

A next-generation operating model for source-to-pay

A next-generation procurement operating model that capitalizes on advances in digital, data, and analytics delivers new levels of performance across the value-creation lifecycle.

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Effective procurement has long been recognized as a source of a competitive advantage (Exhibit 1). But achieving excellence requires a concerted effort to align a variety of capabilities, insights, and activities in an integrated manner across the whole organization.

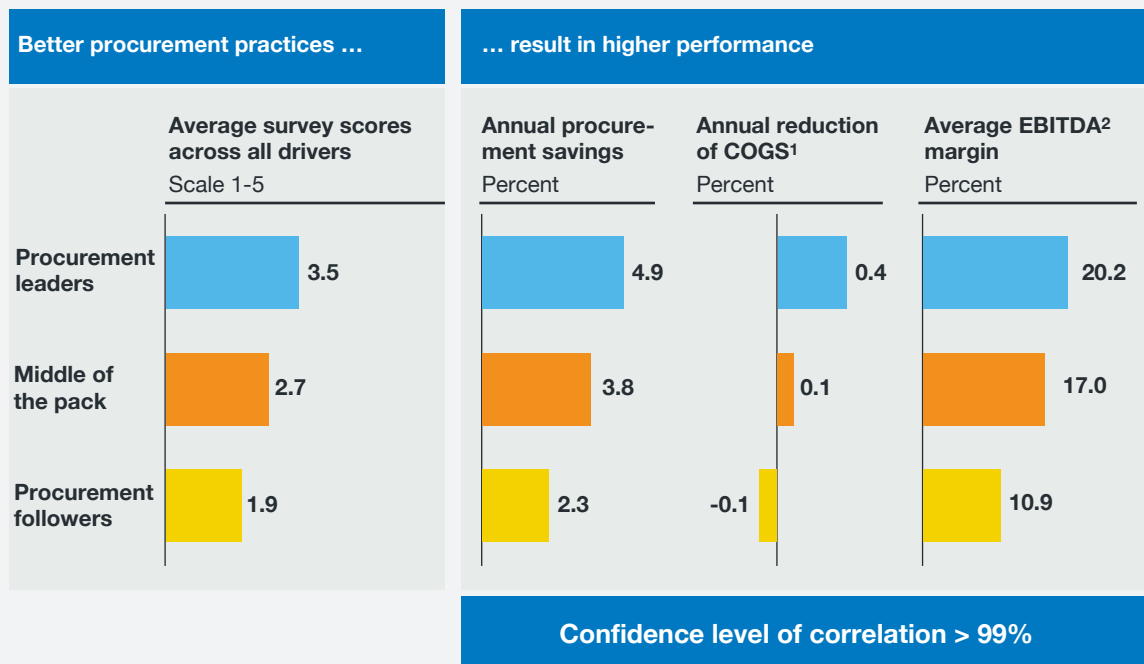
Achieving the level of performance and cross-functional integration required for procurement excellence has never been easy. And the big trends that are reshaping so many aspects of modern business are only adding to the complexity of the challenge. Today's procurement function must

navigate new markets and new sources of supply. It must balance the benefits of global sourcing and standardization against the risks associated with complex logistics, and the need to tailor products and supply chains to suit the requirements of local markets. It must develop the agility to manage price volatility, shortages, and supply interruptions. Increasingly, it must cope with political uncertainty and global trade tensions.

Then there is the proliferation of data and the rise of the Internet of Things, coupled with advances in automation, analytics, and digital technologies.

Exhibit 1

Procurement pays: Procurement health shows a strong correlation to corporate performance.



¹ Cost of goods sold

² Earnings before interest, taxes, depreciation, and amortization

These developments create many new opportunities for procurement, such as allowing companies to learn more about supplier capabilities and customer requirements, and helping accelerate, streamline, and improve the effectiveness of internal processes.

Together, these factors create a business imperative for the C-suite to reexamine, rethink, and reimagine the procurement function. Capturing the opportunities offered by this fast-changing technological and commercial landscape will call for deeper and more interconnected capabilities.

Reimagining procurement

To maximize the impact and potential of the procurement function, companies need to develop and coordinate a comprehensive set of capabilities that encapsulate recent advances in technology, analytics, and management practice. We describe these requirements in a next-generation procurement operating model that restructures the function's relationship with its internal customers and supply base. Our model reframes the remit of the procurement function (the comprehensive set of interconnected activities it should either lead or participate in) as well as the enabling elements (the critical elements needed for efficient and effective execution of these activities).

We define the remit of the procurement function expansively, recognizing the **interconnections** between different activities needed to drive value across the end-to-end source-to-pay lifecycle. For example, insights gained through business partnering will influence specification definition, demand management, and sourcing decisions; decisions made during the contracting will have implications for payment-optimization strategies; the efficacy of the vendor-onboarding process will influence the quality of data obtained for subsequent vendor performance management and spend analytics.

This end-to-end remit is shown as in the honeycomb at the center of Exhibit 2. At the heart of the honeycomb is the procurement strategy. Given the strategic nature of procurement—and its impact on the bottom line—the design of the operating model must start with an understanding of the overall business strategy and how to align specific procurement practices with desired outcomes. For example, if a company is in growth mode, its procurement strategy may emphasize supplier management, development, and innovation. If, however, the company is focused on profitability, more attention will be directed towards traditional sourcing activities aimed at reducing the cost of supply.

The six elements surrounding the procurement strategy represent a comprehensive set of activities needed to **capture** and to **sustain** value. The difference is important. To deliver value, the procurement function must do more than develop appropriate sources of supply. It must ensure transactional and compliance-driven activities are performed correctly, to sustain performance and avoid potential value leakage—which can be substantial.

The seamless execution of these components requires close coordination and synchronization between procurement and its stakeholders, both internal (business operations as well as corporate functions such as finance, IT, internal audit, HR, and legal) and external (the supplier community).

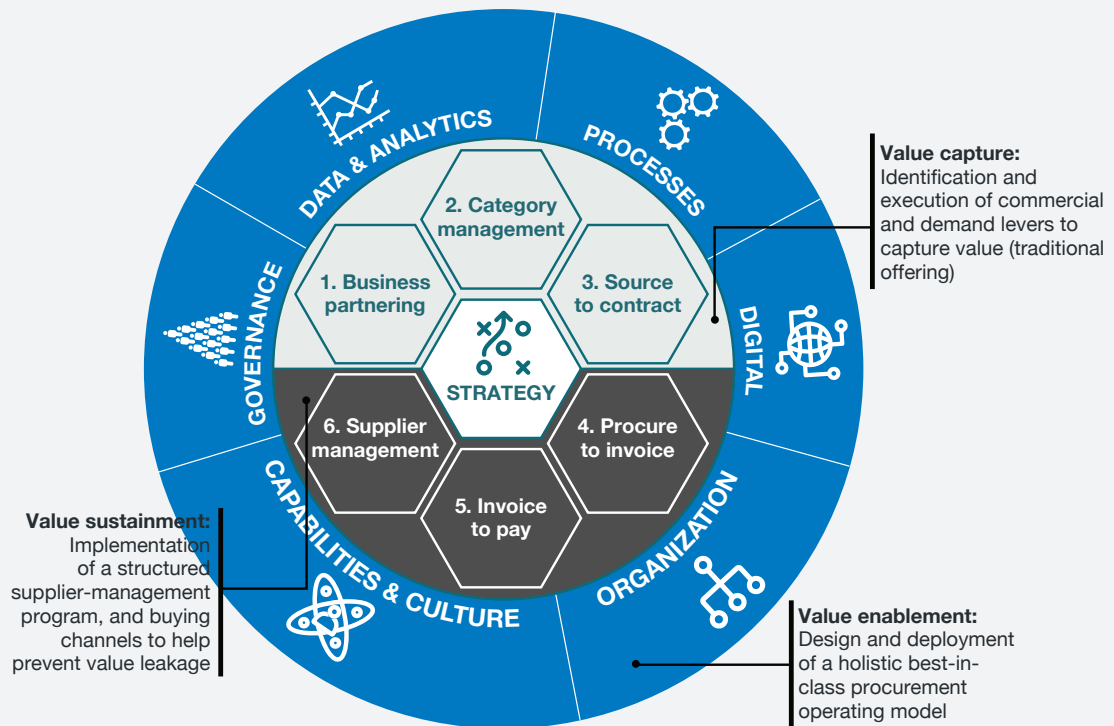
To enable the efficient and effective execution of these six elements, companies must achieve excellence in six enabling components of the operating model—processes, digital, organization, capabilities and culture, governance, and data and analytics—represented by the outer ring of Exhibit 2.

Value capturing

To generate new value for the business, next-generation procurement functions must become adept at three primary activities: business partnering, category management, and sourcing and contracting.

Exhibit 2

A successful procurement operating model coordinates multiple capabilities to enable, capture, and sustain value.



- Excellence in **business partnering** starts with procurement developing a clear understanding of the business’s strategies, goals, and plans, and the business developing an appreciation of procurement’s role in delivering its objectives. A major energy company achieves these twin objectives by closely coordinating interactions between engineering and procurement, with the two functions collaborating in the development and review of purchase specifications. Vendor bidding processes are designed to ensure they meet design-to-value criteria while remaining broad enough to ensure that multiple vendors can compete.
- Best-practice **category management** goes beyond squeezing suppliers for the lowest possible price. High-performing procurement functions capture other sources of value by proactively and continuously managing categories of spend. These tactics can be externally oriented (creating competition in the supply base, negotiating more favorable commercial terms, or investing in joint innovation with suppliers, for example) or internally oriented (such as by better managing demand, or optimizing product specifications to minimize excess costs due to unnecessary functionality).

Next-generation category management will make use of advanced-analytics techniques to identify emerging opportunities in supply markets. For example, consumer-goods companies are starting to use tools that combine machine-learning based agronomic models with local crop, weather, and related data to improve price forecasts and help food buyers make better purchasing decisions.

- Typical **source-to-contract** processes are plagued by repetitive manual activities and inconsistency across the organization, resulting in long cycle times, lack of transparency, and suboptimal outcomes—thus exacerbating friction between procurement and the business. By contrast, a well-managed source-to-contract process doesn't just create value by identifying and selecting the best source of supply. It also deepens supplier relationships. For example, a major telecommunications company has standardized a set of highly institutionalized processes, built around a design-to-value approach. By evaluating bids against clean-sheet cost models, the company finds ways to optimize both supplier prices and product specifications.

Value sustaining

While significant value can be generated through superior business partnering, category management, and sourcing and contracting, these activities alone are not sufficient to ensure this value flows to the bottom line. Once the contracts have been negotiated, mechanisms are needed to drive compliance with these agreements so that the savings are fully realized. To ensure the credibility of procurement's claims to savings, its staff must pay equal attention to the more transactional, but vital, value-sustaining activities of procure-to-invoice, invoice-to-pay, and supplier management.

- **Procure-to-invoice** covers the span of activities from needs identification through to approvals, purchase-order generation (and expediting), advanced shipping notification, and finally to the receipt of goods or services. The procure-to-invoice process can often be highly manual, poorly documented (if, say, an end user places an order by phone directly from the supplier), inconsistent, and opaque. Furthermore, if the requisite controls are not in place, purchases may be subject to long cycle times, value leakage, and fraud potential. Next-generation solutions embed governance into how goods and services are ordered, such as by enforcing well-defined buying channels that prescribe how purchases are made—often digitizing the buying process. A chemicals company has adopted this approach, creating highly automated channels in which robotics expedites simple orders while consolidating more-complex requests in several global centers of excellence, thereby ensuring compliance across the end-to-end purchase process.
- A well-managed **invoice-to-pay** process should not just be a strong business control that ensures the right supplier is paid the right amount at the right time. It should also create incremental value for the business. For example, a global financial institution captured over \$10 million in savings in less than three months simply by identifying and enforcing expedited payment where early-payment discounts could be captured. Another chemicals company found that it could replace 60 percent of the labor required for invoice-processing activities by deploying bots to scan and code invoices directly into its core ERP system. Costs for the automated tasks fell by 80 percent, even though the manual work that

the bots replaced had been conducted in a low-cost, offshore shared-service center.

- **Supplier management** is the discipline of purposefully managing interactions with external providers of goods and services to maximize value for both parties. Too often, this area is reduced to being compliance-oriented or exception-based in reaction to emerging issues. This tactical interaction ignores the opportunity to develop strong, collaborative relationships with key suppliers that can unlock new sources of economic value. Through joint innovation, mature supplier-management organizations can deliver year-on-year sourcing-cost reduction, service-quality improvement, and revenue growth. Our research shows that companies that score higher in supplier-management capabilities see almost double the level of earnings growth when compared to organizations that lag their peers.

Enablers of a next-generation procurement model

While the six areas of the next-generation procurement operating model describe what is required for procurement excellence, they do not describe the capabilities needed to put these elements in place. We therefore also focus on six enablers of superior performance.

Each of these enablers drives incremental value through advanced next-generation practices:

- **Process.** Leading procurement organizations are going beyond defining end-to-end value streams and buying channels. In a next-generation operating model, processes are not only harmonized across business units and geographical regions but also employ category-specific solutions that streamline approval processes for the user journeys associated with

a particular channel and category. This shift can be expedited by recent innovations in process-data mining, so that organizations can use the data that flow through their purchasing and payment systems to identify and address the process variances that lead to suboptimal purchase outcomes (such as an order being placed with a nonpreferred supplier) and rework (such as a purchase order being generated retroactively).

- **Governance.** Governance mechanisms must evolve beyond static steering committees and manual compliance checks. Next-generation procurement governance will use digital tools to institutionalize decision rights through automated workflows that enforce policies in real time. These digital workflows ensure purchases are made via the right buying channel and with the right vendor. Continuous auditing of spend data also allows the development of statistical models that help to identify suspect purchases and allow corrective action to be taken.
- **Organization.** Procurement organizations are starting to embrace Agile concepts where a small proportion of employees oversee highly automated and repeatable processes. This frees up most staff to “flow to where the work is” and engage in those sourcing and partnering activities that add the highest business value. While a small number of staff may be specialists with deep category expertise, this model allows most procurement professionals to work across units and categories, helping the organization respond more effectively to the most pressing procurement issues. One consumer-goods manufacturer made it easy for the business to access procurement

expertise on demand by creating a dedicated center of excellence of thirty staff with skills in contracting, developing requests for proposals, and drawing up robust statements of work.

- **Capabilities and culture.** The most mature organizations embrace a mix of adult-learning and open-source eLearning modules to develop both hard technical skills (such as the construction of clean-sheet cost models or supply-market analysis), and softer skills (such as negotiating techniques and business partnering). Next-generation procurement functions are replacing ad-hoc legacy training efforts by making targeted investments in digital capability building. For example, the global energy company has its procurement associates complete a structured series of online and in-person training courses on topics such as negotiation.
- **Digital.** Advanced procurement organizations are increasingly making use of automation technologies to eliminate unnecessary manual work from transactional processes. Digital approaches can also enhance user experiences by making access to procurement services easier and more intuitive. A professional-services company is piloting a smart-workflow solution that dynamically routes work between procurement and financial systems according to the risk-management requirements of a given supply contract. The system then governs the assignment, onboarding, risk-assessment, and supplier-certification tasks, and may eventually cover supplier performance management as well.
- **Data and analytics.** Advanced-analytics techniques can create better market intelligence to allow more informed decision making in procurement. Next-generation organizations

are building upon clear, correct, and consistent master data, enforced through intelligent automation: using machine-learning algorithms to match invoice data to the right spend category, or robotic process automation to pull the correct vendor information from a trusted data source. They are also developing real-time analytics of procurement and supplier performance, linked to P&L impact. Companies can also use third-party data and indexes to deliver category insights. Solutions now available use machine-learning algorithms to identify and suggest value levers for reducing total cost of ownership for specific categories such as packaging or temporary labor.



Putting the right operating model in place for procurement can be a game-changer, doubling the impact of even “successful” sourcing departments. This extra impact comes from a wide range of sources. The next-generation procurement operating model will be equipped to deliver incremental value in ways that are underexploited today, such as tail-spend management, payment-timing optimization, supply-chain finance, and analytics-driven insights. It will also ensure that the procurement function delivers on its potential, reducing the value leakage that plagues many organizations today.

Getting started on a transition to a next-generation operating model may seem daunting. But the initial steps can be taken quickly. A comprehensive review of each of the six value-creating and value-sustaining elements defined in the model can highlight where an organization needs to focus its investments. Similarly, a review of the extent to which the six value enablers have been

applied to each of those elements will indicate the type of investments required. From these building blocks, a company can construct a comprehensive roadmap for the transformation of its source-to-pay processes. ■

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