

Building superior capabilities for strategic sourcing

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Purchased materials and services often make up 60 to 80 percent of a product's cost. Companies that don't invest in the purchasing team's capabilities are throwing away value.

Jack Welch once notoriously said that “engineers who can't add, operators who can't run their equipment, and accountants who can't foot numbers become purchasing professionals.” Hyperbole aside, General Electric's legendary boss was reflecting a common perception: the purchasing function is little more than a necessary evil in business. No surprise, then, that many companies underinvest in the purchasing team's capabilities and leave sourcing out of strategic decision-making processes in favor of functions, such as manufacturing and sales, that drive revenue.

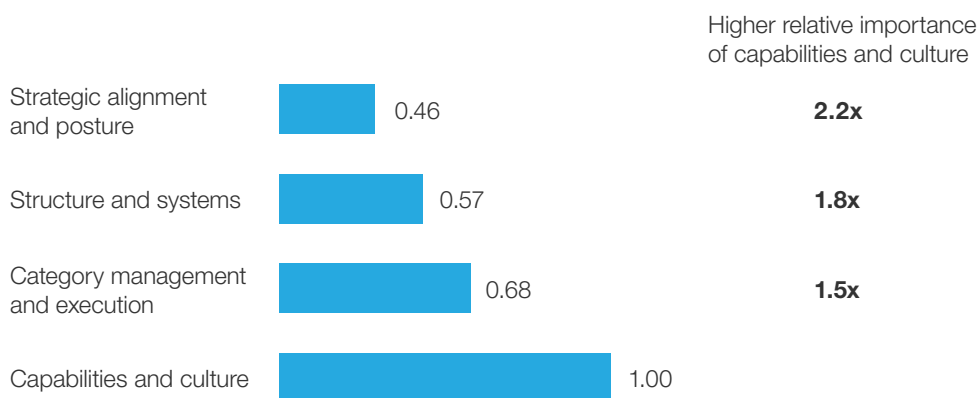
Over time, of course, a negative compounding effect sets in: up-and-coming talent flows to the higher-status functions, often exacerbating the capabilities mismatch when difficult sourcing negotiations come up. If a supplier's heavily supported sales team squares off against an underdeveloped purchasing team, the result, like that of a football match between Fiji and Brazil, is fairly predictable.

Yet purchased materials and services make up 60 to 80 percent of a product's total cost in many industries. As a result, companies that do not invest appropriately in the purchasing team's capabilities and culture are throwing away more value than they realize. Organizations that employ leading-edge purchasing practices achieve almost double the margins of companies with below-average purchasing departments (20.2 percent versus 10.9 percent, respectively).¹ Among the dimensions that affect purchasing's success, capabilities and culture were correlated 1.5 to 2.2 times more strongly with a company's financial performance than the others we studied (exhibit).

We have developed an approach that emphasizes speed and scale to build and institutionalize capabilities, so that performance improves rapidly and continues to get better over the long term. When applied to purchasing, the approach helps to raise the function's profile and to give high-performing procurement professionals more leadership-development opportunities and exposure

¹ These figures are derived from McKinsey's proprietary Global Purchasing Excellence surveys and research on more than 500 companies around the world.

Exhibit Capabilities and culture are key to purchasing success.

Correlation¹ of dimensions to overall purchasing performance


¹Normalized; analysis based on a multiple regression using partial-least-squares optimization to solve multicollinearity.

to senior management. In our experience, companies that employ this program in purchasing are able to attract and retain better purchasing talent and capture the financial impact more quickly and sustainably. This article will discuss how the approach has improved the performance of purchasing organizations and helped several of them realize their goals.

Identifying and building capabilities

To turn the purchasing function into a high-functioning strategic asset, an organization must first identify the specific capabilities that will create the most value. They vary by company but may include technical skills such as the ability to reverse-engineer a supplier's cost structure accurately or to conduct a thorough supply-market analysis that produces insights leading to a competitive advantage. Leadership capabilities—such as the ability to navigate complex cross-functional interests, to manage the trade-offs required to meet competing needs, and to identify alternatives with perspicacity and tact—may also be important.

A company can figure out which capabilities have the greatest potential to contribute to performance by conducting a bottom-up assessment of its technical and leadership capabilities and comparing them with relevant benchmarks. For one leading chemical company, this type of assessment revealed a need to improve advanced “should-cost” analytics (that is, clean-sheet modeling) and cross-functional leadership. The company created a tailored capability-building

program to build these specific skills. One year later, it was routinely convening cross-functional sourcing teams and using clean-sheet-based negotiations to capture savings that ranged from 10 to 20 percent for many categories.

Beyond building individual employees' skills, an organization must embed them in its processes, systems, and tools. For example, after completing an initial phase of capability building for individuals, a leading basic-materials company took the next step. This effort included the implementation of an improved organizational structure to place a greater focus on value-generating priorities: transactional activities, such as purchase-order processing, were organizationally separated from strategic activities, such as category management. Data-collection tools and clear processes were instituted to support a more strategic kind of category management. The company also worked to ensure that the right individuals were placed in the right roles. Finally, performance-management systems were put in place to measure and provide incentives for total-cost-of-ownership savings and continuous improvement.

Use real work and adult-learning principles

According to our research, the traditional method of providing corporate training, through infrequent classroom sessions, is one of the least effective ways to build capabilities. Adults retain new ones more successfully if learning occurs through shorter, more frequent interventions in which the content is delivered "just in time." That is, when training is tied to real work and the specific activities an individual must complete, trainees get immediate practice in incremental new skills that directly affect their day-to-day responsibilities. Over time, these new skills build on each other and develop into a complete set of improved capabilities.

One of the most effective ways to act on these adult-learning principles and scale new capabilities quickly is the "train the trainer" approach. In this technique, a small number of highly skilled and motivated change agents go through a structured "field and forum" program covering technical and leadership capabilities. While these change agents are in this program, they are expected to transfer their newly acquired capabilities to others by acting as mentors for a cohort of key purchasing employees going through an actual category-sourcing process. These purchasing staffers, with some further training, then go on to become coaches and mentors themselves. Through this approach, a combination of coaching and on-the-job training creates an organizational-talent engine that scales up new capabilities rapidly.

The global chemical company mentioned above followed this approach for its purchasing-transformation program. The company's purchasing leaders identified a core set of trainers, who were 100 percent dedicated to driving change in the organization. Every week, these trainers received seven hours of technical and leadership training, and in tandem each of them co-led a cross-functional category-sourcing team. Over the course of 16 weeks, the trainers led their teams

through the full sourcing process while also receiving regular coaching, training, and mentoring from their leaders. At the end of the period, the trainers unanimously declared that this experience had been the most transformative time in their careers, both professionally and personally, and that it helped improve their own skills and mind-sets, as well as the attitudes and capabilities of their colleagues. The trainers went on to train others independently and to become highly respected leaders in the organization. Many were recognized by C-level executives for their achievements.

Scale up and institutionalize

After the first phase of individual and institutional capability building, a company must focus on scaling, across the entire organization, the new way of doing business, so that it is sustainable over the long term. For example, at the basic-materials company mentioned above, this scale-up was accomplished by first setting an austere goal of 7 percent cost reductions across the entire third-party spending base and creating a clear action plan to reach that level in two years. This plan involved a sequence of category-sourcing efforts, with assigned team members and a center of excellence of core trainers and leaders to provide category teams with the necessary capabilities and expertise. A robust mechanism reported results to the whole organization to build excitement and credibility for the cost reductions. Two years later, the organization is well on its way to achieving what many thought a nearly impossible goal.

The final important piece in the capability-building effort relates to culture: creating an environment in which purchasing professionals are proud of the value they add to the organization and have the confidence to take a leadership role in finding and delivering new sources of value. Such cultural change is the bedrock of a sustainable transformation in a purchasing organization. Companies can push this change by creating highly visible senior role models who act out the new culture. These companies do so in several ways: instituting joint purchasing councils with responsibility for ensuring cross-functional collaboration and making use of the right forums to publicize successes throughout the organization and build excitement. Continuing to measure the attitudes and mind-sets of the staff carefully (using employee questionnaires and focus groups, for example) and then making targeted interventions to address challenges are important as well.

For example, at one leading global chemical company, a “victim” mind-set predominated in the purchasing function. Professionals within the group felt directionless and disheartened by an environment in which key sourcing decisions were often made without their involvement. To change this attitude, the company made sure senior leadership was involved in redesigning the purchasing organization, developing and institutionalizing a formal sourcing process, and implementing new databases and tools. Executives participated in weekly stakeholder meetings and periodic gatherings to address concerns as they arose. The company also made a significant

effort to communicate the project's successes to the whole organization. Eighteen months after launch, the purchasing transformation was on track to exceed some radical savings goals in many categories. The transformation was recognized as one of the most significant efforts the company had ever undertaken, not only because of the bottom-line impact, but also because the project fundamentally changed the way the organization operated.



Companies that have invested in developing best-in-class purchasing capabilities have nearly double the margins of those that have not. By identifying the capabilities that will drive value, building them in real work situations using adult-learning principles, and institutionalizing them, a company can create sustainable performance improvements that enhance the bottom line. □

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