

## **Elevating Supply to the Executive Agenda**

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**The most strategic firms recognize supply's contribution at the highest level, and they share some common factors.**

### **In this article ...**

At a glance, here are the main points covered in this article. By reading it, you will learn:

- How supply management is emerging as a key strategic contributor
- How some leading-edge top supply management executives have had an impact at their firms
- What critical factors must be in place to create the most successful sourcing climate

Supply management is one of the greatest areas of opportunity in many companies, because purchased inputs make up the lion's share of the overall cost structure. Successful companies today understand that sourcing is a key capability for improving product and service performance and should sit at the same table as engineering, marketing and finance.

Leading sourcing executives now address a broad range of complex issues. This requires a multidisciplinary focus and the engagement of business unit heads in order to deliver major performance gains. In top-performing companies, supply management goes well beyond leveraging volume and plucking other low-hanging fruit in traditional spend categories to address broader issues, such as supply chain integration with suppliers and advanced product development.

In addition, successful sourcing relies on effective measurement and communication of results. This helps ensure that the function is both accountable to and perceived as valuable by senior management. Raising sourcing to a more strategic level can entail tough trade-offs. Often, it requires going against the grain of established practices and crossing long-drawn organization boundaries. But the benefits are well worth the effort. Fortunately, there are some who have pushed these sourcing frontiers. From their examples, we can not only learn lessons but also identify the critical factors that make sourcing add value and be recognized at the highest levels.

## Pushing the Sourcing Frontier at Legrand

Consider the recent experience of Legrand North America (LNA), a leading manufacturer of electrical supplies. This \$700 million business is comprised of four operating companies, acquired over the past 20 years by Legrand, the French corporate parent. Legrand was bought in late 2002 by private equity investors KKR and Wendel. Slightly earlier, LNA brought in a new CEO, John Selldorff. Investors and management quickly agreed that procurement held major opportunities for improved returns.

On the U.S. side, each of the four business units had operated with a high degree of autonomy; each was led by a president and had its own engineering, manufacturing and other functional executives. Indeed, "corporate" LNA consisted only of a CEO, a CFO, a head of human resources and an assistant. The Pass & Seymour business unit had a vice president of purchasing and logistics, Rick Wassman, plus a handful of buyers. The three remaining units conducted procurement with much smaller staffs and less-defined processes, and there was effectively no sourcing collaboration across the four units.

CEO Selldorff and the U.S. management team embraced the supply management initiative and made it a high priority. At the U.S. kickoff meeting, after savings objectives in the \$10 million range were discussed, Selldorff proposed a \$20 million goal on LNA spending of \$285 million. This challenge set the bar for the team's ambitious work over the next year.

The U.S. team, looking at categories that covered \$220 million in external expenditures, went further and identified \$33 million in savings, or a gain of 15 percent. Realized savings are currently on track to reach this level, far exceeding the initial target. And Wassman, who led the effort, has been promoted to vice president of procurement of the two largest operating companies, coordinating supply management across all of LNA.

## Accounting for Success

The experience of Legrand and other exemplars demonstrates the value of strategic supply management to the senior management agenda. Successful sourcing hinges on several factors:

- A strong vision and real sponsorship by senior executives
- Cross-functional teaming
- Willingness to explore new frontiers
- Meaningful measurement and communication

**A strong vision and real sponsorship by senior executives.** Supply management leaders should have a strategic vision of what the function can deliver, with an organization to support that vision. That means aggressive targets backed up by the right incentives and resources, as well as the CEO or COO pushing line executives to make the hard decisions needed to advance the interests of the whole company over parochial preferences. At Legrand, the effort was visibly led by CEO Selldorff, who chaired each of the monthly steering committee meetings and encouraged line executives to resolve differences, find the needed resources and implement the necessary changes.

On a larger scale, consider the experience of Carlos Ghosn at automakers Renault and Nissan. When he was named COO at Renault in 1996, he began the search for operating gains in procurement. Ghosn set a high goal of \$2 billion in savings over three years. He asked two major questions:

- How can Renault and its suppliers improve performance drastically and permanently in terms of total costs, cycle time and innovation?

- Are Renault's processes, organization, management systems and people suited to achieve these ambitious goals?

What followed involved a complete reworking of the way Renault dealt with its suppliers, how engineers and buyers interacted, the purchasing organization structure, and the measurement of results. As the work proceeded, modest solutions were often presented by functional executives. But Ghosn spurred them to craft new approaches that would meet the aggressive target. His firm hand on the initiative drove savings that exceeded the original goal, as confirmed by an internal audit conducted in 1999. Ghosn later adopted the same approach at Nissan in Japan and again delivered dramatic results that helped turn around the entire company.

**Cross-functional teaming.** Realizing major gains on a broader base will require supply management staff to work closely with other functions within the business units. Such collaboration may initially encounter resistance, as it has at many companies. But the proven principles of teaming with users invariably create the conditions for success.

At Legrand, users from major functional areas worked with buyers on cross-company category teams. For example, the head of human resources joined the effort to address health insurance expenditures, the marketing director helped tackle advertising and printing, and the engineering executives collaborated on important make-or-buy and global sourcing opportunities.

In this regard, one of the leaders worldwide is IBM. The late Gene Richter, IBM's first chief procurement officer, set the tone which John Paterson, the current chief, continues by focusing on shared processes and linked objectives.

IBM global procurement owns the sourcing function across all business units and also manages the daily execution of purchase orders. This mission is supported by a set of common processes ranging from sourcing to fulfillment activities, which allows IBM to achieve scale economies in its spending while offering enough flexibility to take advantage of changing market conditions.

Other groups within IBM heavily influence procurement's objectives, in part because these groups and procurement staff share cost reduction and quality goals in their business objectives. Global commodity councils, convening technical specialists and buyers from myriad IBM divisions set and execute sourcing strategy. Production inputs have been sourced in this manner for many years, and over the past decade, IBM has used this approach on the rapidly growing expenditures for many services it procures, both to support manufacturing activities and to supply human capital for the IBM global services unit.

At the senior management level, successful sourcing programs typically include a steering committee composed of the major business unit heads and chaired by the CEO or COO. The CEO must ensure that the unit heads participate actively in the analytical work, push their people to work on cross-functional spending teams, make decisions as a group, and are ready to move ahead and put those decisions into practice.

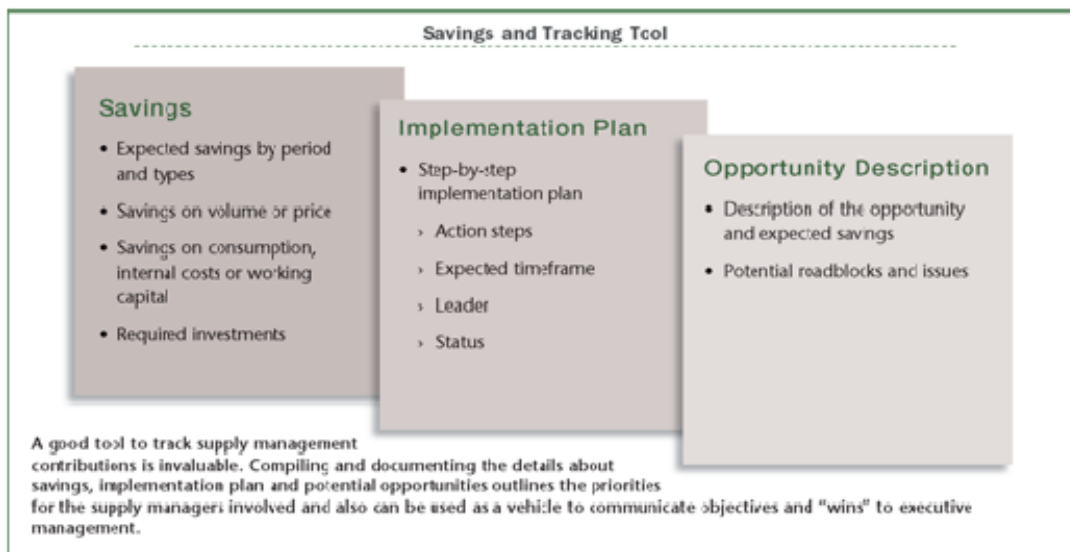
The buyer-user relationship is at the heart of the cross-functional approach, ensuring that requirements are well understood, that specifications are not overly constraining, that life-cycle costs are considered, and that both the realities and opportunities of the potential supply base are addressed. Staff from other functions may need to be engaged around this duo as well. Real engagement by these team members depends on visible involvement by their bosses — hence, the CEO's critical role in the steering committee.

**Willingness to explore new frontiers.** There are many tactics that can be deployed on a cross-company basis to deliver major gains. Supply management executives should be prepared to get up to speed on those that are unfamiliar or more ambitious, such as integrated product development, outsourcing and total cost of ownership. Supply management can take the lead in devising effective solutions to a broad range of supply issues that often involve much more change management internally and sophisticated strategies externally. This can drive substantial savings after the low-hanging fruit has been plucked.

For example, let's explore business process outsourcing, a rapidly growing field as U.S. and European companies seek new avenues for efficiency gains. The emergence of digital communications technologies and of competent offshore providers has created the opportunity to outsource service activities long conducted internally.

Typically, each functional head (e.g., IT, human resources, customer service, engineering) considers the outsourcing opportunity and takes steps accordingly. Large corporations often have multiple teams addressing outsourcing issues with limited coordination. Supply management is a logical choice to centralize a company's outsourcing strategy including decisions on what and why to outsource, how to select the best providers and how to manage the relationship for top performance.

Similarly, supply management is in an excellent position to drive the consideration of make-versus-buy decisions and to apply total-cost-of-ownership thinking to a range of corporate activities. And as companies expand their service offerings, the ability to analyze internal versus external solutions grows even more important.



**Meaningful measurement and communication.** Sourcing programs only endure if executives keep the pressure on promised actions and measure the gains actually realized. To increase visibility, managers can use a tracking tool to measure and report results. Ideally, this doesn't involve rewiring the entire IT system (see the graphic above). A good "dashboard" tool details major supply initiatives, responsible parties and results, connecting initiative savings (cost avoidance as well as reduction) to the corresponding profit-and-loss impact.

Such a tool should be accessible across the organization, installed as an application on a company's intranet, for example. Whatever type of measurement tool is used, senior management should review the results at least quarterly, and they should flow through to the CFO's budget process, so that planned and actual sourcing savings can be incorporated into financial results.

To be sure, no tool can replace the role of the chief procurement officer in communicating the victories achieved through cross-functional teaming and innovative sourcing strategies — a role so well modeled by the executives mentioned here and others on the leading edge. It's about delivering substance, but the story must be told effectively as well.

By prodding and leading the organization in the right ways and pursuing the principles outlined here, supply management executives can expect to see sourcing become the basis for real performance improvement and cultural transformation. Specifically, there are several kinds of benefits:

- **Financial** — quick wins that deliver substantial short-term cost savings
- **Customer satisfaction** — global multidisciplinary teams that are permanently focused on taking cost out and improving customer satisfaction
- **Cultural improvements** — collaboration across formerly siloed operations and divisions to drive sound business decisions, including difficult make-or-buy decisions; a culture of healthy re-evaluation and challenge that keeps people open to new ways of doing things
- **Capability** — an ongoing capability to manage sourcing toward the planning and attainment of long-term objectives

### **Delivering Results**

Effective first steps for supply management are to set more aggressive goals and to establish a pact with the CEO: "We will deliver against the goals, if you will support the program." The CEO's support will be needed to grease the skids in working with other functions, to approve the allocation of resources and funds, and to provide oversight and governance of the sourcing program. We have never seen a CEO turn down this offer when it is proposed as a two-way agreement with a commitment for major impact on the business. Supply management thus offers a real chance to boost operating performance and promote dynamic cultural norms that can raise the profile of the function and make a major difference in delivering value to shareholders.

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