

Operations Practice

Reimagining procurement for the next normal

Procurement has led the way out of a crisis before, and can again. But success will mean rethinking every aspect of the function.

by Tarandeep Singh Ahuja, Yen Ngai, Sukrut Kharia, and Harkanwal Singh Sidhu



The COVID-19 pandemic has put an enormous strain on global supply chains, at times halting manufacturing while shutting down airports and seaports, interrupting delivery of raw materials and finished goods. At the pandemic's onset, procurement departments switched to crisis-management mode to help companies alleviate disruptions, including sourcing personal protective gear for employees and helping smaller suppliers manage their cash flow.

Based on our research and feedback from global procurement leaders, we believe that companies can continue to rely on procurement to recover from the current crisis, in much the same way that they used the function to recover from past crises. But for procurement to lead the way, companies will want to reimagine not just what the function does but also how it operates and which new capabilities it will need.

Our analysis suggests that procurement could gain the most by focusing its strategic initiatives in five key areas: strengthening supply-chain resilience, zero-basing the design of category value-creation strategies, investing in supplier partnerships and innovation, accelerating adoption of digital and analytics, and transforming to an agile operating model. By proactively making these changes, procurement leaders can not only counter some of the worst effects of the crisis, but can also set themselves up to prosper in the future.

Procurement has led prior crisis-recovery efforts

Companies have a lot to bounce back from. As of this writing, many of the world's largest economies were experiencing record-breaking economic contractions.

Yet procurement has helped companies weather global crises before. According to our research, in the five years immediately following the 2008 global financial crisis (GFC), total return to shareholders (TRS) for companies with top-quartile procurement capabilities was 42 percent higher than for companies whose procurement operations were in the bottom quartile (Exhibit 1).

We also found that companies with top-performing procurement functions saw valuations return to pre-GFC levels an average of three years faster, and were able to lower costs of goods sold (COGS) as a percentage of revenue, thus improving EBITDA by 3 percentage points more than bottom performers.

New crisis, new challenges

While procurement can again play a crucial role in recovering from a crisis, this time procurement leaders will want to take a different approach to the function in addressing a range of new issues. In a recent survey we conducted, top Asia-Pacific procurement leaders pointed to a significant difference between recovery efforts after the GFC and what's happening now. Then, most companies focused on strategies to recover from the financial effects of the recession. Today, in addition to recovering profitability and finding ways to preserve cash, companies face the added challenges of shifting supply-market dynamics, changing ways of working, increasingly volatile demand, and de-risking their supply chain to make it less vulnerable to disruption (Exhibit 2).

A closer look at the most significant challenges shows exactly what procurement leaders are up against:

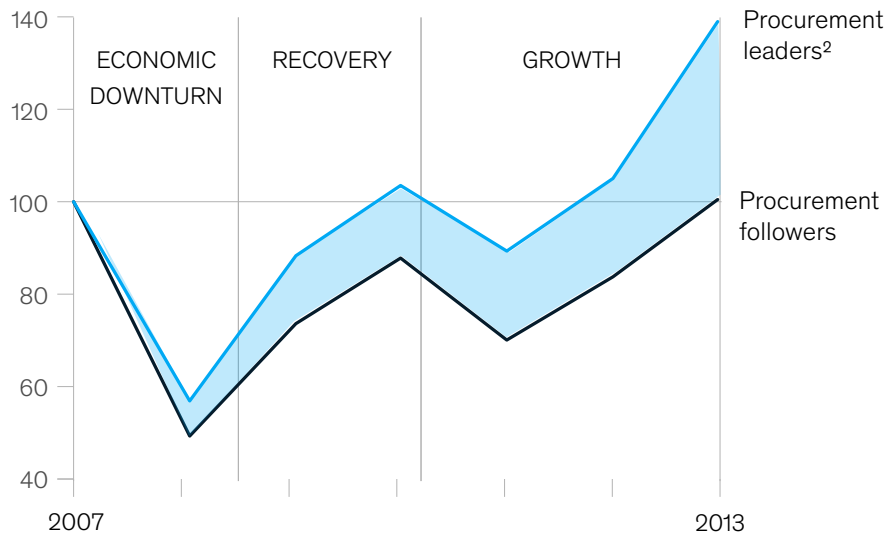
Region-specific shutdowns and supply disruptions. When the pandemic disrupted deliveries, it highlighted the issues in a complex global supply chain. In a separate McKinsey survey, 93 percent of procurement and supply-chain leaders said they planned to increase the resilience of their supply chains, and 44 percent said they would be willing to give up some short-term efficiencies to get it—although this sort of trade-off can prove avoidable in some cases. Building relationships with more diverse suppliers may help companies withstand further disruptions in supply availability.

Shifting market dynamics and value pools. The pandemic upended market dynamics and value pools in many industries: for example,

Exhibit 1

High-performing procurement functions helped companies recover from the 2008 global financial crisis.

Cumulative TRS¹ performance, indexed to 100 (FY2007)



Following the global financial crisis (GFC), procurement leaders significantly outperformed followers

42%

higher cumulative TRS in the 5 years postcrisis

~3 years

faster recovery to pre-GFC TRS

¹TRS = total returns to shareholders, calculated as average of subsectors' median performance within resilient and nonresilient categories; n = 265 companies; excludes financial companies and public-sector enterprises.

²Companies across the sample set identified as in top quartile of performance in global purchasing excellence.
Source: Capital IQ, CPA analytics, McKinsey analysis

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expanding value pools for tech companies with cloud-based platforms that help remote workers communicate and collaborate, while adding pressure to commercial real-estate markets and the airline industry. Decades-old paradigms are being upended: ever-increasing global sourcing now potentially giving way to regionalization of supply, and lean inventory targets being reset in favor of higher buffer stock.

Shortages created by volatile demand. Early in the pandemic, demand spikes and supply disruptions created shortages of consumer essentials such as toilet paper, bleach, and hand sanitizer. Now, construction may see increased demand for selected types of services as governments allocate resources to encourage infrastructure and

residential projects. Procurement leaders will need to collaborate even more closely with sales and demand-planning teams to anticipate and react to market shifts quickly.

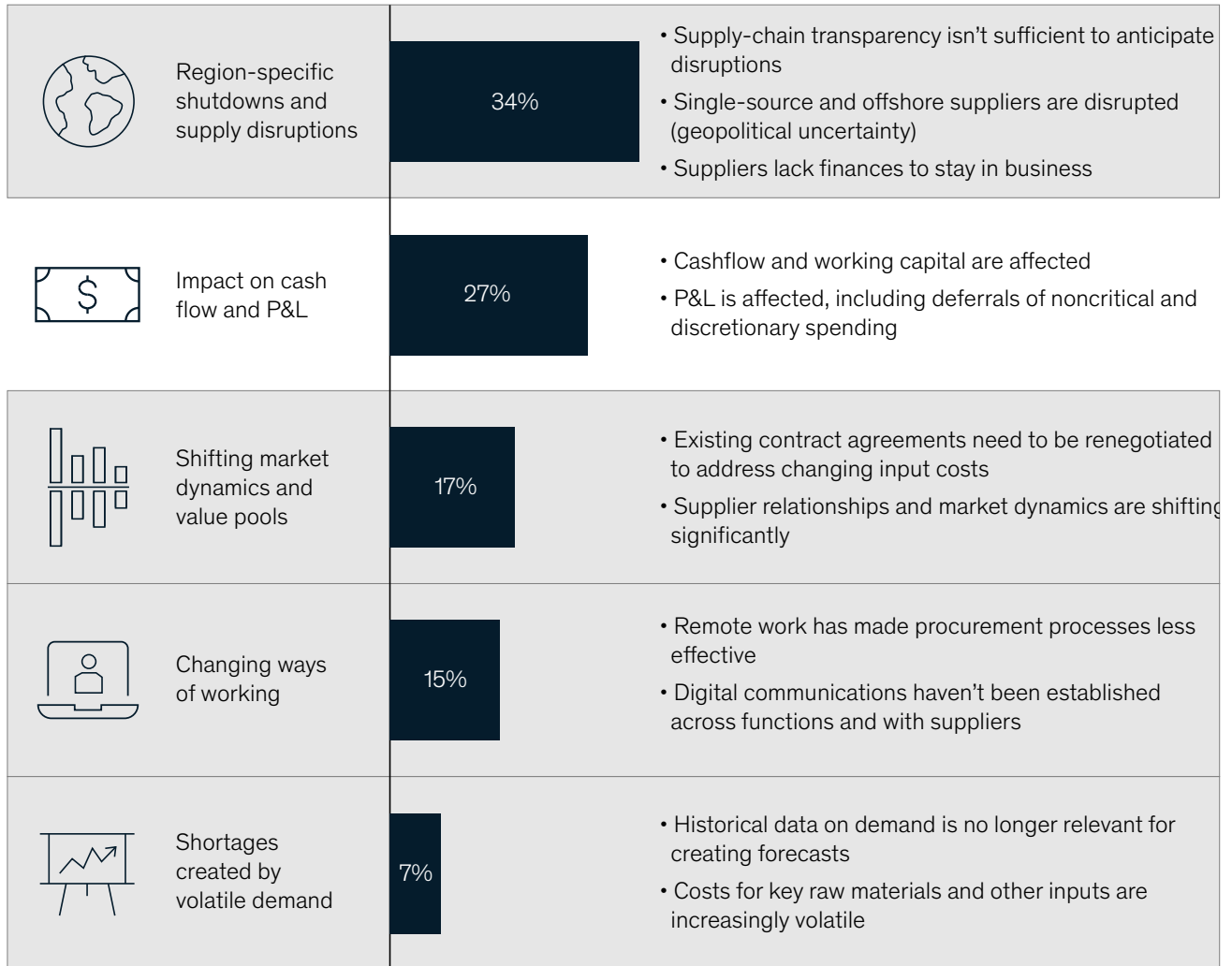
Changing ways of working. Work from home was becoming popular even before the pandemic. Forced social distancing accelerated the reimagining of the workplace—and in particular the switch to remote work—faster than almost anyone could have predicted. As in other departments, the shift changed how procurement operates. Team meetings, supplier site visits, negotiations, and other face-to-face interactions that procurement professionals took for granted went virtual, or went away—all calling for a new ways of working.

Exhibit 2

The COVID-19 crisis created a unique set of challenges for procurement leaders.

Asia-Pacific procurement leaders who selected the following as the top challenges they face because of the pandemic, %

■ Challenges unique to COVID-19 crisis








Source: CPO survey conducted April, 2020 (n=298)

Five steps to reimagining procurement

Based on our research, conversations with global procurement leaders, and our work with large organizations, we believe that five steps will help procurement leaders address the current situation and set up their organizations for success (Exhibit 3).

Strengthen supply-chain resilience. As supply chains become more global and interconnected, they face a range of challenges, including climate change, the rise of a multipolar economic system, added geopolitical risks, and risk of mass health-care events. In the past several years, at least

Leaders can reimagine procurement in five key areas.

				
Strengthen supply-chain resilience	Zero-base category strategies and value creation	Develop supplier partnerships and co-innovation	Accelerate digital and analytics adoption	Transform to a future-ready operating model
Build transparency into the supply chain beyond Tier-1 suppliers	Completely rethink category strategies where demand-supply dynamics have significantly shifted	Explore vendor partnerships to co-innovate products, services, and even business models	Accelerate digitization of procurement processes to enhance remote working	Adopt agile methods, enabling teams to respond quickly to changing goals and circumstances
Multisourcing of critical input	Reassess price, demand, and specification opportunities lever by lever	Develop contractual arrangements that incentivize performance	Leverage spend analytics to build competitive advantage and counter margin pressures	Build capabilities needed to work in new ways
Run simulations and develop business-continuity plans for range of scenarios				

one company in twenty has suffered a supply-chain disruption costing at least \$100 million. Companies with complex supply-chain networks, such as automotive and technology manufacturers, are especially vulnerable.

The time is right to do a thorough assessment of supply-chain risks and manage them more thoughtfully. Companies can create better transparency by working with suppliers to gain information about their next-tier suppliers and their upstream value chains. Business-continuity planning has taken on a new meaning, designing contingencies not just for a single supplier plant to go offline, but for entire countries to be inaccessible. War game-like simulations of possible supply-chain disruptions can uncover hidden vulnerabilities. One global electronics manufacturer conducted a detailed stress test of its supply chain, finding that around a quarter of its spend was at high risk—concentrated in three critical component categories. The company is now implementing a multistep plan

addressing 100 suppliers, with the aim of reducing high-risk spend by 40 percent.

Zero-base category strategies and value creation.

Procurement leaders are reevaluating individual spend categories to make the most of shifting market dynamics and address the risks posed by changing value pools. At the onset of the pandemic, some of the most dramatic value-pool shifts occurred in commercial real estate and oil and gas, which were among the sectors most affected by forced shutdowns. To capture or regain the potential value the shifts created, procurement leaders may need to completely rethink their strategies for the affected categories. To create value in commercial real estate, for example, instead of simply renegotiating leases, a procurement leader can consider how the organization’s work practices will likely evolve in the future as flexible and remote working grow. By collaborating with HR and IT in category-strategy deliberations to determine an optimal office footprint, procurement can help in realizing better long-term

outcomes, such as by emphasizing “access to space as needed” over simply “the most space at the lowest price.”

Some procurement organizations may seek to minimize risk exposure by structuring contracts to build in performance incentives. Instead of contracting with IT suppliers on the basis of time and materials, procurement departments can look to peg contractor fees to performance. Or they can negotiate a switch to subscription-based contracts that tie fees to usage or outcomes, which can improve performance and reduce upfront capital costs.

Invest in partnerships and innovation.

Companies are looking for opportunities to create competitive advantages for themselves to counter the downturn that the pandemic has created, including through partnerships and joint innovation. Connecting with partners that have an existing infrastructure or complementary service can make it faster and easier to adapt to a changing environment. In Australia, in the immediate aftermath of the crisis, supermarkets in need of extra personnel to handle a sudden surge in sales contracted with thousands of airline workers who had been sidelined when airlines downsized. An Indian grocery chain rolled out home deliveries by partnering with a local ride-sharing company rather than taking on the cost of buying its own truck fleet. Strategic investments can also be an attractive option, as illustrated by digital-platform investments in sectors including financial services, industrial equipment, and retail. Partnerships of this type are likely to continue as outperformers look to create competitive advantages by partnering with suppliers for new products or services.

Accelerate adoption of digital and analytics.

Procurement leaders have talked about digitizing procurement for some time. But our discussions with them indicate that progress has been slow. Many are trapped in pilot purgatory, making small investments in select use cases that never scale up to achieve real business impact. The rapid adoption of new ways of working that the

pandemic necessitated forced companies to accelerate the shift to digital. As remote work becomes the next normal, digitization can be an important enabler of effective collaboration across functions. An Asian steel manufacturer improved collaboration in procurement by adopting a cloud-based supplier-negotiation platform. Procurement, operations, and legal staff log onto the platform to prepare and review proposed contract terms, ultimately speeding up negotiations with suppliers and reaching better outcomes.

To counter crisis-induced margin pressures and increased volatility, spend analytics can provide a rich source of new insights and opportunities that together create new forms of competitive advantage. For example, in procurement of selected minerals, predictive analytics can already be used to integrate information including mining activity, shipping data, weather, and economic indicators—and it can even analyze satellite images of at-port stockpiles to give a much more accurate prediction of market prices.

Transform to a future-ready operating model.

To lead in the next normal, procurement departments need to transform how they operate and collaborate with internal and external stakeholders. Adopting an agile operating model could help procurement functions scale up or down quickly to respond to sudden supply challenges. Agile methods could be applied to key strategic issues, such as assigning a cross-functional “sprint team” to accelerate capturing value in a specific spend category, or creating a “negotiation factory” to deliver contract negotiations in assembly-line fashion or rapidly onboarding a new supplier.

These new ways of working require new skills: data engineers and data scientists are becoming increasingly commonplace in leading procurement departments, and demand for data capabilities is increasing across the function. Procurement leaders will also want to step up on the soft skills required to cultivate solid

partnerships with suppliers and to collaborate more effectively with internal functions across the business in a more agile manner. This will require attracting new talent and upskilling the existing talent. Leading organizations are adopting virtual training methods and gamified digital tools to engage experienced workers and develop their talent. The winning procurement organizations will adopt a continuous learning culture as a way of life.

Procurement can drive an organization's pandemic recovery efforts. Forward-looking companies will go a step further and completely reimagine what the function looks like to enhance the value that it can deliver. Investing in stronger, future-ready practices and capabilities will pay off in the short term, and help organizations emerge stronger and better prepared for any future crisis.

Tarandeep Singh Ahuja is a partner in McKinsey's Melbourne office; **Yen Ngai** and **Sukrut Kharia** are associate partners in the Sydney office, where **Harkanwal Singh Sidhu** is a consultant.

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