Presentation to CIPS Financial Services Forum

Procurement: Moving from Cost to Value

Presentation
19 April 2012
The focus of this Presentation

- To what extent is Procurement moving from Cost to Value
- What are the secrets of being a Procurement Leader
- How does Financial Services measure up

We welcome discussion, so please share your views and experiences.
The AEP in its 19th year, is the most comprehensive benchmarking of Procurement practices

Highlights

• 201 companies submitted responses
• Participants from Asia (22%), Americas (27%) and EMEA (51%)
• All industries are represented: Information Intensive Services (30%), Asset Intensive Services (14%), Non-Durable Consumer Products (17%), others (39%)
• Survey remains open; tracking to 500+ participation
• Average participant is US$12.5 B in revenues
• Survey remains open
AEP 2011 is the seventh in the series: 10% of 2011 respondents are in Financial Services

History of A.T. Kearney's Assessment of Excellence in Procurement (AEP)

(1) Over 1,000 elements benchmarked across 33 leadership practices covering 8 dimensions of Procurement
Markets and the economy have changed dramatically over the past years...of course.....

Volatile Cocoa Beans Prices

Real GDP Growth...

Oil Price Development

...but some things are unchanging

Source: A.T. Kearney analysis
We identified 13 Leaders across the 8 dimensions of our House of Procurement

Quartile Performance by Dimension of the House of Procurement™

The average Financial Services organisation is between Quartiles 2 and 3

Source: AEP 2011; leadership requirements: Top overall scores Strong, world-class performance in at least 3 dimension
No dimensions below average
What distinguishes Leaders?

Leaders Share 3 Attributes: independent of Industry

1. Better Collaboration with their Organisation
2. Systematic Category & Supplier Management Processes
3. Superior Management of Data, Systems and People

Leaders achieve a 60% higher return on their investment in Procurement than Followers
Procurement’s stature, influence and reach has never been higher…

**Procurement Organization Stature**
(% Companies Selecting “Fully”)

- **Comparable standing**: 44% (2011 Overall) vs. 29% (2008 Overall)
- **Leadership for all key expenditure areas**: 11% (Financial/Banking) vs. 23% (2011 Overall)
- **Mandate communicated and accepted**: 19% (Financial/Banking) vs. 53% (2011 Overall)
- **Mandate to explore broader value creation**: 19% (Financial/Banking) vs. 41% (2011 Overall)
- **Mandate to identify and recommend new business**: 13% (Financial/Banking) vs. 22% (2008 Overall)

Source: A.T. Kearney 2011 AEP Survey Data
Procurement is slowly being asked to collaborate on the development of top-line strategies for growth...

Procurement Strategy Elements
(% Companies Selecting “Plan is in place and yielding benefits”)

- Increase level/speed of innovation: 25% (Financial/Banking), 18% (Overall), 15% (2008 Overall)
- Integrate suppliers into new product/service: 25% (Financial/Banking), 25% (Overall), 25% (2008 Overall)
- Reduce time-to-market for new products: 25% (Financial/Banking), 19% (Overall), 20% (2008 Overall)
- Create new business opportunities and revenue streams with suppliers: 31% (Financial/Banking), 25% (Overall), 16% (2008 Overall)

Source: A.T. Kearney 2011 AEP Survey Data
…while still being held accountable for bottom-line efficiency improvements

**Procurement Strategy Elements**

(% Companies Selecting “Plan is in place and yielding benefits”)

- **Improve overall value for purchased goods & services**
  - Financial/Banking: 63%
  - 2011 Overall: 54%
  - 2008 Overall: 48%

- **Realise synergies cross division/BU**
  - Financial/Banking: 50%
  - 2011 Overall: 51%
  - 2008 Overall: 48%

- **Integrate procurement with business units to drive**
  - Financial/Banking: 47%
  - 2011 Overall: 47%
  - 2008 Overall: 44%

- **Increase integration with key suppliers to improve supply chain performance**
  - Financial/Banking: 29%
  - 2011 Overall: 29%
  - 2008 Overall: 24%

- **Improve working capital**
  - Financial/Banking: 6%
  - 2011 Overall: 32%
  - 2008 Overall: 41%

Source: A.T. Kearney 2011 AEP Survey Data
...with only limited interest in outsourcing – other than for very specific point solutions

Top-5 Outsourced Tasks for Financial Institutions (% Companies selecting “Outsourced“ as predominant way to accomplish task)

- Requisition, PO Creation / Execution: 13%
- Procurement Database Maintenance: 19%
- Procurement Process Design Implementation: 6%
- Spot-Buying Support: 6%
- Emerging Market Scouting: 7%

Comments

- Procurement is seen as a strategic company function and therefore is rarely outsourced
- Outsourced tasks mainly focus on operational tasks, or tasks requiring specific technical or market knowledge
- In the 2008 AEP, participants also planned to increase outsourcing level but it has not happened in 2011
Buyers have many strategic options to choose from on a daily basis

### Purchasing Chessboard® 64 Methods

<table>
<thead>
<tr>
<th>Demand power</th>
<th>Low</th>
<th>C</th>
<th>D</th>
<th>E</th>
<th>F</th>
<th>G</th>
<th>H</th>
<th>High</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Demand reduction</td>
<td>Contract management</td>
<td>Bundling across product lines</td>
<td>Bundling across sites</td>
<td>Global sourcing</td>
<td>LCC sourcing</td>
<td>Cost based price modeling</td>
<td>Linear performance pricing</td>
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<tr>
<td>2</td>
<td>Compliance management</td>
<td>Closed loop spend management</td>
<td>Supplier consolidation</td>
<td>Bundling across generations</td>
<td>Make or buy</td>
<td>Best shoring</td>
<td>Cost regression analysis</td>
<td>Factor cost analysis</td>
</tr>
<tr>
<td>3</td>
<td>Procurement outsourcing</td>
<td>Mega supplier strategy</td>
<td>Master data management</td>
<td>Spend transparency</td>
<td>Supplier market intelligence</td>
<td>Reverse auctions</td>
<td>Price benchmark</td>
<td>Unbundled prices</td>
</tr>
<tr>
<td>4</td>
<td>Sourcing community</td>
<td>Buying consortia</td>
<td>Cost data mining</td>
<td>Standardization</td>
<td>RFI/RFP process</td>
<td>Expressive bidding</td>
<td>Total cost of ownership</td>
<td>Leverage market imbalances</td>
</tr>
<tr>
<td>5</td>
<td>Bottleneck management</td>
<td>Political framework management</td>
<td>Product benchmark</td>
<td>Complexity reduction</td>
<td>Visible process organization</td>
<td>Vendor managed inventory</td>
<td>Supplier development</td>
<td>Supplier fitness program</td>
</tr>
<tr>
<td>6</td>
<td>Vertical integration</td>
<td>Intelligent deal structure</td>
<td>Composite benchmark</td>
<td>Process benchmark</td>
<td>Collaborative capacity management</td>
<td>Virtual inventory management</td>
<td>Total life cycle concept</td>
<td>Collaborative cost reduction</td>
</tr>
<tr>
<td>7</td>
<td>Core cost analysis</td>
<td>Design for sourcing</td>
<td>Product teardown</td>
<td>Design for manufacture</td>
<td>Supplier tiering</td>
<td>Sustainability management</td>
<td>Project based partnership</td>
<td>Value based sourcing</td>
</tr>
<tr>
<td>High</td>
<td>Invention on demand</td>
<td>Leverage innovation network</td>
<td>Functionality assessment</td>
<td>Specification assessment</td>
<td>Value chain reconfiguration</td>
<td>Revenue sharing</td>
<td>Profit sharing</td>
<td>Strategic alliance</td>
</tr>
</tbody>
</table>

Purchasing Chessboard® 64 Methods is a framework by A.T. Kearney that helps buyers to evaluate and select the most effective sourcing strategies based on their supply and demand power. The methods are organized in a matrix format, with demand and supply power on the axes, and 64 methods are categorized into high and low demand and high and low supply power, offering buyers a comprehensive view of strategic options.
Most Financial/Banking organizations don’t use the upper quadrants to drive value…

Purchasing Chessboard®

Average number of approaches “Systematically used across all relevant categories”
More value will come from SRM, with leaders using a broader set of value drivers to deliver benefits.

**Share of Value, Sourcing vs. SRM**

<table>
<thead>
<tr>
<th></th>
<th>3 years ago</th>
<th>Today</th>
<th>In 3 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>SRM</td>
<td>80%</td>
<td>77%</td>
<td>73%</td>
</tr>
<tr>
<td>Sourcing</td>
<td>80%</td>
<td>27%</td>
<td>20%</td>
</tr>
<tr>
<td>Finance/Banking SRM</td>
<td>73%</td>
<td>73%</td>
<td>64%</td>
</tr>
<tr>
<td>Finance/Banking Sourcing</td>
<td>77%</td>
<td>36%</td>
<td>36%</td>
</tr>
</tbody>
</table>

**SRM Value Drivers**

( % of companies selecting “Primary focus”)

- **Reduce unit cost**
  - Leaders: 39%
  - Followers: 60%
  - Finance/Banking: 69%

- **Reduce TCO**
  - Leaders: 100%
  - Followers: 59%
  - Finance/Banking: 61%

- **Demand management**
  - Leaders: 44%
  - Followers: 26%
  - Finance/Banking: 69%

- **Increase utilization of company’s resources**
  - Leaders: 39%
  - Followers: 36%
  - Finance/Banking: 62%

- **Improve utilization of supplier’s value chain**
  - Leaders: 39%
  - Followers: 24%
  - Finance/Banking: 77%

- **Counter party risk/financial health**
  - Leaders: 33%
  - Followers: 36%
  - Finance/Banking: 62%

- **Policy compliance**
  - Leaders: 77%
  - Followers: 42%
  - Finance/Banking: 77%

- **Maintain agility and flexibility of supply base**
  - Leaders: 28%
  - Followers: 39%
  - Finance/Banking: 69%

Source: A.T. Kearney 2011 AEP Survey Data
Leaders place more importance on supplier-driven innovation

Competitive pressure is driving us to search for more innovative suppliers for the future (% Participants)

Non financial services had a greater need for innovation – 48% selected “Fully”

Supplier innovation (% Participants selecting “Fully”)

- The capability for innovation important criterion when selecting suppliers
- Suppliers play a significant role in driving our innovations
- Suppliers' innovation contributes to increase in our revenues and/or profit
The skill set required of procurement professionals to deliver this is becoming broader and more ‘soft’ in nature.

Skills/Capabilities Required From Procurement Personnel (% Companies selecting “Required”)

<table>
<thead>
<tr>
<th>Skill Set</th>
<th>2011</th>
<th>2008</th>
<th>2011-2008 Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use of IT tools</td>
<td>22%</td>
<td>44%</td>
<td>1.5x</td>
</tr>
<tr>
<td>Spend analysis</td>
<td>17%</td>
<td>58%</td>
<td>1.3x</td>
</tr>
<tr>
<td>Supplier development</td>
<td>17%</td>
<td>41%</td>
<td>1.6x</td>
</tr>
<tr>
<td>Risk management</td>
<td>25%</td>
<td>40%</td>
<td>1.4x</td>
</tr>
<tr>
<td>Project management</td>
<td>22%</td>
<td>39%</td>
<td>1.8x</td>
</tr>
<tr>
<td>Change management</td>
<td>22%</td>
<td>39%</td>
<td>1.6x</td>
</tr>
<tr>
<td>Communication/presentation skills</td>
<td>35%</td>
<td>49%</td>
<td>1.2x</td>
</tr>
<tr>
<td>Team building</td>
<td>17%</td>
<td>58%</td>
<td>1.2x</td>
</tr>
</tbody>
</table>

The survey suggests that your sector values skills less !! Do you agree?

Source: A.T. Kearney 2011 AEP Survey Data
New performance management frameworks emerging...brining clarity, rigour and convention...

Return on Supply Management Assets

Financial Results Delivered

Invested Supply Management Assets

Spend Coverage
- Total Spend
- Visibility
- Spend Governance

Velocity
- Executed Sourcing Events
- Sourcing Strategies
  - Advanced
  - Conventional
- Category Profile

Category Yields
- Sourcing Initiative Yields
- Benefit Stream Forecast

Compliance
- Policy
- Visibility
- Enforcement
- Benefit Stream Realized

Additional Benefits
- Negotiated Value From Prior Periods
- Working Capital Improvement
  - Δ in Inventory
  - Δ in DPO
- e(PV) From SM Enabled Innovation
- Supplier Performance & Exchange

Period Costs
- People Costs
- Roles
- FTEs
- Rates
- External Support Costs
- Other

Structural Investment
- Infrastructure
- Capabilities
- Recruiting
- Process
- Technology
- Training
- Knowledge Management

Return on Supply Management Assets

\begin{align*}
\text{Total Spend} &= \text{Visibility} + \text{Spend Governance} \\
\text{Sourcing Strategies} &= \text{Advanced} + \text{Conventional} \\
\text{Category Profile} &= \text{Executed Sourcing Events} \\
\text{Sourcing Initiative Yields} &= \text{Benefit Stream Forecast} \\
\text{Policy} &= \text{Visibility} + \text{Enforcement} \\
\text{Benefit Stream Realized} &= \text{Negotiated Value From Prior Periods} \\
\text{Working Capital Improvement} &= \text{Δ in Inventory} + \text{Δ in DPO} \\
\text{e(PV) From SM Enabled Innovation} &= \text{Supplier Performance & Exchange} \\
\text{People Costs} &= \text{Roles} + \text{FTEs} + \text{Rates} \\
\text{External Support Costs} &= \text{Other} \\
\text{Infrastructure} &= \text{Capabilities} + \text{Recruiting} + \text{Process} + \text{Technology} + \text{Training} + \text{Knowledge Management} \\
\end{align*}
The Financial Services ROSMA score is higher than the average – driven by higher yields on addressed spend

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Leaders</th>
<th>Followers</th>
<th>Fin./Bank.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Spend Coverage</strong></td>
<td>94%</td>
<td>72%</td>
<td>76%</td>
</tr>
<tr>
<td><strong>Velocity</strong></td>
<td>85% &amp; 2145</td>
<td>64% &amp; 880</td>
<td>68% &amp; 549</td>
</tr>
<tr>
<td><strong>Category Yields</strong></td>
<td>8.2%</td>
<td>6.4%</td>
<td>12.5%</td>
</tr>
<tr>
<td><strong>Compliance</strong></td>
<td>90%</td>
<td>79%</td>
<td>76%</td>
</tr>
<tr>
<td><strong>Additional Benefits</strong></td>
<td>77%</td>
<td>38%</td>
<td>33%</td>
</tr>
<tr>
<td><strong>Invested Supply Management Assets</strong></td>
<td>0.8% &amp; $32m</td>
<td>1.1% &amp; $26m</td>
<td>0.9% &amp; $27m</td>
</tr>
</tbody>
</table>

Source: A.T. Kearney 2011 AEP Survey Data
The 2011 AEP revealed significant shifts in the world of Procurement...

- Efforts to operate Procurement as a pure utility service have not endured. Neither internal attempts to develop it as a “back-room” function nor outsourcing it have really delivered value.
- Expectations have risen for Procurement to go to the next level to drive value in partnership with the business.
- As never before, Leaders have responded to this challenge by significantly upgrading category management, SRM, and their analytical power. However, even the leaders have headroom to take performance to the next level.
- With new performance management frameworks emerging leaders can now demonstrate their holistic true value to stakeholders.
- Overall, Procurement is continuing its long-term evolution to become a strategic function.

Within the context of general improvement, Leaders are still significantly out-performing Followers.
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