

► **Connected Procurement: More than just digital**

How CPOs successfully transform
the procurement business model

Introduction

The transformational impact of digital technologies is a hot topic of discussion in business, politics and media alike. Nearly every business model is either under direct threat or under heavy scrutiny. The music industry is just one example that demonstrates, how changes in consumer behavior transform business models. Initially, consumers just bought CDs instead of records and cassettes, a rather minor change replacing one storage media with another. But then, consumers completely changed how they consume music. CDs were replaced not by a better storage media but by a whole new industry of music download services that offer the ability to buy individual songs. Now these downloading services are under attack by online music libraries that do not sell music but offer the ability to listen to any kind of music anytime. This transformation in consumer preference from owning music to consuming music happened in a matter of years and disrupted the industry as a whole. But how does transformational change impact an organizational unit like procurement? Is the procurement function able to generate sustainable benefits for its customers even in the “second machine age?” Or is the procurement function at risk of being disrupted the same way download services have eliminated the need for CDs? Will ever more intelligent machines automate procurement activities to the point where the procurement function becomes obsolete? Or will procurement departments unleash the power of digital technologies to adapt to new requirements and transform the function as a whole?

This white paper examines the procurement business model and comes to an alarming conclusion: the current business model is outdated. It will not enable the procurement organization of the future to deliver the expectations of its internal customers. Traditional levers for cost improvement have reached the point of marginal return while the benefits of digitization are (still) not reaped.

In a survey conducted by Porsche Consulting¹, CPOs confirm the urgent need to transform the procurement business model. The often cited Procurement 4.0 is not the end point of such transformation. Procurement 4.0 merely describes the digitization of existing business processes and the procurement of digital content or digitally enhanced products. While there is a need for Procurement 4.0 to be done well, it is far from transforming the current procurement business model. Companies wishing for procurement to continue playing a critical role in the way they conduct their business, will need to develop a new approach. In only five steps, companies can transform their procurement organization and make it future proof by elevating it by applying the approach of connected procurement. Thriving instead of just surviving by transforming the procurement business model is the core idea of this white paper.

The procurement business model

In times of digitization, it is all about the creation of new business models and the cannibalization of existing, and often successful business models that until now have stood the test of times. This bears the question: what exactly is a business model and what makes a business model successful?

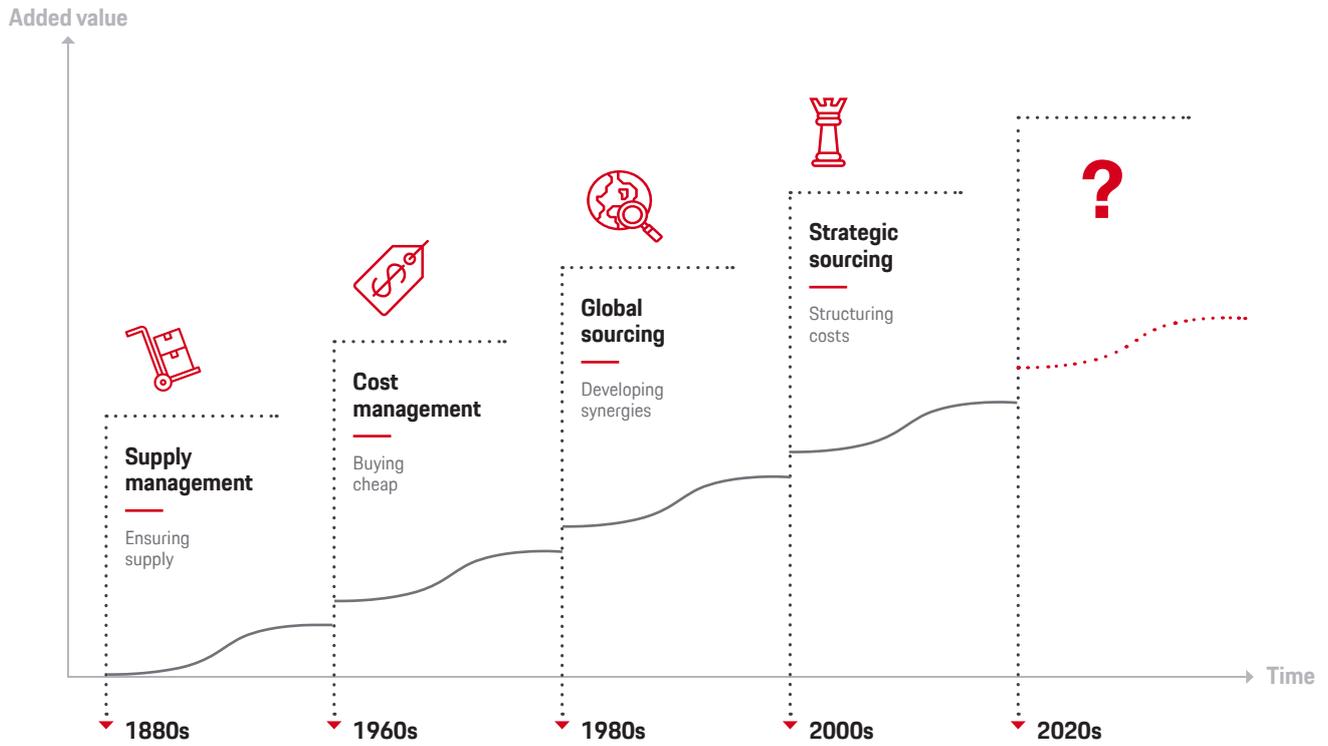
A business model is the sum of the products or services offered to customers and the processes and employees who make these products and services available. To be

successful on the market, companies have to generate added value for which customers are willing to pay. If a business model does not offer customers any value or less value than alternative offers on the market, it loses its right to exist and better models will take its place. As customer demands and alternative offers are constantly evolving, companies looking for sustainable market success need to keep adapting their business models and to monitor market trends and technology developments.

¹ 2016: survey of 100 CPOs about the effects of digitalization on procurement

This is also true for the business models of procurement organizations. Procurement departments also deliver attractive offers to their (internal) customers through their business processes, systems and employees. As internal customer have raised their expectations, procurement departments have expanded their range of services over the years and

increased the performance of their processes and systems and the expertise of their employees accordingly. Since becoming a dedicated organizational unit in the late nineteenth century, procurement has significantly increased the added value for its internal customers, as shown in the evolution of procurement in figure 1.



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Figure 1. The evolution of procurement

A short history of procurement

In the past, procurement departments always found clever ways to deliver unmet customer needs leveraging new technical possibilities to expand their services. Railway construction in the late nineteenth century, for example, required supply chain management expertise to ensure material supply to remote construction locations. Employees in the administration department developed a professional approach to and expertise in material supply and the first professional procurement department was born.

By the mid-twentieth century, internal customers expected their procurement departments to do more than just ensuring supply. At the same time, the new technology of enterprise resource planning (ERP) systems enabled procurement to offer cost reduction to their service offer. Delivering cost savings through

tenders and negotiations, they increased their contribution to company profits and became one of the most important success factors in business. By the end of the twentieth century, new communication technologies made it possible to work on a global scale. International supply chains were enabled by logistics and regulatory simplifications. Procurement capitalized these developments by establishing global sourcing.

In the early twenty-first century, as innovation cycles shortened and the level of supplier integration increased, it became more and more difficult to generate added value by focusing only on after-the-fact material cost optimization. Procurement departments responded to diminishing returns on after-the-fact material cost savings by developing design to cost methods influencing cost already in the early stages of

development. Now, in the age of digitization, the procurement business model is once again under pressure. Internal customers expect convenience and transparency regarding procurement processes and costs. At the same time, companies

are struggling to develop new products and services meeting the needs of a digital ecosystem. What are the implications for the current procurement business model and its ability to continue its record of accomplishments of the past decades?

The procurement business model has reached its limits

Today's procurement business model experience a decrease in value at increasing efforts for the following two reasons:

- 01 Traditional levers for cost reduction have reached the point of diminishing returns
- 02 The value creation potential of digital technologies beyond Procurement 4.0 is not exploited

Traditional cost reduction levers, such as global sourcing, volume bundling, price benchmarking, and negotiations—have been critical success factors to delivering business results in the past. Once innovative tools of cutting-edge procurement organizations, they are now part of a standard tool kit that continues to generate savings but no longer at a level providing a significant competitive advantage. Simultaneously, driving global competition through global sourcing continues to bring supplier profits to globally low levels. Continuing to use only traditional levers will eventually deliver smaller and smaller savings. To put it bluntly: procurement will soon reach the point at which increased savings can only be generated at the expense of product quality or service level.

The much cited Procurement 4.0 is not the answer to a challenging future as it covers only the aspect of digitization focusing on two elements:

a) Increasing procurement process efficiency by introducing new technology solutions such as (Amazon-like) self-service catalogue platforms for internal customers

b) Expanding procurement activities to include new material groups such as software and “smart” hardware or apply existing methods to new use cases. E.g. additive production systems creating new use cases for traditional make-or-buy analysis.

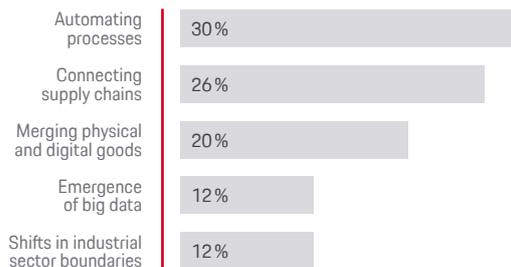
For both of these aspects, the procurement business model remains the same. What changes, is the use of new forms of communication and added value by increasing process efficiency. This raises the question of whether procurement can continue to remain a critical factor to business success in the future, or whether it will relinquish its role as an important corporate function.

In a survey conducted by Porsche Consulting CPOs confirmed the need for digital transformation beyond increasing efficiency through digitization to secure the future of the function and deliver the business results.

IN THE FOLLOWING, THE KEY RESULTS FROM THE SURVEY ARE LISTED:

- ▶ Digital transformation not only needs to significantly increase efficiency via automation, but must also generate added value using “smart” connectivity, especially in the supply chain.
- ▶ New technologies must be introduced quickly and effectively beyond the concept of procurement 4.0.

Which of the following aspects of digitization will have the biggest impact on your procurement department?



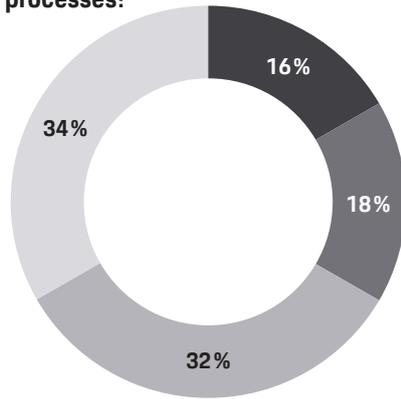
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Figure 2. Aspects of digitization and their impact on procurement

What's the current degree of automation for your procurement processes?

Percentage of procurement processes automated:

- high: 60 - 100%
- medium: 40 - 59%
- low: 20 - 39%
- very low: 0 - 19%



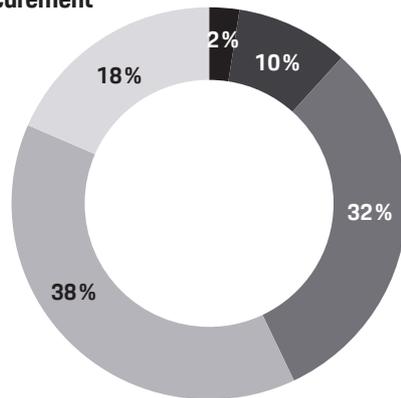
▶ The degree of automation in their own companies lags far behind expectations. The majority of processes are still manual or only partially automated. Efficiency has not (yet) increased significantly.

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Figure 3. Degree of automation for procurement processes

Preparation for the digital transformation of procurement

- very good
- good
- satisfactory
- adequate
- unsatisfactory



▶ Main reasons for results below expectations and lack of transformative power:

- // Insufficient understanding of digital technologies and applications to develop new procurement services that add value
- // Insufficient clarity about the general and/or future role of procurement in the company
- // Consideration limited to departmental processes instead of a company-wide, end-to-end view
- // Implementation of single, opportunistic digitization initiatives instead of a execution of a strategic digitization plan

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Figure 4. Preparation for the digital transformation of procurement

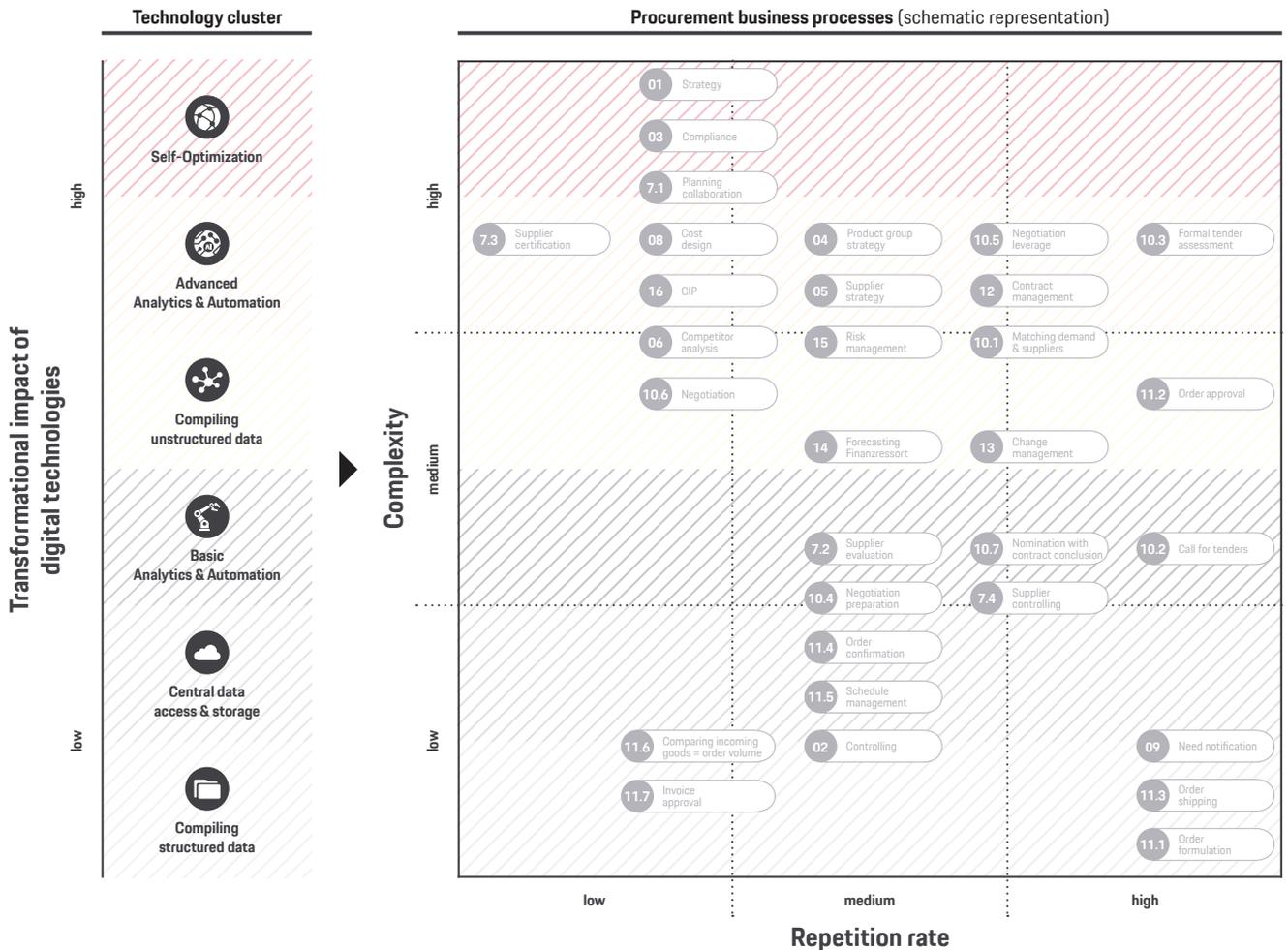
These insights confirm the conclusion that Procurement 4.0 alone does not provide the results needed to ensure the future of procurement. Those who do not look for value beyond Procurement 4.0 become less relevant to the success of their company over time. This fate is not without alternative. Digital technologies are not only cannibalizing existing services but also generating unprecedented business opportunities that offer companies significant incremental value. Procurement organizations that wish to remain successful in the future need to be ambidextrous and deliver both digitization and digital transformation:

- ▶ Optimize current services through automation
- ▶ Develop new services with incremental value for the company

The following sections project what areas of procurement will lose importance in light of digital technologies. In the final section, five new services that can expand and transform the business model and generate incremental value to the business are examined more closely.

The impact of digitization on the current business model was analyzed to identify the services that are subject to cannibal-

ization by digital technologies and will be automated in the future. Determining the degree of maturity of digital technologies and their relevance to procurement, and matching these technologies with procurement business processes (see figure 5) built the basis of the analysis. Using this approach the individual digitization potential for each procurement organization can be quantified.

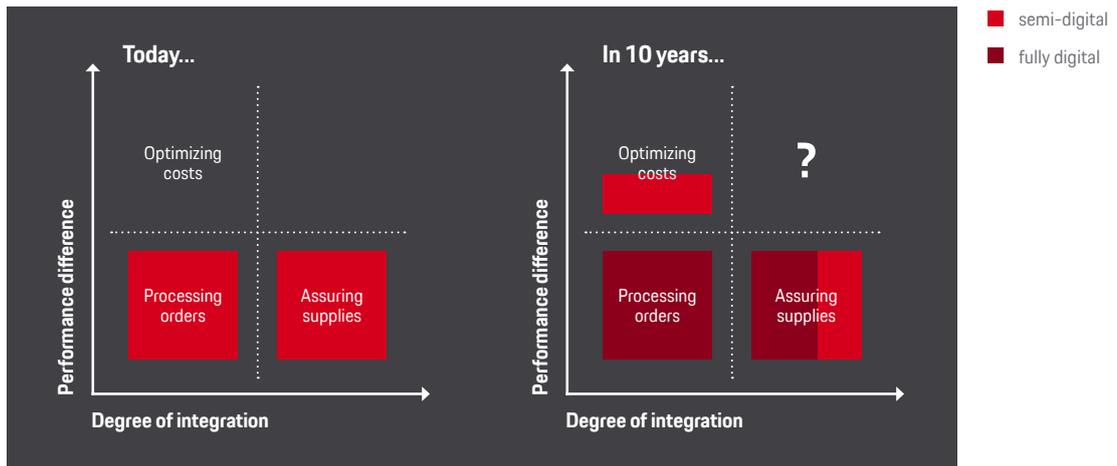


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Figure 5. Potential for digitization in procurement processes

If the digitization potential of new technologies, such as digital work flows and robot process automation (RPA), for a single company is extended to procurement as a whole, the extent to which today's procurement services can be digitized over the next ten years becomes apparent. As indicated in figure 6, the greatest impact is expected in such areas as order processing and supply assurance. But also cost optimization activities such as price comparison and negotiation will be impacted even if the automation will initially be to a lower degree.

A systematic digitization plan can help procurement organizations tackle this transformation in a way that delivers business results. Resources freed up by digitization can be reinvested in new services. But what new services can procurement provide to increase the value it contributes to the bottom line? What does the procurement business model of the future look like?



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Figure 6. Degree of digitization in today's business model and in 10 years

A successful future with connected procurement

The future procurement business model will not only consist of digitized processes. Above all, it will focus on delivering incremental value through connecting data, people and companies (connected procurement) and expand the role of procurement. Looking at the thought leaders in procurement today, we can see the first departments using new technologies to offer new services to their business and in doing so expanding their role. They lead the way in creating a connected procurement business model by:

- ▶ Identifying new forms of cost leverage with the help of artificial intelligence (AI).
- ▶ Delivering unprecedented efficiency gains by optimizing company processes on end-to-end (E2E) platforms.
- ▶ Experimenting with advanced analytics to generate competitive advantage in the supply chains

SAVING COSTS WITH ARTIFICIAL INTELLIGENCE (AI)

Pioneers of connected procurement have realized that tenders, auctions, negotiations (at least certain types), and contract and supplier management are standard operations to which resources will not be allocated in the future. They are using AI to analyze master data throughout their companies, eliminate repetition, and streamline demand toward carry-over parts. In the process, they are both extending their range of services and offering incremental value to their internal customers. In one

example, this approach—with data-driven cost optimization—generated savings of around US\$80 million and sustainably reduced complexity throughout the company.

CONNECTING DATA VIA END-TO-END (E2E) PLATFORMS

Pioneers of connected procurement register the digital fingerprint of every business transaction on their E2E platforms not only within but also beyond company borders. They are using cloud technology and are knowledgeable about the legal and technical requirements of data protection. They are using data transparency not only to optimize processes via process mining, but also to find incremental value by re-designing entire value chains for all participants. E2E platforms are increasing the efficiency of interdepartmental and inter-company collaboration to new levels.

PREDICTIVE SUPPLY CHAIN MANAGEMENT VIA ADVANCED ANALYTICS

Pioneers of connected procurement map worldwide supply chains to the level of sub-suppliers. These maps show demand and capacities for all levels. Preventive supply chain design significantly reduces the risk of bottlenecks. High performance analytics capabilities radically reduce response times in case of supply problems. When new supply chains are designed, previous experience is automatically incorporated—with the help of AI—and the overall system is thereby continuously improved. As an expert link between individual departments and processes, procurement departments organize system intelligence, the compatibility of data structures across system boundaries, and the collaboration of all internal and external partners involved.

The new services

As a logical consequence of expanding procurement services and the role of procurement departments based on increasingly sophisticated digital technologies, Porsche Consulting envisions five potential service offerings applying a Connected Procurement approach on the new business model:

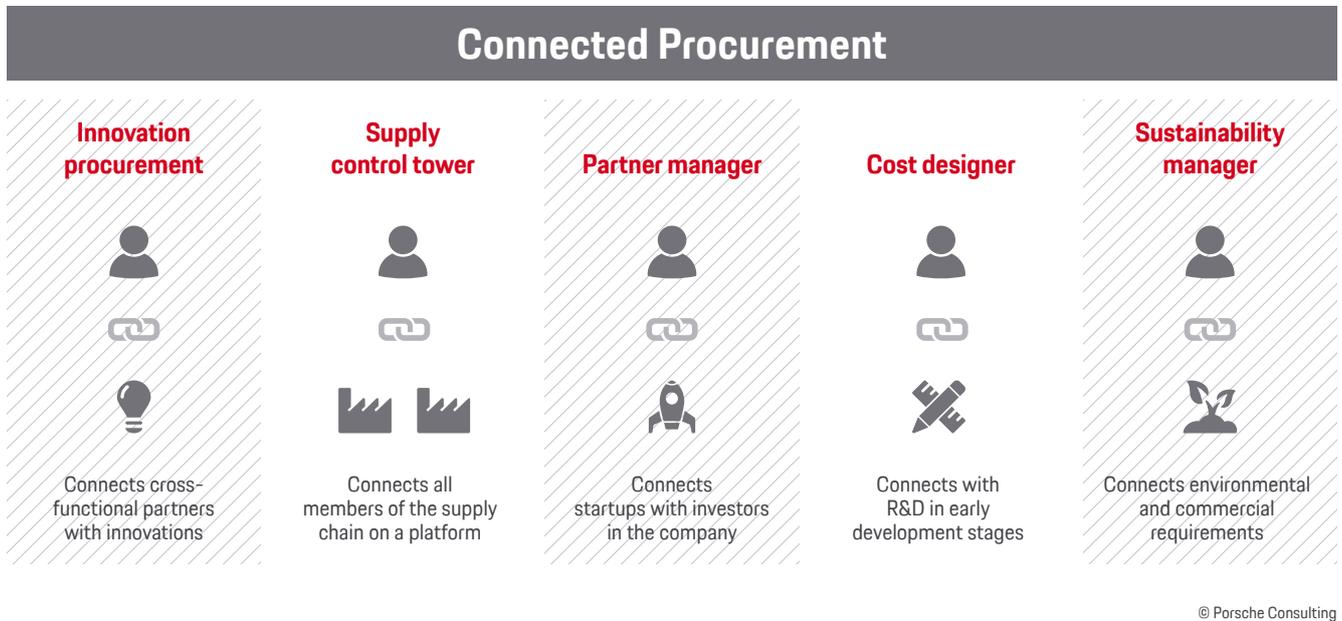


Figure 7. The five services of connected procurement

Following the concept of “innovation scouting”, **innovation procurement** identifies and assesses external ideas and innovation proposals. Together with the relevant cross-functional partners, it develops business cases and commercial solutions for the company. It is an expert in contract design. As an enabler of rapid innovation implementation, it provides a decisive competitive advantage to delight (external) customers and win on the market.

As **supply control towers**, procurement departments bring the different members of a supply chain together on a digital platform, enable exchange between internal and external data structures, use technologies for advanced analytics, and organize optimization measures up to and including a self-optimizing supply system.

As **partner managers**, procurement departments link innovative startups with relevant investors in the company. They also promote the creation of new partnerships by developing business proposals for investment decisions and stipulating programs for the integration and optimization of new partner companies. In effect, they procure entire business models and ensure additional vertical diversification.

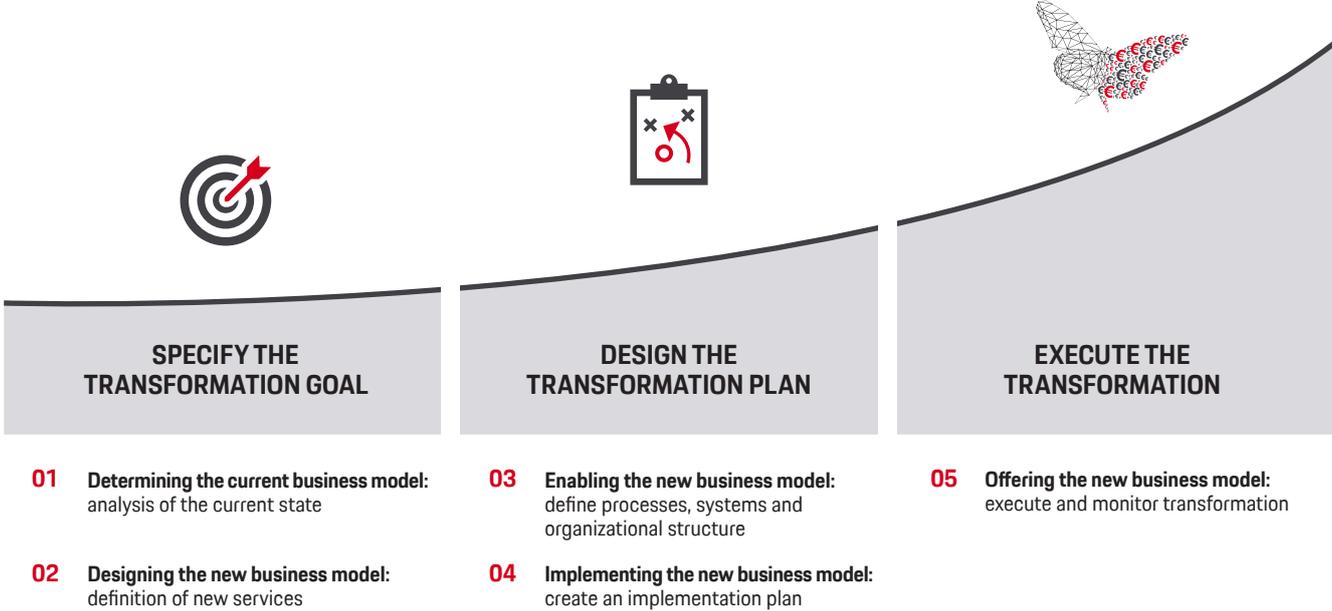
As **cost designers**, they incorporate procurement considerations into early development stages, collaborate with the relevant departments, develop flexible models for cost-conscious design in real time, and supply business cases for ad hoc minimization of component and material complexity.

As **sustainability managers**, they connect future environmental and regulatory requirements with their knowledge of the supply network, and develop standards and commercial solutions for sustainable and competitive supply chains.

Individually or combined, these five services use connections to generate incremental value for internal customers and the company bottom line. CPOs can thus ensure the future viability of procurement as a relevant organizational unit in their companies— and even increase its status. One positive side effect: procurement organizations that capitalize these opportunities and deliver incremental value are not only appreciated within their respective companies but also by their employees. They offer a highly attractive workplace with an interesting and expanded scope of duties. But how do CPOs successfully deliver digital transformation of their procurement business model?

Transformation of the procurement business model in five steps

The following five-step guide shows how existing procurement services can be systematically optimized and new services offered to provide incremental value to the company bottom line. It starts with developing strategic goals and ends with their pragmatic implementation in order to achieve measurable results.



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Figure 8. Road map for transforming procurement

01 DETERMINING THE CURRENT BUSINESS MODEL:

Analysis of the current state

The first step consists of determining the current business model. What services does the procurement department provide? What processes are involved in providing them to the company? What incremental value do internal customers see? How are employees and technologies utilized in procurement? Tools like functional analyses, pit stops, and process mining generate transparency about the use of resources as well as effectiveness and process efficiency while also identifying general procurement strengths and weaknesses of the specific procurement department.

02 DESIGNING THE NEW BUSINESS MODEL:

Definition of new services

The second step consists of determining the digitization potential for procurement and identifying unmet customer needs to define new services. This step not only analyzed the current state of the business but also looks at the challenges in the specific industry in the coming 10 years. After all, procuring raw materials calls for different services than sourcing materials and services for a manufacturer of industrial goods.

Management is tasked with the adaption of the future procurement business model and service offering to the specific market and company needs.

03 ENABLING THE NEW BUSINESS MODEL:

Define processes, systems and organizational structure

The system infrastructure and processes have to be updated to deliver the services defined under the new business model to internal customers. Where needed, processes have to be enhanced by new technologies. Updated process maps, the need for technology and system infrastructure investments are determined based on the desired future state. Turning the new business model into reality does not only require an upgrade of system infrastructure and process but also a restructuring of the organization. The roles and organizational units of the future procurement organization have to be re-designed to deliver the new business model. A strong focus is placed on establishing a high performance organization with enhanced implementation skills to deliver the transformation. Project experience shows that most companies do not lack concepts but the ability to implement concepts quickly and effectively.

04 IMPLEMENTING THE NEW BUSINESS MODEL:

Create an implementation plan

A persuasive vision and strong concepts are not nearly enough to guarantee success. The transformation of a procurement department requires detailed planning to ensure effective and rapid implementation. Short-term, medium-term, and long-term plans are needed to implement the new processes, introduce new systems and deploy the revised organizational structure. All projects and measures are planned out, resources required are mapped to resources available and summarized in an implementation roadmap. Priorities are set by focusing on the highest pain and quick gains while also considering logical sequence and interdependencies between individual measures.

05 OFFERING THE NEW BUSINESS MODEL:

Execute and monitor transformation

"The road to success consists of 5 percent planning and 95

percent execution, but without that 5 percent planning the rest is wasted." Therefore, if a procurement organization wants to transform its business model; execution counts. Effective change management is therefore crucial, for instance, starting with lighthouse projects. Lighthouse projects are of manageable complexity with major relevance and visibility for the majority of the employees. They could be introduction of simple tools and apps that make every day work easier for employees. Next to practice implementing digitization initiatives, it is equally important to build digital capabilities. These include mastery of the appropriate tools and work methods, but also the processes to select and promote digital talent. These are also activities and results, which will be captured in a comprehensive roadmap, which should be viewed as a working document that is continuously updated based on testing, learning and adapting.

CONCLUSION: START TRANSFORMING THE BUSINESS MODEL—NOW!

Digitization does not only bring new challenges for procurement but offers also new opportunities. Internal customers have ever-increasing expectations on "their" procurement departments to continue providing incremental value in the future. If procurement departments do not deliver the business results under rapidly changing conditions, they will relinquish their role as critical success factor within their own companies.

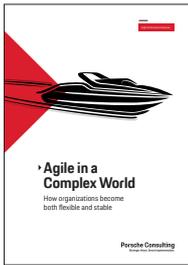
In light of the threat, CPOs might feel compelled to promote change. But there is also a positive outlook equally powerful in promoting change. New digital technologies offer the chance to extend the business model and to think above and beyond Procurement 4.0. Use of AI, advanced analytics, process mining, and other technologies lay the groundwork for developing considerably more effective and comprehensive procurement services, which in turn raise the status of procurement and create an attractive workplace for capable and motivated employees.

This white paper shows that by connecting data, people and companies and taking on new activities, procurement departments can increase the incremental value they contribute to the bottom line. At the same time, the use of digital technologies can free up resources from the organizational units that process orders and assure supply. This creates the capacity to transform the current business model by adding new services.

The core elements of connected procurement are five new services: innovation procurement, supply control tower, partner manager, cost designer, and sustainability manager. All five can create considerable incremental value individually or in combination, and therefore ensure the future of procurement. The five-step model presented in this white paper is a guide to successfully transforming the current business model to connected procurement.

One thing is clear: procurement departments that do not transform their business model will relinquish themselves to insignificance. Many CPOs have already recognized the threat of procurement disappearing, but too few focus on the opportunities that come with the change. They focus on surviving instead of thriving and what they lack most are strategies for transformation. There is a great need for action to re-design the procurement business model and write the next chapter in the evolution of procurement. This is a call for action to all those in charge: start your transformation journey now! Plan first, then implement!

Further reading



Agile in a Complex World



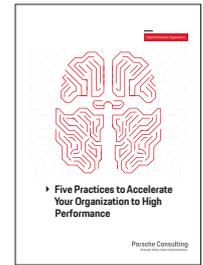
Thinking from the customer's point of view



Business Process Management Reloaded



Efficiency Programs



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