purchasing Chessboard can turn procurement into the most exciting place to be in a company—a place where great procurement athletes are developed and their performance measured. Think of the coach of a great soccer team developing his players. The only difference is that the CPO turns to concepts such an Assessment of Excellence in Procurement (AEP) and Return on Supply Management Assets (ROSMA^{SM}) to develop a winning team.

2 From four basic strategies to 64 methods

To help procurement meet the challenges of an increasingly volatile world, A.T. Kearney developed the Purchasing Chessboard®. This new edition represents the condensed experience and insights acquired by A.T. Kearney from more than 1,000 procurement projects carried out worldwide during the past six years (involving a spend of more than US$1 trillion), and thousands of similar projects conducted over the past three decades.

The basic concept of the Purchasing Chessboard derives from the relationship between supply and demand. Its aim is to help buyers deal with every type of transaction with suppliers.

The laws of supply and demand have influenced the rise and fall of preeminent civilizations and ruling bodies throughout history. The bazaars of ancient Babylon, the Roman Empire, Venice in its heyday, the British Empire, the emerging world power of the United States, the unification of Europe via the Coal and Steel Community, the EEC, and the EU—supply and demand, to a great extent, steered them all. There is no reason to believe that these laws are any less relevant today than they were in days gone by, or that they will be any less relevant in the foreseeable future.

Using the laws of supply and demand as the basic methodological concept to categorize supply relationships in procurement has one principal advantage: all departments and managerial levels understand it. And since top management especially focuses on supply and demand, it becomes a relatively easy matter for procurement to mesh its ideas with the overall corporate strategy (see Fig. 1).

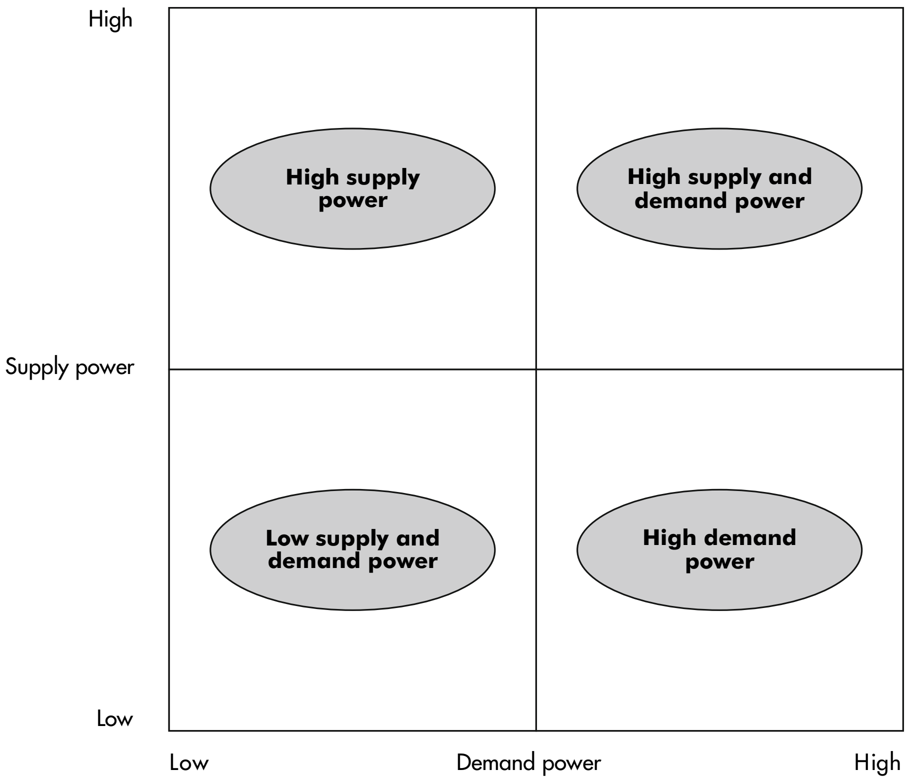

Fig. 1. The purchasing playing field

So how do supply power and demand power become a methodology for "hands-on" procurement? The answer lies in a portfolio that runs the gamut from low to high supply power and low to high demand power.

To illustrate, let's look at four very different situations:

- High demand power: A big carmaker (for example, Volkswagen) buys forged parts. There must be hundreds, if not thousands, of forged-part manufacturers throughout the world, and out of these at least several dozen will be qualified to meet Volkswagen's quality and volume requirements. In this case, Volkswagen is a buyer in a position of overwhelming power vis-à-vis its suppliers, able to exploit competition to its own advantage.

- High supply and demand power: If the same big carmaker now wants to buy engine management systems from Bosch, the situation is completely different. In many segments, Bosch holds a de facto monopoly. Nevertheless, Bosch is just as dependent on the big carmakers as they are on Bosch. In this case, securing joint, long-term advantages is unquestionably in the interest of both parties.

- High supply power: Even the demand power of a big carmaker has its limits, especially when oligopolistic market conditions prevail. A good example is the procurement of traded commodities such as platinum for catalysts. While Volkswagen certainly purchases a large quantity of platinum, it is fully dependent on the quoted prices of metal exchanges. Companies confronted by high supply power will consistently strive to change the nature of the demand in order to gain control.

- Low supply and demand power: An example of low demand power on the part of a big carmaker is air travel. The situation is more balanced