The Purchasing Chessboard™

Buying in a seller's market

Consolidating supplier markets, rising energy prices and the growing demand for raw materials in emerging markets have fundamentally changed the purchasing framework. Suppliers are more powerful than ever, which means buyers must adjust quickly to a new playing field. A.T. Kearney developed The Purchasing Chessboard—a compilation of insights and experience from thousands of purchasing projects performed worldwide—to help procurement professionals master the tools of their trade.

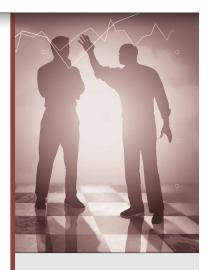
Since the 1980s, most procurement professionals have operated in a buyer's market. Using relatively simple tools—RFIs and RFPs, bundled products and services, and multi-year contracts—companies could negotiate from 1 to 3 percent annual price reductions from suppliers. But this "golden age" of purchasing appears to be over. The ongoing consolidation of the supplier market, rising energy prices and the increasing demand for raw materials from emerging markets means more companies are in a seller's market. And buyers must adopt new tools and strategies to compete effectively on a new playing field (see sidebar: A New Playing Field on the next page).

New Strategies in a Seller's Market

In a seller's market, old purchasing strategies such as pitting suppliers against one another, or simply requesting price reductions, do not work. Suppliers can and will casually raise their prices by 5 percent or more and often are not willing (or able) to ensure supply safety. The shift in power to suppliers requires buyers to adjust their strategies. In a recent A.T. Kearney survey, we discussed the impact of this new seller's market with more than 200 CEOs and managing directors of major companies. Among the most often heard remarks about the market is that their procurement departments are not up to the challenge. "We have a deficit in know-how among our procurement professionals," explains one survey respondent. "There is also a lack of knowledge about how to use analytic tools to improve the process."

The Purchasing Chessboard™

To help procurement professionals master the tools of their trade, we developed The Purchasing ChessboardTM—a compilation of insights and experience from more



In a seller's
market, buyers
must adopt
new tools and
strategies to
compete effectively on a new
playing field.

than 500 purchasing projects performed worldwide over the past three years, and thousands performed over the past three decades. The chessboard constitutes 64 methods, each representing a stand-alone, differentiating way to work with suppliers to reduce costs and increase value. These methods are derived from 16 approaches and four purchasing strategies (see figure 1). The following offers a brief discussion of the four major strategies.

Leverage competition among suppliers. The most celebrated and perhaps most frequently employed procurement strategy is pitting sup-

pliers against one another in a price competition. This is particularly popular in high-demand, low-supply markets. Purchasing basic forgings or welded steel structures fits nicely into this category. Companies typically use four procurement levers: tendering, leveraging global supplier markets, reviewing suppliers' prices and enforcing target prices. Experience shows that most procurement organizations readily employ the first two levers, but only a few companies focus on the latter two: pricing and enforcing target prices.

With this in mind, a cost regression analysis is a key component of the

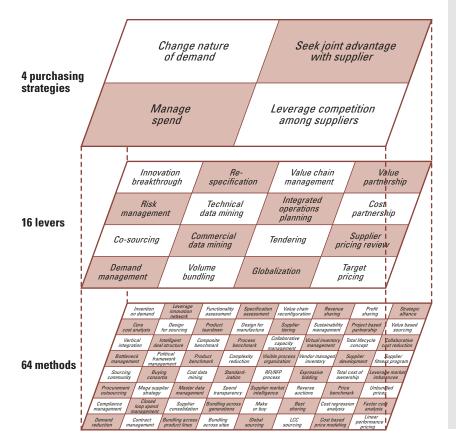
A New Playing Field

As cost pressures force companies to consolidate, suppliers have not been immune. Mergers and acquisitions among suppliers have increased in recent years as companies struggled to leverage economies of scale and withstand rising costs. Hardest hit have been suppliers that passed on productivity gains to their customers, while ignoring their own profitability, and were subsequently scooped up by more powerful competitors. Today, as never before, there are fewer suppliers with more supply power.

Increased energy costs are also affecting suppliers. Rising energy prices were first ignored as a temporary anomaly and attributed to effects such as political tensions in the Middle East. Now, high energy prices appear to be a long-term reality, especially when discussed in the context of sustainability, emissions, and the increasing scarceness of fossil energy sources. The current oil price of approximately \$100 per barrel is expected to double by 2018. While agile organizations can leverage high energy costs and drive break-through innovations, for most suppliers they are a reason to raise prices.

Adding to the new playing field is the rising demand from fast-growing emerging markets such as Brazil, China, India and Russia. Also, developments that seemed inconceivable just a few years ago are now a reality. Steel is getting scarce, coal subsidies are again part of the discussion in Europe, and suddenly Africa and its wealth of raw materials are getting more attention.

FIGURE 1: The Purchasing Chessboard™



Chessboard. The analysis is performed via a statistical methodology that determines target prices based on the technical characteristics of a module. Once identified, the target price becomes the fact base for renegotiating with existing suppliers. In the past three years, this analysis has proved successful for procurement professionals in various industries, including automotive (OEMs and suppliers), mechanical engineering, financial institutions and consumer goods. The analysis is not only for commodities such as castings, hydraulic components and forgings, but also for indirect categories such as IT equipment.

Seek joint advantage with suppliers. When buyers and suppliers in a transaction have equal market power, the first strategy is not sufficient. The automotive industry, for example, procures numerous unique modules (such as engine controls) from its suppliers, so simply pitting suppliers against one another will not suffice.

Instead, companies must strive to find common advantages with their suppliers. The goal is to build joint cost-value partnerships, an integrated and transparent operations planning process, and to manage the entire value chain jointly. Such partnerships can reduce costs while also generat-

FIGURE 2: The Chessboard constitutes 64 stand-alone methods

		Low Demand power						High	
		Α	В	С	D	E	F	G	Н
Low	1	Demand reduction	Contract manage- ment	Bundling across product lines	Bundling across sites	Global sourcing	LCC sourcing	Cost based price modeling	Linear perform- ance pricing
	2	Compliance manage- ment	Closed loop spend manage- ment	Supplier consoli- dation	Bundling across generations	Make or buy	Best shoring	Cost regression analysis	Factor cost analysis
Supply power	3	Procure- ment outsourcing	Mega supplier strategy	Master data manage- ment	Spend trans- parency	Supplier market intelligence	Reverse auctions	Price bench- mark	Unbundled prices
	4	Sourcing community	Buying consortia	Cost data mining	Standard- ization	RFI/RFP process	Expressive bidding	Total cost of ownership	Leverage market imbalances
	5	Bottleneck manage- ment	Political framework manage- ment	Product bench- mark	Complexity reduction	Visible process organiza- tion	Vendor managed inventory	Supplier develop- ment	Supplier fitness program
	6	Vertical integration	Intelligent deal structure	Composite bench- mark	Process bench- mark	Collabor- ative capacity manage- ment	Virtual inventory manage- ment	Total lifecycle concept	Collabor- ative cost reduction
	7	Core cost analysis	Design for sourcing	Product teardown	Design for manu- facture	Supplier tiering	Sustain- ability manage- ment	Project based partner- ship	Value based sourcing
High	8	Invention on demand	Leverage innovation network	Function- ality assess- ment	Specifica- tion assess- ment	Value chain reconfig- uration	Revenue sharing	Profit sharing	Strategic alliance

ing value. Suppliers and buyers work together to generate ideas for optimizing costs and then agree to share in the respective benefits. What begins as an ad-hoc program could eventually turn into a longer-term strategic alliance between buyer and supplier.

Change the nature of demand. In low-demand, high-supply markets—where suppliers are in monopolistic or quasi-monopolistic positions due to their technical expertisecompanies must change the nature of demand. Low-demand markets stem from developing long-term partnerships with key suppliers; these suppliers soon become indispensable, particularly in terms of research and development (R&D) or technological expertise. Companies prolong the problem when they choose not to endure the time and costs associated with shifting to new suppliers.

In such markets, the objective is to change the nature of demand. This is done by re-specifications of components, data mining, developing new technical options and risk management. In our Chessboard, we call this "invention on demand," which is one of the 64 methods (see figure 2). The company systematically challenges the basic elements of a technical system and searches for alternatives throughout the field of science—essentially replacing technical options for modules delivered by suppliers. This approach is relevant for industries where patent-protected components or systems are already successfully employed, for instance, in aviation, engineering and automotive.

Manage spend. The final strategy, managing spend, is particularly useful in low-demand, low-supply

∐iah

markets—for example, for most indirect material categories such as office supplies or MRO (maintenance, repair and operations). In these situations, the focus should be on volume bundling, commercial data mining, co-sourcing and demand management. Apart from defining and monitoring guidelines, the creation of transparency regarding the spend

behavior (for example, through IT-based spend-cube solutions) is a concrete approach to reduce costs and increase value.

Outlook to a New Purchasing Era

The Purchasing Chessboard maps each market situation that takes place between a company's purchasing organization and its suppliers. It is flexible enough to adapt to changing market conditions, such as rising raw material prices, and strategic enough to address the challenges in a new age of purchasing.

Authors

Christian Schuh is based in the Vienna office and can be reached at christian.schuh@atkearney.com.

Robert Kromoser is based in the Vienna office and can be reached at robert.kromoser@atkearney.com.

Michael F. Strohmer is based in the Vienna office and can be reached at michael.strohmer@atkearney.com.

Ramón Romero Pérez is based in the Berlin office and can be reached at ramon.romero@atkearney.com.

Alenka Triplat is based in the Vienna office and can be reached at alenka.triplat@atkearney.com.

A.T. Kearney is a global strategic management consulting firm known for helping clients gain lasting results through a unique combination of strategic insight and collaborative working style. The firm was established in 1926 to provide management advice concerning issues on the CEO's agenda. Today, we serve the largest global clients in all major industries. A.T. Kearney's offices are located in major business centers in 34 countries.

A.T. Kearney, Inc.
Marketing & Communications
222 West Adams Street
Chicago, Illinois 60606 U.S.A.

1 312 648 0111 email: insight@atkearney.com www.atkearney.com