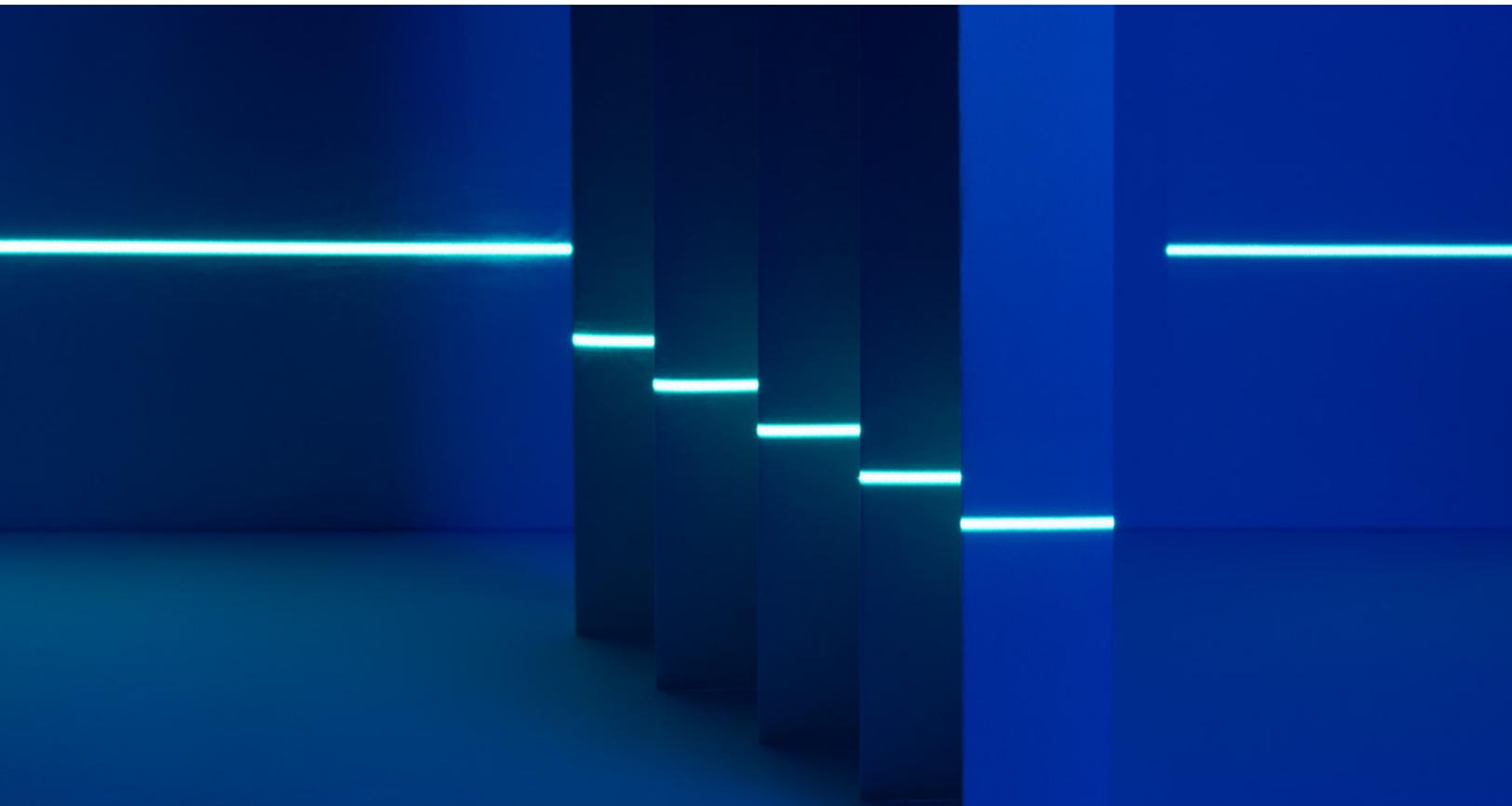


Operations Practice

Shifting the dial in procurement

Procurement has an opportunity, indeed an imperative, to transform from an enabler of cost reduction to a creator of sustainable competitive advantage.

by Tarandeep Singh Ahuja and Yen Ngai



Traditionally, procurement has been the efficient workhorse for organizations, driving cost savings percentage point by percentage point, contract by contract. Yet despite the tremendous impact that strong spend management can have in value creation, the reality is that in many sectors, procurement is still primarily a transactional function with a limited scope of influence. Minimal deference is currently given to a function that, in light of the unprecedented rate of change in the world today, could in fact unlock distinctive competitive advantages for their organization.

There are major shifts taking place globally today to which procurement must respond: value chains are becoming more complex and volatile, with increased risks and opportunities that accompany that complexity; developments in digitization, automation, and analytics that can unlock previously untapped potential; and acceleration of technological advancements and innovations are now more difficult than ever to keep pace with without external partnerships. This rapidly changing setting brings an imperative to change how procurement operates as a business function, as well as an opportunity to extend the scope of procurement's influence in an organization.

Winning in this more complex and digital future will require a complete transformation of procurement as a function: having a broader mandate, way beyond just cost reduction; investment in digitization, automation and analytics; and rethinking the procurement organization.

So, exactly where should procurement leaders start to transform their functions? As a starting point, let's take a closer look at the most important global shifts, and the corresponding implications.

Volatility brings risks—and opportunities

Since 1980, global inter-regional trade has increased eightfold, making supply chains more global and interconnected. However, with rapid growth across emerging markets, ever-increasing

talks of trade wars, and intensifying concerns about sustainability, global supply chains are becoming more complex, more volatile, and more risky. Procurement functions need to be more adaptable as ever to respond.

Recent changes in trade policies are forcing large multinationals to rethink their supply strategies. By some projections, for example, Brexit could cost automakers in the UK billions of dollars in additional tariffs, and potentially force some to shift production elsewhere. Many other industries are also experiencing significant upheavals due to the changing nature of trade relationships between the United States and other countries.

At the same time, by 2025, emerging regions are expected to be home to almost 230 companies in the Fortune Global 500, up from 85 in 2010 (Exhibit 1). In a rebalancing global economy, procurement teams need to look beyond traditional low-cost locations in China and Latin America and explore new emerging markets in Africa or Southeast Asia, which have become attractive for new global sourcing opportunities.

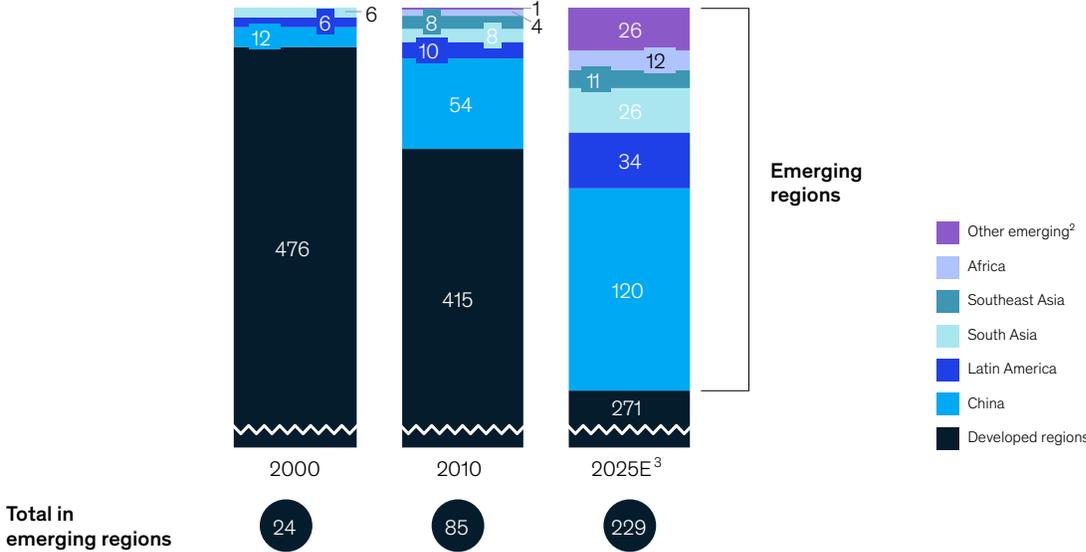
Increasing corporate attention to socially responsible practices adds another challenge in managing complex global supply chains. Greater transparency—and greater expectation to be transparent—means unethical behavior in even a tier-2 or -3 supplier has reputational impacts on the purchasing organization. While ethical sourcing isn't a new trend, the extent to which consumers are now making purchasing decisions based on this is. And companies are responding: in the 2017 McKinsey Global Survey on Sustainability, respondents across all regions reported significant increases in the adoption of sustainability-related technologies.

Take, for example, the use of blockchain for the mining of cobalt, a critical mineral for the automotive and mobile-device industries. Reports of labor abuses in cobalt mines have led producers and customers to deploy blockchain technologies: each bag of cobalt is sealed with a digital tag that ensures full traceability to compliance-accredited mining

Exhibit 1

The rise of new regions means procurement’s focus must change.

Number of Fortune Global 500 companies¹



¹ The Fortune Global 500 is an annual ranking of the top 500 companies worldwide by gross revenue in US dollars.
² All emerging regions with the exceptions of China and Latin America combined until 2000.
³ Fortune Global 500 share in 2025 projected from revenue share of countries in 2025.
 Note: Numbers may not sum due to rounding.

Source: McKinsey Global Institute (MGI) analysis; MGI CompanyScope

locations, creating a new source of competitive differentiation.

Automation, digitization, analytics: fundamentally changing procurement

As with other functions, digital disruption in procurement is already happening. Breakthrough technologies such as automation, digitization, and advanced analytics are enabling a transformation in how procurement operates by empowering procurement functions to identify and capture previously untapped sources of value.

A recent study estimates that close to half of all procurement activities can be automated using

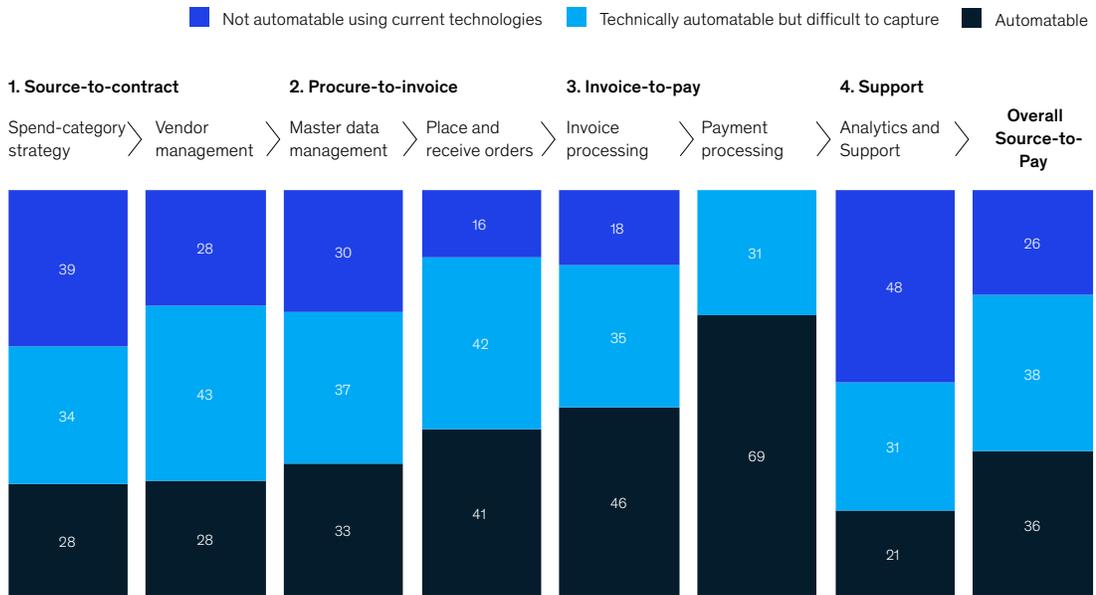
technologies that are already available today (Exhibit 2). These advances promise to free up resources traditionally dedicated to transactional activities for reinvestment in strategic procurement, and in seeking out innovative sources of value.

Artificial intelligence and machine learning are even solving the perennial issue of data quality. Large spend datasets from enterprise resource-planning (ERP) systems can be regularly categorized via text-mining algorithms to decipher even poorly coded spend. Complex spend analyses can be automatically refreshed via spend-intelligence solutions that can extract and analyze spend data repeatedly to generate insights with minimal effort.

Exhibit 2

Automation could dramatically reduce time spent on transactional procurement.

Percent of total employee activity within example process stages



~40% of S2P tasks are currently automatable, and may and may double in the near future

Beyond automation, our recent experience indicates that innovative digital solutions in procurement can unlock as much as an incremental 3 to 10 percent in annual cost savings. For example, a resources company with geographically dispersed operations completely digitized the monitoring of suppliers' key performance indicators (KPIs) through the development of a mobile application, which allowed field supervisors to provide real-time feedback on supplier performance. The result reduced value leakage by up to 5 percent through improved performance discussions with suppliers on schedule and quality attainment.

Advanced analytics-enabled spend-intelligence solutions can offer deeper category insights

to uncover opportunities in strategic sourcing of commodities—particularly for those with volatile pricing caused by the fluctuating cost of raw-material inputs. Disparate data sources can be leveraged to better predict the commodity prices: For example, a construction firm used advanced-analytics models to predict steel rebar prices with an accuracy of greater than 90 percent, significantly improving its ability to bid for upcoming projects.

Finally, Internet of Things (IoT) sensors able to collect real-time data from operating equipment are now being used widely to reduce the total lifecycle cost of operations equipment and consumables. Tire manufacturers, for example, are now sensorizing their products, providing digital tire-monitoring platforms that help fleets lower costs

and increase uptime by analyzing data to determine optimal corrective measures. Procurement and operations teams can then unlock incremental total-cost-of-ownership savings in maintenance time, protecting tires from long-term damage while reducing tire-related breakdowns and improving fuel efficiency and safety.

The need for innovation ecosystems

The pace of advancements in new technologies is increasingly rapidly across sectors. As it becomes more difficult for organizations to keep up, many are looking to partner more with technology providers—whether from established partners or start-ups, or inside or outside the traditional value chain—in developing an ecosystem of innovation. Procurement's unique window into how suppliers are transforming their offerings means it can play a central role in collaborating with suppliers, such through innovative business models, forging partnerships to pilot or co-invest in new technologies, or even establishing start-ups.

An example has been the emergence of “anything as a service” or pay-by-usage/subscription-based models, a market that is forecast to grow by 38 percent from 2016 to 2020 globally. These new options let businesses convert large capital expenditures into smaller operational expenditures that are spread out over a longer time period.

Aircraft-engine manufacturers, for example, are increasingly moving to power-by-the-hour service models that use IoT-linked sensors to collect real-time data on component conditions. The combination enables the companies to sell engine uptime rather than just the engines themselves—and extends engine life with better predictive maintenance at reduced cost. Airframe manufacturers are now reported to be considering a similar model to capture a bigger slice of the maintenance-services market.

As corporates look to keep pace with technology and emerging business models, investments in Industry 4.0 start-ups have tripled in value since 2013, with corporate participation in deals growing

to over 30 percent of total global investment. Companies looking to be at the leading edge of technology and innovation are actively searching and scanning for suitable start-ups. Procurement can play a leading role in both identifying these types of start-ups, and in creating the right contractual agreement to allow for flexibility in collaboration and co-development. For example, a mining company recently held regular open days for start-ups to pitch their products—and engaged a start-up producing an IoT- and AI-powered sensor that reduces condition-monitoring costs, improves equipment reliability, and reduces unplanned downtime.

Let the transformation begin: actions for procurement leaders

These trends leave little doubt that procurement is being disrupted. However, as with any major change, it can be difficult to know how leaders should begin the capitalizing on this disruption. Questions abound: What should the role of procurement in my organization now be? What technologies should we be investing in? What capabilities and talent are required? How do I know there will be a return on the investment?

Based on conversations with CEOs, CFOs, and CPOs over the past 24 months, we've identified a set of actions that all CPOs and procurement leaders should focus on to proactively respond to the trends above—sooner rather than later.

1. Rethink the procurement mandate

- Evolve from an enabler of cost reduction to a creator of sustainable competitive advantage, by collaborating with strategy, operations and other functions to jointly uncover new sources of competitive advantage.
- Identify the optimal manufacturing and supply footprint, with consideration of the current and future global macroeconomic situation.

- Leverage the sourcing and supply-chain strategy to create a distinctive brand proposition, such as through ethical sourcing.
- Identify which M&A opportunities should be explored to take advantage of emerging technologies or innovative business models.
- Play the role of Chief Ecosystem Officer by broadening your perspective beyond the traditional value chain and becoming a source of innovation for your organization.
- Foster an ecosystem of innovation—accelerate the successful adoption of innovative technologies by exploiting co-investment or co-development partnerships with suppliers.
- Explore with your strategic vendors innovative commercial models, such as as-a-service contractual arrangements to unlock additional value through performance-based payments or net-present-value-linked arrangements.
- Unlock previously untapped value via data- and advanced analytics-driven insights.
 - Invest in setting up the right data infrastructure to enable more insights, such as using spend intelligence to automate data cleansing and analysis, along with predictive models to better forecast commodity prices and inform procurement decisions.
 - Leverage IoT technologies and advanced-analytics techniques to create new sources of insights that can be applied to unlock new sources of value, such as predictive maintenance to improve equipment uptime.

3. Future-ready the organization

2. Invest in digital and analytics

- Use automation and digitization to streamline procurement processes and improve internal customer experience.
 - Identify where value can be unlocked by technology in your organization—value-back rather than technology-forward—and determine how digitization, automation or analytics could create value against each of the key procurement levers.
 - Prioritize investments in the right opportunities and create a digital roadmap to sequence the deployment of technologies in a coordinated manner, unlocking value and valuable resources for reinvestment.
- Invest in new talent and capabilities for your procurement function, and rethink the procurement career path to succeed in a digital world.
 - Rebalance roles towards more strategic capabilities requiring new skillsets (in analytics, digital, lean, partner selection and development, sustainability auditing) and increasing automation of transactional activities.
 - Rethink the procurement career path—traditional procurement skills will continue to be critical, but adding new capabilities in digital and analytics may require more new talent, retraining, and functional rotations with other parts of the organization.
- Establish an agile procurement organization to improve process efficiency and keep pace with accelerating change.
 - Set up flexible, business-driven cross-functional teams to allow sharing of specialized procurement or operational

skills across category teams, fostering idea generation and enhancing both category expertise and procurement capabilities.

- Adopt agile methodologies and approaches where relevant, deploying category sprints as an iterative cross-functional approach to develop and execute category strategies.
- Introduce digital solutions to help with the efficiency of the procurement process, such as cloud-based project managers for tracking actions across the team, or

rich messaging platforms for cross-team communications.

Global trends affecting procurement today are evolving at pace; the function must elevate the focus on the corresponding opportunities and respond strongly. While this poses many questions around how to best redefine the role to capture value, it's clear the function will have a much more strategic part to play. Is your procurement function ready to shift the dial?

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